

Libor Fails to Drop From 7-Year High; Crunch Persists (Update7)  
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(Updates bill yields in the 10th paragraph.)

By Gavin Finch

Dec. 13 (Bloomberg) -- The interest rates banks charge each other for short-term loans in Europe failed to decline from the highest levels in seven years a day after central banks joined forces to break a logjam in money markets.

The cost to borrow for three months remained at 4.95 percent, the British Bankers' Association said today. That's 95 basis points, or 0.95 percentage point, more than the European Central Bank's benchmark interest rate, compared with 57 basis points a month ago. The difference averaged 25 basis points in the first half of the year, before losses on securities linked to U.S. subprime mortgages contaminated credit markets.

The highest short-term rates since December 2000 suggest that the first coordinated central bank action since the Sept. 11, 2001, terrorist attacks may not be enough to revive interbank lending. The cost of borrowing dollars fell 7 basis points to 4.99 percent, about half what was anticipated, based on prices of Libor futures contracts.

"It's not going to help us find an exit to this crisis," said Cyril Beuzit, head of interest-rate strategy at BNP Paribas SA in London. "These measures aren't going to address the root cause of the crisis. Banks are still reluctant to lend money to each other because there are serious concerns about potential further bad news."

#### Reacting to Losses

Central banks in the U.S., U.K., Canada, Switzerland and the euro region agreed yesterday to coordinate efforts to promote lending and restore confidence in money markets. Policy makers are reacting to more than \$66 billion of losses announced by banks this year and estimates of about \$300 billion more on securities linked to subprime mortgages, collateralized-debt obligations and structured investment vehicles, or SIVs.

The measures won't succeed in bringing down borrowing rates until next year, futures trading in Europe suggests.

Implied yields on Euribor futures contracts expiring this month through June 2009 rose today, with the December contract climbing 6 basis points to 4.92 percent. The implied yield on the March 2008 contract gained 6 basis points to 4.6 percent.

"The markets don't expect spreads to go down," said Alexander Titsch-Rivero, head of derivatives and structured products in Frankfurt at BHF-Bank AG, a German private bank. "The actions by the central banks were just a placebo, a

tranquilizer that doesn't solve the problem of the mistrust among banks on one hand and the potential for more losses in credit on the other."

### Stocks, Bonds

The interest rate for euros compiled by the European Banking Federation was little changed at a seven-year high of 4.95 percent, compared with 4.18 percent at the start of July.

Stocks extended declines, with the Euro Stoxx 600 index falling 2 percent. Yields on three-month Treasury bills, regarded as a haven for investors in times of turmoil, held at 2.85 percent, close to the lowest since Aug. 20.

The difference between the interest banks and the government pay for three-month loans, called the TED spread, rose to 2.21 percentage points yesterday from 1.59 percentage point on Sept. 18, when the Fed began lowering rates.

"It's a very disturbing sign," said Christoph Rieger, a fixed-income strategist at Dresdner Kleinwort in Frankfurt. "I'm alarmed by the impact this is having, which underscores that the funding difficulties out there are enormous."

The Fed plans four auctions, including two this month that will add as much as \$40 billion, to increase cash in the U.S. The Bank of England said it would widen the range of collateral it will accept on three-month loans.

### Seized Up

Short-term credit markets seized up in August, raising concern that the lack of capital flow between banks will hurt the economy. Goldman Sachs Group Inc. in a report a month ago estimated losses related to record home foreclosures may be as high as \$400 billion for financial companies. If accurate, banks, brokerages and hedge funds would need to cut lending by \$2 trillion, triggering a "substantial recession," the firm said.

Borrowing costs have soared over the past four weeks as banks sought loans that will cover their commitments through to the start of next year.

"We're coming up to a real end of the year liquidity squeeze," said Stewart Taylor, who trades Treasuries in Boston at Eaton Vance Management, which oversees about \$4 billion of taxable bonds. "A lot of people are just pumping into bills rather than lending. Why loan money over the end of the year if you don't have to."

### Brown, Geithner

U.K. Prime Minister Gordon Brown said the surge in credit costs should spur increased transparency in the banking industry

and change the way credit-rating companies work.

``It's a wake-up call for the global economy," Brown told lawmakers in Parliament in London today. ``The existing institutions aren't good enough."

Fed Bank of New York President Timothy Geithner said today central bankers are looking at ``additional instruments" to provide funds to banks in times of stress.

``The market is underestimating the significance of the move by the central banks," said Ciaran O'Hagan, head of interest-rate research in Paris at Societe Generale SA. ``It's a strong action that will tide us safely over year-end and hopefully restore confidence to the money markets early in the new year."

Turmoil in the credit markets has caused losses for everyone from shareholders of New York-based Citigroup Inc., the largest U.S. bank, to Florida schools and towns invested in a state-run fund that owned downgraded and defaulted securities issued by SIVs. Citigroup, which said its mortgage-related writedowns may reach \$11 billion this quarter, has fallen 39 percent since June on the New York Stock Exchange.

The one-week rate for euros was unchanged at 4.13 percent, the EBF said today. The rate for three-month credit in U.K. pounds dropped 12 basis points to 6.51 percent, the BBA said.

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