

The CHRISTIAN SCIENCE  
**MONITOR**

**July 16, 2009**

**Would a CIT failure derail the economy?**

**Plans for a government bailout of small-business lender collapsed Wednesday.**

By Ron Scherer

CIT Group, a major lender to small and mid-size businesses, is now closer to bankruptcy with the collapse of its efforts on Wednesday night to get a government bailout.

If CIT fails, what impact would it have on the economy?

Hundreds of thousands of small businesses would have to scramble to find a new lender, analysts say. Some stores may have bare shelves for the holiday season unless they get a new source of funding, one group also warns.

But analysts don't think the demise of CIT will derail the economic recovery.

"It could show up as a small blip on the economic radar screen," says Fred Dickson, chief investment strategist at D.A. Davidson & Co. in Lake Oswego, Ore. "It's big enough to be seen but not big enough to cause people to feel the economic recovery is derailed."

One of the most likely ways a possible CIT bankruptcy could affect the economy is to add to the unemployment rate, Mr. Dickson says.

"There could be a few hundred thousand people looking for work over the next couple of months," he says. "It all depends on how willing community banks and other banks are willing to step in and provide funding to the former CIT clients."

On Thursday, CIT was still alive after negotiations with the government broke down on Wednesday evening. According to some reports, CIT was talking to some private equity groups about an investment. But if the investment does not materialize, some analysts expect CIT to file for bankruptcy before the weekend.

If that does happen, it may indicate the government feels the financial sector is strong enough to weather the bankruptcy of a large financial institution.

"This may be an indication that the US Treasury and the Federal Reserve believe the financial sector and the economy is strong enough to transition out of the hands of Washington and back into the marketplace," says Joel Naroff of Naroff Economic Advisors in Holland, Pa. "If that's the case, it's a good sign."

Banking analyst Douglass Elliott of the Brookings Institution in Washington says the government's lack of help is an indication it does not believe CIT's failure would create a "systemic" failure of the financial system.

"Probably they are right, and let's hope they are," says Mr. Elliott, a former investment banker. "The problem is, you really don't know until it happens."

One of the reasons the affect on the economy might be "fairly minor" is that other banks might pick up CIT's business, says Mark Zupan, dean of the University of Rochester's Simon School of Business. "There is enough resilience," he says.

However, not all of CIT's customers may get loans. Mr. Zupan points out small and mid-size entrepreneurial firms are among the hardest hit by the recession. "That's why CIT is so vulnerable right now," he says.

In fact, the US Treasury heard from many groups representing people who will be impacted.

The National Retail Federation wrote a letter to Treasury Secretary Timothy Geithner Tuesday warning that shelves could be bare this holiday period if CIT went under.

**"If CIT were to fail, a chain reaction would be set off that could very well leave retailers with a shortage of merchandise during the crucial holiday season," wrote Tracy Mullin, the CEO of the federation.**

**Bankruptcy lawyer Jerry Reisman said his phone was ringing off the hook Thursday from apparel companies who use CIT as a lender.**

**"The government's decision will result in many companies being unable to make payroll on Friday and the inability to pay suppliers, which will have a tremendous ripple effect on the apparel industry already plagued by the downturn in the economy and severe recession," said Mr. Reisman in a statement. "Many of these companies and their suppliers will be forced to file bankruptcy themselves, causing a further decline in the economy."**

It could be messy, agrees Dickson. "Loans could be immediately callable," he says. "And it comes at a time when other banks have tightened their lending standards."