Bankers whistling past the graveyard

by John Hoefle

It is always amusing to read the quarterly reports produced by the Federal Deposit Insurance Corp. (FDIC) on the health of the U.S. banking system. The FDIC does a good job of collecting and compiling the financial reports of commercial banks, and presenting a quarterly scorecard. Unfortunately, for both the FDIC and the people who read their reports, the banking statistics are full of hot air.

According to the latest FDIC *Quarterly Banking Profile,* released in mid-March, the U.S. commercial banking system had its most profitable year ever during 1997, with $59.2 billion in net income, an increase of $6.9 billion—13%—compared to 1996. The banking business has been so good, according to the FDIC, that banks have set record profits every year since 1992, when profits topped $30 billion for the first time. They topped $40 billion in 1993, and $50 billion in 1996, and just barely missed the $60 billion level in 1997 (**Figure 1**).

Not only that, but during the fourth quarter—the quarter which started with Black October and included the so-called "Asian" financial crisis—U.S. banks broke the $15 billion quarterly profit level for the first time, with $15.3 billion, beating the previous quarterly record (set in the third quarter of 1997) by $511 million, or 3.5%. They are now making per quarter, nearly what they made per year in the mid-1980s.

The banks also topped $5 trillion in assets for the first time in 1997, thanks to a record quarterly increase of $145 billion during the quarter.

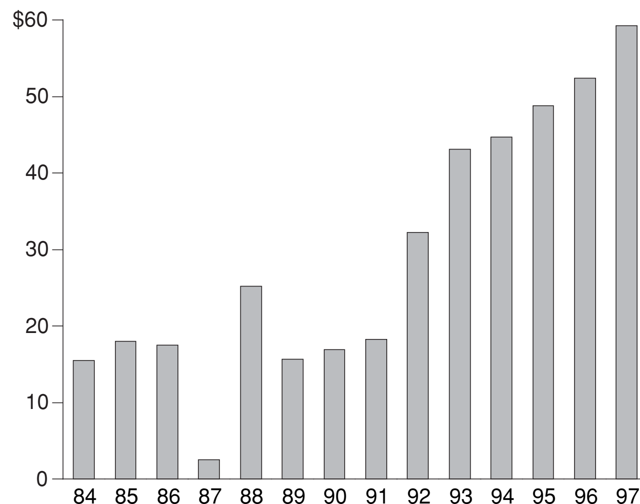
The only problem with these impressive numbers, is that they have nothing to do with the reality that the U.S. banking system is hopelessly bankrupt, carrying trillions of dollars of worthless IOUs on their books, IOUs whose value will evaporate faster than a puddle on a hot summer's day, when the bubble pops.

Off-balance-sheets

The problem facing the banks is alluded to at the bottom of Table II-A of the *Quarterly Banking Profile*—a line which shows that U.S. commercial banks have $25.4 trillion in "off-balance-sheet derivatives," a figure five times the banks' assets (**Figure 2**). The fact that the banks are carrying "off-balance-sheet" exposures five times the liabilities they show on their balance sheets makes a mockery of the concept of truthful disclosure, and the fact that their regulators allow them to get away with it makes a mockery of the banks' continual cries that they are being over-regulated and saddled with "regulatory burden."

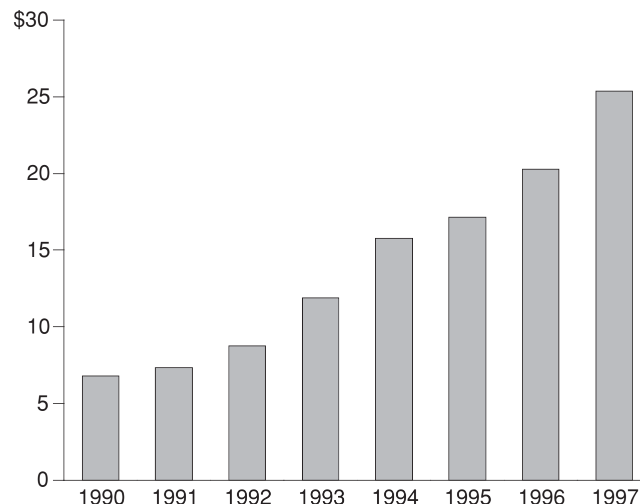
During 1997, the banks' derivatives exposure rose $5.1 trillion, 25%, from the $20.3 trillion reported at the end of

FIGURE 1
Profits claimed by U.S. banks
(billions $)



Source: Federal Deposit Insurance Corp.

