Behind the US banks' profit reports

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The recent spate of better-than-expected earnings reports by major US banks is a testament, not to a strengthening of the basic economy as a result of the government's bailout program, as the Obama administration would have the American people believe, but rather to the undiminished rapaciousness of the bankers.

The trillions of dollars in cash, virtually interest-free loans and government guarantees the banks have been given with no strings attached first by Bush and now by Obama, have, not surprisingly, begun to register as handsome profits on major banks' balance sheets.

Emboldened and confident, based on the financial policies of the Obama administration and the Wall Street personnel who are carrying them out, that they have a pliant instrument of their interests in the White House, the financial barons are employing the same deceptive accounting procedures and gambling with borrowed money that precipitated the crisis in the first place. They are combining these methods with an escalation of predatory policies that threaten millions of workers with destitution.

In recent days, bank CEOs like Jamie Dimon of JPMorgan Chase and Lloyd Blankfein of Goldman Sachs have issued what amount to ultimatums to the government that they will refuse to collaborate further in its restabilization schemes unless it drops even the mild limits on executive pay and other restrictions it imposed in return for cash infusions under the $700 billion Troubled Asset Relief Program (TARP). They want to repay the bailout money they received last October so they can free their hands to wage economic war against surviving rivals, such as Citigroup and Bank of America, which are in worse financial straits than they are.

Given the repeated assurances by Obama and his top economic advisers that they will do "whatever is necessary" to keep the big banks afloat and keep them in private hands, the bankers have every reason to be as arrogant as they are confident. They have been given a carte blanche by the state.

Amidst reports that the banks are ramping up their foreclosures of distressed homeowners and sharply raising interest rates and fees on credit cards, some of the biggest institutions over the past week reported strong profits for the first quarter of 2009. Wells Fargo projected a record quarterly profit of $3 billion, ahead of the actual release of its earnings report next week.

On Monday, Goldman Sachs issued its quarterly report, showing a profit of $1.8 billion. It used this unexpectedly strong showing to sell $5 billion worth of stock the next day, as part of its plan to pay back the $10 billion it received in TARP money.

This was followed by Thursday's report by JPMorgan Chase of a $2.14 billion profit, which it used to carry out a successful sale of $3 billion in bonds not insured by the Federal Deposit Insurance Corporation (FDIC). Since last fall, the FDIC has been guaranteeing the debt offerings of the banks, thus far allocating more than $300 billion in another huge windfall, ultimately to be paid for by the taxpayers.

CEO Dimon told a conference call that he wanted to pay back his $25 billion in TARP money as soon as the government would allow him to do so, calling it a "scarlet letter" and promising to refuse any further government assistance.

On Friday, Citigroup, which has received $45 billion in TARP money plus a government guarantee on more than $300 billion of its toxic assets, announced a profit of $1.59 billion for the first quarter. It was the bank's first reported profit in more than a year. Since the credit bubble burst in late 2007, the company, which speculated heavily in subprime mortgages and related securities, has posted net losses of more than $28 billion.

The profit reports follow a five-week run-up on the stock market, led by financial stocks, which roughly tracks a series of initiatives announced by the Obama administration to further bolster the banks and protect the wealth of the financial elite. These include Treasury Secretary Timothy Geithner's plan to allocate up to $1 trillion in public funds to subsidize hedge funds and other financial companies that buy the banks' toxic assets at inflated prices, with the government virtually guaranteeing double-digit profits for the firms that buy the banks' assets and the public assuming virtually all of the risk.

The Geithner plan coincided with the intervention by Obama and his top economic advisors to squelch legislation in Congress that would have imposed a surtax on executive bonuses awarded by bailed-out companies, such as the insurance giant American International Group (AIG).

It was followed by the decision of the Financial Accounting Standards Board (FASB) to weaken "mark-to-market" accounting rules so as to allow the banks to vastly inflate the value of illiquid home loans and other bad debts on their balance sheets. This move not only allows the banks to manipulate their balance sheets so as to conceal losses and boost reported profits, it also gives them greater leeway to borrow money for speculative purposes.

Even a cursory examination makes clear that there is a large element of deceptive accounting in this week's bank profit reports. Some, if not all, of the banks made use of an obscure accounting rule change enacted several years ago that allows them to book as a gain a decline in the market evaluation of their outstanding bonds, the result of investor concerns about their financial health. According to one press report, this gimmick may account for as much as a third of Wells Fargo's reported first quarter profit. On the same basis, Citigroup posted a one-time gain of $2.5 billion.

Goldman Sachs omitted from its earnings reports the month of December, when it lost more than a billion dollars, on the pretext of a change in the starting month of its fiscal year.

