

## World financial system 'at the boundary layer'

by William Engdahl

On Friday, Aug. 15, within a space of some minutes, the Dow Jones Index of 30 industrial companies lost 247 points, or 3.1%. It was the second worst one-day fall in the history of the New York Stock Exchange, exceeded only by the 508 point drop of Oct. 19, 1987 (a 23% drop). The following Monday, Aug. 18, stock markets across Europe sank between 2% and 3%.

Then, over the next three days of trade, markets in New York and Europe rebounded to new highs, as if nothing had happened.

Is this a sign of the resiliency of the longest and most astonishing stock market rise in world history, as Wall Street economists and stock salesmen from mutual funds argue to their clients? Or is it an ominous warning, much as there were such forewarnings in the weeks before the October 1929 crash, to get out now, before it's too late?

Commenting on the global financial volatility, Lyndon LaRouche stressed, "We are in a boundary layer between two points in time. The past 30 years has been leading up to this point, which has now produced a boundary layer, a layer of maximum turbulence and instability, from which the system will never come out alive."

LaRouche added that the escalating series of crises—from Asian countries like Thailand, to the volatility of stock markets of the United States and most of Europe, to the wild gyrations of the currencies of the world's major trading nations—all add up to a qualitatively new kind of crisis, the end of the postwar monetary and financial system created in 1944 at Bretton Woods, New Hampshire.

"This is not a financial crisis," LaRouche insisted, "or a monetary crisis, or a crisis in the business cycle. It is the accumulated effects of a failed change in policy, which was first formally introduced in the United States in the form of

a population policy perspective in 1966." At that juncture, President Lyndon Johnson made the decision to escalate the catastrophic war in Vietnam, reversing one of John Kennedy's last acts. At the same time, the United States began to slash spending for advanced R&D and technology of the NASA space effort, and opened the floodgates for what became a "post-industrial" era of financial deregulation, disinvestment in economic infrastructure, and short-term hot money flows.

### 'Crash territory'

There is ample evidence to back LaRouche's characterization of the recent turbulent events.

The temporary calm on major stock markets is just that. Commenting on the bloated asset inflation which has driven nominal values of all U.S. publicly traded stocks, so-called total market capitalization, above the incredible \$10 trillion level, Michael Murphy, a California-based fund manager, told *Barron's* financial weekly on Aug. 18, that a "2,000 point drop in the Dow" is imminent, cautioning investors to sell their stocks and hold cash. George Andersen, economist for a large European bank active in global financial trading, added, "This past Friday, Aug. 15, was just a dress rehearsal for what is about to come. We have entered into what I would characterize as 'crash territory.'"

"The developments on the Dow, and on European stock markets, in the dollar and in bond markets, all are moving in the direction where the slightest unexpected shock could trigger a major crash," Andersen explained. "It will take a couple more days like last Friday to really trigger the panic. It could come from some unexpected news. Compared with even two weeks ago, there has been a complete change in mood in the international financial markets for the negative."

The situation is further aggravated by the crises sweeping across Asian economies, which are beginning to have a global impact. The Basel central bankers' organization, the Bank for International Settlements (BIS), announced on Aug. 20 that it would give an immediate \$3.3 billion "bridging loan" to help calm the shaky Thai currency, the baht, which has been in free-fall since May. The BIS report came as the baht hit a record low of 32.6 to the dollar, a 26% fall since it floated free July 2. The Thai BIS loan is merely to get ready dollar cash into the hands of the Bank of Thailand immediately, until the International Monetary Fund can complete arrangements to transfer its part of what will be at least \$16 billion in a Mexico-style emergency rescue package for Thailand. This is an indication that central bankers regard the Thailand crisis as crucial for world financial stability.

### **The Asia trigger**

While Thailand arguably had a speculation bubble in real estate and a mountain of worthless real estate loans, a huge balance of payments deficit, and falling exports, all which made the baht ripe for speculative attack, the crisis in Asia is spreading to economies large and small. On Aug. 13 the Bank of Indonesia, after spending more than \$1.5 billion of its valuable dollar reserves trying to keep the rupiah stable, admitted defeat and let the currency float. It forced short-term interest rates above 30%, triggering panic selling on the Jakarta Stock Exchange, over fears of severe economic recession. The Jakarta stock index fell 24% from its all-time high a month before the float.

