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Banking by John Hoefle

Runs on the banks are growing

Equity investors are pulling out while the banking system collapse "is the biggest coverup in American history."

Federal Deposit Insurance Corp. chairman William Seidman told a nationwide ABC "Nightline" television audience July 31 that despite its problems, the nation's banking system is sound. Were it not, he insisted, regulators and the markets would take action.

Seidman made his statements in response to the charge by Stanford University economist Dan Brumbaugh, a former deputy director of the Federal Home Loan Bank Board who also appeared on the program. Brumbaugh said that many of the nation's largest banks were either near insolvency or already insolvent, including—by name—Citibank, Bank of America, Chase Manhattan, Chemical, Manufacturers Hanover, and Bankers Trust. Brumbaugh further charged that the attempt to cover up the true condition of the nation's banking system was "the biggest coverup in American history."

While Seidman was inaccurate about the system's soundness, he was correct that the market would respond. In fact, the market *is* reacting to the growing banking crisis, in a way which demonstrates the accuracy of Brumbaugh's statements—and of *EIR*'s long-standing assertion that the U.S. banking system is bankrupt.

Since the stock market crash of October 1989, there has been a run on the nation's banks as increasing numbers of investors have abandoned ship. Since that time, stock prices at all of the nation's major banks have declined precipitously: Citicorp's stock has dropped some 50%, as have Chemical and Chase. Overall, the major New York City banks—Citicorp, Chase, Chemical, Manufacturers Hanover, Bankers Trust, and Bank of New York—have lost an average of 42% of their common stock values.

Over the same period, the stocks of the top three Boston banks—Bank of Boston, Bank of New England, and Shawmut—have dropped an average of 70% and prices at the top four West Coast banks—Bank of America, Security Pacific, First Interstate, and Wells Fargo—have dropped 40%. Since March of this year, the prices at Mid-Atlantic region banks have dropped by some 33%, Midwest banks by some 20%, Southeast banks by 15%. Furthermore, since mid-June, the rate of decline has been increasing, reminiscent of a plane which has lost its engines. Clearly, the market is reacting. Bank investors are running for the hills.

One reason for this flight out of bank stocks, according to Ferguson and Co. chairman David Cates, is that institutional investors no longer trust the banks' financial statements and the reports issued by bank analysts.

The "standard accountancy" procedures used by bank holding companies to report their financial status, Cates said, are "notoriously flawed" and "increasingly mistrusted." The recent series of "very bad shocks to the bank stock market has discredited the analytic process," he said.

A prime example of a failure to detect serious problems, Cates said, occurred last year with the Bank of New England. In the third quarter, despite growing problems which would spectacularly manifest themselves in the coming months, the Bank of New England still had a sufficiently high rating to enable it to pull off a $250 million equity issue. The issue was sold through a syndicate including Merrill Lynch, Morgan Stanley, and Goldman Sachs.

If those three prominent investment banks cannot figure out that a bank is in trouble, Cates asked, then who can? Certainly not an average individual or institutional investor, who can no longer even rely on those "experts" for advice. The result is that the investors shun the bank stocks as a group.

The driving force behind the freefall in banking, however, has little to do with bookkeeping. The banking system is extremely unstable because the speculative bubble which propped it up, upon which the entire so-called Reagan-Bush great recovery was based, has popped.

During the 1980s, according to analyses by Cates and the Federal Reserve Bank of Boston, nearly one-third of the 150 bank holding companies with assets of $2 billion or more experienced some sort of financial crisis. BankAmerica Corp. and Mellon nearly failed, virtually the entire Texas banking system collapsed, and the Bank of New England encountered what will likely become terminal problems. And these were the "good" years.

The 1990s will not be so kind. The banking system is undergoing collapse and consolidation, in which many of the big names in banking will simply disappear. The Wall Street crowd and federal regulators will attempt to manage this collapse by merging the smaller bankrupt banks into the larger bankrupt banks, backed up by blank checks from the government. The result will be that the giant money-center banks will increase their grip over a dying economy, and depression-wracked taxpayers will pick up the tab.

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