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Greenspan goes from 'walking on water, to skating on thin ice'

by William Engdahl

The Internet-heavy Nasdaq stock index has bounded past the historic record high of 4,700, with no immediate end to the rally in sight, to hear Wall Street stock brokers tell it. Since November 1999, the Nasdaq stocks, which include Microsoft, Intel, Sun Systems, Cisco Systems, Yahoo, and America Online, have risen 56%. That represents an annualized paper gain of 168%, something which the Cali cocaine cartel would find mouth-watering. This ranks the Nasdaq bubble, as many observers have noted, alongside the South Sea Bubble and the 17th-century Dutch Tulip Bubble for rapidity of rise.

In recent days, volatility in the world's major stock, bond, and currency markets has increased dramatically, often swinging up or down 2% or more within a given trading day, a classic sign of impending market panic. Warnings are coming almost daily from leading central bankers, private fund managers, and financial commentators and economists, that a crash of the Nasdaq bubble is imminent.

The Federal Reserve, under Chairman Alan Greenspan, apparently intends to try to curb the stock-tied consumer-spending boom, in order to prevent a looming U.S. dollar crisis, which would rapidly get out of control. Taking Greenspan's Feb. 17 "Humphrey-Hawkins" testimony before the House Banking Committee, his argument seems to be that, although there is no sign of inflation in the Consumer Price Index, there are alarming productivity gains. Productivity gains, Greenspan continues, lead to higher corporate profits and higher stock prices. The higher stock prices feed the insidious "wealth effect," where families indulge in a spending binge, on the assumption that their wealth is growing, at least in their mutual funds. That consumer binge, he says, is leading to "unsustainable" levels of imports, and near-capacity domestic economic output.

All this can "potentially" lead to inflation, so, the Fed intends to smash productivity growth to contain "potential inflation." Got it? No one else does either. That is because the real target of the Greenspan interest-rate tightening is to rein in the recent stock index rises of 20% and more per annum, especially in the Nasdaq high-stock index. The Fed is trying to stop an out-of-control stock asset bubble, without triggering a crash, or a panic exit from the overvalued dollar.

However, Greenspan's only weapon to do all this, raising short-term Fed funds, or rates of overnight money to the banking system, is affecting everything but the Nasdaq itself. And Greenspan, whose policies fostered the growth of the speculative bubble in the first place, is doing nothing to change those axiomatic policies.

'Old Economy,' 'New Economy'

Continental European bank strategist George Andersen recently remarked to *EIR,* "So far this year, the Fed's interest rate rises and threats of more have hit the Dow Industrials, the place where most of the stocks of the so-called 'Old Economy' are listed. But these companies are not the problem. The Nasdaq is." Yet, the Nasdaq seems immune to Fed rate hikes. A flood of speculative cash is chasing ever riskier and more marginal ".com" companies listed on the over-the-counter Nasdaq.

"The four Fed rate hikes so far have hit the housing sector and home mortgage refinancings," Andersen said. "It has raised the cost of government debt service. It has caused the Dow Industrials index to lose 13% since the New Year. But if it is the case, which many now believe, that the 'wealth effect' Greenspan is trying to kill, is tied to the Nasdaq, and not to the Dow, then Greenspan and the world economy are in deep trouble."

One Wall Street bond analyst summed up Greenspan's impossible dilemma. The Fed chief, who only months ago was seen to have superhuman powers by many in the Congress and the world of finance, has gone "from walking on water, to skating on thin ice," with his interest rate strategy,

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the analyst said. The risk is overwhelming now, that the much-desired "soft landing" of the U.S. economy will turn into a nasty "hard landing."

That would mean not only a crash of the U.S. and global stock markets. But also, it would mean soaring U.S. interest rates, as an emergency measure to protect the dollar from panic capital flight by the record number of foreigners who have piled into the U.S. stock bubble in recent years.

That "Volcker-style" high-interest-rate reaction by the Fed, in turn, would induce a severe U.S. economic depression, in turn triggering a domino-style collapse of the emerging economies in Asia and other countries to the status of "submerging" economies. Europe would lose its largest export market, and itself be plunged into the maelstrom. At that point, most likely an uncontrollable financial, monetary, and economic contraction would be in full swing.