FIGURE 2
Off-balance-sheet derivatives at U.S. commercial banks
(trillions $)



Source: Federal Deposit Insurance Corp.

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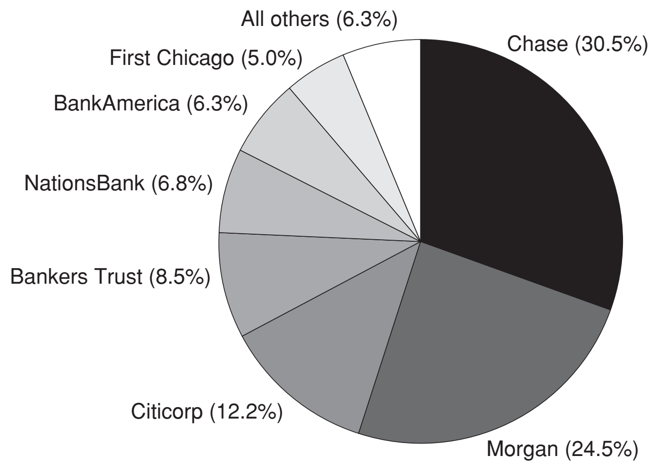
FIGURE 3
Concentration of derivatives at U.S. commercial banks



Source: Office of the Comptroller of the Currency.

1996, and a figure $68 billion higher than the banks' assets at year-end.

When the banking system can add more in derivatives in one year, than the entire banking system has in assets, anyone who speaks of "regulatory burden" is either insane or lying, and probably both.

To make matters worse, these derivatives are concentrated in a handful of banks (**Figure 3**). At the end of 1997, some 93% of these derivatives, or $23.8 trillion, were held by seven banks, and 99% were held by 25 banks, according to the Office of the Comptroller of the Currency (OCC). Two banks alone, Chase Manhattan and J.P. Morgan, accounted for a combined $14 trillion, or 54% of all U.S. bank-held derivatives, backed by $33.1 billion in stockholder's equity capital, and $628 billion in assets. On a derivatives-to-assets ratio, Morgan is by far the most exposed among the big U.S. banks, with derivatives holdings 24 times its assets, 545 times its equity, and 5,750 times its loan loss reserves (**Table 1**).

This is where the banking statistics start to get interesting. With such enormous derivatives holdings, it wouldn't take much of a derivatives crisis to swamp the big U.S. banks. Morgan, for example, would be totally wiped out by a loss equivalent to just 0.02% of its derivatives holdings.

This derivatives explosion is not limited to the United States, either. According to the German Bundesbank (central bank), the level of derivatives at German banks increased 54% during 1997, from 16.8 trillion deutschemarks to DM 25.9 trillion ($9.3 trillion to $14.4 trillion, at today's exchange rate). German bank derivatives have more than doubled since 1995, and now stand at more than seven times that nation's annual Gross Domestic Product. Worldwide, *EIR* estimates that there are $130-150 trillion in derivatives outstanding.

Consolidation

Another of the techniques used over the last decade to hide the increasing bankruptcy of the banking system, in addition to derivatives and fantasy accounting, has been the rapid consolidation of the banking system into fewer and larger banks. Of the ten biggest banks in 1985, half have disappeared through mergers: both Manufacturers Hanover and Chase Manhattan were taken over by Chemical, which now uses the Chase name; Security Pacific was taken over by BankAmerica; First Interstate was seized by Wells Fargo in a hostile takeover; and First Chicago fell to NBD. The last few years have also seen the rise into the top ten of NationsBank and First Union of Charlotte, North Carolina and Banc One of Columbus, banks which have grown rapidly through smaller acquisitions. Among the second tier of banks, the motto has become, "Eat or be eaten."

