

Answers to financial questions

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If you're confused about the recent barrage of financial news, you're in good company. From corporate boardrooms to leading business schools, nobody is. Which is a big part of the problem Markets hate uncertainty.

In the past couple weeks, the government and the Federal Reserve have bailed out mortgage giants Fannie Mae and Freddie Mac, investment bank Bear Stearns. Meanwhile, investment bank Lehman Brothers went into bankruptcy and Merrill Lynch was sold at a fire-sale price to Bank of America.

This string of events is complicated, confusing and unprecedented. So The Miami Herald asked some experts to help us get a handle on the situation. Here are some of their answers.

Q. Is the nation's financial system really worse off this week than last week, or does it just look that way because so much bad news came out in a short period?

A. The nuts and bolts of the financial services industry remain the same as last week, said University of Florida finance professor Mark J. Flannery. But the market is nervous.

"People have been waiting for good news and they got bad news," said Flannery, a specialist in financial industry regulation. "A lot of investors have decided to sell."

Also, some financial services firms are still doing well, said Joseph Nader, managing director of Zenith Capital Partners in Coral Gables.

Investment bank Morgan Stanley posted strong earnings this week even though its stock is falling, and some regional banks like Wells Fargo and U.S. Bancorp.

"Even in this environment they are making money," Nader said.

Q. Why did the government bail out Bear Stearns, Freddie Mac, Fannie Mae and AIG but not Lehman Brothers?

A. Several theories are out there, but here's one "There's not as big an impact of Lehman," said William Hardin, a professor of finance and real estate at Florida State University.

Fannie and Freddie are government-related companies that buy loans from banks so the banks can go out and make new loans. Without these two companies, banks would have a hard time getting loans.

AIG, meanwhile, has many lines of business, but a key one is insuring corporate bonds. Bonds are interest-paying IOU's that big firms use to borrow money. AIG insures the possibility that the bond issuers don't pay.

These insurance policies, called "credit default swaps," are then bought and sold to other investors. The loss of these insurance policies would only increase the risk for investors.

In contrast, Hardin said, Lehman was heavily involved in selling investment products based on mortgages of uncertain value. And Wall Street foresaw the risk.

Q. Why is everyone so concerned about an insurance company? If Allstate was in trouble, would the same thing happen?

A. AIG's niche with these "credit default swaps" suggests this company is different from a typical insurer of cars, homes and businesses.

But without getting into the head of top federal finance officials, it's hard to make predictions about whom they'd bail out and whom they wouldn't.

"We're too much in the middle of it to come up with that," said Nader, who advises wealthy individuals and families on their investments. "This is the kind of decision that's made in a split second."

Q. Who is making these decisions? President Bush?

A. These are extremely technical matters, and many observers think the president is putting a lot of stock in the advice of the government's top finance spokesman, Treasury Secretary Hank Paulson and Federal Reserve Chairman Ben Bernanke.

Paulson is the former chief executive of Goldman Sachs. Bernanke is a respected economist and an expert on the Great Depression.

Q. Do the financial services industry's problems have special implications for South Florida?

A. Flannery said banks may pull back on lending and charge more for loans, which would be bad news for the region's flagging real estate market.

Q. Is there anything to feel good about in the economy?

A. Falling oil prices are good news in that they should lead to lower prices for gasoline, food and other products.

The government said this week that inflation fell nationally in August, although it was flat in South Florida.

Nader noted that lower inflation reduces pressure on the Federal Reserve to raise interest rates, which would slow economic growth.

And Flannery said the government is acting to mitigate the economic damage.