EIR Economics

LaRouche was right again: 'Asian contagion' spreads

by William Engdahl

Feature

In the last two weeks of May, Asia's financial and economic crises have erupted anew with a global vengeance, creating shock waves in financial markets from Moscow to Istanbul to Johannesburg, across all major markets of the European Union, into the New York stock market. The latest events serve as an ominous reminder of warnings issued this past January by *EIR* founder Lyndon H. LaRouche, Jr. who warned, "If you think things are bad now, wait until March or April come around. It's going to be impossible."

Indicative of the new phase of the crisis are the following financial headlines from just May 28: "Yen Weakness Could Test China Resolve to Hold Yuan," "South African Share Prices in Grip of Bears," "Russia Triples Interest Rates to Control Economic Crisis," "Indonesian Banks Face Forex Time Bomb," "Major Stock Market Fall Amid Anxiety Over Asia."

Protest strikes by South Korean trade unions, against planned job losses and downsizing of the giant Korean *chaebol* industrial groups is credited with having triggered the latest round of global market panic selling. In two days, May 25 and 26, the Seoul KOSPI stock index plunged a total of 13%. It has fallen 45% over the past 30 days, and the won dropped another 7% in the week.

"The unravelling of Korea, despite their new law permitting foreign takeovers of Korean firms, sent real shocks through world markets," commented S.J. Lewis, a City of London financial strategist. "It kindled new fears that, if Korea now comes undone, the hopes of Asia finally calming down were wrong. Fund managers are giving the order to sell across the board in all risky markets. On top of that, we have the dramatic deterioration in Russia in recent days, with interest rates being hiked to 150% in a desperate bid to save the ruble and keep foreign capital in the country."

According to Lewis, a next possible focus of market pressure could be the Hong Kong dollar, which until now has fiercely resisted breaking its 14-year peg to the U.S. dollar.

An influential City of London investment adviser, David Roche, has issued a client letter discussing an ongoing Chinese domestic liquidity crisis which, he claims, will soon force devaluation of China's renminbi, forcing the Hong Kong dollar to devalue. "Roche is close to conservative circles in the City establishment and echoes former Hong Kong Governor Chris Patten on 'predicting' devaluation of the Chinese yuan," Lewis noted.

If China and Hong Kong devalue, given the unprecedented instability of currencies across Asia, according to Lewis and other informed financial market sources, "the situation globally would become a meltdown overnight."

Japan in the center of the maelstrom

Making the situation even more fragile is the unresolved political paralysis within the establishment of the world's second largest industrial economy, and the world's largest creditor nation, Japan. After no more than a few days of illusory calm on Japanese stock and currency markets, the yen dropped sharply the week of May 25 to its lowest level since 1991, to 138 yen to the dollar. Fears are that a further fall in the yen, however it might improve Japanese export profits, would severely damage Korea's won and the fragile currencies across Asia. As well, further currency falls across Asia will put enormous pressure on China to break with the stable dollar peg and to devalue.

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The globalization of capital flows over the past seven years or so has made what began as an Asia crisis a year ago, into a global systemic crisis whose true dimensions, predicted by LaRouche, are beginning to emerge only now. The largest lenders to the collapsing Asian economies have been Japanese banks, desperate for high gains to cover catastrophic domestic bad loans believed to exceed $1 trillion. In total, Japanese banks had lent $253 billion across Asia, according to Bank for International Settlements data at the time the Asia crisis first erupted.

While Japanese officials go out of their way to issue calming statements about their Asian exposures, banking sources believe that little of that $253 billion is now providing timely debt service to the Japanese banks; that is, technically, the loans are in default or close to it.

In Indonesia alone, Japanese banks are reported to have given some $40 billion of the total $78 billion in loans held by Indonesian companies. A report on the Indonesian banking system released at the end of May by Moody's Investors Service notes that "Indonesia is now faced with a broadly insolvent banking system." They estimate that fully "30% to 75% of bank loans are, or soon will be, non-performing." In the context of the collapse of the rupiah since last summer by almost 80% and huge flight of capital in the tens of billions, much said to be tied to the Suharto family and their close banking cronies, as well as the impact of disastrous demands from the International Monetary Fund (IMF) last November to close down 16 banks and contract the money supply, the banking system is simply out of money.