The result has been a sharp rise in the number of bank mergers—599 in 1997, and more than 4,000 during the 1990s (**Figure 4**)—and a sharp drop in the number of banks, to just 9,143 at the end of 1997 (**Figure 5**). Many of the mergers are shotgun marriages, arranged by regulators to hide serious losses at the banks involved, while the rise of the super-regional banks permit a rapid consolidation without the political fallout which would occur were the takeovers to be done by New York-based banks.

The banks are also moving in on the investment banks, despite the prohibition against such combinations by the Depression-era Glass-Steagall Act. For a decade, the big money-center banks have operated securities subsidiaries by exploiting what they call loopholes in Glass-Steagall, but even the pretext that such combinations are within the bounds of the law have been dropped. The floodgates were opened in 1997, when Bankers Trust—effectively run by U.S. regulators since late 1994—acquired the Baltimore-based Alex. Brown brokerage. That deal quickly led to others: BankAmerica bought Robertson Stephens, NationsBank bought Montgomery Securities, Fleet Financial purchased Quick & Reilly, First Union bought out Wheat First, and U.S. Bancorp acquired Piper Jaffray, to name a few.

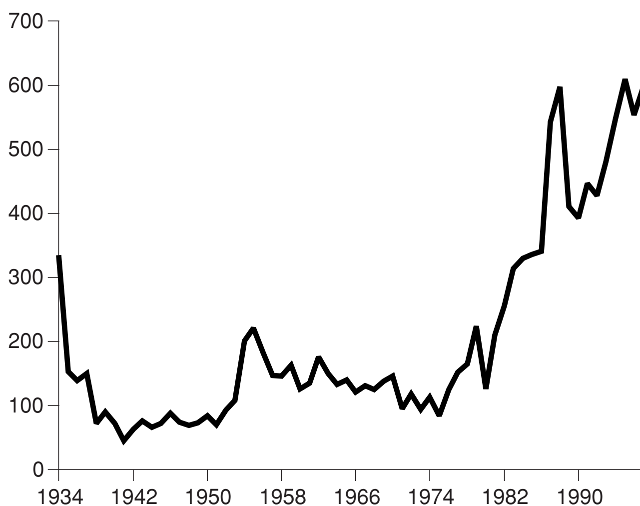
More mergers are in the works. Chase Manhattan has approached Merrill Lynch, and J.P. Morgan has been rumored to be on the block, with speculation as to who would rescue it, ranging from banks like HBSC Holdings (a.k.a, the British Empire's Hongkong & Shanghai Bank of *Dope, Inc.* fame), to investment banks such as Goldman Sachs, and perhaps even a major insurance company.

Also in 1997, Dean Witter Discover acquired Morgan Stanley, and Travelers Group acquired Salomon. All told,

TABLE 1
Loan loss reserves, equity, assets, and derivatives of the top 10 bank holding companies

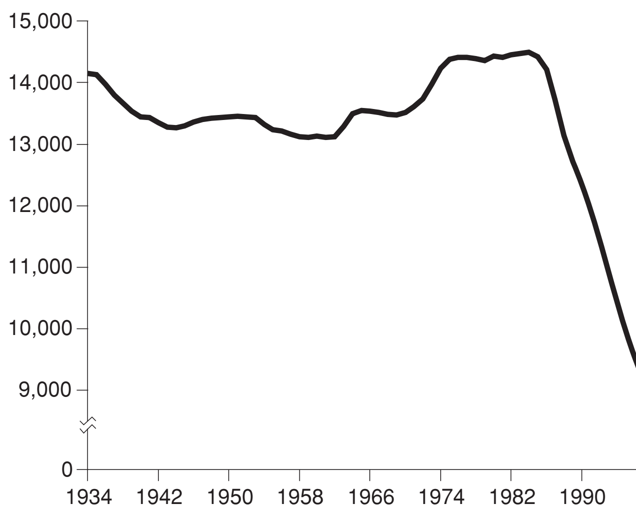
Rank	Bank holding company	State	Loan loss reserves (millions $)	Total equity (millions $)	Total assets (millions $)	Total derivatives (millions $)	LLR (Derivatives as multiple of)	Equity (Derivatives as multiple of)	Assets (Derivatives as multiple of)
1	Chase Manhattan Corp.	NY	$3,624	$21,742	$365,521	$7,738,234	2,135.3	355.9	21.2
2	J.P. Morgan & Co. Inc.	NY	1,081	11,404	262,159	6,216,123	5,750.3	545.1	23.7
3	Citicorp	NY	5,816	21,196	310,897	3,105,924	534.0	146.5	10.0
4	Bankers Trust New York Corp.	NY	997	5,708	140,102	2,146,525	2,153.0	376.1	15.3
5	NationsBank Corp.	NC	2,782	21,337	264,562	1,720,488	618.4	80.6	6.5
6	BankAmerica Corp.	CA	3,500	19,837	260,159	1,593,504	455.3	80.3	6.1
7	First Chicago NBD Corp.	IL	1,408	7,950	114,096	1,266,676	899.6	159.3	11.1
8	Republic New York Corp.	NY	326	3,438	55,638	274,386	840.4	79.8	4.9
9	Bank of New York Company, Inc.,	NY	641	5,002	59,961	205,659	320.8	41.1	3.4
10	BankBoston Corp.	MA	712	4,610	69,268	149,115	209.4	32.3	2.2
	Top ten		**$20,887**	**$122,224**	**$1,902,364**	**$24,416,634**	**1,169.0**	**199.8**	**12.8**

