

The Banking Crisis Is Back in the Headlines

by John Hoeffle

After more than a month of claims that the worst is behind us, the banking crisis is suddenly back in the headlines. Those who compare the propaganda to the calendar will see a pattern forming, revolving around the fiscal quarters, in which the beginning of the quarter is dominated by the reports of the losses from the previous quarter, followed by a period in which it is claimed that, with all that bad news, the worst must be behind us. Then, as the quarter enters its final month, the propaganda machine begins preparing the population for another round of losses. June is the final month of the second quarter, and right on cue, the bad news reports have begun. The banking crisis itself is not back, because it never went away, and is worse than ever.

Far from having been stabilized, the global banking system is on life support, kept alive by extensive government funding while it is being restructured; capital injections are being arranged for failing institutions, steps are being taken to keep the book values of worthless securities from plunging to zero, while the banks are being forced to write down the values of their assets.

This downsizing is already traumatic, but it has really only begun, because the reason for the existence of much of the banking system has disappeared. With the collapse of the securities bubble, the markets in which the banks played are gone. The casino has closed, and the gamblers have been left out in the cold. When the system dies, so do the players.

June Swoon

It was as if, suddenly, a switch had been thrown, with the banking crisis suddenly reappearing in the headlines. Gone is the talk of the worst being over; instead heads are again on the chopping block; there is talk of big losses to come, and even rumors that a major investment bank is in serious trouble.

Wachovia Corp., the fourth-largest U.S. bank holding company by assets, dumped its CEO, G. Kennedy Thompson, after relieving him of the chairman's position in May. Formed by the 2001 merger of North Carolina's First Union and Wachovia, the bank has gobbled up lots of smaller institutions, including the \$26 billion acquisition in 2006 of Golden West Financial, a huge thrift with heavy exposure to California and Florida real estate. Wachovia reported \$363 million in losses for the first quarter, then amended that figure upward to \$708 million. The bank has already written off some \$7 billion in assets, and raised \$10 billion in emergency capital. The firing of its CEO is an indirect admission of much bigger problems.

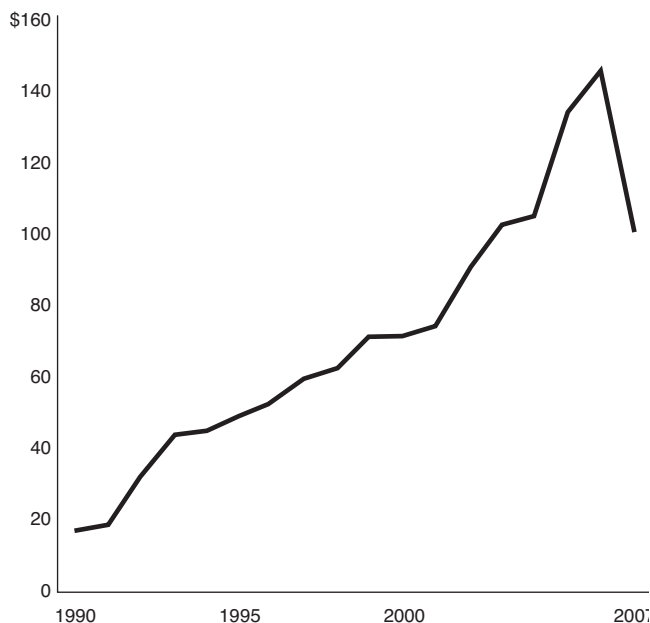
Washington Mutual, the nation's largest savings and loan bank, stripped Kerry Killinger of his chairman's position, though he remains as CEO. WaMu, as it is called, has already written off over \$9 billion, and raised \$10 billion in capital, including a big chunk from pirate equity fund TPG (née Texas Pacific Group). A heavy lender in the plunging West Coast real estate market, WaMu, like Golden West and many others, is helplessly watching its asset-base dissolve.

In Britain, where Northern Rock was nationalized, another mortgage lender is in trouble. Bradford & Bingley, which specializes in making loans to landlords, has dumped CEO Steven Crawshaw, and sold nearly a quarter of itself to TPG for a paltry \$300 million. TPG was introduced to B&B by Goldman Sachs, and the injection took Citigroup and UBS off the hook for underwriting a \$600 million share offering. The rescue was "shepherded" by Britain's Financial Services Authority. Unfortunately for B&B, it still has a deal with GMAC to buy some \$4 billion in mortgages by the end of next year, as GMAC tries to avoid the bankruptcy of its own mortgage unit.

