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## Markets tumble as Rogoff warns worst of credit crisis still to come

By Sean Farrell, Financial Editor

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Renewed fears about the length and severity of the financial crisis sent shivers through markets yesterday after an influential economist predicted a big American bank failure and said the worst was yet to come.

Kenneth Rogoff, the former chief economist at the International Monetary Fund, warned that the financial sector was probably only halfway through the year-old crisis.

"We're not just going to see mid-sized banks go under in the next few months, we're going to see a whopper. We're going to see a big one, one of the big investment banks or big banks," Mr Rogoff, who is now an economics professor at Harvard University, told a conference in Singapore. "We have to see more consolidation in the financial sector before this is over."

American financial stocks suffered for a second straight day amid concerns about the financial strength of Fannie Mae and Freddie Mac, the government-sponsored mortgage finance companies. After each lost about a quarter of their value on Monday, the companies' shares fell again yesterday, with Fannie down 2.3 per cent – to its lowest for 19 years – and Freddie losing 5 per cent to its lowest since 1991.

Mr Rogoff added to fears about the giant companies, which underpin the US mortgage market. "Probably Fannie Mae and Freddie Mac – despite what US Treasury Secretary Hank Paulson said – these giant mortgage guarantee agencies are not going to exist in their present form in a few years," he said.

The financial sector was also spooked by an analyst's note predicting writedowns of up to \$4bn (£2.1bn) in the third quarter by Lehman Brothers, which was the biggest underwriter of mortgage bonds before the credit crunch took hold. "It will be another difficult quarter for Lehman" after benchmark commercial and residential property indices plunged, the JPMorgan Chase analysts said.

Investor fears hit bank shares on both sides of the Atlantic. In London, Barclays and Royal Bank of Scotland shares fell by more than 5 per cent, and HSBC fell more than 4 per cent. In New York, Lehman shares plunged more than 13 per cent, leading other big financial stocks such as Merrill Lynch and Citigroup lower.

The FTSE 100 index closed down 2.4 per cent at 5,320.4. The Dow Jones Industrial Average fell 1.1 per cent to 11,348.5.

Top bankers, including John Varley, the chief executive of Barclays, have lined up recently to say that the biggest threat to the financial system had passed after financial institutions took about \$500bn of charges from the turmoil. Though lenders will have to cope with rising bad debts from the slowing economy, central bank action and the easing of money market pressure had reduced the chances of a big bank failing, they said.

Bear Stearns was rescued in March after the US Federal Reserve arranged for it to be bought at a knockdown price by JPMorgan. IndyMac, a regional US bank, was taken over by US regulators last month.

Mr Rogoff said that state-owned wealth funds, which have injected capital into banks such as Citi, Merrill Lynch and Barclays, did not offer an answer to the financial crisis. "There was this view early on in the crisis that sovereign wealth funds could save everybody: investment banks did something stupid, they lost

money in the sub-prime, they're great buys, sovereign wealth funds come in and make a lot of money by buying them. That view neglects the point that the financial system has become very bloated in size and needed to shrink," he said.

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