Brothers of Lehman: what Bloomberg News crudely exposes

A couple of weeks ago Bloomberg News disclosed an interesting document titled "The Fed´s Secret Liquidity Lifelines" that crudely shows how almost all the biggest participating firms in the US investment and commercial banking system, along with some important European banks, were rescued by the Fed in 2008 – 2009, no matter how these institutions explained then or afterwards this very particular stringent period. The liquidity market got totally disrupted and did not work at all. Under those circumstances, the Fed as the lender of last resort did the right thing by completing this broken market until it could work on its feet again. It provided the liquidity that avoided a deep recession, and for that major achievement it has not yet received a correspondingly due recognition. Beyond the "strength" they boasted, banking officers could only show good disposition towards Fed authorities´ requirements and, in essence, wait for their destiny, for their salvation effectively depended on the Fed, its whims and their political and entrepreneurial networks. Under these delicate and interrelated equilibria, the failed ones could have been any of them. In some sense, they were all brothers of Lehman.

On December 5th, 2008 the combined outstanding balance of the seven programs of the Fed that Bloomberg News tallied reached a maximum of US$ 1.2 trillion, or approximately 8% of US GDP or 13% of total US commercial banking credit or equivalent to a total of US$ 1.2 trillion aggregate equity of US commercial banks at that time [1]. The main beneficiaries were domestic financial institutions in the US and European ones strongly related to US markets, and industrial companies with heavy financial exposure in short term commercial paper such as General Electric. This financing was additional to what was then publicly disclosed, such as the "business as usual" ordinary Fed operations in the monetary market and the US$ 700 billion Troubled Asset Relief Program (TARP) created by then Treasury Secretary Paulson to support the capital structure of financial firms. The summarized figures – from data obtained through the Freedom of Information Act - were the following:

The peak amount of credit to Morgan Stanley reached US$ 107 billion, besides US$ 10 billion in capital reinforcement from TARP. This indebtment represented 7 times its equity market value. Total resources: US$ 117 billion.

Citigroup received up to US$ 99.5 billion of credit and US$ 45 billion in TARP capital reinforcement, with this indebtment representing 13 times its equity market value. Total resources: US$ 145 billion. Citigroup was identified as the most frequent user of these Fed emergency lending programs from 2007 to 2010.

Bank of America received up to US$ 91.4 billion of credit and US$ 45 billion in TARP capital reinforcement, with this indebtment representing 5 times its equity market value. Total resources: US$ 136 billion. Bank of America would then absorb Merrill Lynch and Countrywide, whose also extraordinary financings would amount to US$ 62.1 billion from the Fed and US$ 10 billion in TARP capital reinforcement and US$ 10 billion from the Fed and no TARP capital reinforcement, respectively. Fed financing would consolidate into one once both mergers took place.

Goldman Sachs, the savvy investment bank that would later say "they were not relying on these mechanisms (ie, Fed emergency lending programs)", received up to US$ 69 billion of credit and US$ 10 billion in TARP capital reinforcement. This indebtment represented 2 times its equity market value. Total resources: US$ 79 billion. At the same time, JPMorgan received up to US$ 68.6 billion of credit and US$ 25 billion in TARP capital reinforcement. This indebtment represented one time its equity market value. Total resources: US$ 94 billion. But both of them – and others - are particularly known to have been benefited from AIG rescue that involved previously disclosed emergency credit of US$ 90 billion from the Fed plus undisclosed until now US$ 16 billion of further credit from it, plus TARP capital reinforcement of US$ 70 billion, totaling resources of US$ 176 billion. So much so for the "fortress balance sheet" JPMorgan has many times celebrated, which among others might have also benefited out of emergency US$ 46 billion of credit from the Fed to Lehman Brothers before its own bankruptcy.

[1] See Federal Reserve, Flow of Funds, Credit Market Debt Outstanding, Commercial Banks and Residual (Assets Less Liabilities)

In short summary, total emergency lending resources from the Fed to these financial institutions amounted to US$ 497 billion, plus the previously disclosed one to AIG of US$ 90 billion – not included in the US$ 1.2 trillion credit estimate by Bloomberg -, whereas total TARP resources of US$ 215 billion – out of a US$ 700 billion US Treasury Program – reached them. History repeats itself: some are more equal than others.

As for foreign based financial firms, Royal Bank of Scotland received up to US$ 84.5 billion of credit from the Fed and a capital reinforcement from the British Government of US$ 74 billion; UBS, US$ 77 billion of credit from the Fed and US$ 7 billion capital reinforcement from the Swiss Government; Hypo Bank, US$ 29 billion of credit from the Fed and US$ 14 billion capital reinforcement from the German Government. Deutsche Bank received up to US$ 66 billion of credit from the Fed; Barclays, US$ 64.9 billion; Credit Suisse, US$ 60.8 billion; Dexia, US$ 58.5 billion; BNP Paribas, US$ 29.3 billion and capital reinforcement from the French Government of US$ 7.2 billion; Fortis, US$ 26.3 billion; Norinchukin, US$ 22 billion; Commerzbank, US$ 22 billion plus capital reinforcement from the German Government of US$ 26 billion; Dresdner, US$ 18.4 billion; HBOS, US$ 18 billion plus a capital reinforcement of US$ 27 billion from the British Government; Societe Generale, US$ 17.4 billion plus a capital reinforcement from the French Government of US$ 2.4 billion, among other foreign based financial companies with business operations and interests in the US. Total resources from the Fed among these ones: US$ 594 billion, or almost half of the emergency credit supplied by the Fed. No wonder European banks today, after this scary monetary chapter and now questioned for their investments in some EU Government bonds to be defaulting, are in such a state of stress, more so when these assets are ironically considered at 100% par value in their recent stress tests.

Then we have some particular interesting cases such as General Electric, that received up to US$ 16 billion of credit from the Fed; Ford, US$ 6.9 billion; Toyota, US$ 4.6 billion; Banco Santander, US$ 6.3 billion; Banco BBVA, US$ 4.1 billion.

The list goes on and is incredibly wide, to reach around 2.000 firms, of which approximately 1.600 were discount window borrowers with loan balances that averaged less than US$ 20 million a day.

The Fed has said it had “no credit losses” on any of the emergency lending programs. Nearly all of them have been closed and it expects no losses from the remaining operations. In other words, the Fed would have had both positive private and social returns. The last one is the relevant one, for the objective was to restart an economy from a sudden paralyzing panic of which the Fed was the only one not to be blamed for. The first one is mainly related to wealth redistribution.

However, what worked in the short term will inevitably have consequences in the longer term. The financial system will have to recapitalize and lower leverage ratios as new regulations come forward and markets and governments better price its solvency and liquidity risks. The financial system “sold its soul” to the savior of the day and that is what is being reflected in market values. The Dow Jones Industrial Average is approximately 17% off its 2007 peak value before the financial crisis; NYSE Financial, 58% off. Or under a longer perspective since 2004, DJIA is now 10% higher, NYSE Financial, 40% lower. Both indices are not inflation indexed.

The party is over. Now we will see how these financial companies effectively deliver some aggregate value to the economy, for extreme leverage and related assured Fed rescue will no longer be one of them. With financial services efficiently priced at a social level, the verdict would appear to be that many of them are not and will not be needed. The seven lean and ugly cows period of the Bible is coming to this economic sector. And rightly so.

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