Moody's noted, "Illiquidity is so severe that most banks are unable to lend, and, in fact, many desperately need to collect outstanding loans in order to meet the demands of depositors and creditors to get their money back. Foreign currency availability is the biggest problem. Private banks simply have no foreign currency." On May 27, the Bank of Indonesia revealed that it had given emergency cash injections to prevent the collapse of nation's largest private bank, PT Bank Central Asia, a bank owned by Liem Sioe Liong, the country's wealthiest man, and two Suharto family members.

Japanese bank exposure to the damaged economies of the region complicate the crisis in Japan enormously. For this reason, on the same day, Moody's severely downgraded the credit rating of five of Japan's largest banks, two of the world's ten largest banks, including the giant Bank of Tokyo-Mitsubishi with $720 billion in assets, and Dai-Ichi Kangyo Bank with almost $500 billion in assets. Four of the five were previously considered Japan's "healthy" banks. Other banks are likely to follow. The action, they stated, "reflects concern that Japanese banks are facing a third wave of asset quality problems because of the weakening domestic economy, on top of the problems resulting from the East Asian crisis and the collapse of the bubble economy."

What Moody's did not say, is that to date, Japanese banks, and reportedly many European banks, have taken alarming steps to conceal their Asia loan defaults. "The Bank of England and the Federal Reserve, and presumably the other central banks of the G-7, issued discreet orders last December," a well-placed London banker told *EIR*. "They told banks within their respective jurisdictions to maintain complete silence on any loan losses from Asia and to roll the loans over. Defaulted Asian loans were rolled from the fourth quarter of 1997 onto the first quarter of this year, now onto the second quarter."

According to this report, the European banks have adopted the model developed by Japanese banks over the past decade, to hide bad loans by using off-balance-sheet derivatives to roll over the loans, hoping for an economic miracle that never comes. According to Darrell Whitten of the Dutch ABM-Amro Bank, Japanese banks run "essentially two sets of books. They have been shuffling the bad loans around through different vehicles until no one is sure where they are buried." J.P. Morgan Bank's chief economist in Tokyo, Jesper Koll, estimates that "perhaps one-third of all corporations in Japan are being kept alive by the fact that bad loans are not being written off," but rather rolled over, reportedly using London branches of Japanese banks to hide this reality.

A global yen?

One of the more bizarre policy options being debated inside Japan's Ministry of Finance and the Bank of Japan

In this section

Our *Economics* section this week provides an in-depth report on the worldwide financial and economic crisis, with selected case studies showing how Lyndon LaRouche's forecasts have been borne out. William Engdahl's introduction focusses on the situation in Japan, and is accompanied by a selection of graphics that give a snapshot view of the Asian financial crisis. Then comes a selection of LaRouche's statements, including excerpts from his 1994 "Ninth Forecast." On p. 10 is a report on the explosive Russian situation, and LaRouche's interventions there going back to 1991. Next, come profiles of Indonesia and South Korea, with documentation of LaRouche's warnings and his growing influence. Then are brief overviews of the collapse of the physical economy and the global derivatives bubble—two areas where "the experts" have been consistently wrong, while LaRouche and *EIR* called the shots. We conclude the package with some choice quotes from international commentators—some of whom are beginning to see the light, and some of whom are still completely in the dark.

involves a number of steps designed to "internationalize" the yen. Japanese advocates of the bigger yen role argue that, with the introduction of Europe's single currency, the euro, in several months, the world will be divided into two huge currency blocs—a dollar bloc and a euro bloc. On May 25, Japanese Finance Minister Hikaru Mitsunaga promoted the idea that Asian economies should increase holdings of yen reserves, to help create a regional alternative to the dollar. The ministry is considering removing a 15% withholding tax on non-residents having Japanese Government Bonds, to encourage foreigners to hold yen debt. "If the Japanese government does not act now," argued C.H. Kwan of Japan's Nomura Research Institute, "the yen will have a hard time competing and catching up with the dollar and the euro."

