Europeans fear U.S. is on road to financial disaster

by William Engdahl

Less than one week following the chaotic Washington meeting of the Group of Five industrial nations' central bankers and the International Monetary Fund, the provisional debt agreement between the major New York-led creditor banks and Mexico began to show signs of unraveling. The indications from major West European banking circles, especially in London and West Germany, is that a major shift in attitude is underway against the growing disaster in the U.S. financial markets.

"European banks, especially continental banks, are increasingly in an isolationist mood. This is being fueled in part by the sharpening of tensions between the [West German] Bundesbank and the U.S.," declared one senior City of London financial community source to *EIR*. "Increasingly, they don't want to become further involved in what they see as U.S. problems. They see the U.S.-ordered bailout for Mexico as political, not an economic move," he stressed. "Continental banks want to form some kind of independent European financial system," to shield themselves from a collapse of the dollar sector, he added.

Inside the United States, the reality of the policy split that emerged during the course of the IMF meetings has been papered over by pompous utterances from James Baker in the U.S. Treasury Department and Paul Volcker at the Federal Reserve Board. These two prime shapers of U.S. monetary and credit policy, to maintain the appearance that they continue to have the upper hand, have solemnly announced that the Europeans, and more particularly the Germans and the Japanese, have until next April to bring their policy into line with U.S. dictates.

This is the political side of the dominant U.S. concern of the moment: namely, to avoid a financial blowout in the weeks immediately before the November midterm elections, while attempting to push off all major problems into next year. Volcker and Baker's April deadline for Europe and Japan is also the time span in which the financial fudgery employed for fiscal 1987 budget discussions, as Congress and the administration employed the tricks of the conjurer's repertoire to create the illusion that Gramm-Rudman deficit targets had been met, will also come apart.

Whether such time-buying efforts can continue to work, under conditions of aggravating conflict between the United States and its major financial partners, is another question. Interestingly enough the split that did emerge between the United States and the allies has been the prime focus of Soviet coverage of the International Monetary Fund conference, and has been the unusual feature of TASS coverage of those proceedings. West Germany, especially in recent weeks, has been offered economic carrots, as part of Soviet strategy to fracture the alliance. Among the options for the above cited "independent European financial system," is a gold-based hook-up between the economies of East and West Europe at the expense of the United States and its dollar. Whether Volcker and Baker know it or not, and from Volcker's presence at a conference on economic policy in Venice at the end of August, they are helping the Russians achieve their strategy for the final dissolution of the Western Alliance.

Apart from bitterness over the way U.S. authorities have handled the questions of interest rates and monetary policy, U.S. handling of the recently concluded debt renegotiation package with Mexico has also served as a lightning rod for the split. A spokesman for the leading London financial monthly, *Euromoney*, which organized a recent international bankers' conference, told *EIR*: "There is a great undercurrent

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of dissatisfaction among many banks, especially in the regions of U.S. as well as Europe over how the U.S. has handled the Mexico debt issue."

As part of the charade of "I'm all right, Jack" at the Sept. 30 International Monetary Fund meeting, Federal Reserve chief Paul Volcker and Treasury Secretary James Baker III placed extraordinary pressure on the private banks to announce agreement to funnel an additional $6 billion to keep the Mexico debt game going. As the London leading bankers' daily, *Financial Times,* put it on Oct. 7, the new Mexican loan agreement was struck "only after brutal pressure from Paul Volcker." The same paper admitted the new money is probably "the last of the old-style operations in which creditors put up large amounts of new money just so that interest payments [to the banks] can be maintained. . . . Many lending banks have used them to keep their exposure to Latin America current during four years of crisis."

The upshot of this lunatic policy has been that the major New York banks have continued to keep dangerously worthless debts on their books, while many regional and especially continental European banks have quietly gotten the risky paper off their books even at losses of 40 cents on the dollar or more.

This reality is highlighted by the renewed flurry of speculation about the continued viability of the giant Bank of America. Though that bank, according to some insiders, has been kept around, as a kind of 'time-bomb' to be detonated under the administration any time Volcker sees fit, its condition, relatively speaking, is no worse and certainly no better, than any of the other large American banks. Outside the United States, ongoing take-over discussions, at the deflated price of $1.5 billion for the once enormous bank, are cited as merely indicating the overvaluation of the paper assets of the rest of America's giant banking corporations.

The Gleneagles accord

Recent falls of the dollar on foreign exchanges have prompted unprecedented European central bank intervention, in the absence of any Washington move to support its falling currency. The intervention was agreed upon at a September meeting of European Community finance ministers just prior to the IMF talks.

That gathering, at Gleneagles, Scotland, produced an agreement among European central banks to intervene to stabilize exchange-rate pressures coming from further Washington unilateral lowering of interest rates. The Oct. 6 *Wall Street Journal-Europe* reported that certain European diplomats suggest increasing policy friction between Washington and Europe over interest rates and economic coordination "could create an explosive mixture threatening major damage in relations between the U.S. and its allies."

"This is 'Ponzi finance,'" said a spokesman for London's Standard & Chartered Bank to *EIR,* in reference to the speculative paper debt pyramid exploding in the United States over recent months. (Ponzi was a notorious financial "chain letter" swindler in the early 1920s operating in the United States.)
is real danger in things like mortgage-backed securities, for example. Such security loans do well as long as market values always rise. But they are worthless in a falling market." The same source went on to warn, "If a bear market really takes hold, and I think it will within the next year, then there will be a collapse in the financial system. Central banks are moving from one dead end to another. If securities [stocks and bonds] markets go, this is more dangerous for the economy than a simple bank failure. Securities market collapse will spread to financial institutions and quickly into the real economy."

Volcker and Baker are desperately trying to buy time to keep this mess afloat. Meanwhile, the vessel is springing holes in other parts of its hull, but below the water line. London, the world's second largest financial center after New York, and the center of the multi-trillion dollar "Eurodollar" markets, is a potential trigger for major collapse problems. One London banking source warned privately that the Oct. 27 financial deregulation scheduled in the City of London, modeled on Donald T. Regan's revolution in Wall Street in the 1970s, will produce a major fallout and series of failures of stock brokerage houses under new rules of cutthroat competition.

"Because now all the brokerage houses have merged into big international banks, such stock problems will quickly spread to the banks and, of course, to the Eurodollar markets which are based in London." The same source warned that a combined fall in stock prices with a simultaneous rise in interest rates could create pre-conditions for "default on a massive scale."

This "double whammy" of simultaneous stock depression and interest rises is precisely the time bomb which is ticking in London. On Oct. 8, the British pound sterling plummeted to record lows against the German mark and other major currencies, leading to predictions in London financial circles that the Chancellor of Exchequer, Nigel Lawson, will be forced, unwillingly, to raise United Kingdom interest rates by at least 2% to stop further flight out of the pound.

Lawfully enough, given the perverse nature of the bankrupt system Volcker and Baker are so anxious to appear as presiding over, a successful effort by the Europeans to support the dollar will, over the next few weeks, contribute to further undermining the pound sterling, in reality the weakest of the alliance currencies, and will therefore make the crisis facing the dollar credit system infinitely worse. It's a mixture guaranteed to destabilize the Euromarkets as a whole.

As one observer stressed, the mooted British interest rate increases will "dampen enthusiasm for stock market investment just weeks before the government plans the huge private sale of British Gas on the stock market." It will ominously come also at the eve of the "Big Bang" financial deregulation of Oct. 27, and perhaps unleash much more than is presently expected, especially by those who think they are in the know.