With Europe’s trust shaken, dollar jumps

Three months ago, you needed $1.60 in good American money to buy one euro in Rome or Berlin.

You needed just $1.44 Monday. It cost $1.40 yesterday.

That means, while Fannie Mae, Lehman Bros. Holdings Inc. and Wachovia Corp. were collapsing, the dollar was getting stronger. As the House of Representatives voted down a bailout, the dollar jumped.

How’s that? For all the talk about foreign markets breaking away from the United States, we’re still connected. We don’t just share financial trouble; we’ve exported it.

“Problems from the U.S. are causing problems abroad,” said Mauro Guillen, head of the Lauder Institute of Management and International Studies at Penn’s Wharton School.

“Reckless” U.S. subprime loans were “sliced and repackaged” into “toxic securities” by U.S. investment banks, who resold these bonds to banks and pension funds around the world — cash up front, to be repaid as borrowers made their payments, or defaulted if they didn’t.

Mauro Guillen, head of the Lauder Institute of Management and International Studies at Penn’s Wharton School.

U.S. investors knew last year that some banks had problems; that’s when the dollar sank. Europeans woke up to the losses only when British, German and Dutch regulators had to bail out banks last weekend, Guillen said.

The U.S. bailout, when it passes, will help some, he said. “China, Brazil and Mexico all managed to get out of big banking crises in the 1990s. I can’t come up with an example of a country that let the financial system go down the drain,” he said.

“People don’t like giving money to bankers. Especially investment bankers. But what is the alternative? The alternative is chaos. Companies can’t operate if the financial system crashes.”

More important, the bailout will make it easier for the more-efficient and well-run banks to buy inefficient and failing lenders. Natural selection, with government help, as it were.


U.S. Treasury Secretary Henry M. Paulson Jr. used to be a Goldman executive; predecessor Robert Rubin works at Citigroup, their colleagues advise Barack Obama and John McCain. No wonder.

Guillen says, that’s why they’re in position to buy up troubled bank assets at bargain prices, bailout or no.

But it will be best for U.S. businesses and consumers if European and Asian banks also join the bailouts, Guillen added. “Commercial banks in the U.S. are not very good by international standards. They are not efficient,” Guillen said. “The good retail banks are HSBC, ING Groep, and the Japanese, Canadian and Spanish banks. It would be great for the U.S. retail sector if those banks would come in.”

Panic aside, if U.S. budget and trade deficits continue, the dollar is expected over time to lose ground as the world’s investment and reserve currency. That means “interest rates in the U.S. will be slightly higher,” said Guillen. “And U.S. influence in global financial affairs and even political affairs is going to wane. Standards of living in the U.S. are going to suffer.”

“But I would not underestimate the ability of the U.S. financial system to adjust. It’s brutal, but the beauty is it’s flexible.”

Two or three years down the road, we will be talking about a different situation. But there will be a lot of pain, a lot of people losing their jobs and trying to find other ones, until then.”

Student model?

Student lender SLM Corp. (Sallie Mae) may be pointing the way to the end of the bond-market crisis, without a government bailout.

For the first time since the bond markets started jamming in early 2007, SLM is “testing the waters” of the asset-backed securities market, laying plans to sell bonds backed by student-loan payments, Friedman, Billings, Ramsey Group Inc. analysts Matt Savelling and Bill Jackson wrote in a report yesterday.

That means SLM will have more cash to make more student loans. But it also means more expensive student loans, since bondholders are demanding higher payback in today’s volatile markets. It also means SLM will demand better credit from borrowers, the analysts note.

That’s how the bond market prices will end. Rates will increase; sellers will demand better credit from borrowers, and will give investors better information. More confidence, and better trading, until the next cycle.

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