

Central bankers scramble to stop financial blowout

by William Engdahl

Considerable attention has been given to new daily record highs on Wall Street and almost every major European stock market, with the Dow Jones Industrials index topping 6,000 points. Financial analysts are predicting a near-term Dow Index of 7,000 or more. In less than 18 months, the nominal value of the Dow Industrials has risen by a staggering 50%, and total market capitalization, on paper, of all publicly traded U.S. stocks exceeds \$6 trillion. Stock markets from London to Frankfurt have followed the Dow, breaking all previous records, as money flows in with no apparent end in sight.

Underneath the euphoria of these rising stock prices, however, the systemic crisis is obvious to anyone who cares to look behind the market headlines. Leading financial authorities, from the International Monetary Fund's (IMF) Michel Camdessus, to the Bank for International Settlements, have stepped up the tempo of warnings of looming bank crises. Governments, from France to Thailand to Brazil to Japan, are nervously trying to deal with unprecedented local bank losses. The reality is that the rotted-out international banking system is in slow-motion disintegration and could, at any moment, come crashing down.

This all is reminiscent of the late 1920s speculation frenzy. Then, too, stock markets reached unbelievable highs. When Wall Street finally cracked in October 1929, it was no mere stock market "correction," as had often occurred before. Instead, bank liquidity, from New York to Vienna to Berlin to London, simply vanished, leading to a chain-reaction collapse of the international banking and monetary order.

Alarm at the BIS

Less than a week following IMF Managing Director Camdessus's unusually blunt warnings of new national bank-

ing crises (see *EIR*, Oct. 11, p. 4), the Basle-based Bank for International Settlements (BIS), the organization of the world's major central banks, issued detailed new recommendations for "Supervision of Cross-Border Banking."

According to sources familiar with the background to the new BIS rules, which attempt for the first time to set minimum regulatory standards for the major offshore or unregulated foreign operations of OECD-country banks, "this isn't a response to the BCCI fiasco, as many are claiming." This latter is a reference to the Bank of Credit and Commerce International and its vast offshore banking empire, formerly backed by Britain's Thatcher government, and used as a vehicle for illicit arms and other deals by George Bush, Margaret Thatcher, and others until the bank's liquidation by British government authorities in 1991. "The latest BIS call reflects a growing sense of alarm among international banking regulators to the accidents out there, just waiting to happen," said an informed source.

The BIS report is aimed at banks in OECD countries which have subsidiaries in the world's major offshore bank secrecy havens. The BIS brought in bank supervisors from some of the world's most notorious money-laundering havens, including Cayman Islands, Gibraltar, Netherlands Antilles, Singapore, and Bermuda, to sign the final report. It was the first time such centers have been involved with BIS rule-making. "It's not a delayed reaction to BCCI or Barings Bank. Every major OECD bank today has one or sometimes many international offshore operations. These make control by the central banks of potential problem banks, all but impossible," noted one European banker.

A hint to what has the BIS central bankers alarmed, came in a report in the German financial daily *Handelsblatt*.

In an Oct. 14 article datelined Washington, the paper detailed a recent private experts' seminar, held under auspices of the Institute for International Economics in Washington. According to the report, the seminar, which included some of the world's leading bankers, as well as prominent people from the IMF and BIS, warned of an imminent new series of "Mexico-style" currency crises, to hit various Third World countries.

According to *Handelsblatt*, former J.P. Morgan Bank chief economist Rimmer de Vries warned, "This time, unlike two years ago with Mexico, if problem debtor countries like Thailand or Turkey have a currency crisis, there will not be any billion-dollar rescue packages. The crisis will simply be allowed to happen." De Vries went on to attack the headlong rush of major banks and investment funds into high-risk Third World markets, in search of ever-higher gains. "What today is called 'emerging markets' by the international credit markets, can only be likened to a casino," de Vries said. "And the time will come when the banks and investment funds responsible for this will simply pull the rip cord," that is, bail out and run. Ironically, de Vries's former bank, J.P. Morgan, is currently running full-page ads in the financial press that say, "Morgan means more in emerging markets."

