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CATO Inst: Tsy Needs to Clarify GSE Debt Status**LENGTH:** 986 words**DATELINE:** WASHINGTON

By Yali N'Diaye

This week's comments from Treasury Secretary Timothy Geithner did little if anything to clarify the status of the debt of government-sponsored enterprises, a **CATO Institute** analyst told Market News International Wednesday.

Answering a question from House Rep. Scott Garrett at a hearing Tuesday about the status of the GSE debt Geithner, seemingly reluctant to comment, said GSE and sovereign debts "are different types of obligations."

He insisted, however, the government "will make sure" mortgage giants Fannie Mae and Freddie Mac have the resources they need to meet their obligations "past and future."

That answer, however, left the congressman and other observers in the dark.

"What exactly does that mean," summarized **CATO Institute** Director of Financial Regulation Studies Mark Calabria.

In particular, should the government decide not to allow foreign central banks to take losses on GSE debt, "then we need to treat that as Treasury debt," which would be "on budget," he told Market News International.

In fact, the Office of Management and Budget and the Congressional Budget Office adopt two different accounting approaches, illustrating the difficulty of finding a consensus on the issue.

The two government-sponsored enterprises continue to be regarded as off-budget and are excluded from the formal White House Budget proposals, while the Congressional Budget Office has included them in the federal budget.

"A further review of which approach better fits both legal considerations and goals of budgetary accounting is ongoing," the OMB said when releasing the FY'11 budget in February.

Nearly two months later, the clarifications are still awaited.

"There needs to be a consistent treatment," said Calabria.

In particular, he said, if the Treasury decides not to hold GSE debt on budget, then "we need to not allow sales to foreign entities," he said.

"We need to take an approach that's transparent both to foreign central banks and to the American taxpayers," he said.

In fact, in his testimony before the House Financial Services Committee on Tuesday, he recommended to "Limit or bar holdings of GSE debt by foreign central banks."

That, however, would be "counterproductive," FTN Financial analyst Jim Vogel told MNI.

"One reported catalyst for the quick action Congress and Treasury implemented in the summer of 2008 was the large concentration of overseas holding of GSE securities," Vogel said.

"As developments unfolded, however, outside support for the GSEs would have been necessary even if no bonds had been held overseas," he added, noting "The depth and breadth of the housing market distress was too great, as seen by rising delinquencies and historically high loss severities on conforming loans."

"Focusing on one small historical aspect of the current predicament as part of a suggested 'fix' for GSEs or housing policies is counterproductive," he concluded.

Leaving all options open, Congress has not addressed the possibility of limiting foreign central bank holdings of GSE debt, which could trigger major controversy given the widespread ramification such a move would have.

CATO's Calabria underlined the existence of a process in case foreign entities want to buy equity stakes in U.S. companies, referring . This inter-agency committee chaired by the Treasury Secretary has in fact the ability to restrict sales and in this regard is an exception to the openness of the U.S. to foreign investments.

And Calabria argues that "we need to be treating debt and equity consistently."

If GSE debt is not going to be treated as sovereign debt, "we might want at least to have a process sort of like a CFIUS process," the analyst said, where "we would want to debate" whether the amount of holdings by foreign investors poses a risk.

He said if the amount of debt purchased by China central bank was instead equity, it would have gone through the CFIUS process.

So "there needs to be consistency between equity and debt purchases."

Whether the government decides or not to bring the GSE debt on its books, it needs to be clarified and certainly China's central bank would like it to be clarified, the analyst said.

Despite what Geithner has said, reaffirming that while GSE debt is not sovereign debt the government would make sure Fannie Mae and Freddie Mac have the resources to meet their obligations, "his comments are not reflected on the U.S. budget," Calabria said.

"The government needs to be forced to actually say what that means," he continued.

And that's exactly what Congressman Garrett is doing, by sending a letter to Geithner asking for clarification on the status of GSE debt.

"It seems obvious to me that Congress and the financial markets should consider the combined \$1.6 trillion of debt issued by Fannie Mae and Freddie Mac as backed by the full faith and credit of the United States," Garrett said in his letter Tuesday. "Furthermore, if this is true, should the GSEs' corporate debt be subject to the statutory debt ceiling?"

He cited House Financial Services committee Chairman Barney Frank's comments earlier this month, when he said "People who own Fannie and Freddie debt are not in the same legal position as [those who own] Treasury bonds, and I don't want them to be."

The Treasury then reaffirmed "there should be no uncertainty about Treasury's commitment to support Fannie Mae and Freddie Mac as they continue to play a vital role in the housing market during this current crisis."

"If we know ahead of time," said Calabria, and "we're not going to let U.S. dollar-denominated assets to foreign central banks be defaulted on, then that needs to be treated as sovereign debt."

Weekly federal reserve data show that foreign central banks' holdings of U.S. Treasury and agency debt rose \$29.6 billion in the week ended march 17 to \$3.0 trillion. Agency holdings alone rose \$2.1 billion to \$773.1 billion.

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