A Shock to the Collective Psyche: Bad News and Bank Runs

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The Bush administration is going to be mailing out more "stimulus" checks in the very near future. There's just no way around it. The Fed is in a pickle and can't lower interest rates for fear that food and energy prices will shoot into the stratosphere. At the same time, the economy is shrinking faster than anyone thought possible with no sign of a rebound. That leaves stimulus checks as the only way to "prime the pump" and keep consumer spending chugging along. Otherwise business activity will slow to a crawl and the economy will tank. There's no other choice.

The daily barrage of bad news is really starting to get on people's nerves; it's obvious everywhere you look. Most of the TV chatterboxes have already cut-out the cheery stock market predictions and no one is praising the "impressive powers of the free market" any more. They know things are bad, real bad. That's why the business news is no longer presented like a happy-go-lucky Bollywood extravaganza with undulating females and exotic music. Now it's more like B-grade slasher movie where everyone winds up dead at the end of the show.

A pervasive sense of gloom has crept into the television studios just like it has into the stock exchanges and the luxury penthouses on Manhattan's West End. It's palpable. That same sense of foreboding is creeping like a noxious cloud to every town and city across the country. Everyone is cutting back on non-essentials and trimming the fat from the family budget. The days of extravagant impulse-spending at the mall are over. So are the big ticket purchases and the trips to Europe. Consumer confidence is at historic lows, disposal income is a thing of the past, and credit cards are at their limit.

In the last three months bank credit has shrunk faster than any time since 1948. The banks aren't lending and people aren't borrowing; that's a lethal combo. When credit-creation slows, the economy falters, unemployment rises and the misery index soars. That's why Bush will mail out a new batch of stimulus checks whether he wants to or not; his back is up against the wall.

On Friday, after the market had closed, the FDIC shut down two more banks, First Heritage Bank and First National Bank. Kaboom. Two weeks earlier, regulators seized Indymac Bancorp following a run by depositors. The FDIC now operates like a stealth paramilitary unit, deploying its shock troops on the weekends to do their dirty work out of the public eye and at times when it will least effect the stock market. The reasons for this are obvious; there's only one thing the government hates more than seeing flag-draped coffins on the evening news, and that's seeing long lines of frantic people waiting impatiently to get what's left of their savings out of their now-deceased bank. Lines at the bank signal that the system is broken.

Banks-runs are a shock to the collective psyche. When depositors see a bank run they realize that their money is not safe. People aren't fools; they can smell a rat. When their confidence wanes, it extends to the whole system. Suddenly they start questioning everything they once took for granted. They become skeptical of the institutions which, just days earlier, seemed rock-solid.

Bank runs are a direct hit on the foundation of the free market system. Unchecked, the tremors can ripple through the entire society and trigger violent political upheaval, even revolution. The public may not grasp their significance, but everyone in Washington is paying attention. They take it seriously, very seriously.

An article in the San Francisco Business Times said that the FDIC is worried about the reporting on Internet blogs. They'd rather keep the information about the troubles in the banking system out of the news. Sheila Bair, chairman of the Federal Deposit Insurance Corp., summed it up like this after the run on Indymac:

> "The blogs were a bit out of control. We're very mindful of the media coverage and blogs in controlling misinformation. All I can say is were going to continue to stay on top of it. The misinformation that came out over the weekend fed a lot of depositors' fears."

Is that a threat? The cure for a failed banking system is adequate capital and prudent oversight not threats to impartial critics of the system. That's balderdash. Commissar Blair apparently believes that bloggers should be treated the same way as journalists in Iraq, who, if they veer ever so slightly from the Pentagon's "the surge is a great triumph" script, find themselves on the smoky end of an M-16 at some unmarked checkpoint outside Baquba.

Last Sunday, sought Treasury Secretary Henry Paulson tried to reassure the public that the banking system is sound, while bracing people for more trouble ahead:

> "I think it's going to be months that we're working our way through this period — clearly months. But again, it's a safe banking system, a sound banking system. Our regulators are on top of it. This is a very manageable situation."

Paulson is wrong; the banking system is not sound nor is it well capitalized.

If the rate of bank closures continues at the present pace, by the middle of 2009 their will be restrictions on withdrawals. Bet on it.

Journalist Bill Sardi summed it up nicely in an article last week on lewrockwell.com titled "Could Your Bail Fail?":

> So, while your bank still has money and can process your checks, it may be time to pay down debts, pay quarterly taxes and mortgage payments in advance, and think of having money outside of banks (gold, foreign currencies), etc., before your money is inaccessible or even evaporates! Don't think all your investments outside of banks are immune from all this turmoil.

For example, money market mutual funds, where Americans have invested $3 trillion, are not covered by FDIC insurance (however, money market accounts offered by banks are covered). Recent losses in some of these money market mutual funds have caused some companies to rush to plug the losses. For example, Legg Mason Inc. and SunTrust Banks Inc., recently pumped $1.4 billion each into its money market funds. Bank of America Corp. has injected $600 million.

As for your checking and savings accounts, recognize you may have five different accounts in the same bank, but the FDIC only insures individuals, not each account, up to $100,000. Putting your money in different accounts in the same bank does not necessarily provide better insurance for your deposits.

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