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Deep breath time

The contrarian

The Goldman greed syndrome

Goldman Sachs' savvy bet against the credit economy may foreshadow troubled times, says Jon Entine

Even self-proclaimed progressives cheered when Goldman Sachs released fourth-quarter earnings of $3.2 billion in December.

Uh-oh. It's time to take stock when Goldman-owning "ethical" fund managers fete a Wall Street firm for not only dodging the subprime mortgage train crash, but also turning the credit collapse to its advantage. The credit calamity could cost the worldwide economy trillions of dollars and hundreds of thousands if not millions of jobs. But Goldman has helped salvage many funds' yearly performance metrics.

Let's call it the Goldman Greed Factor – celebrating other people's misfortunes. It's a trait that cuts across ideological lines. This is not to knock Goldman Sachs – I wish I held its stock – but something is out of whack. Many of us (in accord with human nature) have taken perverse pleasure as über-barons of the financial world have seen their rocket ships, powered towards success by smugness and luck, curve downwards. But to turn Goldman into a hero because it short-sold an index of mortgage-backed securities – betting house money that a huge part of the economy would go south – sends a chill down one's spine, especially considering what the venerable company was doing with its investors' dollars.

Ever hear of Goldman Sachs Alternative Mortgage Products? With one hand, Goldman's economic models, which it used to handle the really important money of its millionaire partners, forecast a sinking subprime market. But Goldman's other hand packaged risky mortgages to the quacking ducks of Wall Street, ethics be damned. GSAMPs were just one of 83 mortgage-backed issues totalling $44.5 billion that Goldman sold in 2006. Most are way underwater, which has hurt investors, but profited Goldman. "Although we recognised significant losses on our non-prime mortgage loans and securities," Goldman crowed in an autumn SEC filing, "those losses were more than offset by gains on short mortgage positions."

Social fabric frayed

I can't shake a growing uneasiness that the sight of any firm profiting from this disaster may not sit so well with large sections of the population that find themselves losing their houses or suddenly finding car loans hard to come by. If the credit crunch spreads it could tear the social contract that has been in place for decades. Over the past 25 years, we've witnessed an extraordinary period of economic growth. Even regions such as Africa have been growing well above historical averages. For consumers in developing countries and in the developed world, this phenomenon could be called the Wal-Mart Effect: when modern conveniences come within the reach of everyday consumers, what economists call "consumption inequality" shrinks.

What does this mean? Most people don't need to zip around in Porsches to feel good about life. A daily Starbucks and an iPod work wonders. Consumers' ability to buy stuff – flat screen TVs, consumer staples, cheap food and houses – had encouraged them to overlook the excesses in the "new Gilded Age", as the income gap in the US, UK and elsewhere grew to historical proportions. We have accepted the contradictions of corporate and state capitalism because of a belief that the future looked brighter than the recent past.

Stability is only as secure as the perception of fairness

This period may already have ended. Stability is only as secure as the perception of fairness. But the promise sealed by flexible credit appears to have ruptured. It is not a good sign when responsible lenders are demonised and even those borrowers with the strongest balance sheets find credit hard to come by. People with sizeable credit obligations who have respectable jobs will find that new credit is now, at best, devastatingly expensive. The real worry is that the sharp turn in the rules of the economic game will take the heart out of the next generation of aspirers, whether in the inner city of America or on the streets of Kiev.

The danger is that the Goldman Greed Factor overwhelms the Wal-Mart Effect. Consumption inequality may be about to grow – dramatically and dangerously. It may be easy for the secure among us to say that those who suffer deserve their comeuppance, that the reckless who gorged on credit are now paying just dues. But this is no time for righteousness.

Credit has been one of the wonders of the modern economy and it is central to consumption, which drives 70 per cent of the world economy. If credit dries up for an extended period, it could provoke far more than a mere recession. If a worse case scenario unfolds, watch out below. ■

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