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Financial Reform Newsletter: January 27, 2017
Trump's financial de-regulation agenda makes another devastating crash almost certain & sooner rather than later

If the Trump administration does just half of what it says it's going to do in economic policy and financial regulation, another financial crash is almost certain and sooner rather than later. Worse yet, if they do that, the next crash will be much worse than the last one.

Why another crash? Because it appears he is going to cause an asset and stock market bubble at the very same time he is reducing or eliminating the most sensible financial regulation designed to prevent the highest risk gambling on Wall Street. Tax changes that favor the wealthiest and repatriation of overseas profits that will most likely fund stock buybacks and M&A will be a short term boost for the stock market. However, there has been almost no discussion of concrete policies that would actually produce sustainable and durable economic growth in the real economy.

We have already seen the beginnings of the stock market bubble, with financial stocks leading the way as investors think that Wall Street's highly profitable, but highest risk activities will create outsized returns – look at the front page of the Financial Times the day before the Inaugural, which detailed the astoundingly large 4th quarter trading profits from fixed income, currencies and commodities (FICC) . If financial regulation designed to protect Main Street's jobs, homes and savings from Wall Street's excesses are weakened or eliminated, then those activities will lead to financial excesses and almost certainly end in a financial crash.

And don't believe the unsubstantiated claim that the problem is one of supply, i.e., not enough capital or lending for the real economy. The real problem is one of demand: not enough jobs paying good wages for people to pay their bills **and** have money left over to spend on other items. Plus, tens of millions of America's families are still paying down debt, including more than a trillion dollars of student loan debt, due to the financial crash and too many are still dealing with un- or under-employment. That is the fundamental problem holding back real economic growth.

When the real economy begins to grow and more companies increase employees' pay and hire more people then there will be more demand and only then will we be able to determine if there is sufficient capital availability and lending to meet that need. That is also when the engine of growth will kick in: people will start small businesses again at robust rates.

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The financial crash killed small businesses because home equity and personal guarantees are the critical financial foundation for getting a small business off the ground and keeping one going in tough economic times. Underwater homes (i.e., **negative** equity homes where the mortgage is more than the value the house can be sold for) reached 40% at the height of the economic crisis caused by the financial crash. Combined with the financial crash throwing 27 million Americans out of work or forced to work part time because they couldn't find full time work starting in October of 2009, few Americans have had the home equity or creditworthiness for a personal guarantee to be able to start a small business.

Ignoring these facts and that credit availability is not the problem, President Trump, his associates and allies have talked about the need to get rid of financial rules so that lending can be unleashed. They have talked about deregulating derivatives, permitting banks to do proprietary trading (i.e., rolling back the Volcker Rule), allowing investments in hedge funds, eliminating brokers' duties to act in the best interests of retirement savers, reducing capital and liquidity requirements, killing the orderly resolution mechanism for too-big-to-fail banks and removing the authority to regulate the shadow banking system. If the Trump administration does just half of what is being discussed, finance will be dramatically deregulated **again** and could look a lot like the fragile system in 2005-2007 that lead directly to the crash in 2008.

Crash caused firefighters to be laid off

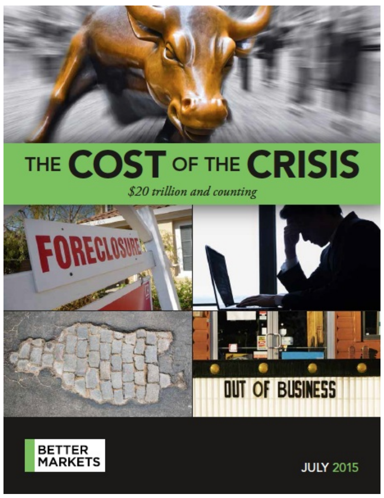
Why will the next crash be worse than the last? The only reason the last cras has stopped and a second Great Depression was avoided is because of trillions of dollars of bailouts and rescue programs that prevented the collapse of the financial system. That was due to both fiscal policy like the $700 billion TARP program as well as extraordinary monetary policy like zero interest rates and the Fed's many bailout programs. The result of all that, on the fiscal side, has been trillions in deficits and debt and, on the monetary side, an exploding Fed balance sheet that now exceeds $4 trillion. And, of course, with interest rates at zero or effectively zero, there isn't room to lower them more (leaving aside for now the fascinating theoretical discussion of breaking the zero lower bound).

As a result, the fiscal and monetary capacity of the US and other countries to respond to another crash are greatly reduced. Add to that the elimination or weakening of the financial reform rules giving the government the ability to respond to crashes like resolution authority then the next crash is almost certain to be much worse.

How bad was the last financial crash? In total, it is going to cost the United States **more than $20 trillion** in lost gross domestic product (GDP), which is more than $170,000 for every living woman, man and child in the country.

Those numbers obscure the human suffering the financial crash caused, which included the 27 million Americans thrown out of work and more than 16 million foreclosure filings, throwing families out of their homes. Tens of millions of Americans watched their savings disappear along with the American Dream. Their economic security was destroyed and they ended up in a financial hole that far too many are still trying to get out of. The $1.3 trillion student loan debt is really a proxy for the ongoing employment crisis in the country: too many people are unemployed or employed at such low wages that they cannot live and pay their student loans. No one should be surprised at the economic pain and anxiety that many voters reflected last November.

To fully understand the devastating impact of the 2008 financial crisis, read our [Cost of the Crisis report](#).



Getting rid of the financial rules that protect American families and our financial system from another catastrophic financial crash is the opposite of what President Trump and his economic team should be doing. It's clear why Wall Street's biggest banks and their lobbyists would like to go back to their old, high risk gambling habits that generated historic bonuses for them, but weakening or eliminating financial rules will not spur economic growth or job creation. It will again prove to be a job-killer of historic proportion and inflict lasting damage on an economy that is just now repairing itself from the last crash.