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Will there be a world financial crash by May 15?

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Treasury Secretary Baker, Budget Director James Miller, and White House Chief of Staff Howard Baker succeeded, in a Chinese fire drill April 17, in convincing the world that a general financial catastrophe would emerge sooner, rather than later, and perhaps as early as the middle of May.

Budget Director Miller, who called reporters into his office to warn that rising interest rates would put the United States into "deep soup," was right; as *EIR* reported last week, a rise of U.S. interest rates by another 2% or so will bankrupt the entire $1.2 trillion savings system, triggering a chain-reaction run against bank deposits, collapse of bond prices, and a general banking crisis. The bankruptcy of the world banking system since Mexico's August 1982 de facto moratorium, and the May 1984 collapse of Continental Illinois, has been covered by lower interest rates, which permitted the entire banking system to earn securities-trading profits, to replace the income on bum loans. Rising rates will take the thrifts out first, and bring the rest of the system down with it.

The events of April 22-23, on which the dollar fell to new record lows against the Japanese yen despite an estimated $3-$4 billion worth of currency intervention, and long-term bond prices fell by almost 3% of their total value, may well have marked the turning point at which everything went out of control.

Top London bankers are convinced that a general crisis may emerge by May 15. "Unless the U.S. acts very soon, we will have a catastrophe," a spokesman for one of London's leading international banks said. He pointed to the midnight May 15 expiration of the U.S. government debt ceiling. "If Congress fails to approve a new ceiling by then, it reverts automatically to last year's lower ceiling. This hits at the time of the next quarterly Treasury bond auction, which needs to raise $28 billion between May 6 and May 15. Then, if, under present pressures, Japan is not a major buyer in those Treasury sales, U.S. bond primary dealers holding the bonds could be forced to unload their paper. This could trigger a real fall in bond markets."

What a "real fall in bond markets" may signify, must be judged from the fact that the Treasury 30-year bond, the benchmark for the market, has lost 11% of its value since the end of March, the most rapid collapse of U.S. government bond prices in history; that is a rough index of the credibility of Washington's non-policy. Since not only U.S. thrift institutions, but the banking system in general, have "securitized" their portfolios extensively during the past five years, a 30-50% collapse of the Treasury bond market will eliminate the equity position of the entire dollar-based banking system.

Washington's trade pressure against Japan appears to have backfired; the dollar is now falling out of control, despite Secretary Baker's belated efforts to "talk the dollar up." In an April 20 television appearance, Baker went as far as to say that Washington would tolerate higher interest rates, in order to keep money flowing into the dollar.

The dollar proceeded to collapse to its lowest levels ever against the Japanese yen regardless, watching Washington's hands—i.e., the trade sanctions against Japan—rather than its mouth. European central banks intervened in early trading with an estimated $3-4 billion in order to prevent a dollar fall following the abrupt breakdown of talks in Tokyo and Washington. U.S. Trade Negotiator Clayton Yeutter and Agriculture Secretary Lyng left Tokyo April 22 telling reporters they were "very disappointed at the stance taken by the Japanese." According to European financial dealers, this sparked renewed selling of dollars. News of the Japan-U.S. breakdown was reported in London to be behind the 51-point fall in the New York stock exchange after close of trading hours in London on Wednesday April 22.

The stock market's whipsaw on April 21 and 22—up 66

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points, then down 51—convince Western European financiers that a market crash is at hand. "These markets have become so volatile in the last days that the financial community is expecting a major crack to occur," emphasized a spokesman for a major West German bank today. London financial sources say the 51 point fall on Wall Street, following the roller coaster up/down fluctuation of the previous week, "is significant not so much for its size, but that it indicates a major direction shift. The bull market is over."

Europe views the debate between higher interest rates and a stable dollar with undisguised horror. "It is argued that unless interest rates go up, the dollar will go down, down, down," said a prominent London banker. "But, if the U.S. does increase interest rates, this could bring about a slump of horrendous dimensions. Look at the scale of indebtedness in the U.S. Now, add to that an increase in the cost of debt. Companies who have to borrow will go bust. Banks that have high debts tied up in these companies, will also go bust. It's an open question, if major American corporations and banks can survive this. My estimation is that, what has already happened in the U.S. farm sector and in the U.S. energy sector, will multiply into the U.S. industrial heartland, where we will see the next collapse process in the U.S."

Gold at $800?

"Capital is flowing out of the dollar; the question is, 'where is it going'?" said an officer of a major Swiss bank. "It's not going into Eurobonds. Not into Japanese stocks or D-marks. If the German economy even had some good news, it would be easier, but it is all bad, so it's not going there. Gold? People are trying to hedge, or get into cash. The only market not being hit by this volatility is the foreign exchange, and only because of concerted central bank intervention."

The Swiss banker added, "For six weeks, we have been advising our clients to get out of dollar-denominated stocks and bonds." Not only the Swiss are blowing the whistle; reportedly, E.F. Hutton told clients during the third week of April to "get out of U.S. equities." Hutton is reportedly advising clients to diversify into a portfolio with "35% cash and 10% gold," because of the extraordinary market uncertainty.

On March 18, Swiss Bankers' Association official Hans-Georg Rudloff warned that the world stood at the brink of history's worst financial crash. One of his most prominent colleagues, Hans Vontobel of the bank bearing his family name, now advises investors to put money only into best-rated banks, treating others as if already bankrupt. Vontobel states that "all United States banks are in a bad situation, because of their high Latin American debts." The one exception he makes is J.P. Morgan Bank, which is given the exclusive "A"-rating, together with five others—the three leading Swiss Banks, Deutsche Bank and National Westminster Bank.

All the other banks follow, in Vontobel's rating-system, in due distance: Chase Manhattan Bank, for example, is rated in the fourth category only, together with Germany's bankrupt Bank für Gemeinwirtschaft. In the fifth category, Vontobel places Banco do Brasil and Banco di Roma, and Bank of America is found in the sixth category—no good sign, as the seventh category is already reserved for banks "gone beyond the brink."

Gold has already reached a four-year high of about $450 an ounce, and the panic rush out of dollars may push it much higher very soon. "There simply is not enough physical gold out there to be gotten" in the event of a flood of panic money into precious metals, according to one of London's leading gold analysts. "At present there may be some 50 tons total to play with in the whole world. At today's price, this represents only 2.5% of the present capitalization of IBM. If gold goes over $500, it could really go through the roof, because people will really start stampeding to buy."

Misestimating the Japanese

Japanese investors' apparent boycott of the U.S. bond market appears to have been left out of Washington's calculations. The U.S. Federal Reserve is in a struggle 'almost like a game of chicken' with Japan, the *Wall Street Journal* European edition reported April 23, confirmng what *EIR* has said for months. The Fed is refraining from "nudging U.S. interest rates higher because it doesn't want to take pressure off of the Bank of Japan to ease credit, according to U.S. officials."

Rather than be bled, the Japanese have decided to throw their financial weight around. The British government has already backed off, tail between legs, from an emerging trade confrontation with Japan. Said one knowledgeable British source: "The British buckled in, not the Japanese, and suddenly the Thatcher government has abandoned its confrontationist stance, of threatening to close down Japanese financial institutions operating in London. The British sent a minister to Tokyo, to threaten and badger the Japanese. The Japanese responded: 'You'd better pack your bags and go. We don't talk under threats.' Since then, people in the City of London have put great pressure on Margaret Thatcher, not to do anything to alienate the Japanese, because there is great fear of losing Japanese funds, which are holding up the equity markets."

The U.S. securities market is far more dependent on Japanese funds than London's, and Washington officials may find themselves with nothing left in their pension funds if the confrontation continues.

However, Japan's special envoy, Shintaro Abe, visiting Washington April 22, did offer Washington a way out: Japan will put $30 billion over three years into a special fund for Third World debtor nations. Informed Washington sources translate Japan's offer: If you adopt a sensible plan for the Third World debt crisis, we will offer substantial help; if you continue to act irrationally, we can take these markets for ourselves.