Wall Street sheds jobs amid talk of bank failures

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Job losses on Wall Street are set to escalate as Goldman Sachs, the best performing of the major banks, began implementing a series of layoffs last week. The bank intends to cut 10 percent of its workforce in mergers and acquisitions advice and corporate fund raising, aside from its normal workforce rotation.

The layoffs come on top of rival Citigroup's 10 percent reduction of its investment banking workforce, as well as other cuts throughout the financial sector. Adekunle Ademakinwa, a credit strategist at Deutsche Bank, recently said that, given further market turbulence, "[T]he overall available profit pool going forward is too small to support the current size of the financial sector. The only outcomes are either defaults or ...consolidation. The latter is the better of two evils."

Meanwhile, bond insurers—known as monolines—are under increasing pressure. Ambac and MBIA, the two such largest firms, lost their AAA credit ratings last week, resulting in cascading downgrades on the debt they insure. With other options cut off, the firms have sought to recover their creditworthiness by requesting that banks "commute" insurance policies on over $125 billion of assets in order to prevent broader damage to the financial system.

Turbulence in the monoline sector has intensified as falling real wages and rising unemployment have led to increased default rates on all forms of debt. Delinquencies on home-equity loans have reached record levels, and late payments on auto loans issued by dealerships are at their highest level in 18 years, according to the American Bankers Association. The home mortgage delinquency rate has now reached 2.24 percent, according to the FDIC.

Meanwhile, the downward real estate price spiral, which started with sub-prime home mortgages, has spread into commercial real estate, dealing further damage to bank balance sheets. Wachovia senior economist Ryan Lentell recently predicted that commercial real estate prices would fall by 15 to 20 percent. The four major Wall Street firms held some $84 billion of commercial real estate loans last year and have written down the values of these holdings by $7 billion in the past 18 months.

House prices have continued to fall. The most recent S&P/Case-Shiller index statistics show that home values plunged by 15.3 percent year-on-year in April, the sharpest fall on record. Harvard University's latest "State of the Nation's Housing" report, published Monday, notes that homeowner equity fell by 6.5 percent in 2007. Meanwhile consumer confidence figures have reached their lowest level in 16 years.

Paul Kasriel, an analyst at Northern Trust Securities, observed, "We are not finished with the mortgage problem, but you are starting to see increased delinquencies in other forms of consumer debt." He continued, "we are in the eye of the hurricane. We had the first wave of the credit crisis, and it was quite damaging. But there's another wave coming, and it's likely to be as destructive."

As default rates skyrocket, banks—especially smaller ones—have encountered serious difficulties raising capital. Investors have become wary of holding bank stocks, as prices have plummeted in recent weeks by as much as 40 percent. "The window for capital-raising is closing," Brad Evans, a portfolio manager who works with regional banks, told the *Wall Street Journal*. "Investing in a bank right now means investing in a large portfolio of loans that are essentially a black box."

Washington Mutual, the United States' largest Savings and Loan association, received a capital

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infusion of $7 billion from a private equity firm in April at about $13 per share. The firm's stock was trading at about $5.80 on Tuesday. Earlier in the year, Federal Reserve chairman Ben Bernanke warned that there bank failures would likely crop up as the downturn intensifies. This prediction is now coming true, as some small banks have already folded and others are finding it ever harder to keep afloat. In keeping with the Fed's policy, this will likely end with further bailouts by the federal government. As the *Wall Street Journal* reported Monday, "If problems at US banks worsen, the federal government—in other words, taxpayers—is likely to be on the hook for sorting out much of the mess."

These developments hang in the air as the Federal Reserve Open Market Committee is set to meet on Wednesday. All 101 economists questioned in a recent Bloomberg survey said they expect the Fed to keep rates unchanged at the meeting. Increasing inflation—which reached 4.2 percent year-to-year in May—and skyrocketing gas prices have led the Fed to hint that it will raise rates in the future, but the new threats to bank solvency, surging default rates and rising unemployment are pushing against such action.

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