

## Why there's more bad news to come from the banks

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04.08.2008

by David Stevenson

The British bank reporting season is now in full flow. It's the time of year for all those lenders, who've been happily turning down all your pleas for that extra loan or higher overdraft, to admit to all the cash they have managed to mislay over the last six months.

And the picture that's emerging isn't very pretty. Not only have the numbers so far been worse than expected, there seems no end in sight to the sorry tales of credit write-down losses. It looks like there's a shedload of more bad news on the way.

Today it was the turn of HSBC to face the music, and it duly coughed up another telephone number credit write-down. Last week, Lloyds TSB and HBOS turned in the sort of results that would have been seen as quite unthinkable until recently. Another round of write-offs, totalling a combined £1.7bn, blitzed the income statements and slashed profits by more than 50%.

But HSBC has just unveiled write-downs three times as large. The bank, which reports in US dollars, has set aside another \$10.1bn (£5.1bn) this year for its 'loan-loss reserves', i.e. a charge against the bank's capital to allow for losses on assets that have gone bad.

Very painful. Maybe as HSBC is Europe's biggest bank by market value, it's not too surprising that it should top the table of lenders' largest losses. But even so, the level of write-offs is still absolutely staggering. Because the key word here is 'another'. Last year the charge was \$17bn and in 2006 it was a further \$10.6bn. That means HSBC has totted up to an eye-watering \$38bn, give or take the odd \$100m, in just 30 months.

Ouch.

The net result was that HSBC's first-half profit declined 29% to \$7.7bn, equal to 65 cents a share, from \$10.9bn - or 94 cents a share - a year earlier. To be fair, that's a lesser decline than the bank's peers, and amazingly, was slightly lower than that expected by analysts surveyed by Bloomberg - though as I wrote last week ([Don't be fooled – the bad news isn't priced in yet](#)), for the pundits already to be factoring in this level of decline as almost 'normal', is a scary reflection of current thinking.

But the real issue is what happens now on the write-down front. Is this the end of these huge losses, or are there fires still to be fought?

It certainly doesn't look like the end, certainly not for some of the other big players in the banking sector.

Those banks reporting last week revealed that bad debts had jumped by more than 30% in the first six months of the year, while Alliance & Leicester revealed that its profits had been all but wiped out by the credit crisis. What's more, Lloyds TSB warned that UK mortgage defaults are rising as house prices fall, while HBOS expects, in bank-speak, to see "upward pressure on impairments losses".

But the banks' problems aren't just in UK housing. While the threat of crisis here has been building up for several months, UK Plc had until recently been considered to be much more resilient.

No longer. HBOS last week wrote off almost £1bn in its corporate loan book, almost twice the size of the provision the bank took against its £237bn mortgage book. And Lloyds TSB admitted that bad debts had almost doubled in its commercial banking division, which deals with smaller businesses.

The number of companies becoming insolvent jumped by 15% during the second quarter of 2008 against the same period last year, according to the Insolvency Service. Dozens of retailers have failed this year, with even the General Trading Company, the Chelsea-based store that provided the wedding list for the Prince of Wales and the Duchess of Cornwall's 2005 nuptials, recently going to the wall.

"This is just the tip of the iceberg," said Matthew Prest, head of Close Brothers' European restructuring business, "there's a lot more to come. The problems in the corporate economy are only just beginning to appear."

Last week I showed how British business is running out of cash, according to the latest money supply numbers from the Bank of England ([More bad news: British businesses are running out of cash](#)), whose data also shows that corporate Britain owes its banks nearly £545bn, almost as much as the UK government's debt.

For retailers, the next key day will be 25th September, when the quarterly shop rent bill falls due. "Expectations are mounting that these rent payments could sound the death knell for a number of struggling outfits. This would in turn spell trouble for the banks that are owed money", says the Times.

"We believe that corporate-lending credit-loss charges will once again prove the biggest variable in bank profits in an economic downturn," said Robert Law, an analyst at Lehman Brothers. In other words, watch out for some more nasty news.

It looks like the problems for UK banks have only just started...

Published in Moneyweek on 4<sup>th</sup> August 2008