

Schroders Quickview



US Congress narrowly rejects TARP 30 September 2008



Keith Wade, Chief Economist

- **US Congress narrowly rejects the Troubled Asset Relief Program (the TARP)**
- **We expect that some form of rescue package should be passed later this week**
- **Whatever deal is eventually struck, this will only be the first step on the road to recovery for the banking sector**
- **Markets should be braced for more capital raising as banks restore their balance sheets**
- **Ultimate recovery will also require the demand for credit to rise – investors should anticipate rate cuts, and even tax cuts, as policymakers focus on boosting this demand**

Global stockmarkets continue to be dominated by concerns about the ongoing weakness in the banking sector.

Markets were dealt a further blow on Monday 29 September as it was announced that the US Congress had narrowly rejected the US Treasury and Federal Reserve's initial rescue package proposal. Following the announcement, Wall Street's Dow Jones saw its biggest one-day points fall and Asian stocks were hit by big declines as a result of heavy trading.

It is hoped that some form of rescue package will be agreed and passed by the US Congress when they meet again - probably later this week. By ridding the banks of their toxic assets, interest rate spreads should narrow and monetary policy will become more effective.

However, it is important to re-iterate that whatever form of assistance is eventually promised to the banking sector, it will only be the first step on the road to recovery for the system – and should not be anticipated as a cure-for-all.

Depending on the price that is set for buying toxic assets, it may well imply further write-offs and, in some cases, bankruptcy as losses as crystallised. Given the scale of the problem, we may well need to see TARP 2 and markets will certainly need to be braced for more capital raising as the banks restore their balance sheets to a position where they are willing and able to lend again.

It is also important to remember that the TARP that the US Congress has rejected addresses the supply side of the problem while ultimate recovery will also require the demand for credit to rise. Falling house prices and rising unemployment suggest that households will not be rushing to gear up when the credit crunch eases. Investors should look for rate cuts, and even tax cuts, as policy makers switch their attention to boosting demand.

We now expect the Federal Reserve to cut rates by 50 basis points at the end of October and have brought forward the first cut by the European Central Bank to January from March next year. We still expect the Bank of England to cut by 25 basis points in November.

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