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Paulson's \$100 billion "Bankers Bankruptcy Fund" and the G-7 Fiasco

By Mike Whitney

10/22/07 "**ICH**" -- -Friday's bloodbath on Wall Street proved that the troubles in the credit markets have not been relieved by the Fed's rate cuts. The Dow Jones slipped 367 points on the 20th anniversary of Black Monday, the stock market's biggest one-day loss in history. Since Friday, Asian markets have plunged; stocks are down sharply in Japan, Australia, Hong Kong, Indonesia, the Philippines, Taiwan and South Korea. The global sell-off is a reaction to ongoing problems in the subprime market and deeper-rooted systemic issues related to the US's structured-debt model.

The sudden downturn in the stock market provided a fitting backdrop for Treasury Secretary Paulson's appearance at the G-7 meetings in Washington DC. Paulson has largely shrugged off the decline in housing and the growing volatility in the equities markets. As the representative for the world's biggest economy, Paulson instructed the other nations on how best to adjust their currencies and on the dangers of "sovereign wealth funds". No one was listening. Foreign ministers and central bankers are less receptive to the scolding of US officials. America needs to put its own house in order before it gives advice to anyone else.

What everyone at the meetings really wanted to know was why the United States destabilized the global economic system by selling hundreds of billions of dollars of worthless mortgage-backed securities to banks and pension funds around the world? Aren't there any regulators in the US anymore?

And how Paulson going to make amends to the institutions and investors who lost their shirts in this massive mortgage-scheme?

Unfortunately, the Treasury Secretary didn't address any of these questions. He offered no recommendations for fixing the problems in the credit markets and he refused to explain what he would do to shore up the faltering dollar. Instead, he reiterated the same lame mantra that the US follows a "strong dollar policy".

Baloney. The Federal Reserve has been trashing the greenback for the last 7 years without pause. Paulson needs to rethink his approach and start telling the truth. Markets thrive on credibility and transparency; that's what strengthens investor confidence. If Paulson thinks that the people are dupes; he's in for a shock.

Last month's net foreign inflows show how quickly capital can evaporate when confidence is lost. Foreign investors pulled \$163 billion out of US securities and Treasuries in August alone. Net capital inflows have turned negative and that money won't be returning until the United States shows that it's "got its act together".

Are you listening, Henry?

The multi-trillion dollar subprime swindle was the greatest financial fraud in history. Investors are looking for accountability. They want to hear someone in the Bush administration and at the Central Bank stand up, take responsibility, and offer concrete regulatory changes to fix the system.

Are you listening, Henry?

No one is interested in another scam like the new \$100 billion "Bankers Bankruptcy Fund". All that does is provide the over-extended and under-capitalized investment banks another chance to dump their poisonous Mortgage-backed slop on the gullible public. Forget about it. That plan needs to be tossed in the circular receptacle. If Paulson really wants to know what people think about his new Mega-fund he should listen to Nick Parsons, the head of markets strategy at National Australia Bank. Parsons summed up the fund's goals saying:

"By insulating the junk from the sellers of junk, the holders of junk should be spared the problems of junk. The one flaw in this cunning plan, however, would be if investors took fright at being reminded just how much junk is still in the system."

Parsons is right. Junk bonds are still junk whether they're logged on an SIV's debit-sheet or wrapped in Treasury Dept red-ribbon. What difference does it make? It's still garbage. Write down the losses and get on with it.

It's worth noting that Paulson—who felt vindicated in reproaching China for currency manipulation; also blasted Iran saying,

"We discussed ways to deal with Iran's pursuit of a nuclear capability and ballistic missiles, its vast financial support to lethal terrorist groups, and the deceptive financial tactics employed by Iran to evade sanctions and mask illicit transactions."

Give it a rest, Hank.

Apart from the fact that the United Nations nuclear-watchdog agency (IAEA) has found "no evidence" that Iran is conducting a nuclear weapons program; it's none of Paulson's business anyway. He needs to devote more time to cleaning up his own mess and less time criticizing others for their fabricated offenses.

The rest of the world is already fuming at the US for creating the problems that threaten to send the global economy into a prolonged tailspin.

Developing countries that joined the G-7 meetings lambasted the US for generating "serious problems of financial fragility" which are endangering the "prosperity of the world economy". (Bloomberg)

The G-24 is demanding "increased surveillance of advanced economies, putting as much focus in evaluating their vulnerabilities as it does in emerging-market economies."

Indeed. And yet Paulson and his colleagues at the Fed continue to blame everyone else. No one in China or Iran cooked up this "structured finance" rip-off which sent millions of homeowners into foreclosure, shuttered 160 mortgage lenders, and undermined the global banking system. That was the work of the Wall Street con-artists and their accomplices at the Fed.

