EIR Economics

Guarantees Are Worthless, When the System Is Bankrupt

by John Hoefle

While the Federal Deposit Insurance Corporation (FDIC) has gone to great lengths to assure the public that their bank deposits are safe—at least up to the insured limit—it is obvious that the agency lacks the capital required to back up its claims. As long as the FDIC closes only small banks, it can meet its responsibilities, but it does not have the resources to even begin to deal with the magnitude of the crisis it faces.

The same is true of the Federal Reserve, which is running out of room on its balance sheet to continue the escalating bailout process it began last December, and also true of Fannie Mae and Freddie Mac, whose role as a dump for the toxic waste of the banking system means that they will not survive on their own. All of these players, the FDIC, the Fed, Fannie and Freddie, and others like the Federal Home Loan Banks, can always turn to the Federal Government for cash, but the Federal Government itself is operating at a deficit, already borrowing money to meet its spending requirements. Thus, while there is no shortage of guarantees, none of the players actually has the money it needs to satisfy those guarantees, in anything approaching a worst-case scenario.

The Federal Government, it is assumed, can always borrow more money, but under our current unconstitutional central banking monetary system, it borrows that money by issuing bonds, which are sold through the Fed into the financial markets. That is, it is borrowing money from the very financial markets it is attempting to bail out. One does not have to be a professional economist to spot the flaw in such a scheme (in fact, it appears, the only people who fail to see the glaring flaw in the scheme are professional economists, bankers, and their pet regulators, who have a vested interest in ignoring the obvious).

In the end, whatever the Federal Government does manage to borrow, becomes the obligation of the taxpayers, most of whom are themselves dependent upon borrowed money for their survival, and living in an economy which has been operating below breakeven for some four decades, and falling further behind by the day. Ultimately, the guarantees are worthless, because there is nothing backing them.

Shrinking Banking System

For those who would prefer to believe that the banking system is sound, the FDIC's just-released second-quarter report is not encouraging. For one thing, the net income reported (read: claimed) by FDIC-insured commercial banks and savings institutions was just $5 billion, the second-lowest figure since 1991, and a whopping 87% below the second quarter of 2007. This is not surprising, given the huge losses the banks have been reporting of late, and while we believe that the reported income figures are seriously overstated, the plunge from the consistent $30 billion plus quarters of recent years shows a trend which cannot be ignored. The FDIC also reported a small drop in the total assets of the 8,451 institutions it insured, to $13.30 trillion from $13.37 trillion in the first quarter. Such drops are uncommon—

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it is the seventh quarterly drop since 1987—but it is also the largest, and a sign of things to come. The asset drop was also accompanied by a small drop in equity capital.

One item which did increase was the notional amount of the banks' derivatives holdings, up $2 trillion to $183 trillion. The vast majority of these derivatives are held by just three banks, J.P. Morgan Chase, Citigroup, and Bank of America, with Morgan alone accounting for nearly half the total.

Reflecting the deterioration of the financial condition of the banks' customer bases, the banks also reported significant jumps in the level of non-current loans and leases, and in net charge-offs of loans. Despite the increase in the amounts of money banks set aside as reserves against losses in their loan portfolios, the increase in non-current loans surpassed the increase in loan-loss reserves for the ninth consecutive quarter. The banks as a group now have just 88.5 cents in reserves for every $1 in non-current loans, the lowest level in 15 years.

These statistics are not important in and of themselves, since the banks are hardly being honest about their true conditions, but they do nevertheless reflect, however understatedly, the descent of the banking system from the fictitious profits of earlier years to an increasingly obvious insolvency. The FDIC raised to 117 from 90 the number of banks on its "problem" list, with a combined $78 billion in assets. The Fed has a secret list of 1,400 troubled banks, and the assets for that list surely run in the trillions. Reality is much worse than the "official" statistics indicate.

All of which brings us back to the question of deposit insurance. According to the FDIC, its Deposit Insurance Fund held $45 billion in mid-June, against insured deposits of $4.5 trillion. That's about a penny on the dollar. On top of that, the deposits of all FDIC-insured institutions stood at $8.6 trillion as of June 30, meaning that there are another $4.1 trillion of uninsured deposits in the banks. Roughly half of all deposits are uninsured, and the rest are backed by a penny on the dollar. What could possibly go wrong?

Lies and Lehman

The investment banks are also in big trouble. Lehman Brothers, which has been shopping itself around looking for a savior, had proposed to sell a big chunk of itself to South Korea's government-owned Korean Development Bank, at a price 50% over book value. KDB chairman Min Euoo-sung, who had been the chief of Lehman's Seoul branch for three years before joining KDB in June, was in favor of the deal, and other Korean bankers saw it as an opportunity to expand their nation's role in the global financial arena. However, the plan was shot down by the government.

"After a review of its [Lehman's] account book, we found that its insolvency was serious," a senior government official stated, according to the Aug. 22 English-language edition of the *Chosun Ilbo*.

For a government official to publicly admit that a major investment bank is insolvent is extraordinary—and refreshingly honest!—but clearly, from the standpoint of the international bankers, totally unacceptable. A number of papers carried the *Chosun Ilbo* story, until Reuters, the British propaganda outlet, issued a false story claiming that KDB was considering buying Lehman anyway. The original story quickly disappeared, replaced by the phony one, which was touted enough to send Lehman's stock soaring. The lie prevailed, at least in the short term, in what was just another day at the office for the spin doctors.

Other Indicators

As we have said repeatedly, there is no financial solution to the current crisis, only political ones. The current financial system has died, and what will replace it is a political question, one which is being fought out before our eyes, even though it is not identified in that way. On the domestic front, there are two significant elements which bear watching: the way in which the Presidential campaigns are being shaped to prevent any FDR-style recovery movement, and the relentless implementation of police-state measures. The development on the foreign front is the revival of the Cold War confrontationist policy against our alleged enemies. Under the Bush/Cheney regime it was the specter of "terrorists" everywhere, a specter now being replaced by the Russians. Behind it all lay the British puppetmasters, determined to manipulate America once again into a self-destructive, and self-defeating, stupidity.

The closer we get to the final, open disintegration of the financial system—the day the banks don't open, the day the economy stops—the louder the British brainwashing will be. The volume of the lies, financial, political, and military/security, is itself one of the best economic indicators we have. Don't think, be terrified, and let the "experts" decide your future. That's the plan, and it will work, unless we stop it.