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U.S. Banks Lead Global Financial Collapse

by John Hoefle

Caught between rising levels of unpayable debts and a failing economy, the U.S. banking system is disintegrating. Only by ignoring the vast wasteland that the banks count as assets on their books, are the banks able to keep their doors open. On top of that, the indications are growing that two of America's largest banks, J.P. Morgan Chase and Citigroup, have been secretly taken over by the Federal Reserve to keep their insolvency out of public view. There are also rumors that Bank of America has received a line of credit from the Treasury, to calm nervous counter-parties.

Some might argue that these banks are solvent, citing their publicly disseminated balance sheets as proof, and indeed the banks do publish figures which show black ink on the bottom line; but these balance sheets are, to put it politely, pure fiction. We have already seen the banks post billions of dollars of losses on companies such as Enron and WorldCom, and there are a lot more hidden losses in the corporate world than have been revealed so far. Were corporate America to publish an honest set of books, the loan losses alone would sink the banks, and the level of loans pales in comparison to the level of off-balance-sheet derivatives and other funny business. The U.S. banking system as a whole, and the big derivatives banks in particular, are likely bankrupt several times over.

Vaporizing Banks

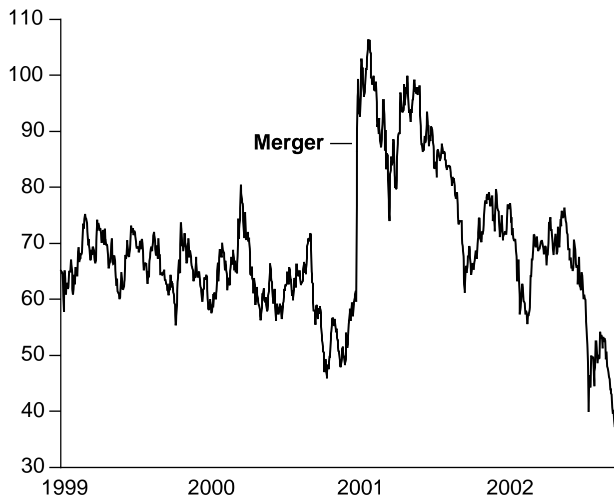
Leading the pack is J.P. Morgan Chase, the world's largest derivatives bank. Morgan isn't really a bank any more, but a giant casino specializing in the derivatives market. As of June 30, 2002, it had over $26 trillion in derivatives—up $2 trillion from the first quarter—compared to just $207 billion in loans, which amounts to $127 in derivatives for every dollar of loans. In fact, the bank has more credit derivatives outstanding—$278 billion—than it does loans. Morgan has over half the credit derivatives held by all U.S. banks, easily topping Citicorp's $106 billion and Bank of America's $77 billion.

Morgan's derivatives exposure is so great, that a loss equivalent to just 0.16% of its derivatives portfolio would be enough to wipe out every nickel of its $43 billion in stockholders' equity, making it insolvent by any standard.

Only compared to Morgan Chase does Citigroup look good. Citigroup had $9.5 trillion of derivatives in the second quarter, backed by stockholders' equity of $86 billion, meaning it would take a loss equivalent to a whopping 0.5% of its derivatives portfolio to wipe out its equity capital. Bank of America's $10 trillion in derivatives gives it a wipe-out point of 0.9%. For the U.S. banking system as a whole, the comparable figure is 1.2%.

J.P. Morgan Chase Vaporizing Market Capitalization

(Billions $)



This incredibly thin margin is all that stands between a nominally solvent U.S. banking system and a total collapse, and there indications that some banks have already gone over the edge.

Morgan Chase, for example, has seen its market capitalization drop sharply in recent months (**Figure 1**), making the bank worth less than Chase Manhattan was alone, before it acquired J.P. Morgan. In effect, all of J.P. Morgan and a chunk of Chase have simply vaporized, and the plunge is continuing. Morgan Chase's market capitalization is off 74% from its post-merger peak, while Citigroup is off 50% from peak and Bank of America is off 27%.

These banks are in a death spiral, and no amount of market manipulation, such as the desperation moves now being tried in Japan, will be able to save them.

Wave of Scandals

Related to this collapse is the current wave of scandals hitting the banks, reflecting their descent ever deeper into unethical and even criminal behavior, in an attempt to fleece enough money out of their customers to maintain the appearance of solvency.