FIGURE 1

Net Income at FDIC-Insured Banks Annually, 1990-2007

(\$ Billions)



Source: FDIC

In other bad news, State Street Corp., the 13th-largest U.S. bank holding company, is facing a reported \$3.4 billion in losses on its mortgage-related securities portfolio, and is seeking to raise \$2.5 billion in capital. The bank, like many others, is issuing new stock to raise funds, thereby diluting the value of the stock already held by existing stockholders.

The investment banks are also taking a beating. Standard & Poor's has downgraded Merrill Lynch, Morgan Stanley, and Lehman Brothers by one notch each, saying it had lost some confidence in the banks' abilities to meet their financial obligations. Given the promiscuous quality of S&P's ratings in the past, and its dependence upon the investment banks, these downgrades are tokens of much more serious problems.

Also indicative of growing problems is the announcement by the FDIC that the \$5.8 billion in profits reported by commercial banks in the fourth quarter of 2007, has since been restated downward to a mere \$646 million, the lowest quarterly profit since 1990 resulting in \$100 billion profits on the year (**Figure 1**). The FDIC said the banks were still profitable in the first quarter, earning \$19 billion, but that is about half the \$36 billion the banks reported in the first quarter of 2007, as loan losses grew, and the values of securities held by the banks declined. The level of loan-loss reserves to non-current loans fell to \$0.89 in reserves for every \$1 of non-current loans, the lowest level since 1993, despite the addition of \$37

billion to those reserves—and the official level of non-current loans is just the tip of the iceberg.

Life Support

Since this financial crisis began last year, the world's banks—commercial and investment—have written off nearly \$400 billion in assets and credit losses, led by the big institutions. Citigroup, UBS, and Merrill Lynch have all taken writeoffs in the \$40 billion range; HSBC has written off nearly \$20 billion, and Royal Bank of Scotland, Bank of America, and Morgan Stanley hover around \$15 billion each.

These are big numbers, but they pale in comparison to the monies the central banks have injected. Since last Summer, the central banks, led by the Fed and the European Central Bank (ECB), have made some \$3.5 trillion in loans to the banks, an intervention unrivalled in human history.

In the United States, the Fed has created a number of what it calls "lending facilities" as the crisis has deepened. In mid-December, it created the Term Auction Facility (TAF) as a way to make loans to depository institutions. The first TAF auction occurred on Dec. 12, 2007, offering \$20 billion; the demand was high, with 93 banks submitting bids totalling \$62 billion. Another \$20 billion was auctioned Dec. 20, with 73 banks seeking \$58 billion. In this way, U.S. banks were given \$40 billion in December to help them clean up their books at the end of the year. In January, the Fed increased the loan limit at its twice-monthly TAF auctions to \$30 billion each, and in March, bumped it up again, to \$50 billion. In May, the limit was raised to \$75 billion; and for June, the Fed plans to hold three auctions instead of just two. To date, the Fed has lent \$585 billion through the TAF, with another \$150 billion available later in the month. Assuming all the money is taken—and it has been every time—that would bring the total to \$735 billion in just a bit over six months (**Figure 2**).

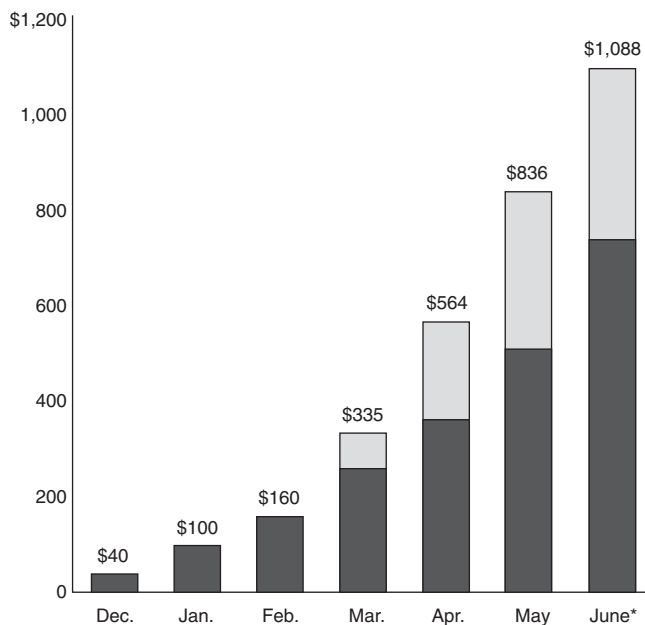
The Fed created two more lending facilities in March, the final month of the first quarter. On March 11, the Fed announced the Term Securities Lending Facility (TSLF), under which it would lend up to \$200 billion to primary securities dealers, through weekly auctions beginning March 27. Before the TSLF could begin, however, disaster struck in the form of the Bear Stearns crisis, so the Fed created yet another facility, the Primary Dealer Credit Facility (PDCF), to lend an unspecified amount to the primary dealers effective March 17. In less than three months of operation, the TSLF has lent out over \$378 billion (**Figure 2**). The Fed does not report the amount of money it lends through the PDCF, but before the month of June is out, the Fed should easily surpass the \$1 trillion mark in loans to financial institutions through these new facilities.

