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Banking by John Hoefle

Securities holdings hide capital crisis

The increase in U.S. government securities is part of a covert effort to bail out the insolvent banking system.

For the first time in 27 years, the amount of business loans outstanding at U.S. banks has fallen below the amount of government securities held by those banks. In fact, the banks are now the largest purchasers of U.S. government securities.

According to data released on July 24 by the Federal Reserve, U.S. banks held $607.3 billion in U.S. government securities at the end of June, compared to $598.5 billion in commercial and industrial (C&I) loans. During the previous 12 months, the banks' holdings of government securities rose 21%, from $502.4 billion in July 1991. During the same period, the amount of C&I loans shrank 4%, from $623.8 billion.

By comparison, real estate loans rose 1.6% during the period, to $881.0 billion from $867.3 billion, and loans to individuals fell 2.9%, to $360.0 billion from $370.9 billion. Total loans fell by 0.7%, to $2,089.0 billion from $2,095.5 billion.

How loans to businesses and individuals could be shrinking during a period when the Federal Reserve has repeatedly lowered interest rates for the stated purpose of relieving the so-called credit crunch, is an interesting story.

During testimony before the Senate Banking Committee July 21, Federal Reserve chairman Alan Greenspan was grilled by Sen. James Sasser (D-Tenn.) about the banks' preference for buying government securities instead of making loans.

The result of the interest rate cuts, Sasser said, is that the banks are making money "by squeezing the Mom or Pop who has the CD [certificate of deposit] and taking the funds that they get from the Fed at a low rate and then investing them in long-term government bonds. So, in effect, the taxpayers are bailing out the banks . . . and the CD holders are paying the freight on it."

Greenspan responded by claiming that "the major reason for that accumulation [of government securities] is basically a lack of loan demand. In other words, as we pump reserves into the commercial banking system, they either have got to lend it or they've got to put it in securities, because we've pumped up the system. But from what we can evaluate, while I still think there is an element of credit crunch involved in a number of institutions, by far the largest part of the motive for accumulating the securities is a lack of loan demand, rather than an endeavor to invest in government bonds as distinct from making loans."

Greenspan's contention that the banks are being forced to put their money into government securities because they can't find anyone to lend it to is ridiculous. The move into government securities by the banks is a key part of the ongoing covert bailout of the insolvent U.S. banking system.

The benefit of holding government securities instead of loans is clear, if one looks at the capital standards required by the Bank for International Settlements' Basel Committee on Banking Supervision.

Under the Basel Accords, which will be fully in effect at the end of 1992, banks will be required to have $4 of equity capital for every $100 in "risk-weighted" assets. Under the risk-weighting scheme, banks will have to give full weight to business and individual loans, while giving only a 50% weight to home mortgages. Government securities, on the other hand, carry no weight at all.

Thus, for their $598.5 billion in C&I loans, banks must set aside $24 billion in capital, but they do not have to set aside any capital for their $607.3 billion in government securities. By investing so heavily into government securities rather than full-weighted loans, the banks have cut by more then $24 billion, the amount of capital they must have to meet the Basel capital standards.

This is not a trivial figure, representing just over 10% of the $239.3 billion in total equity claimed by U.S. banks as of March 31, 1992. And, as *EIR* has demonstrated, that reported equity figure is a myth; the banking system as a whole is actually hundreds of billions of dollars in the red.

To facilitate this covert bailout, the Federal Reserve Bank of New York recently announced a major restructuring, consolidating the bank's domestic market and foreign exchange operations under Executive Vice President William McDonough. Reportedly, the Fed has begun buying long-term U.S. Treasury bonds in an attempt to lower long-term interest rates.

The Bush administration is doing its part by demanding relaxed bank regulation and increased forbearance.

The United States "must repeal the antiquated laws that prohibit banks from modernizing to meet competitive challenges," Treasury Secretary Nicholas Brady told a meeting of international bankers in June. American banks must be allowed to branch nationwide, and "well-capitalized banking groups" should be allowed to sell underwrite and sell securities and insurance, Brady said.

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