It is not clear to what extent the FASB rule change on "mark-to-market" accounting contributed to the banks' first-quarter profit reports. But it is well known that the banks are essentially concealing many billions of dollars in bad loans and other toxic assets.

It is estimated that US banks are still holding some $1 trillion in bad home loans and mortgage-backed assets that they have not downgraded. They are reportedly holding another trillion dollars in questionable assets related to commercial real estate, credit cards, auto loans and other consumer debt.

The banks refuse to either account for these bad debts or sell them off, so as to avoid having to absorb further write-downs and losses. Instead, according to a Goldman Sachs analysis, the banks are valuing their mortgage-backed assets at the absurdly high level of 91 cents on the dollar.

Meanwhile, the banks have refused to significantly increase their lending to other businesses or consumers—the ostensible purpose of the government bailout. As the financial Web site RGE Monitor noted on Wednesday, "[I]n the real economy credit growth to the private sector has continued to slow at a fast pace in the US...."

A second major factor in the improved earnings of the banks is reduced costs resulting from mass layoffs. US financial firms have laid off more than 400,000 employees over the past two years, and 148,000 in the final quarter of 2008 alone. In its report, Citigroup said it had cut the size of its work force to 309,000 people from 374,000 at its peak—a reduction of more than 17 percent. The bank has laid-off 13,000 people just since the end of 2008.

A third source of improved earnings is an escalation of the banks' direct attacks on working people. Having been assured that they will face no opposition from the Obama administration, the banks have intensified their drive to foreclose on delinquent home owners. They have also begun to sharply ramp up their credit card charges. The *Detroit Free Press* reported Friday that some 4 million Bank of America customers were notified in the past week that their annual percentage rate will jump from less than 10 percent to a range of 14 percent to 16 percent. For some customers, the newspaper said, the changes mean a doubling of rates.

Beyond these factors, the banks have been able to take advantage of certain profit opportunities thrown up by the worsening economic and social crisis. One major source of increased revenues was a spurt in mortgage refinancings. This was made possible by the Federal Reserve's drive to lower mortgage rates by massively increasingly the volume of dollars in circulation and adding another trillion dollars of debt to its balance sheet, a policy that will eventually rebound on the public in the form of inflation and massive cuts in social programs.

At the same time, the collapse in home prices and household savings, and the escalating wave of layoffs have provided an unlimited supply of working people desperate to lower their monthly mortgage payments by extending their loans and, over time, giving the banks an even bigger share of their income.

In the case of Well Fargo, which is based in California, the catastrophic fall in house prices has led to a certain uptick in new mortgages, a lucrative source of profit. A major portion of the new home sales are of foreclosed properties.

All three of the banks that issued quarterly reports registered strong gains in the bond and currency trading departments. This, however, was largely an expression of the general financial turmoil. Speaking of Goldman Sachs, *Financial Times* columnist John Gapper wrote on Thursday, "Yet its fixed income and currencies trading desks have exploited the wide spreads caused by market disarray to make more money than ever."

All three banks that released their earnings reported a huge increase in credit losses from delinquent or defaulted home loans, credit card debt and other consumer loans, and they warned of more to come as the unemployment rate continues to rise.

Nouriel Roubini, professor of economics at New York University's Stern School of Business, aptly summed up the state of affairs as follows: "In brief, banks are benefiting from close to zero borrowing costs and fewer competitors; they are benefiting from a massive transfer of wealth from savers to borrowers given a dozen different government bailout and subsidy programs for the financial system; they are not properly provisioning/reserving for massive future loan losses; they are not properly marking down current losses from loans in delinquency; they are using the recent mark-to-market accounting changes by FASB to inflate the value of many assets; they are using a number of accounting tricks to minimize reported losses and maximize reported earnings; the Treasury is using a stress scenario for the [bank] stress tests that is not a true stress scenario as actual data are already running worse than the worst case scenario."

The banks are continuing, with the blessings of the Obama administration, the same predatory policies that generated massive fortunes on Wall Street and eventually plunged the US and world economy into the deepest crisis since the Great Depression.

In his *Financial Times* column, John Gapper gave an example of the continuity between the pre- and post-crash policies of the banks. "Mr. Blankfein," he wrote, speaking of the Goldman Sachs CEO, "criticized Wall Street's past pay practices as 'self-serving and greedy,' but Goldman is still putting aside 50 percent of revenues—$4.7 billion in the first quarter—for the bonus pool. Inside, it may feel 'humbled,' as Mr. Blankfein said, but it looks like the same old bank.

"Once it has repaid the $10 billion, Goldman hopes to go back to paying employees what it wants, buying and selling more or less what it fancies and operating as before."