

Despite the current credit squeeze, the world can grow only by extending more credit to more people. That in turn will bring new opportunities for securitization, and the development of new financial instruments.

Whose Debt Is It Anyway?

By Clark Winter

As the U.S. sub-prime mortgage crisis unfolds, it has suddenly become very difficult for borrowers to obtain new credit. Even those of substantial means—the buyers of expensive New York City real estate, for example—are discovering that their banks, which just a few weeks ago would have written them a jumbo mortgage in a New York minute, suddenly want either lots more collateral, or no part of the mortgage at all. Sub-prime lending problems, moreover, are spilling over into the commercial paper market, and like any contagion moving from one host to another, into the short-term money market fund business. It turns out that money market fund managers, hoping to boost their returns for competitive purposes, invested in lots of commercial paper, whose investors were also buying lots of sub-prime mortgage paper. Thus do localized problems spread and become general problems.

Because countries such as China and Japan are large buyers of American loans, the contagion has spread abroad as well, and has already been reflected in a downturn in Asian markets, and—you guessed it—increasing difficulty for Asians as they attempt to buy new homes of their own. The average citizen of Shanghai or Beijing can always work around this problem in a way that most Americans cannot: Their savings rates are higher, and the elaborate networks of family obligation and *guanxi* (the interconnection among people that allows one to prevail upon another in times of trouble) will ensure that few Chinese mortgages will go into default. If only that was the end of the story.

While the international banking system is likely to do a decent job of containing the sub-prime debacle, it may come at a larger cost to the global economy. In many nations, consumer credit is just beginning to take off. While there are more credit cards than people in the U.S., and while most Americans have a negative net worth, people around the world are just starting to develop an appetite for credit and the products, services and experiences that credit can purchase. Moreover, most non-U.S. banks restrict the issuance of credit to their best customers, and continue to place tight limits on how much can be charged to each card. Beyond credit cards, most loans outside the U.S. are secured with business collateral, which is one reason why many nations are not worrying about America's credit woes.

Nevertheless, since so many nations now hold so many billions of dollars in U.S. government and commercial paper, there is some worry about whether the U.S. credit crunch might spread, driving the American economy into recession, and causing a substantial cooling of economies dependent upon exports to the U.S. A spreading credit crunch would be like a rock thrown to the far end of a pond, where the rebound ripples come from behind. They are ripples nevertheless, and the kind often not guarded against.

So what's a country like Hong Kong or Singapore, or even China, to do? The answer, surprisingly is, loosen up credit standards a bit. If more credit is made available in foreign markets, more goods might be sold locally, or intra-Asia, making those exporting countries a bit less dependent on U.S. markets. Going down a level or two in creditworthiness will not mean creating a sub-prime market, but if banks are worried about defaults, they can develop their

own credit derivatives and hedging strategies, package these, and sell them to investors. One reason that credit is still scarcer outside the U.S. than in it is that while there has been an explosion in locally currency debt issuance in recent years, the total amount is still minuscule compared to local needs. While many Asian and Middle Eastern nations have begun to gain experience with equities, and have developed roaring stock markets, they are still novices in the world of debt structures.

Given that the American debt markets appear to have become almost impossibly complicated, wishing the same on others sounds like wishing

a plague on everyone's house. Not so. While there will inevitably be some abuse of debt and credit structures as nations democratize the availability of credit, well-designed laws and regulations can keep such problems in check. After all, in debt-ridden America, mortgage defaults are well under 2%, and credit card default is also extremely low. More important, democratizing credit will speed market development at a time when the world needs it the most. The development of securitization on a global scale will bring additional stability, not less, to world markets, and will provide new outlets and opportunities for financial institutions. ■

Clark Winter has a long history in investment management, at Morgan Guaranty Trust/JPMorgan, where he opened offices in Spain and Mexico, as CEO of Global Asset Management (now part of UBS), and as founder and president of Winter Capital International, an independent advisory firm that is now a subsidiary of the Citigroup Private Bank. He has written for *Forbes* and other publications and is the author of "**The Either/Or Investor**," a book to be published in January, 2008. Copyright © 2007 by Clark Winter