President's message: Coping with the economic crisis

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The past decade has seen the largest expansion in U.S. private sector leverage since World War II. The reversal of a debt fueled speculative asset boom always causes severe financial pain on borrowers and lenders and this cycle is once again proving this scenario. However, one primary difference between the current economic trouble and the late 1980s and early 1990s is that 10 years ago government debt was the primary factor, whereas today's meltdown is driven by private debt creating the potential for the massive slides we have seen with Bear Sterns, Lehman Brothers and Washington Mutual.

American household debt has more than doubled in the last decade from $6.8 trillion in 1999 to $13.8 trillion at the end of 2007, the vast majority of it in mortgages and home equity lines of credit, but now that home values are dropping, teaser rates are expiring on these notes, and we are seeing what amounts to margin calls on these home loans and the associated Wall Street bets on these asset's performance.

Even though the "originate to distribute" banking model moved most of the originated loans off banking balance sheets, it still resulted in growth in the stock of the banks and today banks are far more exposed than they were in the cycle of the late '80s.

What distinguishes the most recent decade of banking is the growth of securitization and complex structured products. This has led to leveraging of the leverage. The outstanding value of pooled securities overtook that of bank loans in 2001, meaning that banks face losses on their loans and even greater losses on the securitized products when values dropped. Another issue which this nation has not confronted before is "credit default swaps" which when boiled down amount to complex wagers on how certain asset classes will behave which when tied to the volatility of Wall Street proved to be Bear Stearns' undoing and almost led to the demise of the nation's largest Insurer: AIG.

Will the bailout work? Only time will tell but the alternative of no bailout would most likely have led to a full blown recession or depression. As stated in previous articles, it is my hope additional defaults will not act to deepen the crisis and we'll muddle along over the next year or so while these issues are absorbed by the market.

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