Here's why the U.S. banking system has gone bankrupt

by John Hoefle

The banking system of the United States is insolvent, the country's biggest banks are insolvent, and the Federal Deposit Insurance Corp. (FDIC), the traditional "safety net," is likewise insolvent. That is the situation today, and it is only going to get worse as the greatest financial collapse in the history of the country unfolds.

The Reagan-Bush speculative bubble has popped, leaving trillions of dollars of paper debt unpayable. These glorified IOUs are rapidly unraveling, setting off a chain reaction of defaults throughout the financial system, and cutting a wide swath through the financial system, corporate America, and millions of homes.

Since the stock market mini-crash of October 1989, the nation's banks have taken a devastating pounding. Category after category of their loan portfolios have gone sour, as the depression works its way through the economy. The Third World loans were rendered unpayable by the International Monetary Fund conditionalities which the bankers unwisely imposed upon those poor nations. The high-flying junk bond and takeover business came to a halt, leaving the banks holding junk bonds and bridge loans with nominal values in the billions of dollars and real values measured in cents. The real estate bubble, propped up by all sorts of get-rich-quick schemes which drove prices to dizzying heights, exploded as prices became too high for normal people to afford.

The supposed bright spots in banking were credit cards and other types of consumer debt. Despite our troubles in other areas, the bankers bragged, our consumer lending business is doing quite well, thank you. The implications of this personal borrowing binge are only now beginning to sink in, as the default rate on credit cards and consumer installment debt begins to skyrocket.

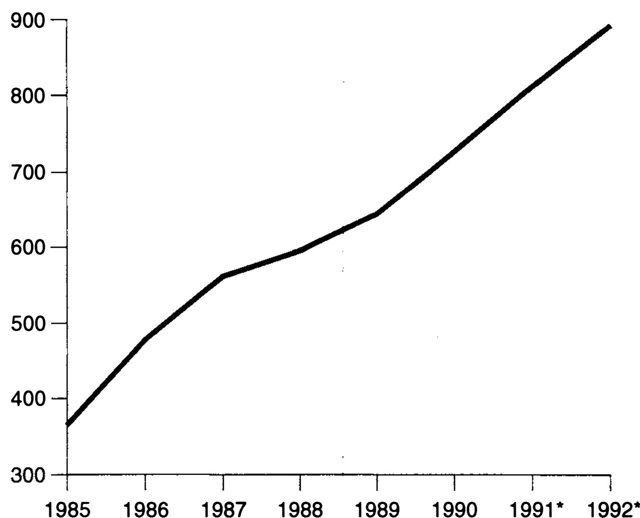
Individuals were borrowing all that money because they were broke. Their expenses were greater than their income, so they borrowed money to make up the difference. They ran their credit cards up to the limits—and beyond, thanks to eager bankers. They stretched their car payments out over absurdly long periods, and financed every purchase possible. They loaded themselves down with more debt than they could ever manage to pay, in the vain hope that the economy would somehow recover enough for them to dig themselves out of the hole.

Bankruptcies skyrocket

Now the consumer bubble has popped, too. In 1985, there were 364,536 corporate and personal bankruptcies filed in federal courts (see **Figure 1**). By 1990, that figure had nearly doubled, to 725,484. The Administrative Office of the U.S. Courts projects that the number of bankruptcies handled by federal trustees will reach 810,000 this year, 890,000 in 1992, and will exceed 1 million by 1994. These statistics do not include the hundreds of thousands, or more likely millions of people who quietly slide into bankruptcy each year without filing with the federal government.

In 1985, corporate bankruptcies involving some $5 billion in assets were filed. By 1988, that figure had increased nearly ninefold, to $43 billion. In 1989, there were $72 billion in assets involved in corporate bankruptcies, an increase of nearly 15 times in just four years. Over the first three

FIGURE 1
Personal and business bankruptcies filed with U.S. federal courts
(thousands)



Source: Clerk of the U.S. Courts

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months of 1990, the asset size of corporate bankruptcies reached $47 billion, more than the entire year of 1988. Given the growing problems in the defense, airline, retail, computer, and auto industries, just to name a few, the rate and size of failures is sure to accelerate.

Many corporations have staved off bankruptcy in the short term by massive borrowing, through bank loans, bond issues and the like. With business drying up, these companies are bankruptcies waiting to happen.

