

FSLIC hole deepens, as budget sequestration looms

by Webster G. Tarpley

Behind the scenes at the June 20-21 Toronto Economic Summit, Treasury Secretary James Baker and his team of Bushmen were apparently able to extract commitments from certain financial power centers, including the Japanese, to administer yet another dose of adrenaline and formaldehyde to the putrescent United States dollar. The purpose of these arrangements, which are seen by knowledgeable financial observers as being highly artificial and very short-term, is simply to prevent a crash of the dollar before the November presidential elections in the United States.

Using the obvious types of strong-arm tactics, Baker and his henchmen have seemingly overcome the Japanese reluctance to increase yet again their long positions in the dollar. Japanese traders are now buying dollars, and many of the dollars are being used to buy U.S. Treasury securities. That has furnished an ephemeral stability to the bond market, and the bond market in turn has added a modest impetus to what the British call the "mugs' rally" of the New York Stock Exchange, bringing the Dow Jones Industrial Average to a new post-crash high of around 2,150.

How long can it last? Not long, despite Baker's determination to run the United States Treasury as a demagogic adjunct to the Bush for President Campaign. Even as Baker's latest machinations were becoming evident, the Federal Home Loan Bank Board was announcing a new all-time record loss of \$3.8 billion rolled up by the nation's thrift institutions in the first quarter of the year. On the same day, the Treasury Department released its own set of figures, foreshadowing a budget crisis that will erupt with the Aug. 15 "deficit snapshot" which must be furnished by the Office of Management and Budget (OMB) and the Congressional Budget Office (CBO), according to the provisions of the Gramm-Rudman-Hollings Act. That "snapshot" is due on the same day that

the Republican National Convention opens in New Orleans. There is thus the concrete possibility that the brutal reality of budget sequestration—across the board, automatic cuts, equally divided between defense and non-defense spending categories—may be on the front page at the height of the presidential campaign, raising issues that both Bush and Michael Dukakis would prefer to ignore.

In addition, there remains the issue of the second crash or further recrudescence of financial panic, which Baker's measures are of course designed to postpone at all costs. Baker deludes himself that he is controlling the process, but in reality it is the process that is controlling Baker. If Baker thinks that by jacking the Dow up to 2,150, he has evaded the inexorable forces of depression, he is wrong. During 1930, the post-crash recovery of the Dow Industrials reached the levels seen immediately before the October 1929 crash. In today's terms, that is about 2,250. Therefore, even a further rise of the Dow to 2,250 falls amply within the margins of the "uncanny replay" of 1930—the nemesis from which Bush and Baker are trying to escape.

Crisis at the thrift institutions

On June 21, the Federal Home Loan Bank Board informed the public that between January and March of this year, American savings and loan institutions suffered an aggregate loss of \$3.8 billion, a record high, and substantially up from the previous record loss of \$3.2 billion for the fourth quarter of last year. The thrift "industry" is therefore now losing money at the staggering rate of some \$15.2 billion per year, with a significant acceleration in the rate of loss.

According to James Barth, the chief economist of the Bank Board, 954 unprofitable thrifts lost a total of \$5.106 billion in the first quarter, down slightly from the \$5.129 lost

by 1,098 unprofitable institutions in the previous quarter. This was balanced against a profit of about \$1.3 billion posted by 2,164 profitable thrifts in the first quarter of 1988, compared to a similar profit of around \$1.3 billion by 2,049 profitable institutions in the last quarter of 1987.

The thesis of the Bank Board is that the thrifts are bifurcated into two groups, the solvent ones and the insolvent ones, with the solvent group improving and the insolvent group deteriorating rapidly. Thus, the Bank Board stresses that its Dallas district alone accounts for \$3.9 billion in losses. Inside the Dallas district, 117 Texas thrifts are responsible for fully \$3.3 billion in losses. Most of the 20 "worst offenders" on the loss and insolvency list are in Texas, with losses of about \$3 billion. A single thrift institution, the Sunbelt Savings Association of Dallas, by itself accounted for a loss of \$1.2 billion in the first quarter. According to the Bank Board, a large portion of the losses was generated through "writedowns" of the real estate assets that the thrifts have been carrying on their books.