The one fly in this ointment is the fact that prospects for the yen are gruesome into the far distant future, as things now stand. A classic case of Japan's bureaucratic right hand not realizing what its left hand does, on April 1, the Ministry of Finance implemented a new law permitting Japanese to hold offshore non-yen investments without limit. With Japanese banks only able to offer depositors a miserly 0.3% interest, and interest on ten-year Japanese Government Bonds today at 1.21%, Japanese savings have begun a steady flow abroad, further weakening the yen.

"Capital outflow out of Japan has just begun," commented Alex Balfour, manager of a London-based hedge fund, Furinkazan Fund, tied to the Greek Latsis family bank. "On April 1, Japan's Big Bang deregulation opened the door. Already in April we saw more Japanese savings go into foreign assets than into domestic Japanese investment. With interest earnings in U.S. Treasuries close to 6%, and almost that in German bonds, Japanese savings will steadily leave Japan. Pressure on the yen will be immense, and I see a real danger of a snowballing into a capital flight crisis, which could trigger a meltdown at some stage."

With prospects of a falling yen, it is hard to believe that anyone would want to increase their share of such a disappearing asset. "The economies of East Asia, with their present problems," noted Lewis, "could hardly want to hitch their economic wagon to a Japanese yen horse now. The time for that would have been in the 1980s, when all the world wanted to hold the yen."

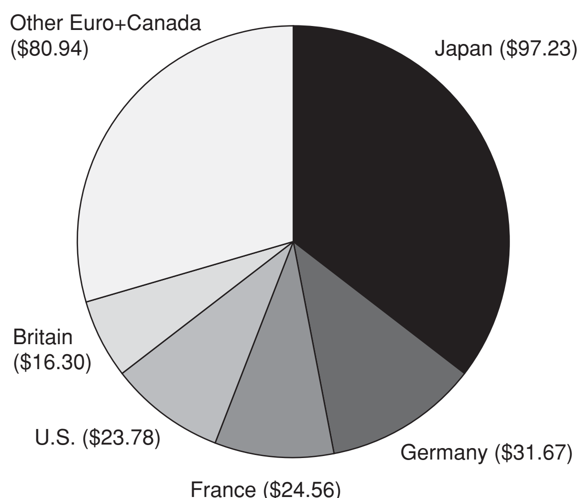
Most notable about these latest events around the world, is not the nominal size of the daily market or currency falls, though they are notable. Rather, it's the very fact that such a titanic eruption is taking place now, fully 12 months after the first shocks in Asia hit in May 1997. What is slowly beginning to dawn on policymakers, is the qualitatively different nature of the present crisis from any seen in the entire postwar period—indeed, as LaRouche notes, from any period in this entire century. Traditional IMF "crisis management" and such methods are worthless to contain this process.

The Asian financial crisis

FIGURE 1

Foreign debt owed to Japanese and Western banks by South Korea, Indonesia, Thailand, Malaysia, and the Philippines, June 1997

(billions $)

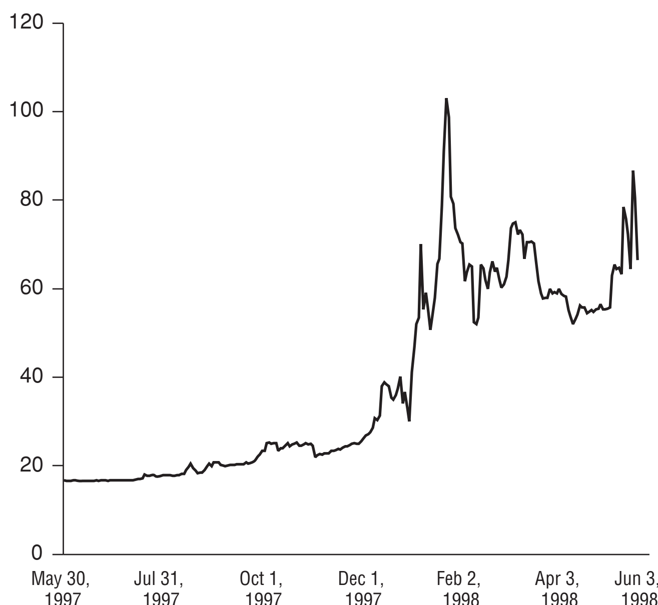


Source: Bank for International Settlements, June 1997.