According to the IMF's latest statistics, the flow of capital into these "emerging markets" is of staggering dimensions. In 1990, the total net flow of funds, including loans and direct investment as well as purchases of stocks or bonds, was \$57 billion. By 1993 that sum had risen to \$180 billion. Now, only months after the Mexico shock, the flows have again surpassed all records. In 1995, a sum of \$211 billion went to these emerging markets, and this year that record will be passed by far, at present trends.

Crisis looms in the 'emerging markets'

"The problem the next time, is that there is much resentment among especially the European members of the IMF and BIS, over the strong-arm tactics of Washington in arranging the Mexico bailout last year," said S.J. Lewis, a senior City of London financial market analyst, to *EIR*. "But the big banks and, especially, U.S. mutual funds, have again been piling into these markets, seemingly without care. A major accident is inevitable at some point."

Lewis noted a number of potential crisis candidates, including Brazil, Mexico, Indonesia, and Thailand—the last, until recently, one of the "success stories" of East Asia. "Thailand's finance minister just resigned, after only five months in office. The real issue is the licensing of banks. In Thailand, to get a bank license is tantamount to a license to print money. Thailand is notorious for its lax central bank supervision," Lewis added. On Oct. 14, Finance Minister Bodi Chunnanda resigned unexpectedly, only a month before national elections, leading to market speculation that Thai banking and financial problems were far more serious than generally

recognized. The Bangkok Stock Exchange, where large foreign investments have propped up the Thai currency in recent months, fell by another 1.5% after the news of his resignation hit. Since last year, stock values have fallen by over 30%. With Thai dependence on short-term borrowing, and with the value of company stocks collapsing, and, with declining exports, all the ingredients for a new Mexico-style currency crisis appear in place.

Indonesia has been mentioned by some as a potential crisis candidate, given the growing political opposition to the Suharto regime and signs of similar hot-money flows creating a bubble in Jakarta real estate and stocks in recent years. And even Malaysia, which had been hailed as an example of sound "emerging market" growth in recent years, is causing some concern among investors.

Trouble in Europe, Japan

But today's banking problems are in no way restricted to these "emerging market" economies. The problem involves the banks of the world's largest industrial nations, including especially Japan, but also France, as well as significant yet-hidden problems in a number of other countries. One major shock could force all these hidden problems into the open. "All it would take at this point would be, for example, a wire report that Yeltsin had died of heart failure," stated one European banker.

Japan bank bad loans, unofficially, are estimated at anywhere between \$800 billion and \$1.2 trillion, despite an almost six-year attempt by Japanese authorities to deal with the mess left from the collapse of the 1980s "bubble economy" of real estate and stock speculation. While more than 15 months of record low interest rates of 0.5% have taken that crisis off the front pages of the world's newspapers, French banking continues to hover on the brink of a major new crisis.

"The problem is *Crédit Lyonnais*," one senior Scandinavian banker told *EIR*. "Their losses from the misdeeds of the 1980s are simply too huge for the state to hide or to swallow." Recent estimates are that an added 100 billion French francs (\$20 billion) will be needed to clean up the huge bad debts of the largest French bank. "Because it is a state-owned bank, there won't be the classic 'run' on deposits," the Scandinavian banker continued. "The French taxpayers will simply have to pay." The bank just asked the state for another FFr 12 billion (\$2.4 billion) last week, to stabilize the bank's capital reserves.

"But if *Crédit Lyonnais* is now forced to dump its bad loans, something it and the government resist, that alone would bring down the entire Paris real estate market, and numerous insurance and other financial entities with it," the banker said.

In Belgium, which has been rocked by scandals of murder and pederasty in recent weeks, Parliament has just opened an investigation into \$1 billion in losses by the government in

ill-conceived derivatives speculation between 1989 and 1992. The Parliament recently gave Prime Minister Dehaene emergency powers to rule by decree, reminiscent of the austerity-by-decree Heinrich Brüning regime in Germany in 1930-32. Dehaene's mandate is to slash public spending in order to meet European Union public deficit targets for the European Monetary Union, due in 1999.