The impact of this wave of bankruptcies on the banking system has been devastating. Between 1934 and 1990, 1,948 FDIC-insured banks failed in the United States (see **Figure 2**). Of that total, 1,226, or 63%, occurred between 1982 and 1990. In the last four years alone, 799 banks failed, or 41% of all bank failures since 1934. Adding the 180 failures projected by the FDIC for 1991, that would mean 46% of all post-1933 bank failures in the country had occurred during the last five years. The picture is even grimmer if the 490 Depression-related bank failures in the 1934-42 period are removed. Of the 1,458 banks which have failed in the post-Depression era, 86% have failed since 1980, 73% since 1985, and 55% since 1987. More banks failed in 1988 alone than failed between 1943 and 1979.

While the number of failed banks per year has dropped slightly since the 1988 peak, bigger banks are now failing (see **Figure 3**). In 1980, the average failed bank had $24 million in assets. In 1985, the average failure was $73 million. The average dropped in 1986 and 1987, but came roaring back in 1988 at a record $162 million. After lesser averages of $141 million in 1989 and $96 million in 1990, the average failed bank in 1991, according to the FDIC's own projections, will some $390 million in assets.

This rapid disintegration of the banking system has led many stock market investors to shun bank stocks. Since October 1989, the stock of the major New York banks—Citicorp, Chase Manhattan, J.P. Morgan, Chemical Bank, Manufacturers Hanover, Bankers Trust, and Bank of New York—has lost about 50% of its value. While J.P. Morgan has recovered about 95% of the ground it lost since October 1989, and the Morgan-controlled Bankers Trust has recovered nearly 80% of its losses, Chase and Chemical have lost about 75% of their value, with Citicorp, the nation's largest bank, down 65%. The same basic pattern holds true for banks in the rest of the country, with greater declines in New England and lesser declines elsewhere.

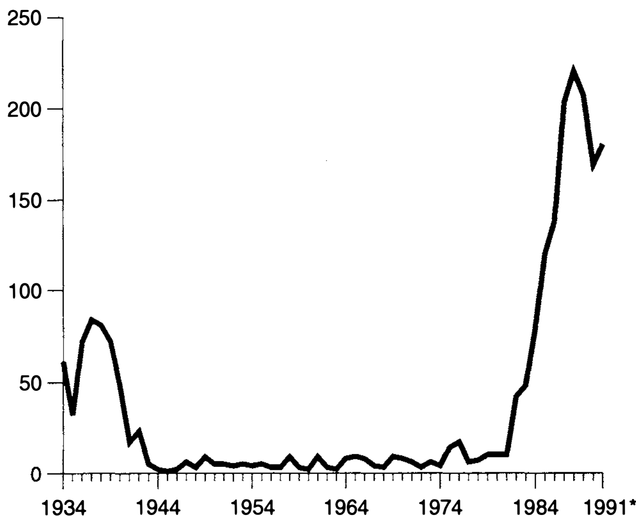
During the first nine months of 1990, the total value of all publicly traded bank stocks dropped $25 billion, or nearly 25%.

The biggest banks in the country are in the worst shape, even by their deliberately understated figures. The 48 banks with assets greater than $10 billion have the lowest equity-to-assets ratio and the highest level of non-performing assets of any of the four FDIC bank size categories (see **Table 1**). The equity ratio for the large banks is 30% less than the ratio for the smallest banks, those with assets of less than $100 million. The biggest banks also have the worst equity to non-performing assets ratio.

FIGURE 2

Failures of FDIC-insured banks, 1934-91*

(number of banks)

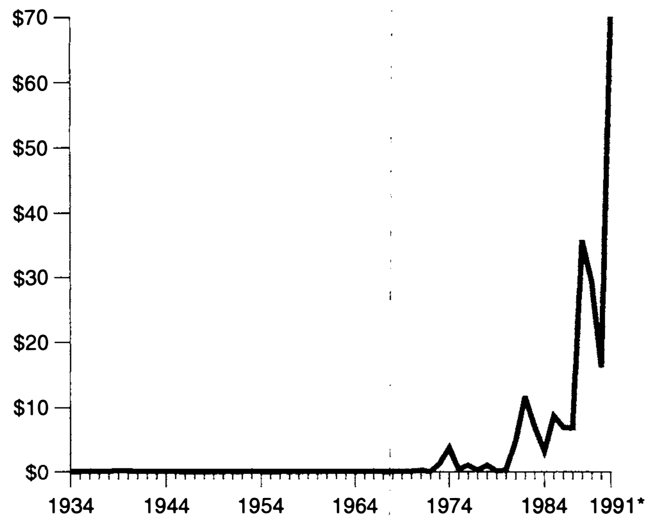


* FDIC estimate
Source: FDIC

FIGURE 3

Assets of failed banks in United States, 1934-91*

(billions $)