The Bank Board is upset that the bankrupt thrifts, in order to attract deposits, must pay interest rates that are between 15 and 25 basis points above the money market norms, thus forcing the still-solvent institutions to pay higher interest rates to compete with them.

The Bank Board's own figures indicate that the problem cannot be so narrowly defined. Barth conceded that there are 504 thrifts that are insolvent according to generally accepted accounting principles (GAAP), and these institutions lost a total of \$4.6 billion. The largest concentrations of these totally bankrupt thrifts are in Texas (133), Illinois (54), California (32), Louisiana (29), Florida (20), Ohio (19), and Oklahoma (19)—a pattern of some regional diversity. In addition to the GAAP-insolvent institutions, there is a second group of upwards of 500 thrifts of very little net worth, known among financial observers as the "walking dead." This means that at least a thousand thrifts are in big trouble—about one-third of the total.

The Bank Board concedes that the "insolvent institutions dominate the picture of the industry," but asserts that "we have the funds" to "deal with the seriously troubled institutions." The Bank Board wants to liquidate or merge thrifts to "get the hopelessly insolvent thrifts out of the system" and "get the cost of funds down." The Bank Board's criteria are allegedly to deal with the institutions which are deteriorating fastest, "where the hole is rapidly getting deeper," not necessarily starting with the biggest losers.

The plain fact is that the Federal Savings and Loan Insurance Corporation lacks the funds to reimburse the depositors of all the bankrupt thrifts. The FSLIC says \$22.7 billion would be needed to bail out 511 insolvent institutions; the General Accounting office says the figure is between \$29 and \$36 billion; and non-government estimates begin at \$75 billion. By contrast, when the FSLIC paid out a record \$1.35 billion several weeks ago to wind up two bankrupt S&Ls in

Costa Mesa, California, that expenditure was reported to be about 40% of the FSLIC's cash on hand. In that operation, the agency acquired real estate and real estate loans with a book value of \$607 million. Bank Board head Danny Wall hopes to sell off these assets for \$418 million. But that estimate is more than the FSLIC has realized from such distressed merchandise sales in any recent year. Wall will be attempting to market rental apartments, condominiums, and commercial buildings which the *Wall Street Journal* describes as "the country's least desirable real estate." The very attempt to liquidate such extensive assets may by itself provoke the panic collapse of the U.S. real estate bubble, and drive many more thrifts into bankruptcy.

Selling insolvent thrifts to investors like the Merabank of Phoenix, Arizona is also no solution, since such deals require large, long-term "assistance packages" to protect the buyers from losses on bad loans and foreclosed real estate (about \$84 million in the Merabank deal alone, for only three S&Ls). With thrift losses increasing, there is no way FSLIC can liquidate insolvent thrifts without massively looting the taxpayers.

Gramm-Rudman sequestration ahead

On June 23, just after the Toronto Summit, Beryl Sprinkel of the White House Council of Economic Advisers told the press that the administration's rosy scenario for the economy had turned out to be not rosy enough: "The economy is better than our expectations." But hours later, OMB director James Miller was describing himself as "very concerned" about the specter of Gramm-Rudman sequestration to the tune of at least \$10 billion, after the Aug. 15 snapshot.

The deficit target for FY1989, beginning Oct. 1, is \$136 billion, plus a \$10 billion margin of error. The initial snapshot is to be followed by detailed CBO and OMB reports on the deficit on Aug. 20 and 25, followed by an initial presidential sequestration order, if needed, on Aug. 25, followed by a detailed message to Congress within 15 days. Then there will be revised CBO and OMB deficit estimates on Oct. 10 and 15, followed by the President's final sequestration order on Oct. 15. Quite a wind-up for a presidential campaign!

How deep the trouble is for next year's budget may be gauged from the troubles of this year's budget. Although the Gramm-Rudman limit is \$144 billion (plus the \$10 billion margin of error), the Reagan administration is slyly projecting a \$146.7 billion deficit. But the Congressional Budget Office says it will be at least an illegal \$157 billion. In reality, the first eight months of FY1988, now concluded, have already accumulated a deficit of \$127.49 billion, up from \$119.88 billion in the corresponding period last year. In September, probably starting about Sept. 10 when the Congress receives the detailed automatic cuts order from the White House, the stage is set for a new budget confrontation of a more concentrated kind than that of October-November 1987.