Similarly, the Malaysian ringgit fell to a four-year low and the Singapore dollar, reputed one of the strongest currencies in Asia, was hit by massive selling pressure. On Aug. 15, the Hongkong dollar became a target of speculators, with the monetary authorities there forced to raise overnight rates sharply to hold the peg to the U.S. dollar. The result was a 3.9% fall in the HangSeng stock market on Aug. 19. Some Asian financial sources regard the attack on the Hongkong dollar as a prelude to an ultimate speculative attack on the currency of mainland China.

As the Thai, Philippine, Indonesian, and other Asian currencies have fallen against the dollar, making their exports to Europe and North America potentially more competitive, China's currency has risen against the dollar. At some point soon, currency traders believe the Bank of China will be forced to abandon its firm strong currency policy, part of an effort to attract huge foreign direct investment in modernizing its economy, and sharply devalue. That would potentially lead to a vicious round of Asian competitive devaluations, whose effect would be to flood the world markets with cheap manufactured goods, not unlike what took place in the early 1930s.

But not far in the background to the dramatic unwinding of the currencies and economies of Asia is the debacle in Japan. During the period of Japan's internal financial col-

lapse, after its stock market and real estate bubble collapsed in 1990-91, Japanese banks shifted their focus into other Asian economies, such as that of Thailand, to make a profit. The yen at that time was rising to new postwar highs against the dollar, making it ultra-profitable for Japanese banks and corporations to invest in Asia, while the domestic economy went into depression.

Japanese banks have been the largest lenders to Thai companies, as well as to most Asian growth economies, over the past decade. Those same Japanese banks, however, are still choking on an estimated \$1.2 trillion of worthless real estate and other loans they made in the late 1980s "bubble era," mainly to Japanese real estate and construction companies. On Aug. 19, Daito Kogyo, a mid-sized construction company, filed for bankruptcy, with \$1.3 billion of debts owed its bankers. In total, Japanese banks have more than \$270 billion of loans to such construction companies on their books. New rules from the Ministry of Finance which will police bank lending more closely after Sept. 30, have led to a credit freeze by Japanese banks to such smaller companies. That, in turn, is preventing any economic recovery in Japan which could allow the banks to write off more of their bad loans.

Japan's problems and Thailand's are perversely linked.

Of Thailand's estimated \$79 billion in foreign debt, most owed by private companies, some \$40 billion is owed to Japanese banks. The Thai Ministry of Finance reportedly is asking Japanese banks to roll over that \$40 billion, which cannot be paid back in present crisis conditions, as well as giving an added \$5 billion in new loans to Thai companies. So far, Japanese banks are refusing to jump in, calling on American and European banks to share the risks. To date, there have been few volunteers, however, and the Thai crisis is programmed to worsen in the autumn.

### **Germany, the Telecom suckers' market**

The stock markets of Europe have generally continued to bound to record new highs, even as European unemployment soars to equally record highs. Since January, the Swiss stock market has risen more than 44%; the Dutch, by 44%; even the Italian stock market, once the sick man of Europe, by 36%. But by far the biggest gains since January have come in the German stock market, which has risen by 48% in the past six months, to all-time high levels.

This exemplifies the speculative fever sweeping Europe in recent months—the more so, as Germans had prided themselves on avoiding the "vulgar excesses" of Wall Street stock market speculation. Since 1891, when the collapse of Barings bank and of the Argentine bond market triggered a chain-reaction banking and financial crisis in Berlin banks, German law has made speculation by ordinary citizens in the stock market unattractive.

Until, that is, this past March. The government of Chancellor Helmut Kohl, under pressure to cut the deficit to meet the strict deficit limits for the new euro single currency,

launched a propaganda campaign to convince ordinary Germans that buying shares in the privatized German Telecom was where their savings should go.

