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**Saying no to CIT a big gamble for Team Obama**

By Emily Kaiser - Analysis

WASHINGTON (Reuters) - In leaving CIT Group Inc to sink or swim on its own, U.S. officials are gambling that financial markets and the economy are now strong enough to withstand the possibility a big lender collapses.

On Wednesday, ten months to the day after the bankruptcy of Lehman Brothers exacerbated the global credit crisis, CIT said bailout talks with the government had ended, a development which may push the 101 year old company closer to failure.

Judging from the calm reaction in credit and stock markets on Thursday, it appears investors think leaving CIT to fend for itself is a safe bet.

But the broader economic impact may be far more damaging, particularly for already struggling retailers that rely on CIT as a major source of financing.

"The company's collapse would certainly ripple through thousands of small and medium businesses that rely on CIT for trade financing and lending," Gail Dudack, chief investment strategist at Dudack Research Group, told clients.

"This raises the risk of more bankruptcies and more unemployment and would be a significant negative for an already fragile economy," she said.

Indeed, that is what makes CIT's situation particularly tricky for President Barack Obama and his economic team.

CIT probably needs about \$6 billion to avoid bankruptcy, after reporting eight quarterly losses in a row, analysts said. It only has assets of about \$75 billion, making it only about one tenth of the size of investment bank Lehman when the government allowed it to file for bankruptcy last September.

On the other hand CIT has about one million customers who may lose funding, including about 300,000 retailers.

Politically, it looks like a lose-lose. While the administration was keen to show that it would not bail out every struggling company, refusing CIT, which is a big lender to small businesses, makes it look like the White House is turning its back on Main Street.

It is hard to argue that CIT's collapse would pose a systemic risk on the scale of Lehman Brothers, yet it may threaten the consumer spending that drives the economy.

Even in the first quarter of 2009, when U.S. real gross domestic product fell at a 5.5 percent annual rate, consumer spending growth tempered the decline by almost a full percentage point.

**Nearly 15 million people worked in the retail trade as of June, according to the U.S. Labor Department data, representing more than 10 percent of the labor force.**

**Jerry Reisman, a bankruptcy attorney at law firm Reisman, Peirez and Reisman, said he was "deluged" by panicky calls from apparel companies worried about losing access to credit.**

**"The government's decision will result in many companies being unable to make payroll on Friday and inability to pay suppliers," he said. "Many of these companies and their suppliers will be forced to file bankruptcy themselves, causing a further decline in the economy."**

BACK TO LIFE

As far as financial markets were concerned, it was generally business as usual on Thursday. While CIT's shares and bonds took a beating, there was little spillover into the broader markets.

According to credit data firm CMA DataVision, the spread on five-year U.S. credit default swaps, a measure of how likely investors see the risk of a default, actually tightened to 36 basis points from 37.5 basis points late Wednesday. That suggests investors saw no new threat to U.S. financial stability from a possible CIT bankruptcy.

It was a very different story during that wild week last September, when U.S. officials allowed Lehman to go bankrupt but then turned around and bailed out insurer AIG days later.

Credit default swap spreads soared then, and at one point investors priced in a bigger risk of a debt default by the United States than Germany.

In an interview with Bloomberg Television on Thursday, U.S. Treasury Secretary Timothy Geithner pointed to signs of greater confidence and stability in the financial system when asked why the government refused to extend any more help to CIT.

"We're seeing life start to come back into these markets that shut down at the end of last year. And we're going to make sure we do enough to help reinforce and sustain that process," he said.

While he didn't come out and say it, Geithner seems to be indicating that he has already done enough to help markets and there is no need to save CIT. The risk is that he is underestimating the broader economic impact.

The administration's hope is that other lenders will step in to fill the void if CIT files for bankruptcy. That is a big assumption considering banks are still trying to rebuild balance sheets damaged by bad bets on the housing market.

With unemployment and home foreclosures rising, banks may not be in a hurry to extend more credit to companies dependent on consumer spending.

(Additional reporting by Jennifer Ablan and Richard Leong in New York)