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- Exclusive
- Worldwide
- Regions
- Markets
- Industries
- Economy
- Politics
- Law
- Environment
- Invest
- Science
- Opinion
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- Arts and Culture
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U.S. Treasury May Buy Stakes in Banks Within Weeks (Update2)

By Robert Schmidt and Rebecca Christie

Oct. 9 (Bloomberg) -- The government is planning to buy stakes in a wide range of banks within weeks as the credit freeze increasingly threatens to tip the U.S. economy into a deep recession.

Treasury Secretary Henry Paulson and top aides are still considering options on how the purchases would work, including having the government acquire preferred stock, two officials informed of the matter said.

The move would be a shift in emphasis in Paulson's original intention for the $700 billion bailout package passed by Congress last week. While the Treasury still aims to buy troubled mortgage-backed securities from financial institutions, a direct capital injection would offer more immediate relief by giving banks quick access to funds they could then lend out.

``The Treasury is no longer looking for one silver bullet,'' said Steve Bartlett, president of the Financial Services Roundtable, which represents 100 of the biggest firms in the industry. ``They have to proceed on all fronts.''

The Treasury aide named to run, on an interim basis, the office that will implement the rescue package, Neel Kashkari, is scheduled to speak Oct. 13 in Washington on progress in putting plans together. Paulson's ultimate goal is to help banks make new loans to jumpstart the economy.

$200 Billion

Bartlett said that buying into the banks would be ``a major piece of the puzzle'' and that an infusion of $200 billion would be ``plenty adequate'' to kick start the plan.

A $200 billion to $300 billion figure would probably pay for minority stakes in U.S. banks not on the brink of failure, according to estimates by Duke University finance professor Campbell Harvey in North Carolina.

``It is important to inject capital into the system,'' Edward Lazear, chairman of President George W. Bush's Council of Economic Advisers, said in an interview with CNN. The Treasury will inject funds ``in short order,'' as soon as it works out the details of the initiative

As a credit freeze sends rates on loans between banks soaring, the world's biggest economies are stepping up efforts to prevent a financial meltdown. In the U.K., Prime Minister Gordon Brown is engineering a 50 billion pound ($87 billion) program that partly nationalizes at least eight British banks. He's also enacting other measures to help the banking system.

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Global Efforts

Japanese lawmakers are considering reviving a law that would allow the government to inject public money into regional financial companies. Spain's government this week said it will establish a fund of as much as 50 billion euros ($68.5 billion) to buy up bank assets.

Paulson and Federal Reserve Chairman Ben S. Bernanke will meet with their counterparts from the Group of Seven major industrial nations tomorrow in Washington.

The Treasury is ``laying a foundation'' for a global effort, said Tim Ryan, head of the Securities Industry and Financial Markets Association. ``There is obviously concerted action among at least a few of the large developed countries to deal with the confidence issue in the financial markets.''

Banks worldwide aren't raising enough capital to offset losses. While posting $592 billion in writedowns and losses during the crisis, they have added just $442.5 billion of new capital, according to data compiled by Bloomberg. The International Monetary Fund anticipates losses will more than double to a total of $1.4 trillion.

Biggest Failure

In the U.S., the 14-month old credit crisis has caused 13 bank failures, including the nation's largest in history -- Washington Mutual Inc.

Paulson and Bernanke, when lobbying Congress for the bailout legislation last month, played down calls by some lawmakers for the government to take equity stakes in individual companies. Still, Treasury officials say that such a move was always an option under the broad power the law gives Paulson to help banks and other financial institutions.

While the bank stock purchase plan being considered at the Treasury would be voluntary, it is assumed that many companies would jump at the chance of getting government funds.

The Treasury's financing is likely to come with restrictions and it could trigger limits on executive pay that were mandated by Congress, potentially reducing the appetite of some banks to participate. Government stock purchases could also dilute existing shareholders, or confer a stigma of a bank in trouble.

Mid-sized banks including KeyCorp and Huntington Bancshares Inc. have plunged this month on concern the deepening credit crisis will cause the economy to contract and send loan defaults soaring. Cleveland-based Keycorp has slid 53 percent in the past week to $6.42 at the close in New York Stock Exchange trading. Columbus, Ohio-based Huntington is down 38 percent the past three days, to $6.79.

There are 8,451 U.S. banks and thrifts with $13.3 trillion in assets whose deposits are insured by the Federal Deposit Insurance Corp., according to second-quarter data.

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