These loans, it must be noted, are gross, not net. Most of them are 28-day loans, meaning they must be paid back. When a loan is paid back, the net amount is zero, and the money is available to be loaned again, so a cumulative total of \$1 trillion in loans does not mean that there is \$1 trillion outstand-

FIGURE 2

Cumulative Fed TAF and TSLF Loans by Month, December 2007-June 2008

(\$ Billions)



* June figure includes the \$225 billion TAF lending already announced for June, and the \$27 billion in TSLF loans issued June 4.

Source: Federal Reserve

ing. According to the Fed, the amount of loans outstanding through these credit facilities and others, such as the discount window and the repo market, have increased from \$76 billion in mid-December, to \$440 billion at the end of May.

Supposedly, these loans are being made to mitigate the effects of the “credit crunch,” but providing the banks with money is only half the story. When they take out these loans, the banks provide collateral to the Fed, which means that, in effect, the Fed is trading cash for “illiquid” securities. What is really going on here is a huge debt-recycling scheme, in which worthless securities are transferred from the books of the banks to the Fed, in exchange for cash or Treasuries, which helps the banks hide the fact that they are insolvent.

In theory, the banks should get their collateral back when they repay the loans, but it is also possible that the Fed keeps the collateral in lieu of full or partial repayment. The Fed is silent on this issue; asked explicitly about it by *EIR*, the Fed punted, directing us to a page on its website which does not answer the question. Even if the collateral is returned, the issuance of one-month loans twice a month provides plenty of room to repay old loans with new ones, keeping the collateral away from the banks’ books.

These types of maneuvers are nothing new. Nazi/British banker Hjalmar Schacht used similar methods to recycle

German debt via Mefo bills, and Felix the Fascist Rohatyn used similar measures to loot New York City with Big MAC. Austerity, backed by fascist economic policies, is old hat.

What is new, is the scale of these actions, in a crisis which is just beginning. The accompanying figures give a hint of what is to come as the bailout escalates to cover the growing holes in the books of the players in this bankrupt casino. Will the existing facilities be sufficient to get through June, or will more extraordinary measures be required, as they were in March, when Bear Stearns collapsed, and the Fed intervened to stop a chain reaction of derivatives defaults?

Bear Stearns was the smallest of the major investment banks, and is no more, having been taken over by J.P. Morgan Chase with some \$50 billion in help from the Fed. That leaves Lehman Brothers as the smallest, and rumors are swirling around it like sharks in a feeding frenzy. Lehman insists—just as Bear did—that it is solvent, that there is nothing to worry about—but that can’t possibly be true, for it or its larger cousins. They are creatures of a dead system, a system which no longer has the capacity to support them all. The securities market is virtually dead, and the shrinking of credit is crushing everything in its path, from households to corporations to financial institutions. The system is not coming back, and without it, the speculators have no chance of survival. The world these dinosaurs inhabited is no more.

The danger, as is becoming more visible every day, is that the attempt to save these beasts—and the money they represent—is sending the dollar into a hyperinflationary frenzy. There are consequences to pouring trillions of dollars into such a process to try to save it, instead of shutting it down. Those consequences can be seen every time you go to the gas station or the grocery store, in soaring prices, and if that’s where you see them, you are one of the lucky ones. In a growing number of countries, the food is too expensive for most people, and in some places, the food simply isn’t there.

In a very real sense, there is no banking crisis because the banking system is already gone. The path we are on, with the futile and foolish attempt to bail out the money, will inexorably lead to the sort of hyperinflationary shock which destroyed Weimar Germany and paved the way for Hitler. The fascists are now in the wings, waiting for the opportunity to make their move. The fascists on the Right, typified by Cheney and the howling mob around Fox News; and the fascists on the Left, typified by Rohatyn, Soros, and Gore, are but two sides of the same coin.

The only alternative to that is a return to the American System policies of Hamilton, Lincoln, FDR, and LaRouche. Either the U.S. government steps in and asserts its sovereignty to put the financial system through bankruptcy, or the financier oligarchy will put the government through bankruptcy. If the former, we can quickly begin rebuilding our nation and the world; if the latter, we will soon have a much more sensuous understanding of how the Nazis came to power in Germany.