Faced with declines in corporate lending, the big banks increased their credit card and consumer lending businesses

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by expanding into the sub-prime market, where higher fees and interest rates could be charged to customers with poor credit records.

To bolster its consumer-lending business, Citigroup bought Associates First Capital, the largest U.S. consumer finance company, in 2000, merging it into its CitiFinancial unit. In March 2001, the Federal Trade Commission filed suit against Citigroup, charging Associates with "systematic and widespread abusive lending practices." On Sept. 19, 2002, the FTC announced it had reached a settlement with Citigroup, under which Citi would pay $240 million, the largest consumer-protection settlement fine in agency history.

"The Commission will not tolerate the fleecing of subprime borrowers through deceptive lending practices," stated FTC Chairman Timothy Muris.

The banks are also catching flak for their use of shares in initial public offerings (IPOs) and hanging "for sale" signs on their analysts' stock ratings to drum up investment-banking business. Earlier this year, Crédit Suisse First Boston, a unit of Switzerland's Crédit Suisse, paid $100 million to settle charges that it gave certain hedge funds IPO shares in exchange for inflated commissions on other stock trades, and the bank faces possible criminal charges on other IPO-related abuses. In May, Merrill Lynch paid $100 million to settle charges by New York State Attorney General Eliot Spitzer that it traded favorable ratings on Internet stocks to bolster its investment-banking business. Spitzer, who called Merrill's actions "a shocking betrayal of trust by one of Wall Street's most trusted names," is also investigating Citigroup's Salomon Smith Barney for both IPO abuses and tainted research.

The National Association of Securities Dealers (NASD) also investigated Salomon Smith Barney, charging it with issuing "materially misleading" reports on the telecommunications company Winstar. Salomon agreed to pay a $5 million fine for touting Winstar as a good buy to its customers, even as the company collapsed. "What occurred in this case was a serious breach of trust between Salomon and its investors," said Mary Schapiro, NASD's head of regulatory policy.

The larger point which must be made, however, is that it was common knowledge, on Wall Street and in Washington, that these practices were occurring. These practices were known, defended, and even aided by the so-called private regulatory bodies, government regulators, and Congressional oversight committees. Only after the dot.com and telecom bubbles have popped, and the money stopped flowing, are the regulators taking any action.

Depressing Economy

While the banks augur in, the physical economy is falling with breathtaking speed. One indicator of this is the record current account deficit reported in the second quarter; at $130 billion, it is not only the highest quarterly deficit in U.S. history, but a larger deficit than any other nation has ever reported for a full year! The major component in the current accounts deficit is the trade in physical goods, in which the U.S. imported $123 billion more in goods than it exported, reflecting a decline in domestic manufacturing.

At the same time, domestic debt is soaring, with U.S. credit market debt rising $600 billion in the second quarter, to $29.8 trillion. Household debt topped $8 trillion for the first time, even while the net worth of households plunged by $1.4 trillion, mainly due to evaporating stock markets. The conjunction of rising debt and falling net worth is yet another indicator of economic collapse.

Home mortgage foreclosures also hit a record in the second quarter, with nearly 640,000 homes put into foreclosure. While that represents only 1.2% of the total home mortgages outstanding, it was the highest foreclosure rate in the 30 years the Mortgage Bankers Association has been keeping records. Another 4.8% of all home mortgages were at least 30 days delinquent, the highest level since 1985.

Global Meltdown

The news is no better outside the United States, with markets falling all around the world, and desperate measures a sign of the times.

In Germany, insurance giant Allianz has begun a mass sell-off of its stock market portfolio, in an attempt to stem the decline of its capital base. Other insurers, including Munich Re, are also selling, further depressing German and other stock markets.

In Japan, Bank of Japan Governor Masaru Hayami announced on Sept. 18 that the central bank would begin buying some of the shares held by his nation's banks. Japanese banks hold large amounts of stock in the nation's industrial and infrastructure companies, and Hayami's action is an attempt to protect Japanese banks and companies from the effects of the global blowout.

In Ibero-America, the values of national currencies are plunging versus the dollar, making it even more impossible for those nations to pay their dollar-denominated debt and escalating their inevitable descent into default. Seven of the ten worst-performing currencies in the world this year are in Ibero-America, falling against the dollar even as the dollar falls against other major currencies.

This is a systemic, global collapse, with no recovery in sight absent LaRouche's recovery plan.

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