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Banking by John Hoefle

Banks claim record earnings

Interest-rate gouging and a "no such thing as a bad loan" policy hide massive insolvency in the second quarter.

Commercial banks in the United States earned a record $7.9 billion in the second quarter of 1992, according to the latest Quarterly Banking Profile of the Federal Deposit Insurance Corp. (FDIC), demonstrating once again the outrageous statistical fraud which permeates government banking statistics, especially in an election year.

The second quarter earnings surpass the previous quarterly profit record of $7.6 billion, set just three months earlier. Thus, the banks have supposedly earned $15.5 billion in the first six months of the year, and are on a pace to smash the yearly earnings record of $24.9 billion, set in 1989.

According to the FDIC, there were "two primary factors" which led to these record profits. First, "favorable interest conditions produced wider net margins for the fifth consecutive quarter," and second, "loan-loss provisions continued to shrink." Another factor cited by the FDIC was "gains on sales of investment securities."

Part of that is true. The banks have indeed made a killing because of the low interest rates, by dropping the interest rates they pay for money faster than the interest rates they charge for money. This price gouging does indeed produce "wider net margins." For the quarter, according to the FDIC, the banks earned $64.5 billion in interest income, against $31.6 billion in interest expense, yielding a net interest income of $32.9 billion.

The rest of the story is pure fiction, sprinkled with just enough facts to make it fly. Banks have indeed been cutting back on their loan loss reserves, which are funds set aside to cover future loan losses. At the end of the second quarter, the banks' aggregate loan loss reserves stood at $55.3 billion, or $516 million less than at the end of the first quarter, and some $45 million less than at the end of 1990.

The banks' justification for this decrease in loan loss reserves, is that the level of non-performing loans has also been dropping. According to the FDIC, $71.9 billion of loans and leases were 90 days or more past due at the end of the second quarter, down from $75.3 billion the previous quarter, and down from a peak of $85.4 billion in the first quarter of 1991. The level of "troubled assets" (non-current loans and leases plus foreclosed real estate), was $99.7 billion at the end of the second quarter, the first time since the end of 1990 that figure has dropped below $100 billion.

The claim that non-performing loans have been decreasing during a period in which the economy continues to deteriorate, while the biggest real estate bankruptcies in history are occurring, is absurd. What these figures really reflect, is massive collusion among bankers, regulators, and the press to hide the skyrocketing level of bad loans, and the bankruptcy of the banks, from public view. In effect, a political decision has been made that there is no such thing as a bad loan.

Thanks to this creative accounting, the banks reported a record $9.3 billion increase in equity capital during the quarter, bringing total equity capital to $248.5 billion, and yielding an equity capital-to-assets ratio of 7.23%, the highest level since the 7.44% recorded for 1966. During the first half of 1992, equity capital increased a whopping $16.7 billion, by the FDIC's phony numbers.

The situation with the banks would look much different, were one to perform some simple calculations with the FDIC's bad-loan data.

According to the FDIC, U.S. banks had $858 billion in real estate loans outstanding at the end of the second quarter, of which 4.43%, or $38 billion, were officially classified as non-current. The banks also held $27.7 billion in foreclosed real estate. Together, that's $65.7 billion in bad real estate, of which roughly half is held by the big banks. That $65.7 billion is more than eight times the "record" profit reported for the quarter. Had the banks set aside reserves for just 12% more of their admitted non-performing real estate, the alleged record profit for the second quarter would have disappeared. Had they increased their reserves enough just to cover that admitted non-performing real estate, the $10.4 billion required would have given the banks a loss for the quarter. Had they increased their loan loss reserves enough to cover their $99.7 billion in reported troubled assets, they would have had to add $44.4 billion, wiping out their "record profits" nearly six times over.

According to *EIR*'s calculations, had the banks merely matched their loan loss reserves dollar for dollar with their admitted non-current loans and leases, the $94 billion profit reported by the banks since the beginning of 1987 would have been transformed into a loss of $398 billion, and the $248.5 billion in equity capital would have been transformed into a negative $243 billion.

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