Consider this article in Sunday's UK Telegraph:

"Barclays and Royal Bank of Scotland have lined up emergency funds of up to \$30 billion from the US Federal Reserve to bail out American clients caught up in the global credit crunch.

The Fed's board of governors wrote to both banks 10 days ago, granting them access to funds for customers "in need of short-term liquidity"

The letter to RBS made particular reference to investors holding mortgage-backed securities -- which have been at the centre of the sub-prime crisis. ("Barclay's, RBS prepare emergency credit with Fed", UK Telegraph)

Great. Another humongous bail out for the victims of America's deregulated mortgage-laundering racket. Is that China's fault?

Another article appeared in yesterday's New York Times by economics reporter Gretchen Morgenson, "Get Ready for the Big Squeeze":

"Anyone who thinks that we have hit bottom in the increasingly scary lending world is paying little mind to the remarkably low levels of reserves that the big banks have set aside for loan losses. Indeed, loss provisions as a percentage of total

loans held for investment plummeted to a historic low in the second quarter of 2007.... Part of the problem for banks is a result of an almost two-decade drop in loan loss reserves..... Now that a credit bust looms, banks have far fewer reserves on their balance sheets than they might have had in previous cycles.”

Still want to talk about China and Iran's problems?

The present gang of Wall Street warlords have transformed the world's most transparent and resilient markets into an opaque galaxy of complex debt-instruments and shady “off-balance sheets” operations. It's no better than a carnival shell-game. As the banks continue to get rocked from explosions in the housing industry; the unwinding derivatives and carry trades will precipitate a mass exodus from the equities markets. That rout will be matched by a corresponding downward slide in the real estate market which is expected to continue until 2010.

Crisis dynamics have returned to the credit markets. Surging oil and food prices are bearing down on maxed-out consumers and slowing retail spending. Discretionary income is vanishing from rising inflation and shrinking home equity. Wages have remained stagnant for over a decade while personal savings have dipped to minus digits. On top of it all, consumer debt is at record-highs and the danger of default has expanded beyond housing to every area of personal finance.

A report in Sunday's Financial Times sheds light on this new and worrisome development:

“Poor quarterly results from banks across the US over the past two weeks suggest credit problems once confined to high-risk mortgage borrowers are spreading across the consumer landscape, posing new risks to the economy and weighing heavily on the markets.

US banks have raised reserves for loan losses by at least \$6bn over the second quarter and by even larger amounts from last year, indicating financial executives believe consumers will be increasingly unable to make payments on a variety of loans.

Banks are adding to reserves not just for defaults on mortgages, but also on home equity loans, car loans and credit cards.

“What started out merely as a subprime problem has expanded more broadly in the mortgage space and problems are getting worse at a faster pace than many had expected,” said Michael Mayo, Deutsche Bank analyst.” (“US Loan Default problems Widen” Financial Times)

The aftershocks from Alan Greenspan's “cheap credit” policies will be felt for decades. The American consumer is more over-leveraged and economically

vulnerable than any time in history. Simply put; he owes money on everything---- cars, mortgages, electronics, student loans, and credit cards. The path to indentured serfdom is paved with the Fed's low interest green paper.

Record US trade imbalances coupled with a steadily-declining dollar, is negatively impacting European industry as well as the Euro. Further weakening is likely to trigger a stampede away from dollar-backed assets and securities. The plan to strangle the dollar to reduce US balance of payments is pure lunacy---an idea as zany as invading Iraq. No country has ever devalued its way to prosperity. (Steven Roach) Destroying the dollar will destroy the country.

Global credit markets are now facing unprecedented disruptions due to the mortgage-derivatives fraud which originated in the United States before spreading across the world. \$400 billion in asset-backed commercial paper (ABCP) has failed to roll over, the mortgage securitization process has stalled, the colossal leveraged buyout deals (LBOs) are DOA, and millions of bankrupt homeowners are being driven from their houses. The big investment banks have been forced to take \$280 billion of new debt on their balance sheets since the middle of August. This is limiting their ability to issue new loans and generate profits. The banking system has already smashed into the iceberg and the decks are quickly filling with water.

Interest rates cuts will do nothing to slow the inexorable deterioration in the housing or stock markets. Cheap credit will not dispose of the toxic debt clogging the system or slow the pace of defaults. Trillions of dollars in market capitalization will be lost.

The system is blinking red. These problems cannot be ignored or swept under the rug any longer.

Leadership is critical in times of economic crisis. This isn't the time for prevarication, obfuscation or public relations gimmicks. We need leaders who will tell the truth, make remedial policy recommendations, and forestall the growing probability of social disorder.

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