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FINANCIAL TIMES

"Without fear and without favour"

Saturday November 29 2008

A loyal subject advocates close reading of the FT

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From Mr Paul Hodges.

Sir, Scot Young requests those "who saw it coming" to explain how they tried to warn the Queen, and her subjects, that financial crisis loomed (Letters, November 22/23). "In the FT", is my answer.

Two years ago, you published my letter advising readers to "Beware lending institutions bearing gifts" (November 3 2006). You then published my letter asking central bankers for "Action, not words, to end the liquidity party" (March 23 2007). And finally, you carried my warning of the coming collapse, "Every mania is based on an illusion" (September 4 2007).

Mr Young also adds that those "who saw it coming" should try to "clear as many people as you can from danger and destruction". I work in the chemical industry, one of those most affected by the downturn, and I did just that in my 'ICIS Chemicals and the Economy' blog. ICIS (part of Reed Elsevier), has recently published a special article titled "The Crystal Blog", making clear that its readers "were well forewarned about the full-blown financial crisis".

One is naturally very hesitant to offer advice to Her Majesty. But in response to her question, perhaps she might want to suggest to her advisers, and ministers, that they read the Financial Times a little more carefully in future? "No FT, no economy" might be a suitable way to make the point to her.

Paul Hodges,
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"Without fear and without favour"

Tuesday September 4 2007

Every mania is based on an illusion

From Mr Paul Hodges.

Sir, There is another reason Washington should follow your excellent advice and "resist" the urge to intervene in the subprime crisis ("Subprime loans – subprime solutions", editorial September 1). This is that the scale of the problem is probably too large for any congressional action to be effective.

All investment manias have their illusion. They then gain in strength as the "fact" underpinning the illusion becomes more widely accepted. Thus large numbers of dotcom investors came to believe that "page-clicks" would lead to profits. So US house-buyers, and lenders, all began to believe that house prices would always rise.

When brokers pushed unaffordable loans to low-earning borrowers, they were sure that increasing property values made subprime loans bankable. The ratings agencies were happy to consider AAA ratings, because their models showed that US house prices hadn't declined nationally since the Great Depression. And central banks were keeping global interest rates low, thus encouraging investors to chase the higher yields on offer.

The problem is that the whole story turns out to have been an illusion. The S&P/Case-Schiller US home price index is firmly in negative territory, while the number of unsold houses is climbing. A "buyer of last resort", such as the Federal government, would probably now need to emerge if the situation is to be stabilised.

Even Congress would surely balk at the amount of money that this scale of intervention would require. Unfortunately, therefore, the myth behind the US housing mania is likely to become increasingly transparent, as the fallout from it widens.

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TUESDAY MARCH 27 2007

Time for action (not words) to end the liquidity party?

From Mr Paul Hodges.

Sir, Mohamed El-Erian provides a fascinating analysis today of why "In the new liquidity factories, buyers must still beware" (March 22).

It would seem that, individually, central bankers might well agree with him. Sir John Gieve of the Bank of England commented last December that one would expect mispricing of risk to be "counteracted by market forces", but then added that "in a world of short run return targets, it is not surprising to find this is unpopular".

Equally, Ben Bernanke of the Fed noted recently that "there seems to be little basis for concluding that globalisation overall has significantly reduced inflation in the US in recent years; indeed the opposite may be true".

But collectively, central bankers seem unwilling to implement the famous dictum of William McChesney, the long-serving Fed chairman in the 1960s, that "the job of the Federal Reserve is to take away the punch bowl just when the party starts getting interesting". Instead, they seem to confuse being market-friendly with being friendly to markets. One doubts that Mr McChesney would have shared the worry of the Bank of England last week that "an unexpected move by the [monetary policy] committee could provide an unwelcome addition to the uncertainty and volatility in financial markets".

Last week was also remarkable in that the BoE's minutes noted that the balance of risks to inflation was "to the upside in the medium term", while the Fed statement said recent readings on core inflation "have been somewhat elevated". If the authorities really believe their own analysis, then it is surely time for actions not words to reduce demand pressures, irrespective of whether this brings the current liquidity party to an end?

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FRIDAY NOVEMBER 3 2006

LEADERS & LETTERS

Tempted should beware lending institutions bearing gifts

From Mr Paul Hodges.

Sir, Your front-page headline "Home loans on offer at five times salary level" (November 1), is surely the answer to the Bank of England governor's comment to the House of Lords (report, November 1) that it is "difficult to understand why house prices relative to conventional earnings are as high as they are".

The governor's implied concern is well-founded. If one strips out the effect of inflation, it is clear that the UK housing market is not particularly responsive to short-term changes in interest rates.

Over the past 35 years, house prices have risen in real terms when interest rates have risen, and fallen when interest rates have fallen. Instead, the main correlation has been between changes in gross domestic product and the direction of real house prices.

Today's relaxed lending standards certainly reflect the UK's exceptional period of continuous GDP growth since 1992. Maybe the advent of independent central banks means that recessions are now a thing of the past. If not, one must accept that house prices, like other forms of financial investment, can go down in real terms as well as up.

And it is also worth remembering that before 1992, the impact of recession on the housing market was lessened by high inflation rates. These helped to avoid negative equity becoming a widespread problem by reducing the real value of the loan. Today's borrowers may not have this cushion if central banks stay on their guard against inflation.

"Beware lending institutions bearing gifts" might therefore be the most appropriate advice to those tempted to take on these loans.

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