FIGURE 4
Number of bank mergers



Source: Federal Deposit Insurance Corp.

FIGURE 5
Number of U.S. banks



Source: Federal Deposit Insurance Corp.

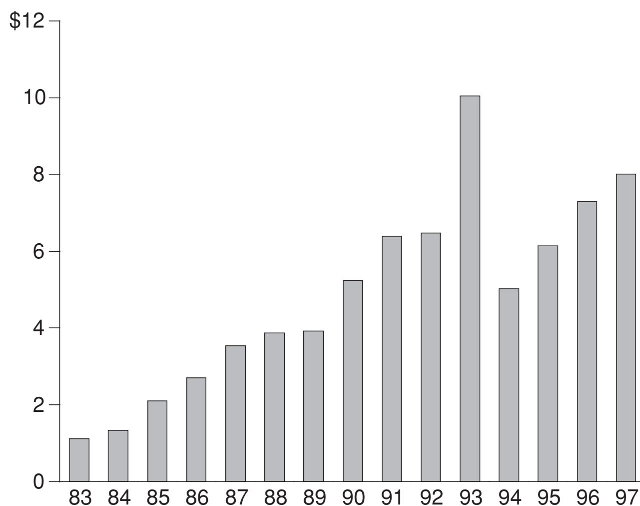
some $59 billion in mergers involving investment banks were recorded in 1997, almost 40% of all such deals since 1980.

Trading losses

Despite the record profits reported by the banks in the fourth quarter, hints of losses are beginning to surface. According to the OCC, derivatives trading revenues at the big banks dropped 52% during the quarter. Cash and off-balance-sheet trading revenues dropped to $1.2 billion in the final quarter of 1997, from $2.5 billion in the third quarter of 1997.

The banks posted a gain in foreign exchange revenue, from $1.1 billion in the third quarter to $1.3 billion in the fourth quarter, reflecting the revenue grabbed in the insider-trading raids organized against Asian currencies, but those gains were more than offset by a sharp drop in revenues on interest rate derivatives, and losses on equity, commodity, and other derivatives. Interest rate trading revenue was just $534 million in the fourth quarter, compared to $1.2 billion in the third, while equities posted a loss of $305 million compared to a profit of $103 million, and commodity and other

FIGURE 6
Trading revenue at U.S. commercial banks
(billions $)



Sources: Keefe, Bruyette and Woods; Office of the Comptroller of the Currency; company reports.

derivatives posted a loss of $320 million, compared to a gain of $125 million in the third quarter.

Even with the fourth-quarter decline, the banks claimed a record $8 billion in trading revenue in 1997 (**Figure 6**), but as the fourth-quarter results show, those gains came at the expense of blowing up a large section of the world's economy. The banks' books might look good, but people in Indonesia and elsewhere in Southeast Asia are suffering and dying as a result. Killing nations is a not a sound long-term investment strategy.

The case of J.P. Morgan

The effect of this cannibalization strategy can be seen in the fact that both J.P. Morgan and Chase Manhattan are seeking mergers. That Morgan, which has long been one of the British Empire's most important strategic assets in the United States, is now casting around for a bailout, is a sign that serious derivatives losses have either already occurred, or are percolating through the system.

