Business Briefs

Pension Funds

GM's Deficit Needs $13 Billion in Bonds

General Motors will issue $13 billion in new debt to finance its pension fund deficit, and to keep up its auto finance unit. Due to the recent years' stock market crash, the deficit in General Motors' pension plans, both domestically and internationally, doubled in one year, to $25.4 billion at the end of 2002. About $10 billion of money raised from the corporate bond issue will be used for the GM pension plans, the remaining $3 billion for the GM finance unit. It will be one of the biggest corporate bond issues ever worldwide, following France Telecom ($16.4 billion) and Deutsche Telekom ($14.5 billion), and larger than WorldCom's $11.9 billion.

In a special June 21 feature on the U.S. automobile giants, the Swiss financial daily *Neue Zürcher Zeitung* pointed to the precarious financial situation at General Motors, Ford, and DaimlerChrysler. On top of the pension fund problems, there is the ongoing incentives war which will probably further escalate in September, when usually the car sales go down sharply. According to CNW Marketing, the average incentive—price discounts and zero-interest financing schemes—reached an all-time high of $3,916 for every car sold by General Motors in May. The other U.S. automobile producers grant similar incentives. Moody's has recently downgraded General Motors debt to a level only slightly above "junk," and indicated another downgrading to come. The *Zeitung* quotes a statement by Saul Rubin of UBS Warburg, saying that if present trends continue, General Motors and Ford will be forced to file Chapter 11 within the next 5 to 10 years, while DaimlerChrysler will be broken up in two pieces.

Mortgage Bubble

Fannie Mae May Be In Worse Trouble

The June 23 *New York Times* revealed that Fannie Mae, the U.S. mortgage loan corporation and big sister of Freddie Mac, made no money in 2002, despite reporting $6.4 billion in "core earnings," and $4.6 billion in earnings as measured by standard accounting rules. "On an economic basis, they made no money last year. That's the simplest way to put it," Sonic Capital president Lawrence Kam told the *Times.*

Kam said that Fannie Mae underestimated how fast interest rates would decline and homeowners would refinance their mortages, and did not protect itself against the risk that some of its higher-yielding mortgages would be replaced by lower-yielding ones. These losses will show up in Fannie's income statements over the next several years. As a result, over the last three years, the discrepancy between what Fannie Mae has reported as earnings, and the actual change in the value of its net assets, is a shortfall of $9.7 billion. Kam reported that this is not a matter of breaking the accounting rules, but of the failure of standard measures of profit and loss to capture the underlying economic reality of the derivatives business.

The home mortgage refinancing binge, which has been necessary to keep housing payments down, and consumer spending and debt service up, is hitting the mortgage-backed securities market from below, in a classic example of blowing out one part of the bubble in an attempt to save another.

IMF

Turkey Resists Demands, Banks Attack

The International Monetary Fund's permanent senior representative in Ankara, Odd Per Brekk, indicated at a conference on June 21 that the IMF will most likely postpone the payment of the next tranche of its total $28 billion rescue package, because the Turkish government has failed to implement demanded "reforms." He warned that the "government needs to address a number of issues to ensure continuity in the reform effort." In particular, the demanded changes in social security bankruptcy laws, and job cuts at large public corporations, have not been implemented yet. As the *Financial Times* noted on June 25: "Sentiment was further affected when three members of the government spoke of their desire to dispense with the IMF's services after a three-year programme expires in 2004." Turkish Economics Minister Ali Babacan downplayed the events, and then described the next IMF tranche of $500 million as being anyway rather "symbolic."

Already on June 21, J.P. Morgan downgraded Turkish eurobonds, telling investors to sell. Merrill Lynch followed on June 23. Isaac Tabor, head of emerging markets fixed-income research at Merrill Lynch, according to the *Financial Times,* put out a warning to the Turkish government.

Hungary

Currency Crisis Hits the Forint

Highlighting the fragility of Eastern European economies and the political fights behind the upcoming enlargement of the European Union, are events that took place on the financial markets of Hungary this Spring. In the expectation of Hungary's entry into the European Union, and later also into the euro-zone, international funds directed huge amounts of hot capital into the country, boosting the foreign exchange value of the forint, Hungary's currency. In order to keep up Hungarian exports, the new government then exerted pressure on the central bank to devalue its own currency. Finally, in early June, the reluctant central bank followed these demands, and reduced its target for the forint/euro rate by 2.3%. What followed was an immediate crash of the forint by 7%.

The central bank, on June 10-19, reacted by a shock increase of interest rates from 6.5% to 9.5%. Bankers quoted by the German-language *Financial Times* on June 25 noted that this may have been just the beginning of a much more severe currency crisis. So far, only some short-term-oriented hedge funds have sold the currency. But once the large investment funds pull out, the situation would become very critical for the Hungarian currency and economy. The current account deficit reached 5% of gross domestic product (GDP) last year, while the government budget deficit is almost at 10% GDP. The *Financial Times* quoted an analyst at J.P. Morgan, warning that these events will already postpone Hungary's entry into the euro-zone, currently planned for 2006-08, by several years. The same could happen at any moment in Poland or other Eastern European countries.

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