Slowdown signs - OECD predicts subprime losses to hit USD 420 billion

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According to an analysis by the Organization for Economic Co operation and Development, losses from the collapse in the US subprime mortgage market will total between USD 350 billion and USD 420 billion.

The figure contrasts with the hair raising USD 945 billion estimate given by the International Monetary Fund last week. The OECD had previously put subprime losses and write downs at about USD 300 billion, based on market prices last September, but it said the market panic had distorted pricing so much this method was no longer reliable.

Its new estimates assume that lenders would recover 40% to 50% of foreclosed loans, if growth and unemployment were similar to the recession of 2001 but house prices weaker than in the early 1990s. It added that “To get anything like recent mark to market losses would require a 0 per cent recovery rate which seems extreme even for the most bearish.”

The IMF’s estimate is based on market prices but includes losses and writedowns in other areas, such as commercial property and leveraged finance.

A more focused IMF analysis, looking only at residential mortgages, suggested a lower level of losses about USD 480 billion but the OECD said its figures were based on a bigger pool of mortgages.

Mr Adrian Blundall Wignal deputy director of OECD that “If looking at a comparable pool of mortgages, the OECD’s estimate of losses would be even lower, at USD 262 billion to USD 315 billion.”

Even though the scale of first round losses could be less than feared, the risks of a credit crunch more acute than that suffered in the US in the early 1990s remain considerable.

The OECD said that USD 60 billion of direct losses could lie with US commercial banks and that it could take from six months to two years for banks to recapitalize. The report said that “The arithmetic of getting quickly back to business as usual requires much more capital than simply offsetting the losses.”

OCED said that interest rate cuts and a policy of cutting dividends to bank shareholders could speed the recovery, but avoiding the 1990s type scenario could require further capital injections and, as a last resort, a government backed bail out of the assets affected.

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