Standard & Poors has put a number of German banks on its credit "watch list," expressing concern over the depression in German real estate in recent months.

Governments must act

The global financial system is in such a precarious state at present, that any of several events could trigger a collapse. Several European bankers have suggested that a crash in the inflated U.S. government bond market, triggered by soaring oil prices, could do it. Given the sheer size of the U.S. bond and stock market, that market is viewed by many as the greatest danger point. And given the United States' dependence on foreign borrowing to support its debt, a crisis in the dollar would detonate an explosion.

Foreign central banks' holdings of U.S. Treasury securities (long- and short-term), as of Oct. 2, totalled a record \$591 billion. Rumors are rife that Asian central banks have begun to quietly dump dollars for other currencies. Were that to accelerate, and were European central banks to follow, and the dollar go into free fall, that in turn would pull stock and bond markets down with it. Given the extent of global financial derivatives contracts, some \$40 trillion worth by BIS estimates, such a dollar crisis could spread at lightning speed.

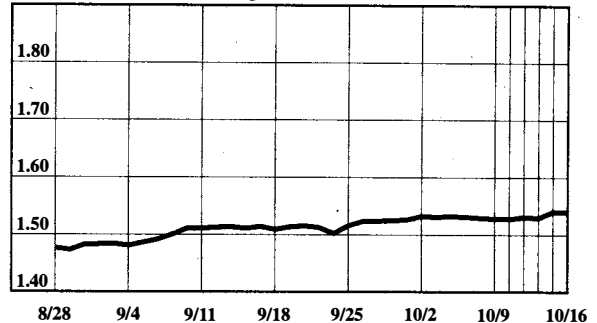
Whatever the possible detonator, the relevant issue at present is what steps governments are taking to preemptively deal with such a crisis. In the last such global systemic crisis, that of 1929-33, it was foolish governments, beginning with Herbert Hoover's United States and Brüning's Germany, which rigidly held to the orthodoxy of Montagu Norman and the Bank of England's gold standard. That monetary orthodoxy dictated savage public spending cuts to maintain budget "balance," and to stabilize the tie to the fixed value of gold. The result turned a stock market crash into a global depression.

Today, the very same governments are replaying the same madness. The deflationary role of the gold standard is now being played by the Maastricht Treaty's rigid limits on government spending for the 15 nations of the European Union. In the United States, the Republican Congress has blocked vigorous government action to rebuild national economic infrastructure, the only way to shift into sustained real economic growth again. When the full-scale financial dimension of the crisis erupts, these political fetters in the world's major industrial economies will prevent emergency action, unless there is a dramatic policy shift by the U.S. administration in the very near term.

Currency Rates

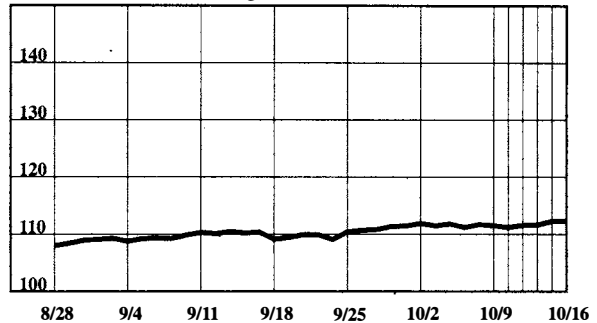
The dollar in deutschemarks

New York late afternoon fixing



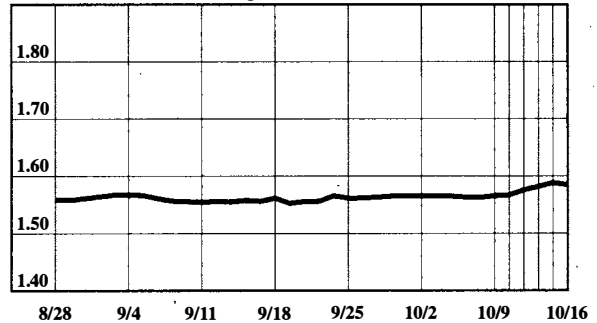
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing

