US recession fears grow as bank losses mount

Barry Grey
21 November 2007

The crisis in US housing and credit markets is taking a growing toll on major banks and financial institutions in the US and around the world, and increasingly affecting other sectors of the economy. Mounting bank losses and tightening credit are deepening the housing slump and impacting retail sales, hi tech business and corporate profits as a whole.

US officials are now acknowledging that there will be no early resolution of the financial crisis and are revising downward their economic forecasts for 2008. While they avoid the word “recession,” there is growing concern, if not panic, on Wall Street that a potentially deep and protracted downturn may be looming.

The crisis is compounded by the continuing plunge in the value of the US dollar on world currency markets, which is increasingly placing a question mark over the dollar’s status as the world reserve currency and raising the specter of a dollar panic, which could plunge the world economy into a recession—or even a full-blown depression.

Stock markets around the world are moving lower in the face of the credit crisis and its spreading impact on the general economy. On Tuesday, the New York Stock Exchange managed to record its first gains in five sessions, after sharp declines Monday on all of the major stock indexes.

The modest increases—51.70 points for the Dow Jones Industrial Average, 3.43 points for the Nasdaq Composite Index and 6.43 for the Standard & Poor 500 Index—came despite more negative news on housing and retail sales and the announcement by Freddie Mac, the giant government-sponsored mortgage insurer, that it had lost $2 billion in the third quarter, in large part due to the collapse of securities linked to subprime mortgages.

Indeed, a major factor in the upward spurt that enabled the indexes to finish the session in the black was a gloomy economic growth forecast issued by the Federal Reserve Board on Tuesday. The Fed’s prognosis for economic growth in 2008, revised downward from 2.5-2.75 percent to 1.8-2.5 percent, convinced many big investors that the US central bank would announce yet another cut in interest rates when its policy committee meets again on December 11.

The banks and big investment houses are clamoring for another rate cut, despite its potentially disastrous implications for the dollar and the threat of an inflationary spiral, because they see cheap credit and an endless supply of liquidity as the means for rescuing them from the consequences of their reckless speculation in subprime mortgages and other high-risk deal-making.

They also fear that, without a bailout from the Fed, the ensuing financial wreckage will expose shady and concealed financial manipulations and accounting gimmicks similar to those which came to light six years ago with the collapse of Enron, WorldCom, Tyco and other major corporations.

On Monday stocks fell sharply after Goldman Sachs downgraded its advisory on Citigroup, the biggest US bank, to “sell” and predicted that banks would have to write off another $48 billion in bad investments by the end of 2008.

According to Goldman, Citigroup—the most heavily invested bank in subprime-linked collateralized debt obligations (CDOs), speculative off-balance-sheet entities called structured investment vehicles, and debt linked to leveraged buyouts—will take the biggest hit. Goldman forecast that Citi will write down $22 billion, split between $11 billion in this year’s fourth quarter and the remaining $11 billion in the course of 2008.

The Goldman report brought Citi’s shares down 5.9 percent, bringing its loss for the year to over 42 percent.

Goldman also predicted write-downs of $13 billion for Merrill Lynch and $8 billion at Morgan Stanley, shared over the final quarter of 2007 and 2008.

Among European banks, UBS could have the biggest write-downs, according to the research house CreditSights. The research firm expects UBS to have more than $9 billion in further CDO write-downs, which would add up to more than 70 percent of the bank’s 2006 pre-tax profit.

Dresdner Bank and WestLB could also end the year with write-downs in excess of 50 percent of their prior year’s profits.

The spreading impact of the credit crunch was also demonstrated by the announcement from Swiss Re, the world’s biggest reinsurer of bond insurance firms, of a $1.08 billion write-down of securities linked to subprime mortgages.

Confidence in the credit-worthiness of major financial institutions is evaporating, resulting in a reluctance of banks to lend to one another and to other corporations. This credit squeeze worsens the plight of all sorts of financial companies that depend on readily available and cheap credit to make speculative profits, and are now unable to find buyers for their bonds.

© World Socialist Web Site

Suddenly, hedge funds and private equity firms that were flying high only a few months ago and reaping gargantuan profits from leveraged buyouts are unable to sell their bonds. On Tuesday, Cerberus postponed its planned sale of $4 billion in bonds related to its buyout last summer of Chrysler.

