Thrift institutions

$11 billion of 'Monopoly money'

by Joyce Fredman

On Sept. 1, 1988, M. Danny Wall, Chairman of the Federal Home Loan Bank Board, announced that the amount of promissory notes issued to rescue failing savings and loan institutions would exceed $11 billion by the end of the month. This calculation came from Wall's latest bailout of 14 thrifts in Oklahoma, costing $1.9 billion. According to the FHLBB, there are an estimated 200 insolvent thrifts that are currently in various stages of negotiation, bidding, and marketing. The Federal Savings and Loan Insurance Corporation (FSLIC) hopes to have half of the cases resolved by the end of 1988.

The announcements from Wall have come fast and furious. An Aug. 19 report stated, "Seventy-six cases nationwide have been concluded since Jan. 1, or 28 more than in all of 1987. The number of Texas institutions resolved under the Southwest Plan has now reached 32 since the plan began in May." "Resolved," "concluded"—the former chief of staff of the Senate Banking Committee has chosen his words carefully. One might almost get the idea that something is being accomplished.

Instead, there is a pathetic shell game occurring: Names are changing, titles are changing, but in fact, the S&Ls are still the disaster area they have been. The funds that Wall is so generously handing out do not exist. And the notes that are issued, are not even meant to address the overall problem. Rather, that is simply the amount the regulators are using to keep the institutions operating until a buyer is found.

The insanity of this operation would be uproariously funny, were it not so costly to American citizens. The price tag for this comedy team is upwards of $100 billion, with at least $65 billion scheduled to come directly out of taxpayers' pockets. Wall's strategy is to continue to issue promissory notes until he gets someone's attention. He wants to pressure Congress to put the full faith and credit of the U.S. government behind these notes. If there are any congressmen left who are able to add, the prospect is grim.

FSLIC, the agency through which the notes are issued, is itself completely in the red. FSLIC started 1988 with a negative net worth of $11.6 billion. That was double its deficit in 1986, and appears to be half of what its deficit will be at the end of 1988. It needs close to $50 billion for depositors at the 500 thrifts that FSLIC has recognized as in trouble. (One can assume a similar amount needed for the other 500 recognized by those not living in Disneyland, that combined make up the 1,000 thrifts—one-third of the country's S&Ls—in rocky shape.) FSLIC is not making any money, but is losing about $1 billion a month. Nonetheless, Congress last year authorized the insurance corporation to borrow $7 billion over three years.

Now Wall is issuing promissory notes like there's no tomorrow. There may not be, if this insanity continues.

The Volcker heritage

The question of how this all came about, is not an irrelevant one. When then-Federal Reserve chairman Paul Volcker took interest rates sky high, it became impossible for the thrifts to cut a profit. No longer could savings and loans survive by financing home mortgages, which was the original purpose of these institutions. (Clearly, Mr. Volcker never saw *It's a Wonderful Life*.) Thrifts around the country were forced into absurd speculative investments, trying to make it from day to day.

The most notorious example of what occurred is the real estate market in Texas. The thrifts had two major areas of operation, Houston and Dallas. In Houston, the rapid rise of oil prices fueled one of the biggest real estate speculative booms in the country. Thrifts from all over the United States jumped into the pool. When the oil bubble burst, real estate followed. In Dallas, lakeside condominiums were the item of the day. This brilliant investment opportunity was premised on the "Great Recovery." When the economy collapsed, the condominiums became white elephants. So much for President Reagan's claim of "68 months of recovery" in the Lone Star State. Interest rates are presently on the rise again. The S&Ls are in a no-win situation.

Standing on the precipice, these thrifts, however, have no lack of regulatory agencies behind them. Such agencies are more than willing to spread more funny paper throughout the economy. The Federal Home Loan Mortgage Corp. ("Freddie Mac") operates a secondary market for home mortgage loans. They recently approved a plan to open up trading in its preferred shares on Jan. 1, as well as to increase the number of shares each stockholder may own. Ownership of the 15 million preferred shares is currently restricted to thrifts, but after Jan. 1, they will be open to the public.

Chairman Wall's comment was simply that he hoped the board's decision "will end speculation about the potential use of Freddie Mac to aid the Federal Savings and Loan Insurance Corp., which is clearly not going to be done."

A balanced budget

The U.S. budget deficit was $144 billion as of Oct. 1, 1987. As of Oct. 1, 1988, all outstanding FSLIC notes will be counted as part of the federal government's budget deficit. With the loose cannons of the FHLBB, the previous year's deficit could be doubled. However, for Chairman Wall, this serves as an incentive to keep on writing notes. "This [the inclusion of FSLIC debt in the budget deficit—ed.] is one of the monkeys on our back that is moving us to do deals."

