Financial Crisis: The Next Big Bank Bailout is on the Way

By Mike Whitney

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Housing is on the rocks and prices are headed lower. That's not the consensus view, but it's a reasonably safe assumption. Master illusionist Ben Bernanke managed to engineer a modest 7-month uptick in sales, but the fairydust will wear off later this month when the Fed stops purchasing mortgage-backed securities and long-term interest rates begin to creep higher. The objective of Bernanke's $1.25 trillion program, which is called quantitative easing, was to transfer the banks "unsellable" MBS onto the Fed's balance sheet. Having achieved that goal, Bernanke will now have to unload those same toxic assets onto Freddie and Fannie. (as soon as the public is no longer paying attention)

Bernanke's cash giveaway has helped to buoy stock prices and stabilize housing, but market fundamentals are still weak. There's just too much inventory and too few buyers. Now that the Fed is withdrawing its support, matters will only get worse.

Of course, that hasn't stopped the folks at Bloomberg from cheerleading the nascent housing turnaround. Here's a clip from Monday's column:

"The U.S. housing market is poised to withstand the removal of government and Federal Reserve stimulus programs and rebound later in the year, contributing to annual economic growth for the first time since 2006. Increases in jobs, credit and affordable homes will help offset the end of the Fed's purchases of mortgage-backed securities this month and the expiration of a federal homebuyer tax credit in April. Sales will rise about 6 percent this year, and housing will account for 0.25 percentage point of the 3.6 percent growth, according to forecasts by Dean Maki, chief U.S. economist for Barclays Capital in New York…"The underlying trend is turning positive," said Bruce Kasman, chief economist at JPMorgan Chase & Co. in New York."

Just for the record; there has been no "increases in jobs". It's baloney. Unemployment is flat at 9.7 percent with underemployment checking-in at 16.8 percent. There's no chance of housing rebound until payrolls increase. Jobless people don't buy houses.

Also, while it is true that the federal homebuyer tax credit did cause a spike in home purchases; it's impact has been short-lived and sales are returning to normal. It's generally believed that "cash for clunker-type" programs merely move demand forward and have no meaningful long-term effect.

So, it's likely that housing prices–particularly on the higher end–will continue to fall until they return to their historic trend. (probably 10 to 15% lower) That means more trouble for the banks which are already using all kinds of accounting flim-flam ("mark-to-fiction") to conceal the wretched condition of their balance sheets. Despite the surge in stock prices,

the banks are drowning in the losses from their non performing loans and toxic assets. And, guess what; they still face another $1 trillion in Option ARMs and Alt-As that will reset by 2012. it's all bad.

The Fed has signaled that it's done all it can to help the banks. Now it's Treasury's turn. Bernanke will keep the Fed funds rate at zero for the foreseeable future, but he is not going to expand the Fed's balance sheet anymore. Geithner understands this and is working frantically to put together the next bailout that will reduce mortgage-principal for underwater homeowners. But it's a thorny problem because many of the borrowers have second liens which could amount to as much as $477 billion. That means that if the Treasury's mortgage-principal reduction plan is enacted; it could wipe out the banks. Here's an excerpt from an article in the Financial Times which explains it all:

"A group of investors in mortgage-backed bonds dubbed the Mortgage Investors Coalition (MIC) recently submitted to Congress a plan to overhaul the refinancing of underwater borrowers by writing down the principal balances of both first and second mortgages. The confederation of insurers, asset managers and hedge funds hope to break a logjam between Washington DC and the four megabanks with the most exposure to writedowns on second lien mortgages, including home equity lines of credit.

The private sector initiative coincides with House Financial Services Committee Chairman Barney Frank's open letter dated 4 March to the CEOs of the banks in question – Bank of America, Citigroup, JP Morgan Chase and Wells Fargo – urging them to start forgiving principal on the second lien loans they hold.

But the banks are unlikely to take action until they get new accounting guidance from regulators that would ease the impact of such significant principal reductions on their capitalization ratios."

(Ed.–"Accounting guidance"? Either the banks are holding out for a bigger bailout or they're looking for looser accounting standards to conceal their losses from their shareholders. Either way, it's clear that they're trying to hammer out the best deal possible for themselves regardless of the cost to the taxpayer.)

Financial Times again: "The four banks in question collectively own more than USD 400bn of the USD 1trn in second lien mortgages outstanding. BofA holds USD 149bn, Citi holds USD 54bn, JP Morgan holds USD 101bn and Wells Fargo holds USD 115bn, according to fourth quarter 2009 10Q filings with the Securities & Exchange Commission.

As proposed, the MIC's plan entails haircuts to the first and second lien loans to reduce underwater borrowers' loan to value ratios to 96.5% of current real estate market prices, according to two sources close.

For the program to work, HAMP would place principal balance forgiveness first in the modification waterfall. The associated second lien would take a principal balance reduction but remain intact through the process – ultimately to be re-subordinated to the first lien, the sources close said.

A systemic program to modify second lien mortgages called 2MP does exist but Treasury has stalled on implementation because the banks that hold them can't afford it, six buyside investors said. The sources all said implementation of the program, called 2MP, would result

in “catastrophic” losses for the nation’s four largest banks, which collectively hold more than USD 400bn of the USD 1trn in second lien mortgages outstanding.” (“Mortgage investors push for banks to write down second liens”, Allison Pyburn, Financial Times)

Hold on a minute! Didn’t Geithner just run bank “stress tests” last year to prove that the banks could withstand losses on second liens?

Yes, he did. And the banks passed with flying colors. So, why are the banks whining now about the potential for “catastrophic” losses if the plan goes forward? Either they were lying then or they’re lying now; which is it?

Of course they were lying. Just like that sniveling sycophant Geithner is lying.

According to the Times the banks hold $400 billion in second lien mortgages. But –as Mike Konczal points out–the stress tests projected maximum losses at just “$68 billion. In other words, Geithner rigged the tests so the banks would pass. Now the banks want it both ways: They want people to think that they are solvent enough to pass a basic stress test, but they want to be given another huge chunk of public money to cover their second liens. They want it all, and Geithner’s trying to give it to them. Wanker.

And don’t believe the gibberish from Treasury that “they have no plan for mortgage principal reductions”. According to the Times:

“Treasury continues to tell investors that any day now they will be out with a final program and they will be signed up”….“The party line continues to be they are a week away, two weeks away,” the hedge fund source said. ”

So, it’s not a question of “if” there will be another bank bailout, but “how big” that bailout will be. The banks clearly expect the taxpayer to foot the entire bill regardless of who was responsible for the losses.

So, let’s summarize:

1–Bank bailout #1–$700 billion TARP which allowed the banks to continue operations after the repo and secondary markets froze-over from the putrid loans the banks were peddling.

2–Bank bailout #2–$1.25 trillion Quantitative Easing program which transferred banks toxic assets onto Fed’s balance sheet (soon to be dumped on Fannie and Freddie) while rewarding the perpetrators of the biggest financial crackup in history.

3–Bank bailout #3–$1 trillion to cover all mortgage cramdowns, second liens, as well as any future liabilities including gym fees, energy drinks, double-tall nonfat mocha’s, parking meters etc. ad infinitum.

And as far as the banks taking “haircuts”? Forget about it! Banks don’t take “haircuts”. It looks bad on their quarterly reports and cuts into their bonuses. Taxpayers take haircuts, not banksters. Besides, that’s what Geithner gets paid for–to make sure bigshot tycoons don’t have to pay for their mistakes or bother with the niggling details of fleecing the little people.

The next big bailout is on the way. Prepare to get reamed!

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