Click here for Full Issue of EIR Volume 14, Number 38, September 25, 1987



# Worst bank losses ever only the start

*Are we looking at $20 billion losses for the fourth quarter of 1987?*

Twenty billion dollars in bad-loan reserves pushed the American banking system into the red for the first time since 1934, and by a margin far worse than any Great Depression losses. But bank analysts at major brokerage houses are beginning to admit what *EIR* asserted in May, when Citibank began the fun with a $3 billion special reserve against losses on developing-sector loans: the second-quarter disaster looks puny compared to what the banks will write off in the next several quarters.

Major banks are scrambling to put storm-measures into effect. Chemical bank will lay off 2,100 employees, a tenth of its workforce, and close some offices, in a general restructuring which will result in a third-quarter loss of about $65 million. The closures will supposedly save $150 million a year, and the bank will sell off consumer operations to raise $300 million.

Last month, Mellon Bank announced plans to cut between 1,800 and 2,000 jobs from its work force of 19,000. Other banks, notably Manufacturers Hanover and Chase Manhattan, have also cut staff.

It is difficult to tell whether the problems on the surface—e.g., oil and real-estate loans in Texas, or farm loans in the Midwest—are a bigger danger than the problems just below the surface at the major banks. The latter are not figured into the FDIC's profile of profit and loss in the banking sector, which is terrifying enough as it is.

According to the FDIC's quarterly banking profile, 2,354 of the nation's commercial banks, or 17%, were unprofitable for the quarter ended June 30. That compares with 2,019, or 14%, in the first quarter. That is to say, that an additional 300 banks went into the red during the second quarter alone. The inexorable unraveling of the real estate market in depressed parts of the country—which include about two-thirds of the 50 states—is gradually taking the banking system under.

But the worst will come in late October, when Treasury and Federal Reserve bank regulators have scheduled a decision on the treatment of U.S. banks' $25 billion-plus Brazil debt. The big write-offs announced for the second quarter barely account for a fifth of banks' exposure. Under the regulators' standing rules, banks should have set aside an additional $20 billion in loss reserves as of Aug. 20, i.e., for the second quarter, when Brazil's debt-service payments turned six months overdue.

At least two American banks, Bank of America and Manufacturers Hanover Trust, would become technically insolvent, were they to write down their Brazil paper; put differently, they do not have enough capital to set aside the required reserves.

What the regulators, who have postponed their decision awaiting the outcome of Brazilian debt negotiations, will finally do, is hard to imagine. In the meantime, the price of Brazil's (and other debtor nations') debt on the secondary market has crashed.

Between bad oil and real estate loans, which cost the Federal Deposit Insurance Corporation $1.4 billion when First City Bank of Houston failed in mid-September, and the Third World debt, the second-quarter disaster appears almost trivial.

But the worst might come fastest in the S&Ls sector, the weakest part of the banking system. *EIR* has emphasized that a Federal funds rate of 8½-9% would wipe out an additional 1,000 S&Ls, on top of the 500 already considered "brain-dead," costing the regulators close to $150 billion to close, against the $50 billion backlog now facing the Federal Savings and Loan Insurance Corporation.

Federal Home Loan Bank Board chairman Danny Wall warned Sept. 9 that the FSLIC's planned $10.82 billion borrowing, plus $7 billion expected from deposit insurance premiums and liquidation of defunct assets units, would not stabilize the industry. Wall said he hoped it would last three years. In the event of a run, it wouldn't last three weeks.

The problem is the credibility of FSLIC guarantees, which are now being used to solicit deposits for the "brain-dead" institutions. The Federal Reserve fears a general exodus of healthy, premium-paying S&Ls from the FSLIC system, that wants to permit commercial banks to buy up S&Ls—in order to keep the insurance premiums coming.

After six months of soliciting institutional investors to buy high-interest, small denomination, guaranteed certificates of deposit from bankrupt institutions, as an alternative to closing them, the FSLIC faces the worst of all possible alternatives, namely, a run by institutional investors, who are less easy to dupe than the unsuspecting saving public. When a few of them decide that the risk isn't worth it, the withdrawals will swamp the FDIC's resources within a matter of weeks.



© 1987 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.