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RECESSION: The Decimation of Bank Profits

Falling revenues, increasing losses, profits adrift...

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Falling revenues, increasing losses, profits adrift: this is the Western banking background in late 2011! And yet all this is happening in a very favorable context for banking institutions' balance sheets who continue to assign their own prices to their assets (using the accounting tricks of « hold to maturity » (1) – or « fair value »). But even this may not last more than a further quarter or two … because of Greece and Euroland! And yes, they really are the causes of something very damaging to the banking model of recent decades, but not in the sense that Wall Street and the City would want to believe, i.e. because the Euroland banks would collapse dragging down the whole world with them (so far, only Wall Street and the City in 2008 gave us a banking system collapse, sealed off – for a time – by a raid on taxpayers' money (2)). No, if there really is Greek and Euroland responsibility, it's in Euroland's willingness to require creditors to include the losses in their balance sheets, putting pressure on the banks to take on a substantial portion of these losses. This wasn't done in 2008. Greek debt is now at a 50% discount. But Greece is but a drop in the ocean of coming bank losses: the entire Western banking system floats on a sea of more than doubtful debts.

US consumer credit (1961-2011) (brown: revolving credit / blue: non-revolving credit / yellow: student loans) – Source: Econompic, 10/2011
Primarily US residential property, which is at a 50% discount at least, and which will be unlikely to see any increase in prices before 2020 (3). Then we have the Irish residential property, Spanish (4), Portuguese, all at the same level, but obviously in smaller numbers overall. Then commercial real estate, which will plunge again with the confirmation of the global recession and the current US and UK depressions. Then, there are local and national authority insolvencies which, de facto, depreciate the banks' true balance sheets even more ("Munis" in the United States (5), public debt in Europe (6)). Finally, we come to the core of a multitude of financial assets (including consumer credit (7) in a context of unemployment (8) and an unremitting recession (9) and business failures (10)), most of which are worth nothing at all because, in fact, they have no real counterpart. These are the 15 trillion USD of ghost-assets going up in smoke during this half year and during 2012 it will be the trillions (difficult to quantify exactly) of CDS which are at the heart of many major Western banks' markets (which has been one of Wall Street and the City's cash cows for years). The closely hidden connections between the major Western banks, hedge funds, in complete disarray since the summer of 2011 (11) and the "black" side of global financial markets (dark pools) prevent regulators and policy makers even more from assessing the extent of the bank shock in the making (12).

One thing is certain for our team: If the Western banks provoke fear today, it is primarily in their own leaders who no longer know how to get out of the death trap in which they themselves are caught, believing that they were able to "manage" all events, with "tractable" (13) politicians and controlled in their service, and crony central banks (14). Yet this time, politicians, even chosen for their docility, are showing reluctance. Even the French President Nicolas Sarkozy is no longer able to defend French banking interests (15) at a European level (16) on a permanent basis. Under these conditions, there is no longer a way for banks to contemplate a preservation of their profits pared on all sides: increased regulation affecting the most profitable areas, an economic crisis reducing classic business activity, increased competition between institutions and between regions even at the West's core (17), reduction of their socio-political "weight" because of reduced staff, funding capacity at half-mast, and balance sheets sinking more and more sharply into the "red" (18).

Notes:

(1) The longer the crisis lasts, the greater the maturity value becomes a problem for bank balance sheets (as well as other financial players) because the continuing recession and falling asset values involves a balance sheet collapse. And these are not "playground" comparisons to see who has the biggest reserves that will make the difference in this area given the gulf that separates these reserves from the recapitalization needs generated by the unremitting collapse in the value of assets held by the banks.

(2) A hold-up done in a hurry, without taking the time to think, with neither parliamentary nor democratic debate. This same time that Euroland is supposed to "lose" in its laborious path towards common decisions, full of all-out discussions on the relevance and effectiveness of the likely options.

(3) Source: CNBC, 01/10/2011

(4) In Spain the real estate crisis has begun to catch up with the banks. Source: New York Times, 22/09/2011

(5) 46 out of 50 American States are insolvent and the risks of city bankruptcies are growing rapidly, like the recent bankruptcy of the Pennsylvania capital, Harrisburg. Sources: Economic Policy Journal, 12/09/2011; Washington Post, 13/10/2011

(6) Thus "toxic" loans have infected more than 5,500 local authorities in France, as well as Belgium and Luxembourg. This has led directly to the breakup of Dexia, with a takeover or guarantee by the public. States cannot "afford" more than one or two failures of this type. Sources: Le Monde, 21/09/2011; Irish Times, 11/10/2011

(7) The US consumer's insolvency remains topical with an average rate of indebtedness of 154%. The salvation of the US economy and its banks will be not, therefore, come from household consumption. On the contrary for the banks, since the non-repayment of loans are rising. Sources: USAToday, 02/10/2011; MarketWatch, 05/10/2011

(8) In the United States in particular, the weakness of the social safety net literally throws out the unemployed from the status of consumer. With six million unemployed reaching the end of their benefits in 2012, in a context of political deadlock in Congress to extend their benefits, US household spending, already faltering, will sink further into negative territory.