Morgan has always functioned as a financial warfare arm of the British Empire on Wall Street, tracing its roots to a merchant bank set up in London in 1838 by George Peabody, an American, and opening its first U.S. office at the time of the Civil War. The House of Morgan was anti-American from the start, an implacable foe of the American System of Economics and of the potential of the United States to free the world from the grasp of the British Empire, a role it maintains to this day. The House of Morgan played a major role in the operation to bankrupt the bank of Jay Cooke, which helped finance the Union during the Civil War, and smashed U.S. industry via the creation of industrial conglomerates in the decades after that war. The House of Morgan was instrumental in the 1913 creation of the Federal Reserve System, and was a bitter adversary of Franklin D. Roosevelt's attempt to bring to heel what FDR called the "economic royalists."

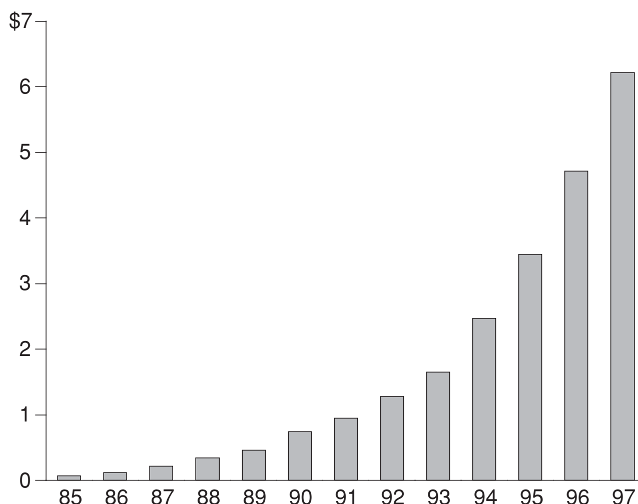
In 1933, in the depths of the Depression, the Senate Banking Committee launched an investigation of the activities of the big banks in the lead-up to the Crash of 1929. The hearings, led by special counsel Ferdinand Pecora, revealed how Chase and National City Bank (Citicorp) had engaged in fraudulent stock manipulation, then turned its attention to J.P. Morgan, revealing that Morgan had a "preferred list" of political heavyweights—including many influential government officials—to whom he steered sweetheart financial deals, and a "fishing list" of those who were targetted for bribes.

"The power of J.P. Morgan was . . . a stark fact," Pecora later wrote in his book, *Wall Street Under Oath*. "It was a great stream that was fed by many sources: by its deposits, by its loans, by its promotions, by its directorships, by its pre-eminent position as investment bankers, by its control of holding companies which, in turn, controlled scores of subsidiaries, and by its silken bonds of gratitude in which it skillfully enmeshed the chosen ranks of the 'preferred lists.' It reached into every corner of the nation and penetrated into public, as well as business affairs. The problems raised by such an institution go far beyond banking regulation in the narrow sense. It might be a formidable rival to the government itself."

The abuses revealed by the hearings paved the way for the Banking Act of 1933, better known as the Glass-Steagall Act, which prohibited the banks from engaging in the sale of securities. One result was the forced split of the U.S. side of the House of Morgan into two parts: J.P. Morgan & Co., the commercial bank, and Morgan Stanley, the investment bank. The House of Morgan has neither forgotten nor forgiven the U.S. government for this act of sovereign regulation, and, to this day, is the leader in a fight to repeal Glass-Steagall.