* FDIC estimate
Source: FDIC

TABLE 1

Financial status of FDIC-insured banks in the third quarter of 1990

(billions of $)

	Number	Assets	Deposits	Equity capital ratio	NPA*
By size of bank:					
All banks	12,399	$3,381.20	$2,601.73	6.45%	2.65%
> $10 billion	48	1,346.34	952.03	5.01%	3.38%
$1-$10 billion	331	1,037.44	783.45	6.55%	2.49%
$.1-$1 billion	2,653	638.06	548.15	7.80%	1.87%
< $100 million	9,367	359.37	318.10	9.19%	1.73%
By geographic region:					
All banks	12,399	$3,381.20	$2,601.73	6.45%	2.65%
Northeast	1,075	1,326.12	953.97	5.57%	3.73%
Southeast	1,960	498.96	390.10	7.18%	1.75%
Central	2,746	544.20	433.53	7.10%	1.49%
Midwest	2,961	216.17	176.50	8.04%	1.49%
Southwest	2,193	263.28	222.25	6.70%	2.89%
West	1,464	532.47	425.37	6.55%	2.34%

* NPA = noncurrent loans and leases plus other real estate owned, to total assets

Source: FDIC

TABLE 2

Estimated debt defaults in the United States

(trillions $)

Debt category	Amount	Delinquency rate	Estimated default Low	Estimated default High
A. Already in default				
Total debt	13.0			
Private debt	10.0		2.30	3.75
Consumer	3.7			
Mortgages	2.6	5.0%	0.10	0.20
Consumer credit	0.8	4.7%	0.04	0.08
Financial	1.1			
Bonds	0.5	100%	0.50	0.50
Non-financial	3.5			
Corporate	2.1	15%	0.30	0.30
Total already in default			0.94	1.08
B. Potentially defaulting debt				
Mortgages	3.70	33-66%	1.20	2.50
Third World loans	0.25	100%	0.25	0.25
Total potentially defaulting			1.45	2.75
C. Total defaulted debt				
Already in default			0.94	1.08
Potentially defaulting			2.45	2.75
Total estimated default			2.39	3.83

Source: EIR

The 48 largest banks have, according to the FDIC, roughly $67.5 billion in equity capital and roughly $45.5 billion in admitted non-performing assets. Were they to write off these non-performing assets, they would lose 67% of their capital. The banks in the $1 billion to $10 billion range have admitted non-performing assets equal to 38% of equity, compared to 24% for banks in the $100 million to $1 billion range, and 19% in the under $100 million category.

What the banks aren't reporting

What the banks report on their books, however, is but a small part of the story. By comparing the total amounts of debt owed in various categories to the reported delinquency rates for each category, we estimate that between $940 billion and $1.08 trillion of domestic paper assets have already evaporated (see **Table 2**). With the mortgage delinquency rate currently at about 5%, *EIR* estimates that between $100 million and $200 million of the $2.6 trillion of total mortgage debt has already disappeared. We estimate that between $40 billion and $80 billion of consumer credit debt, including credit cards and installment loans, has disappeared. Given that the banks are insolvent and the government has thus far refused to stand behind bank bond holders, we have written off the roughly $500 million in bank debt. Finally, we have written off the entire $300 billion junk bond and highly leveraged transaction debt.

That means that between $940 billion and $1.08 trillion of assets currently being carried on the books of banks, companies, and individuals is unpayable, and will have to be written off. This amount is four to five times the size of the equity capital for the entire U.S. banking system.

This trillion-dollar hole in the financial system will set off a chain reaction of devaluations and defaults. The most significant impact will be on the real estate markets, with $3.7 trillion in mortgages and related real estate debt. Domestic real estate values will likely fall by between 33% and 67%, resulting in a loss of between $1.2 trillion and $2.5 trillion. Add that to the $250 million banks have loaned to Third World, and the probable financial loss to the economy totals between $1.45 trillion and $2.75 trillion.

Thus, with between $940 billion and $1.08 trillion already lost, and the loss of another $1.45 trillion to $2.75 trillion likely, the estimated loss to the financial system is between $2.39 trillion and $3.83 trillion.

The United States currently has some $13 trillion in domestic debt, of which $3 trillion is owed by federal, state, and local governments. That leaves a total private debt—of banks, corporations and households—of $10 trillion, of which 8.6-10% has already evaporated and as much as 23-37.5% is likely to disappear. Overall, the amount of assets which will soon disappear could amount to 22 times the equity capital of the banking system.