Meanwhile, US employers expect a sharp increase in layoffs in the coming months. But in Germany as well, the economy has broken down with the inevitable consequences for growth and the banks.Sources: CNNMoney, 12/10/2011; Los Angeles Times, 06/10/2011; Deutsche Welle, 15/10/2011

(9) Symbol of the enduring depression in the United States, the GAP brand has just announced the closure of 20% of its US stores … whilst it's opening new ones in China. And changes in US household income is clear-cut. Between the official "end" of the recession in June 2009 and June 2011, US household incomes fell 6.7%! Besides German investors now believe that the US market is riskier than those in the Middle East and Latin America and it has no growth prospects. Yet it's information that you won't find in mainstream media headlines while the study was financed by Goldman Sachs.Sources: USAToday, 15/10/2011; New York Times, 09/10/2011; New Khabrein, 21/09/2011

(10) Source: Reuters, 11/10/2011

(11) Even the « pontiff » of hedge funds, John Paulson, has ended up with huge losses. Source: CNBC, 11/10/2011

(12) A parameter for distinguishing these opaque but real links between the two faces of the financial sector: the layoff epidemic that now affects them. The laying off of the financial sector secondary players is more low profile news-wise than that of the big banks, but it's accelerating and reflects a collapse of the entire sector's business model. Wall Street, like the City is currently the scene of a growing jobs purge in this sector. Sources: « More jobs expected to go in the Square Mile », Financial Times, 14/10/2011; Le Monde, 11/10/2011

(13) According to an eminent banker.

(14) The Fed is now out of ammunition and paralyzed in terms of an exit via a massive printing of dollars. See previous GEAB issues. The ECB oscillates between its mandate, its "bancophilia" and increasing political pressure, particularly sent by public opinion against any new illicit bank rescue. Even if Jean-Claude Trichet, who has had better inspiration, is trying to play off a reflex of fear at European political leader level, calling Europe the epicenter of the crisis and a European systemic crisis . By mixing anything and everything, we create panic, but no understanding: it's a feature of the strategy followed by the Western banking lobby for the last three years. Our team remembers, however, that it pointed out to ECB officials in the first half of 2011 that the crisis couldn't wait quietly for 2013 for the EFSF to be strengthened and made permanent and in fact it would have to be done by autumn 2011. At the time, not that long ago, the ECB thought it could wait, and it was wrong. If we could anticipate this development, it's because it seems clear to us that the accelerated deterioration of the economic, financial, budgetary, social and political situation in the United States from the summer of 2011 would trigger a series of shocks undermining investor confidence even further and reinforcing the absolute necessity to "buy time" for the United States and the United Kingdom, including at the expense of the "European ally." There is in fact one epicenter of the current crisis: it's the United States as we have analyzed since 2006, a key element of our ability to anticipate changes in the crisis. And if there really is a European systemic crisis it's a second-rate event which is due to the maladaptation of Euroland's current institutional and political process which has been ignored for ten years to the benefit of the mechanisms of the EU 27, totally ineffective to deal with Euroland problems. On this subject, there has been an undeniable systemic improvement for the last 18 months. As regards the systemic European decision-making

crisis, such a statement by Mr. Trichet in 2007/2008 would have been helpful. Now it's rather like yelling fire after the fire-fighters have arrived.

(15) For which the battle of numbers on the recapitalization issue shows the sector's complete opacity. Source: La Tribune, 07/10/2011

(16) It just manages to complicate and slow the definition of common positions with Germany and the rest of Euroland.

(17) Euroland banks are now at open war with their Anglo-Saxon counterparts, against a background of orchestrated attempts by the latter to destabilize and / or suffocate them. And 2012 will see a new front opening between the City and Wall Street on the one hand, because the market will continue to shrink, making it impossible to keep "two Anglo-Saxon hearts" at the core of the global financial system, and between the City, Wall Street and Euroland on the other hand, because the Euroland banks, pushed by their governments, will gradually cease to lend in US Dollars to concentrate on loans in Euros, including the trade in raw materials (oil included). The violent and sharp crises leave no room for the nostalgia of past partnerships. This will be the start of the Western financial market's final fragmentation, one of the last stages of Euroland's development and a new fatal blow to financial institutions having built their business model on the transatlantic financial partnership. We'll return to this very important point in GEAB N ° 59 regarding the United States and Euroland's future.

(18) In fact, apart from retail banking, 2012 will show that there is virtually no profitable segment for the banking sector.