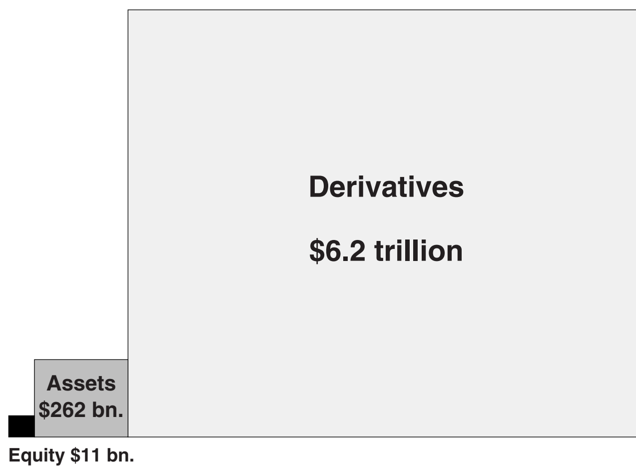
In the wake of the revelations of the 1930s, Morgan had chosen to remain in the background, letting others implement its financial warfare against the United States. The junk bond house of Drexel Burnham Lambert, home of convicted felon Michael Milken, was used by the Morgan and Rothschild interests as a battering ram against corporate America. The junk bond-fuelled takeover frenzy of the 1980s affected not only the companies which fell prey to these attacks, but also drove potential targets into the arms of the investment bankers, who saddled them with enormous debts as part of "poison pill" anti-takeover strategies. Drexel ultimately

FIGURE 7
J.P. Morgan & Co. off-balance-sheet derivatives
(trillions $)



Sources: Office of the Comptroller of the Currency; company reports.

FIGURE 8
J.P. Morgan & Co.'s derivatives, assets, and equity compared
(as of Dec. 31, 1997)



collapsed, but only after laying waste to much of industrial America. This bankers' coup led directly into the derivatives bubble, where Bankers Trust, another Morgan creation, took the lead. Bankers Trust was the poster boy for the international derivatives business, the bank pointed to by bankers and regulators as the proof that derivatives were safe—until 1994, when Bankers Trust blew up, and was taken over by regulators, under the guise of cleaning up fraud (Bankers Trust got caught red-handed cheating its customers on derivatives deals, but the fraud charges, while real, were just a pretext for regulators to take over the bankrupt bank and bail out its derivatives portfolio).

As a result of the 1994 problems at Bankers Trust, Kidder Peabody, and other financial institutions, J.P. Morgan began to take more of an open role in the derivatives market, and its derivatives holdings began to rise sharply (**Figure 7**). The banks' derivatives rose from 12 times assets in 1993, to 16 times assets in 1994, to 19 times assets in 1995, to 21 times assets in 1997, and nearly 24 times assets in 1997. The result, at the end of 1997, was a bank with $23.71 in derivatives for every $1 of assets, and $545 in derivatives for every $1 of equity (**Figure 8**).

Bankers are cutting their own throats

Morgan, with its tight relationship with the Fed (Alan Greenspan was a director of Morgan prior to becoming chairman of the Fed) and with the Group of 30 derivatives task force, was the natural choice to help build the derivatives bubble and deal with the derivatives crises at Bankers Trust and other U.S. banks, but that role carried a heavy price.

The characteristic of the financial system, is that each attempt to bail out the bubble, only makes the situation worse.

The banks made the decision in the early 1980s to deal with their non-performing Ibero-American loans by forcing brutal austerity upon those nations, with the result that they owe more than ever, despite having paid back more than they owed at the time. This bankers' arithmetic allows the banks to book profits, even as their financial situation deteriorates. During the 1980s, the banks organized real estate and junk bond bubbles to generate even more virtual profits, but both bubbles collapsed in the latter half of the decade. In Texas, the combination of a collapse in the price of oil and the death of the real estate bubble, wiped out virtually the entire banking system; the real estate and junk bond collapse also wiped out much of the savings and loan sector, and led to bank runs in New England.

To counter this, regulators pumped money into the banking system, ignored bad loans, merged bankrupt institutions and helped the banks set up the derivatives bubble. Japan came under serious pressure to rescue the banking system through the creation of an Asian bubble, and the banks rushed to set up "emerging markets" throughout the (formerly) developing sector, helped by the International Monetary Fund (IMF) and its conditionalities. The result was a dramatic increase in the global derivatives market, and the apparent success of the so-called "Asian Tigers," which were touted as economic miracles right up until they disintegrated in 1997.

The reason all these efforts fail is quite simple: The rapid growth of financial markets comes at the expense of the productive sector. Money which should go into building infrastructure and industry, into the education, health, and welfare of the population, is instead siphoned off into the bubble. The result is a hyperbolic growth in financial claims, and a decrease in the productive activity which pays the bills. By sucking money out of the productive sector, the bankers are cutting their own throats—and everyone else's as well.

