Greenspan Says Banks Still Have a 'Large' Capital Requirement

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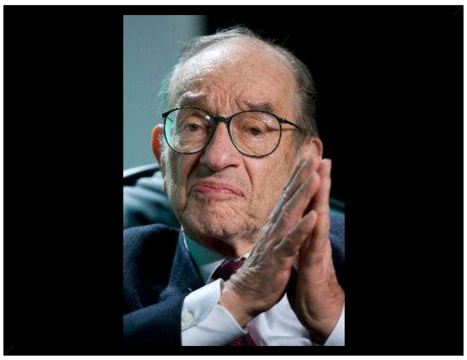
By Alison Fitzgerald



May 21 (Bloomberg) -- Former Federal Reserve Chairman **Alan Greenspan** signaled that the financial crisis has yet to end even as borrowing costs tumble, warning that U.S. banks must raise "large" amounts of money.

"There is still a very large unfunded capital requirement in the commercial banking system in the United States and that's got to be funded," Greenspan said in an interview yesterday in Washington. He also said that "until the price of homes flattens out we still have a very serious potential mortgage crisis."

Greenspan's comments suggest he sees a bigger capital shortfall in the banking system than reflected in regulators' stress tests on the 19 biggest U.S. lenders. Treasury Secretary **Timothy Geithner** told lawmakers yesterday that banks have issued more than $56 billion in new stock or debt since the tests found 10 firms needed to raise about $75 billion.

A lack of capital at banks may inhibit lending to consumers and businesses, tempering any economic recovery. The former Fed chief, who left the central bank in 2006, said that the continued slump in home prices is putting at risk millions of borrowers.

"We're on the edge and if this thing doesn't get resolved quickly I'm worried," he said before a meeting with House of Representatives members on financial regulation that was organized by the Washington-based Bipartisan Policy Center.

Home prices will only start to stabilize once the "liquidation" rate of single-family homes has peaked, he said. "I don't think we're there yet."

'Remarkable' Improvement

More broadly, "things have unquestionably improved" across the economy and financial markets, he said. "They've improved everywhere in the world. It's remarkable."

The London interbank offered rate, or Libor, for three- month dollar loans fell 3 basis points yesterday to 0.75 percent, the British Bankers' Association said, the 35th straight drop. The Libor-OIS spread, a gauge of banks' reluctance to lend, narrowed to 55 basis points, the least since February 2008. It was as high as 364 basis points in October.

That's an "extraordinary improvement," said Greenspan, who last year said that the credit crisis would be at an end once the Libor-OIS spread narrowed past 25 basis points. "Virtually all of the various credit spreads not only in the U.S. but globally have come down."

Alan Blinder, a former Fed vice chairman, also said on Capitol Hill that "if there are no more reversals, history will judge that by May 2009 we will have passed the worst of the crisis."

GDP Call

"My current guess would be in terms of GDP the second quarter will be a bottom and by the third quarter we're eking out a positive," Blinder said.

Greenspan agreed, estimating that U.S. gross domestic product will decline at an annual rate of 1 percent in the second quarter.

Members of the Fed's Open Market Committee who met in Washington April 28-29 saw "some signs pointing toward economic stabilization," and some officials detected prospects for "a trough" in the housing market's downturn, according to minutes of the meeting released yesterday in Washington.

Fed governors and district-bank presidents project that the economy will shrink 1.3 percent to 2 percent this year and grow 2 percent to 3 percent in 2010, according to median estimates released yesterday.

Greenspan separately said he opposed the creation of a "systemic risk regulator," a concept that has been backed by the Obama administration and Fed Chairman **Ben S. Bernanke**. The agency would be given an impossible task of trying to foresee crises, he said.

"If you put the power into the hands of people, very smart people, but if you ask them to do more than is possible I think they will create problems for the system," said Greenspan, who said in congressional testimony in October that "a flaw" in the ideology of free-market risk management contributed to the the "once-in-a-century" credit crisis.

The former Fed chairman also reiterated his view that the central bank's emergency lending should be done instead through the Treasury.

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