And the bailouts are just beginning. The figures being discussed for such actions, are also only the minimal amounts. Take the five actions in August. On Aug. 18, an investment group, Gibson Group/LSST Financial Services, acquired 12 insolvent thrifts in Texas. They contributed $48 million, and the FSLIC is providing $1.3 billion. On Aug. 19, eight insolvent Texas units were consolidated, including Sunbelt Savings. The cost used by the FSLIC to bring its total to date to $11 billion, is $2.5 billion. However, FSLIC itself has said that the cost could easily go to $5-6 billion.

On Aug. 23, a holding company headed by former Treasury Secretary William Simon agreed to pay $207.5 million for Bell Savings of San Mateo, California, plus the outstanding stock of Western Federal Savings, also from California. FSLIC is providing over half a billion dollars. On Aug. 26, FHLBB announced five separate transactions, in which it will inject $1 billion into 10 savings units that will be merged into healthy institutions. That's the other part of this ingenious scheme—merging disaster thrifts with marginally healthy institutions. This has gone over so big with the thrifts that still can stand, that many are threatening to leave to join the Federal Deposit Insurance Corporation. (William Seidman, FDIC's Chairman, has looked disparagingly at any such mooted moves. He has enough problems of his own. *EIR* has counted 281 bank failures for 1988 alone, as of Sept. 2, 1988.)

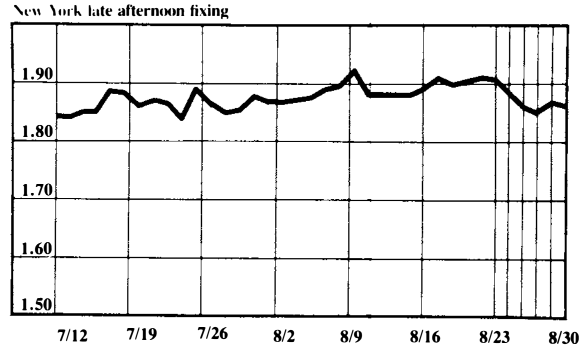
The last transaction, announced on Aug. 31, was to consolidate 14 of Oklahoma's S&Ls into six larger ones. Although the announced figure was $1.2 billion, it was then mentioned that in fact it will probably be closer to $2 billion. Another bailout is being rumored for the troubled American Savings and Loan Association of Stockton, California. Wall is projecting that by the end of September, the bill could be as high as $20 billion. In other words, the grand total for papering over this mess is approximately $200 billion.

One year ago, this author wrote an article on the S&L industry, stating, "The situation in the financial community has reached the height of absurdity. In a scene reminiscent of 'The Emperor's New Clothes,' M. Danny Wall, the new chief regulator of the FHLBB, has been foisted on the American public to reassure us all that there is no problem with the S&Ls of the country."

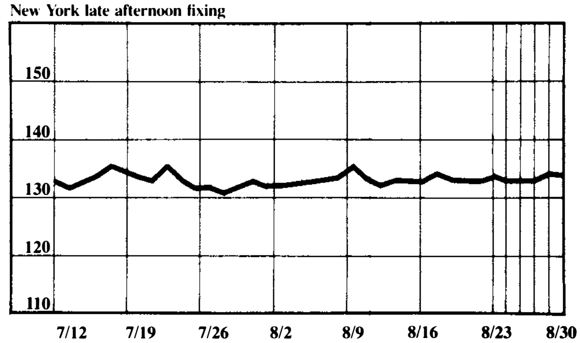
The idea that 12 months and billions of dollars later, this madman is still in D.C. issuing promissory notes on a song, is more than the American population should tolerate.

Currency Rates

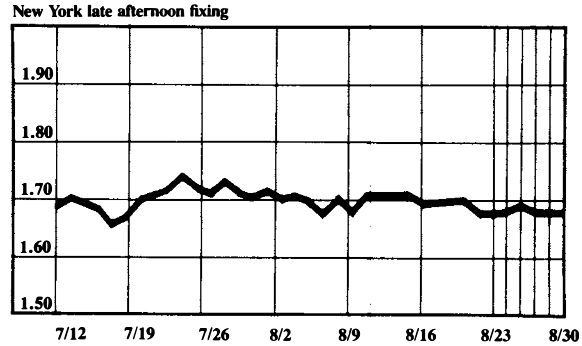
The dollar in deutschemarks
New York late afternoon fixing



The dollar in yen
New York late afternoon fixing



The British pound in dollars
New York late afternoon fixing



The dollar in Swiss francs
New York late afternoon fixing