Now the financiers are pushing for another round of deregulation, to let commercial banks, investment banks, and insurance companies merge into one big "financial services" miasma. But typically, every time a deregulation bill hits Congress, the three sectors start squabbling over who should get to eat whom. Take H.R. 10, the "Financial Services Act of 1998," which was withdrawn by the Republican leadership in the House on March 31, due to heavy opposition from the American Bankers Association. The ABA, while favoring deregulation, came out strongly against the bill, claiming that it gave too much advantage to the securities firms and insurance companies. The securities firms and the insurance companies backed the bill, which Merrill Lynch Chairman David Komansky called "the most profoundly important economic legislation" before Congress.

On March 27, a three-quarter-page ad appeared in the *Washington Post,* supporting H.R. 10. The ad was signed by a bevy of insurance groups, securities firms, and two banks: J.P. Morgan and Banc One. Fittingly, the other quarter of the page was taken up by a story about a Bank of Boston banker who was wanted by the FBI over a series of $73 million in suspicious loans.

The oligarchy is bailing out

This infighting among the "financial services" crowd reminds one of what must have happened among the dinosaurs, when the climate changed. Unable to comprehend that their world had changed, they were powerful but doomed, fighting each other for control of an increasingly hostile environment. For all their apparent power, they were unable to adapt to a changing world, and disappeared.

That is the situation facing the bankers today. The more they try to hold on, the more loot they extract to keep their coffers full, the more bankrupt they become, and the greater the inevitable explosion. Rolling over unpayable debt doesn't solve the problem, it just creates even more unpayable debt. Printing money doesn't solve the problem, but ultimately leads to hyperinflation, which is precisely where the IMF bailouts are headed.

While the bureaucrats of the banking world—the central bankers, commercial bankers, and investment bankers, whom most people consider to be at the top of the financial food chain—are fighting to keep their doomed system going, their bosses at the higher levels of the financial oligarchy are bailing out, selling off their paper assets and moving into hard assets.

The maneuverings of the British Empire are exemplary. While the foolish American bankers are rushing to merge, creating bigger, more bankrupt banks, the Brits are selling out. The pattern is striking: one after another, the financial crown jewels of the Empire are being sold to outsiders. The 300-year-old Barings, and other famous institutions of the oligarchy, such as Hambros, S.G. Warburg, Kleinwort Benson, and Smith New Court, have been sold to foreign banks, in a process Lyndon LaRouche has called "selling to the suckers."

A few more savvy Americans, such as Warren Buffett, have also been selling: Buffett sold Salomon to Travelers, and has moved big chunks of his money into Treasury bills and silver, which have more chance of surviving the crash than the IOUs which are touted as such lucrative investments among the dinosaurs.

A New Dark Age

Unlike the bankers, who are mere clerks in the scheme of things (the power belongs to those who own the money, not those they hire to manage it), the upper echelons of the financial oligarchy know a catastrophic crash is coming.

They know, because they organized it.

Ever since the American Revolution, this centuries-old financial oligarchy has been struggling to destroy America and the ideas for which it stands.

The oligarchs consider themselves to be the Gods of Olympus, with the world as their plantation and its people nothing more than slaves and cattle. Britain's pagan Prince Philip has spoken of the need to "cull the human herd," and expressed his desire to be reincarnated as a deadly virus to kill off large sections of humanity. Britain's Lord William Rees-Mogg has stated that only 5% (guess which 5%) of the human race should be educated, with the rest kept at the level of ignorant peasants, too stupid to challenge the power of their masters.

This is the world the oligarchs are planning, a new Dark Age in which the clock is turned back to the days when the empires ruled the world, and the masses knew their place. What we are facing is death and destruction not seen since the Dark Ages, with the Four Horsemen of the Apocalypse riding unchecked.

But it doesn't have to be. As the young United States proved, the nation-state is a superior form of political entity to the empire, because it develops the power of reason among its citizenry, a power against which, if properly wielded, the bestiality of the oligarchy cannot win.

That is the issue which must be on the table April 16, when representatives of 22 nations meet in Washington to discuss the financial crisis. Either the nations stand up and assert their sovereignty, or they and their people will die.