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Financial Institutions Sector
Industry Comments

November 6, 2008

Views on the Banking and Securities Sectors

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The New Deal is Back

Everyone Becomes a Socialist When They Are Losing Money

It has been reported repeatedly that Ben Bernanke, Chairman of the Federal Reserve, has studied the Depression in the United States extensively. The actions taken by the Bush Administration to this point suggest that he has learned these lessons well and is putting them into effect. The new Obama Administration is likely to continue the trend.

Therefore, the key issue is who is going to fund this program. If the dollar remains strong, it will go through. If the dollar weakens a new approach must be found.

Comparing Programs

- The Reconstruction Finance Corporation (RFC) was actually created by Herbert Hoover.
  - During the Depression it bought preferred stocks in banks under the theory that bank capital had to be bolstered to solidify the safety of the system.
  - The TARP program created by the Treasury Department allows the government to buy preferred stocks in banks.
- The RFC had multiple functions.
  - An additional function of the RFC utilized by the New Dealers was to make loans to banks so that they would in turn make loans to the public. The banks refused to do this which is why the RFC started making loans directly.
  - The Federal Reserve is making credit available to the banking system with the goal of having the banks lend the money. The banks are becoming reluctant to make high risk loans so that the TARP program may be used to make loans to weak companies like GMAC and others.
- Another RFC function: debasing the Currency
  - Franklin Roosevelt took the United States off the gold standard. It used the RFC to buy and sell gold in the open market. It was a core program of the government to weaken the currency to stimulate inflation.
  - The Federal Reserve has debased the currency by more than doubling the size of its balance sheet and making loans against questionable assets. The goal here is also to prevent deflation among other factors.
- The Home Owners Loan Corporation (HOLC) was a New Deal program.
  - In the 1930s, it refinanced mortgages based on the current value of housing and the ability of home owners to pay. It also provided funds to pay taxes and repair problem dwellings. It is believed that 1 of every 5 homes in the country ultimately was financed by the HOLC.

Disclosures and Analyst Certifications can be found in Appendix A.

  - The President, Congress, and the FDIC are currently putting in place a similar set of programs to help housing.

- The Federal National Mortgage Corporation (FNMA) and the Federal Housing Administration (FHA) were created.

  - Banks refused to make 20-year self-amortizing mortgages so the FHA was created to guarantee the new instruments and the FNMA was created to buy them.

  - The Bush Administration has taken over both Fannie Mae and Freddie Mac to insure that they keep buying mortgages. The FHA is guaranteeing more product.

- The National Industrial Recovery Act (NIRA) was established for multiple purposes.

  - In the Depression, as part of this program, the government funded the Public Works Administration (PWA). The PWA made extensive improvements in the nation's infra-structure.

  - It is being suggested that the new Obama program will have $150 billion set aside for a new PWA.

- The two Glass Steagall Acts were passed and there were two bills passed to regulate the securities industry setting up among other functions the Securities and Exchange Administration.

  - There were intensive hearings held by the Pecora Committee to regulate the financial industry.

  - The new Congress has promised to take an in-depth look at the financial sector and develop new regulations. One might argue that the Treasury Department has already begun nationalizing the banks and that more controls and regulations are coming.

Comparing Costs

One reason that the New Deal could put into effect the programs that it had initiated was because the United States government had a solid financial structure. From 1919 to 1930, the Federal government had been paying down its outstanding debt while the economy expanded. Debt had fallen by 36.4% in this period while real GNP fell by 8.7% (it declined by 13.3% in 1930). Thus, the capacity for increasing the debt was substantial.

Clearly the problem today is that the United States is broke. From mid 2000 to mid 2008 the nation's debt has grown by 66.9% while real GNP is up by 19.6%. The deficit was rising before the reintroduction of the New Deal and today the country does not have the money to pay its bills.

Therefore, if the Obama team wants to continue the Bush team policies of recreating the New Deal, some entity must lend the country the money to do so. Americans do not like buying Treasury debt so foreigners are being relied upon to fund this program.

Thus, one must watch the dollar. If it drops in value, it will force the Americans to buy the new debt (higher interest rates will be necessary) or the Federal Reserve to further debase the currency to pay for the new programs. In the next six months, the government must raise $915 billion. It will be very important to monitor this fund raising process to determine if New Deal redux will be put in place.

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