Banking by John Hoefle

Will Gramm-Rudman be axed?

"Time is not on our side," admitted Federal Reserve Board chairman Alan Greenspan.

The U.S. "recovery that never was" was officially buried by Congressional Budget Office (CBO) director Robert Reischauer Jan. 23, when he informed the Senate Budget Committee that the CBO now forecasts two consecutive quarters of economic contraction—the fourth quarter of 1990 and the first quarter of 1991. By doing so, the CBO is preparing the repeal of the Gramm-Rudman-Hollings balanced budget law, and a taxpayer bailout of the big banks.

The budget was in no danger of being balanced, anyway. White House budget director Richard Darman has publicly predicted that the budget deficit for the current fiscal year will hit a record $318 billion, and that doesn't include the cost of the Gulf war, much less the bank bailout.

The Resolution Trust Corp., the agency responsible for disposing of the assets of the failed savings and loans, is taking in assets faster than it can sell them. The RTC has already spent more than twice the $50 billion the S&L cleanup was supposed to cost, and now Treasury Secretary Nicholas Brady says that without another $77 billion by March 1, the agency will grind to a halt. Brady asked Congress for a blank check to fund the RTC, but was turned down.

Thanks to its takeover of Columbia S&L on Jan. 25, the RTC is now the third-largest holder of junk bonds in the U.S., with $7 billion in face value of these worthless IOUs.

The real estate picture is even worse. "I believe we are in a free fall of real estate values," RTC Oversight Board member Robert Larson warned the Senate Banking Committee Jan. 23. Next to the Mideast war, he said, "it's the most important single issue facing Congress." The RTC directly holds some $16 billion in real estate, and owns tens of billions in loans backed by real estate. The agency can't find buyers for these properties, and can't afford to keep them either.

The blowout is even grimmer in commercial banking.

Citicorp chairman John Reed recently admitted that the $228 billion bank needs to add $4-5 billion to its $8.6 billion capital reserves—a 50% increase—over the next three years. Citicorp has $2.5 billion in admitted non-performing real estate loans and another $8.6 billion in leveraged buyout loans. The bank is also taking huge hits on its credit card business. According to a recent study by Moody's Investors Services, credit card defaults rose 49% between November 1989 and November 1990, and credit card delinquencies rose 35%.

Citicorp has been searching worldwide for investors, with little success thus far. Moody's made the search even more difficult by once again lowering Citicorp's credit rating. There are rumors that the Kuwaitis and Saudis will be persuaded to bail out the giant bank. Perhaps they will. The Federal Deposit Insurance Corp. (FDIC) certainly can't.

The CBO estimates that the FDIC's Bank Insurance Fund (BIF) "would almost disappear by the end of [fiscal year] 1991" on Sept. 30, "and the fund would be insolvent by early in fiscal year 1992." Reischauer told the Senate Banking Committee Jan. 29 that the BIF would have only about $1.4 billion left by Sept. 30, and would probably spend that before Dec. 31.

In Rhode Island, where many citizens have lost faith in the banking system, the depth of the distrust was vividly demonstrated Jan. 23, when a Cable News Network (CNN) newsclip on the state's problems included a shot of Old Stone Bank, one of the so-called healthy banks. The runs began the moment the bank opened its doors, as depositors jammed the bank's 28 branches. It took the combined efforts of the bank, the Federal Reserve, Gov. Bruce Sundlun, and CNN two days to stem the outflow of deposits and restore a modicum of temporary calm.

The explosiveness of the situation was further demonstrated when hundreds of enraged depositors stormed the Rhode Island Statehouse Jan. 24, to demand that the state stand behind all the deposits at the dozen financial institutions which remain closed in the state's banking holiday.

People are jumpy in neighboring Massachusetts, too. When Leon Dusoe, a vice president of Granite Bank of Keene, New Hampshire, was arrested for allegedly embezzling over $1 million from his bank, the news prompted a rash of calls from depositors of the Granite Cooperative Bank of Quincy, Massachusetts. The Quincy bank is also known as Granite Bank, but the two banks are not related.

Where Rhode Island and Massachusetts go today, the rest of the nation will soon follow. Caught between an enraged population and a depression, the government will find it difficult to force the taxpayers to rescue the banks.

"Time is not on our side," Federal Reserve chairman Alan Greenspan observed recently. No kidding.