The inevitable correction to years of exponentially rising financial and monetary values at the expense of the physical economy, as depicted by Lyndon LaRouche's "Triple Curve," or typical collapse function, will—barring a global financial reorganization along the lines of LaRouche's proposal for a New Bretton Woods system—cause hundreds of millions more human beings to be thrown onto a waste heap of joblessness and worse.

A 'red-Dye' trail

One of the more clinical signals of impending market collapse, came with the report that one of the most prominent City of London fund managers, Tony Dye, has been forced to resign.

Dye has been one of the most outspoken critics in the City of London in recent years against the Internet speculation mania. He abruptly resigned as Chief Investment Officer of PDFM, a major fund manager arm owned by the Swiss UBS bank. Dye's resignation, ironically, comes on the eve of the very global stock market crash which Dye has warned of for the past five years.

Dye has repeatedly publicly attacked the absurd practice popular among fund managers, who simply track the large stock indices, such as the S&P-500, the Dow Industrials, or the London FTSE-100, where only five or six stocks often can manipulate a rise in the entire index. He railed against the stratospheric over-valuation of Internet companies, the stocks of the so-called "New Economy," which have yet to prove that they are able to even earn a profit, while traditional stocks of blue chip companies, which are healthy and profitable, are being dumped simply because they are deemed "Old Economy" in the eyes of the new generation of fund managers.

Dye was forced to resign, according to sources, for adamantly resisting the rush into the hyperinflated Internet stocks—or stocks at all. He kept a major part of his fund in liquid cash. His refusal reportedly led to mass withdrawals by pension funds and other major clients out of PDFM, as PDFM fell to last place in earnings at the end of 1999. As the London *Sunday Telegraph* said in its Feb. 27 editorial, "One . . . more harbinger that a catastrophic bust is now a real possibility is the departure of the City's most famously bearish fund manager, Tony Dye of Phillips & Drew. . . . At the moment when Mr. Dye's doomsaying may at last be about to come true, his message is least acceptable to his clients."

The editorial cited the alarming trend in Britain where homeowners take out mortgages against their dwellings in order to reap the whirlwind in Internet stocks. "If both the housing market turns down and the dot.com bubble bursts—as it surely will—borrowers who have taken the equity out of their houses and blown it in the stock market will be in a penurious state," it said.

More warnings

The Bundesbank's (Germany's central bank) February *Monthly Report* gave an unusually blunt warning of world trouble ahead. "While looking at the fairly positive dynamic globally," it said, "at the same time there exist a number of risks. Among them, within primarily the OECD [Organization for Economic Cooperation and Development] countries, the risk in the extremely high stock markets should be cited, especially in the United States. Were there to be a significant fall in the stock market in the United States, the effect it would have, in the context of the dependency of the level of U.S. consumer demand on [stock market] investments, would be especially negative. . . . As well, in the list of risks, there is the continuing danger of a worsening of the American balance of payments. This could lead to a weakening of the dollar, which can lead to a growing price inflation there."

On Feb. 28, Bundesbank President Ernst Welteke warned that "stock prices, particularly of technology stocks, have risen dramatically." He expressed "worries that a dangerous speculative bubble has emerged," and urged banks to restrict lending to avoid feeding stock speculation.

That same day, Hans Meyer, president of the Swiss central bank, similarly warned of coming dramatic developments on global markets. It will be "something between a crash and a correction," he forecast. "Above all in the U.S.A and in high-tech stocks, the high stock prices no longer correspond to realistic expectations. That a correction is coming, I am convinced. The question is only when."

The London *Guardian* joined in the alarm on Feb. 28. City Editor Larry Elliott, in a feature titled "History Points to Another Crash Landing," said that the "gravity-defying performance of stocks in London and New York is eerily redolent of 1929." Greenspan is desperately trying to push stock prices down smoothly, Elliott said, because "he knows that the alternative could be a full-scale panic."

Some British and continental European commentators are finally waking up to what LaRouche and *EIR* have been saying. But they have yet to draw the necessary conclusion: That the current financial system is hopelessly bankrupt, and needs to be replaced with one that values the physical economy of nations—not the profits of shareholders.