Since March, the large German banks, led by Deutsche Bank and Dresdner, have pushed their customers to buy stocks, which, under German law, banks are allowed to sell. The result has been what one banker termed “a phenomenal jump” in the amount of money ordinary Germans place in stocks. It has been compared crudely to U.S. mutual funds. But the process has become self-feeding. As more savings find their way into stocks, stock prices rise, luring more sav-ings to follow suit.

In the first four months of 1997, more funds have poured into German stocks than in all 1996. On July 26, the daily *Frankfurter Allgemeine Zeitung* reviewed the situation: “For professionals in the stock exchange business, this is a clear warning signal, namely that stocks are going from strong hands into weak hands.” Traditionally, large German banks had been the major owners of company stocks. Private citizens put their savings into very conservative *Sparkassen* sav-ings accounts for future purchase of a house, or into state bonds. The shift into stocks means that naive investors, who have not the slightest idea of market risk, are propping up European stock markets, much as in the United States in recent years under 401K tax-deferred pension plans and other stock mutual funds.

### Why October?

At this stage, all signs point to eruption of a major financial and monetary crisis sometime in the autumn. “Certainly by October,” LaRouche stressed, “we should expect a real, major blowout. October is the hot month, but this system is so unstable it could go any day.”

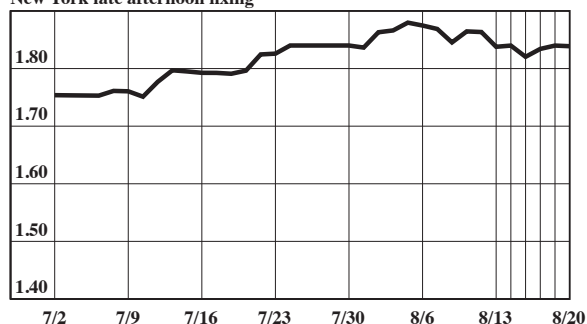
Arguing for such an October conjuncture is the growing pressures on the Federal Reserve to raise interest rates, as warning signs of inflation grow daily. The Federal Open Market Committee meets next on Sept. 30. That day is also the Japanese semi-annual fiscal year accounting deadline. By the first two weeks of October, Japanese banks and companies begin to report how bad their losses are. In October, the European Monetary Union could well erupt into a full crisis, as the critical issue of whether Italy joins the EMU in 1999 will be decided. The European Union Commission in early October is due to release its official deficit estimates for all 15 EU member states, part of determining which countries qualify to join EMU in 1999. Brussels insider reports are that Italy will not be in the first group. “If that’s true,” noted one European banker, “that will detonate a monetary, bond market, and stock market crisis which will cut across Europe.”

The pieces are coming rapidly into place defining LaRouche’s boundary layer. The question soon posed for governments will be, what system they intend to replace the bankrupt Bretton Woods system.

## Currency Rates

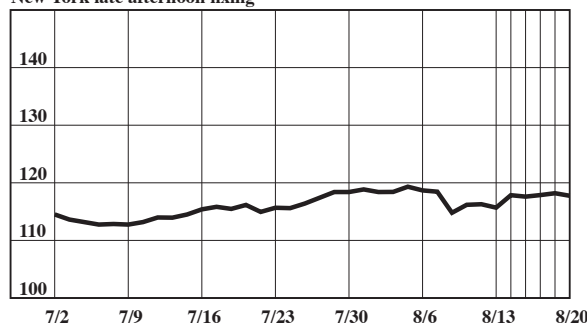
### The dollar in deutschemarks

New York late afternoon fixing



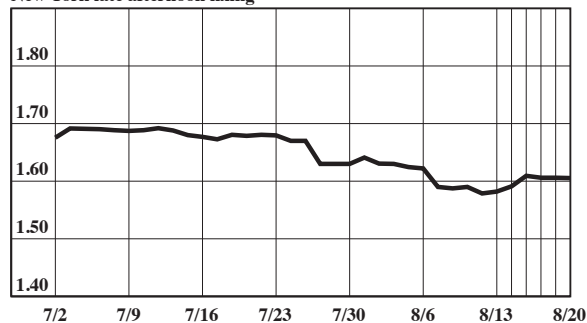
### The dollar in yen

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

