EIR Economics

Reality is popping Wall Street's bubble

by John Hoefle

The outlook for Wall Street is "negative," according to the credit-rating agency Standard and Poor's. On March 28, S&P dropped its outlook to "negative" from "stable" for six of Wall Street's top investment banks, Bear Stearns, CS First Boston, Goldman Sachs, Morgan Stanley, PaineWebber, and Salomon. Retaining its "negative" outlook was a seventh Wall Street firm, Lehman Brothers, which was downgraded by S&P last September. On March 21, Moody's Investors Services, another credit-rating agency, had downgraded Lehman's long-term senior debt to BAA1 from A3, triggering a sell-off in the firm's stock.

"Turbulent conditions continue to plague the global capital and currency markets, exposing most of these firms to trading results that could further aggravate" their problems, since "core earnings for some firms may prove insufficient to absorb potential trading losses," S&P said. "We worry about the tendency of market turbulence to feed upon itself," S&P Managing Director Mark Bachman told analysts. "This is a dynamic that poses a direct threat to most of these firms. . . . Until we have a more stable market environment, we don't feel comforted by what we see."

The S&P action confirms the report given to *EIR* by a senior European banker who had just returned from extensive client meetings with numbers of top fund-managers, banks, and Wall Street firms.

"The major Wall Street houses are in the worst possible situation," the banker advised. "I have never seen a situation such as I just saw. Last September, when I was in New York, the mood was simple panic. Today it is beyond panic. These seasoned investment managers have gotten every major shift of global markets wrong in the past six months. They are utterly bewildered. But more to the point, I heard again and again in private discussion three names: J.P. Morgan, Bankers Trust, Goldman Sachs. They are rumored by market insiders to each have suffered huge losses. They are losing their corporate clients, who used to pay them hefty fees to buy derivatives. After the derivatives disasters of the past months, these corporations are refusing to buy, and this is hurting these banks' business badly. To compensate, they are reportedly being more risky than ever in their own proprietary trading in markets, making mistakes and compounding losses. There is widespread talk in the New York markets that no one would be surprised to see one or even all three firms go 'belly up.' "

Losses in the trillions

"World markets are heading toward a long-term negative phase," wrote Munich-based investment manager Jens Ehrhardt in the March 28 issue of the German daily *Die Welt,* under the headline "Many Signs for a Market Crash—Preconditions as Bad as 1929."

Ehrhardt noted that "the stock market decline in Japan, from 40,000 to now below 16,000 points, means that investors have lost more than $3 trillion. . . . Last year's crash of the century on international bond markets has wiped out another $3 trillion." Furthermore, he added, "the decline in worldwide real estate markets in recent years has reached a multiple of this." On top of that, he said, overall stock prices on the New York Stock Exchange have fallen by 30% in one year, despite the record highs reported by the 30 stocks of the Dow Jones Industrial Average.

The Germans have reason to be worried. A few weeks ago, Deutsche Bank, one of Germany's big three banks, reported losses of $18 million in derivatives trading in France, and it is rumored to have lost an order of magnitude more than that. On March 14, Deutsche Bank's stock fell

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heavily on the Frankfurt DAX stock exchange. Deutsche Bank, which reported profits of $2 billion in 1994, compared to $2.9 billion in 1993, is not alone when it comes to derivatives losses. Germany's Metallgesellschaft reported $1.3 billion in derivatives losses in 1993, and the German firm Balsam lost $400 million in derivatives last June.

Hans Tietmeyer, the chairman of the Bundesbank (the German central bank) responded to these rumors in an address to a gathering of the Saar banking association in Saarbrücken, with what he termed an "unmistakable warning." Freedom and responsibility go together, Tietmeyer said, and "whoever wants to realize potential gains must also be prepared to realize potential losses. He who wants to neglect this principle will have to learn a lesson . . . that can be bitter." In the event of a Barings Bank-style crisis in Germany, the central bank chief warned, "the central bank cannot and will definitely not be available with generous liquidity as a life-saver." Any attempt by investors to compensate for their losses by passing the risks on to third parties, will not be tolerated, he warned.

In France, the banking crisis escalated, when the government announced on March 27 that it was pouring a $200 million emergency loan into the state-owned Banque Société Marseillaise de Crédit. The bailout of Marseillaise Bank follows on the heels of the emergency $20 billion loan the government gave to Crédit Lyonnais, the largest bank in Europe and one of the world's 15 largest banks.

The problems at Crédit Lyonnais, which lost $2.4 billion in 1994, are actually much worse than has been admitted, but are being covered up until after the presidential elections. Meanwhile, European press reports indicate that the collapse of French real estate values of between 40% and 50% over the last couple of years, have led to some $40 billion in unreported losses at French banks.

Observers expect more emergency support actions for other financial institutions, as the French government tries to head off a chain reaction which could take down the whole state-owned banking sector.

In Japan, banking problems have led to the merger, announced by the Bank of Japan (central bank) on March 28, of the Mitsubishi Bank and the Bank of Tokyo. The merger, which will combine Japan's third- and tenth-largest commercial banks, will create the largest bank in the world, with assets of more than $800 billion. The new bank will be more than three times the size of Citicorp, and larger than Citicorp and Crédit Lyonnais combined.

The Bombay Stock Exchange, India's largest, was closed for three days beginning on March 22, due to the failure of broker R.S. Jhaveri to pay $5.4 million for shares he had purchased.

Growing resistance

Meanwhile, the $51 billion rescue package arranged for Mexico by the U.S. government and international financial institutions, is already falling apart. The commercial banks have withdrawn their $3 billion in promised financing, leaving $48 billion to cover $63 billion in payments due this year. Furthermore, thanks to default clauses in other debt agreements, should Mexico default on any payment this year, another $60 billion would become payable immediately, leaving the country with just $48 billion to cover $123 billion in payments due.

More than 1 million people have lost their jobs, and over 1,200 companies have shut their doors in Mexico over the last four months, while purchasing power has dropped by 25%, according to the Mexican Labor Federation. With interest rates of over 80% on government bonds, and credit card rates as high as 170%, those losses are escalating, and pressure to reject the austerity measures imposed by the International Monetary Fund are rising.

"It must be stressed that Mexico's economic troubles are neither the origin, nor the cause of the crisis we are currently undergoing, but merely the isolated symptoms of a problem that is affecting the whole world," wrote Gil Gil Massa, a Mexican Embassy official in the Dominican Republic, in an open letter in the March 22 Dominican daily *El Nuevo Diario*. The Mexican crisis was the "detonator for other explosive charges beyond our borders," he wrote, "but the gunpowder was not Mexican." The real explosive, he stressed, was global financial speculation, and what happened in Mexico, foreshadows events to come globally.

In Argentina, where the Inter-Press Service reports that some 30,000 companies have closed since the Dec. 20 devaluation of the Mexican peso, opposition is also growing.

"Human Beings Come Before Usury," was the headline of an article by Carlos González, political secretary to former Argentine President Arturo Frondizi, in the March 17 Argentine weekly *El Informador*. "The foreign debt is unpayable, not only for Argentina but for all of Ibero-America."

Global crisis

"There is a global financial crisis; the entire system is coming down," Lyndon LaRouche observed in an interview with the weekly "*EIR* Talks" radio show on March 28. "Argentina's going down the tubes. Chile is a different case, but it's also in trouble. Brazil is on the edge. Italy is contracting, collapsing. Spain is disintegrating financially; the government may fall soon. France: The Crédit Lyonnais problem is *bigger* than the Barings problem, and nobody knows where the bottom is. . . . In London, by May perhaps, [Prime Minister] John Major will be out of government, totally as a result of this combination of events, including the Barings event. The empty suit of clothes called John Major is simply going to be sent to the cleaners, shall we say."

The ability of the international financiers to sustain their speculative bubble is ending, LaRouche warned. The bubble is too big, and the world economy too depleted.