COMMENT

# Global crunch will cause more lessors to close down

Derek Soper

There have been financial and banking crises before, but the current one, on its global scale, is surely "rocking the boat". Some experts say the credit crisis could be nearing its finale, while others suggest it might merely be the first stage of much longer turbulence. We will only know who is correct as events continue to unfold, but the credit crunch is a massive stress test for the global financial system. It signifies a crisis when a credit boom has been extinguished by "natural causes".

Powerful global forces are at play and their impact, both domestically and internationally, are extremely uncertain and difficult to predict. Economic and market interconnectedness has become more complex and potent, and unwelcome developments are easily and speedily transmitted globally. However, we all have to get on with running our businesses and, although the way we get to our objectives may change, the objectives themselves don't change.

In mid-March, the International Monetary Fund (IMF) called for "decisive policy action" to strengthen the global financial system, noting authorities worldwide must also "think the unthinkable" so they can better anticipate and react to potential global economic risks.

## Financial markets

They went on to say the first priority must be to reverse the spreading strains in global financial markets and to restore the normal functioning of the financial system in advanced economies because there is a critical need to assure market liquidity. Policy actions worldwide, so far, "may not prove to be adequate" to deal with the "low probability but high-impact events" that may materialise and undermine global financial stability.

The IMF points to the potential for a global financial decelerator that could amplify the impact of financial turmoil on the economy. It emphasised: "A downward credit spiral, driven by rising defaults or margin calls that force asset sales even as the value of collateral deteriorates, could produce new rounds of de-leveraging and asset-price deflation." Will tighter credit conditions combine with asset-price weakness or, worse, feed off each other? This is of more concern to our industry.

In the past two issues of *Leasing Life*, I covered the importance of adequate risk mitigation and business controls. I mentioned some asset financiers – including certain "seniors" – are reviewing their strategy and highlighted potential people issues in our industry.

Allco Finance Group is focusing on shipping, and other assets, amidst the credit crisis

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These are ongoing and deepening concerns. Moreover, there is evidence that some banks across the globe are considering whether it is time to pull out of leasing or, at least, out of some of the less profitable activities. Certainly, many banks are reluctant to consider new activities that, under normal circumstances, would be attractive investments. Even those that are being considered are carrying substantially increased pricing – not surprisingly, it is in times like these that the focus is back on 'pricing for risk'.

The media is full of tales of banking's woes. One example from the other side of the world, which is being followed up in Western media, are the troubles besetting Allco Finance Group (AFG), the diversified global financial services business listed on the Australian Stock Exchange.

AFG hit the headlines when its operations, finances and outlook were adversely affected by global credit market developments and equity market volatility. The group has embarked on a restructuring programme to focus on its core asset classes of aviation, shipping, rail and real estate, and dispose of non-core assets to reduce debt. It is in discussions with its banks to restructure its debt facilities. Further ramifications are doubtless yet to unfold and other examples of beleaguered banks will be found closer to home.

I have alluded to the ability to access funding as being the important differentiator for asset financiers and, of course, this in turn will affect some customers as they look for funding on favourable terms. More stringent lending conditions, and the increased cost of finance, are at the fore, raising concerns about the knock-on effect on investment.

## Under the microscope

Uncertainty and fears are causing more companies to review their investment plans, and to be more selective in support of existing activities. There is strong evidence that specific leasing activities are under the microscope and that the time has come to weed out the underperformers – we expect to see some divisions, subsidiaries and departments of major leasing groups either sold or closed down.

In the UK, Government data shows that business investment for Q4 2007 was 1.7 per cent higher than the same period of 2006 and 0.5 per cent lower than the previous quarter.

An indicator of future trends may lie in the latest quarterly Business Opinion Survey from the Institute of Directors. This showed business investment optimism has fallen sharply and, while the IoD cautions there is both good and bad news, the collapse in optimism is significant, largely because a sharp swing in business investment could potentially turn an economic slowdown into a recession. Despite the tail-off in future optimism, actual performance remains strong. As the IoD acknowledges, this is a tricky survey to interpret. We need to see whether pessimism translates into reality.

History does not give a clear steer on what happens next in this period of global uncertainty.

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