Moreover, the subprime contagion is spreading to other forms of consumer debt. Lehman Brothers in a report issued Monday said US car loan delinquencies have risen sharply in recent months. “We are beginning to see deterioration in auto asset-backed securities credit conditions,” Lehman Brothers said, suggesting that write-offs of another category of debt-backed securities held by big banks and investment houses may be in the offing.

This crisis feeds off itself, intensifying the housing slump, slashing orders for hi tech and industrial goods, and dragging down consumer spending.

Building data released Tuesday suggested the US housing slump would deepen in the months ahead. Groundbreaking permits fell 6.6 percent in October to their lowest level in over 14 years, a sign that builders were cutting back on residential home projects. Permits have slid nearly 25 percent since October 2006, Commerce Department said.

Construction of single-family homes dropped again last month, and over all housing starts remained near the lowest level since the recession of the early 1990s. The chief executive of Wells Fargo bank last week described the housing slump as the worst since the Great Depression.

Moreover, the credit crunch is increasingly dragging down building activity in the commercial sector.

In another sign of impending recession, US industrial production fell 0.5 percent in October, the biggest decline since the aftermath of Hurricane Katrina in September 2005.

And over the past several days, a series of companies have reported lower sales or profits for the third quarter and warned of weaker sales and earnings in the months ahead. These include the retail chains JC Penney, Kohl’s and Target, the home improvement chain Lowe’s, the package-moving giant FedEx and even Starbucks, the biggest coffee house chain.

Corporate profits are also trending down. According to Standard & Poor’s Index Service, operating earnings for the companies in the S&P 500 stock index fell 8.5 percent in the third quarter, the first decline since the fourth quarter of 2001, i.e., during the recession that followed the collapse of the 1990s’ stock market bubble.

At the same time, inflationary pressures are building. Crude oil futures closed over $98 a barrel on Tuesday, and home heating oil rose by $2.69 a gallon.

The US dollar, which has dropped 16 percent this year against a basket of major currencies, fell to new lows against the euro. The relentless slide of the dollar is roiling economies around the world and further destabilizing the global financial system. It is hurting exports from countries with stronger currencies, including the European Union and Japan, and fueling inflation in countries, such as the oil-exporting Persian Gulf states, that peg their currencies to the dollar.

All countries with large hoards of US dollar-denominated assets and dollar currency reserves are seeing the value of their holdings steadily erode, fueling talk about shifting to other currencies, such as the euro.

On Monday, Chinese Premier Wen Jiabao told a business audience in Singapore that it was becoming difficult to manage China’s $1.43 trillion foreign exchange reserves. “We are worried about how to preserve the value of our reserves,” he said. His remark increased speculation that China may be shifting a portion of its reserves out of the dollar.

And at a weekend summit of OPEC countries in Riyadh, Saudi Arabia, the weakness of the US currency emerged as a major topic. Iran and Venezuela pushed for a statement in the summit communiqué on the impact of the falling dollar on the group’s revenues, which are being hit because oil prices are set in dollars.

This produced a clash with the Arab states, led by Saudi Arabia, which was inadvertently broadcast live to reporters covering the summit. Saud Al-Faisal, the Saudi foreign affairs minister, warned the meeting: “The mere mention that OPEC is studying the issue of the dollar is going to have an impact.” He said a reference to the US currency in the summit declaration could cause the dollar to “collapse.”

The *Financial Times* on Tuesday quoted Stephen Lewis of Insinger de Beaufort as saying, ““If the Gulf nations dropped their objection to pricing oil in currencies other than the US dollar, the dollar’s global reserve role could be severely impaired.”

The newspaper’s lead editorial on OPEC’s dollar dispute concluded by warning: “Yet as the monetary consequences of the falling dollar worsen for those countries pegged to it, the risk of revaluations and subsequent flight from dollar assets gets higher. A dollar rout in still a danger.”

The newspaper over the weekend reported another sign of the times in regard to the dollar: India’s culture minister announced that the US dollar will no longer be accepted as payment for admission to the country’s cultural sites, such as the Taj Mahal. While in the past the government encouraged tourists to use the US currency to buy admission tickets, they are now insisting on payment in rupees.

On the most fundamental level, the erosion of the global position of the dollar expresses the immensity of the crisis of world capitalism and the fact that it is centered in the center of the world capitalist system, the United States.

To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact

© World Socialist Web Site