

Press Release

For Immediate Release

Corporate Communications
+ 81 3-5571-7200

LEHMAN BROTHERS' "*DAMOCLES*" WARNING SYSTEM PREDICTS LIKELIHOOD OF FINANCIAL CRISES

-- Asia Notably Stronger Since Currency Crisis; Emerging Markets Now "Benign"--

TOKYO, 4 September 2003 -- Lehman Brothers, the global investment bank, said it developed "*Damocles*," a proprietary early warning system to identify the likelihood of countries entering into financial crises.

Damocles is based on ten carefully selected macroeconomic and financial indicators that comprehensive stress-testing have confirmed to be exceptionally accurate in forecasting crises – either banking or currency related. Based on a thorough sample of past crises in Asia, Europe, and Latin America, *Damocles* assigns points and weightings to the various indicators. If the ten variables collectively total 75 points or more, *Damocles* warns that a country's balance of payments is vulnerable to crisis. A reading above 100 signals that a crisis could erupt at any time.

Asia overall has notably reduced the risk of crisis across the region since its 1997-98 currency crisis. Lehman Brothers reports that "there are growing signs that global capital is now returning to Asia," and that the region "is in a much better condition to weather future financial storms."

The Lehman Brothers report examines Argentina, Brazil, China, Hong Kong, Indonesia, South Korea, Malaysia, Mexico, Philippines, Poland, Singapore, South Africa, Taiwan, Thailand, and Turkey to determine respective levels of crisis risk. For June 2003, the most recent month measured, *Damocles* assigned ratings ranging from zero (Mexico, Poland, Thailand) to 58.3 (South Africa).

"*Damocles* suggests that the contemporary risk of a financial crisis in the developing world is relatively benign. Looking beyond the current ambit of *Damocles*, perhaps the biggest risk to the emerging market economies at present stems from the

developed countries, many of which are exhibiting large economic imbalances,” said Rob Subbaraman, Lehman Brothers’ Senior Economist and co-author of the report *Financial Crises: An Early Warning System*.

Development and structure of *Damocles*

Subbaraman said, “Financial crises in emerging markets have been all too common, and we have every reason to believe they will remain a periodic and highly destabilizing feature of the global economic landscape. The benefits of developing a system to predict crises are clear cut.”

Based on past events, the Firm’s economists have determined that capital flow volatility is of central concern in forecasting crisis likelihood. While ebbs and flows bring both costs and benefits to any country, “*Damocles*” combined with a holistic look at the country in question can identify external vulnerabilities that may in certain circumstances develop into a full-blown crisis.

Damocles specifically measures: (1) foreign reserves/imports; (2) foreign reserves/short-term external debt; (3) external debt as a percentage of GDP; (4) short-term external debt as a percentage of exports; (5) current account as a percentage of GDP; (6) broad money/foreign reserves; (7) domestic private credit as a percentage of GDP; (8) real short-term interest rate; (9) stock market index; and (10) real trade-weighted exchange rate.

Emerging markets overall

Lehman Brothers’ economists have applied the system to 15 major emerging markets. Subbaraman reports that today’s emerging market landscape is “relatively benign.” He adds, however, that the biggest risk today to emerging economies is the developed world where many countries are exhibiting imbalances “that would set *Damocles*’ alarm bells ringing.” Most conspicuous of these threats is the United States, where any financial crisis could cause considerable spillover effects to the rest of the world.

Lehman Brothers cautions that *Damocles* cannot be used alone to grasp a country’s full financial picture. “*Damocles* should be used but not abused. This is a useful starting point to determine a country’s vulnerability, but it must be embedded in a broader analysis that takes into account critical complexities like non-economic events and contagion to make a full assessment,” said Subbaraman.

Copies of *Financial Crisis: An Early Warning System* by Rob Subbaraman, Russell Jones and Hiroshi Shiraishi, are available to the media by contacting Lehman Brothers Asia Corporate Communications at +813-5571-7200 or by email at ascorpcomm@lehman.com

Lehman Brothers (ticker symbol NYSE:LEH), an innovator in global finance, serves the financial needs of corporations, governments and municipalities, institutional clients, and high-net-worth individuals world-wide. Founded in 1850, Lehman Brothers maintains leadership positions in equity and fixed income sales, trading and research, investment banking, private equity and private client services. The Firm is headquartered in New York, London, and Tokyo and operates through a network of offices around the world. For further information about Lehman Brothers please visit our Web site at www.lehman.com.

###