Banking by John Hoefle

The brink of financial meltdown

Forced to choose between propping up the banks or the dollar, Bush will likely sink both.

'The U.S. was literally on the brink of financial meltdown" the week before Labor Day, a senior City of London financial insider told *EIR* Aug. 28. "I think someone got to the President and told him to make some minimal gesture of conciliation for the moment, or all would financially blow up in his face."

While Bush managed to stave off a financial blowout a little while longer, his finger-in-the-dike approach to economic policy is doomed to failure. The U.S. economy continues to collapse at a breathtaking pace, as the ground underneath the nation's financial system crumbles.

According to Moody's Investors Services, the nine largest U.S. banks—BankAmerica, Bankers Trust, Chase Manhattan, Chemical, Citicorp, Continental, First Chicago, Manufacturers Hanover, and J.P. Morgan—are encountering increasing difficulty with their real estate loans and junk bond portfolios. All but Morgan and Bankers Trust are undercapitalized, Moody's said, due to "the sharp deterioration in domestic asset quality and low domestic reserves." The nine institutions have a combined $55 billion in real estate loans, Moody's noted. Chemical leads the group with nonperforming loans equal to 15.5% of its total loans, followed by Citicorp at 13.9% and First Chicago at 12.6%.

Moody's, like its fellow credit rating firm Standard & Poor's, has downgraded most of the nation's largest banks in recent months as their financial problems became more acute. Even so, the ratings given by these companies are highly optimistic, as they calculate them according to the current regulatory environment rather than a more objective standard. If the regulators are willing to overlook certain problems, then so are Moody's and S&P. Given the "see no crisis" mania of the Bush administration, one must take the statements of the credit rating companies as merely mild reflections of the crisis.

While trying to retain the appearance of calm, both the administration and the financial community are frightened about the instability of the banking system. Rumors abound of the imminent failure of major money center banks such as those named above. Chemical is the bank most frequently named, but by no means the only one.

Chemical, the nation's sixth largest bank with some $71 million in assets, has heavy exposure to the troubled real estate and junk bond markets, on top of its Third World debt. It was the first major bank to move into Texas, with its 1988 purchase of Texas Commerce Bancshares, the source of much of its real estate problems today.

According to discussions with knowledgeable banking sources, Chemical is experiencing a severe liquidity crisis and is being kept afloat in large part by massive lending from the Federal Reserve Bank of New York. The New York Fed loaned $6.6 billion to its member banks in the week ending Aug. 22, according to Federal Reserve reports, and most of the money went to Chemical, according to *EIR* sources. So far this year, the New York Fed has loaned about $15 billion to its member banks, over $11.5 billion of that in the last three months.

The panic is not limited to the money center banks, either. The tottering Bank of New England ended a week of rumors Aug. 30 when its stock dropped nearly 40% in one day, hitting an all-time low of $1 per share in heavy trading. The panic was so great that the bank, the Federal Deposit Insurance Corp. (FDIC), and the Office of the Comptroller of the Currency were all compelled to deny persistent reports that the feds were going to close the bank Aug. 31. The bank was hit with similar rumors around Memorial Day and Independence Day, as many felt that regulators would need a three-day weekend to close such a big bank.

The Bank of New England's precarious situation was exacerbated earlier in August, when a Shearson Lehman Hutton investment advisory quoted the Cabot Market Letter as warning that the "Bank of New England may not be around much longer." Shortly thereafter, the FDIC confirmed that it was opening a 400-person liquidation office in Boston to dispose of the assets of seized institutions. The FDIC claimed that the office was being set up to dispose of $1.2 billion in assets taken from four recently closed Boston and Milford, Connecticut banks, but obviously the FDIC is gearing up for a big failure.

The Bush administration and the Federal Reserve are caught between Scylla and Charybdis. To ease the liquidity crisis facing the nation's banking system, the Fed must sharply cut interest rates. But such a move would send the already sickly dollar plummeting. And if the government is forced to bail out a large bank like Chemical, a senior London banker observed, "That could topple the entire U.S. financial house of cards at this very fragile moment."