FIGURE 4

Indonesian rupiah required to repay U.S. bank debt, May 1997-May 1998

(trillions)

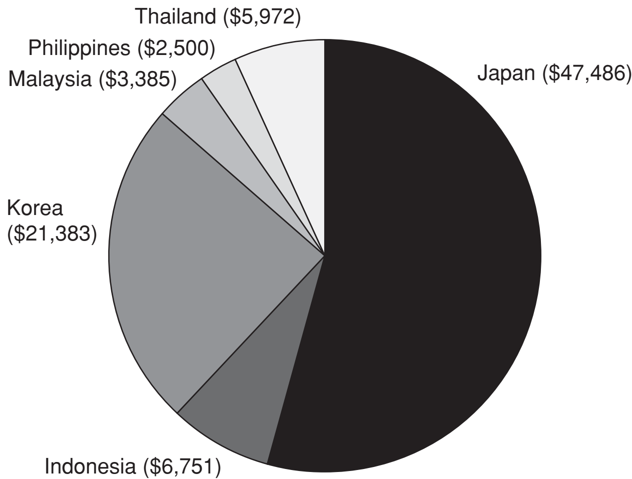


at a glance

FIGURE 2

Foreign debt owed to U.S. banks by East Asian nations as of Dec. 31, 1997

(millions $)



Source: Federal Financial Institutions Examination Council, December 1997.

FIGURE 3

Malaysian ringgit required to repay U.S. bank debt, May 1997-May 1998

(billions)

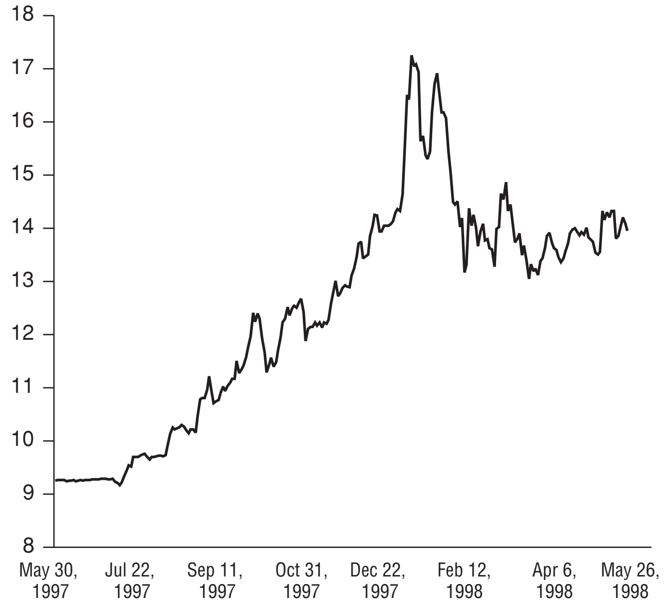


FIGURE 5

Japanese yen required to repay U.S. bank debt, May 1997-May 1998

(trillions)

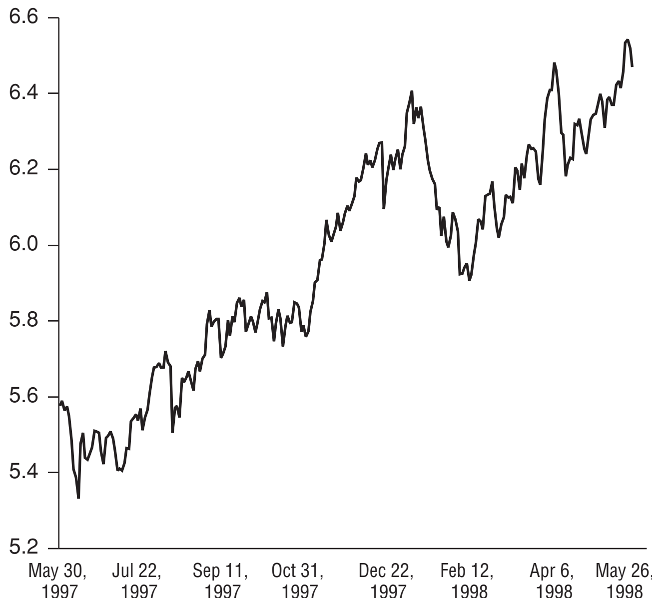
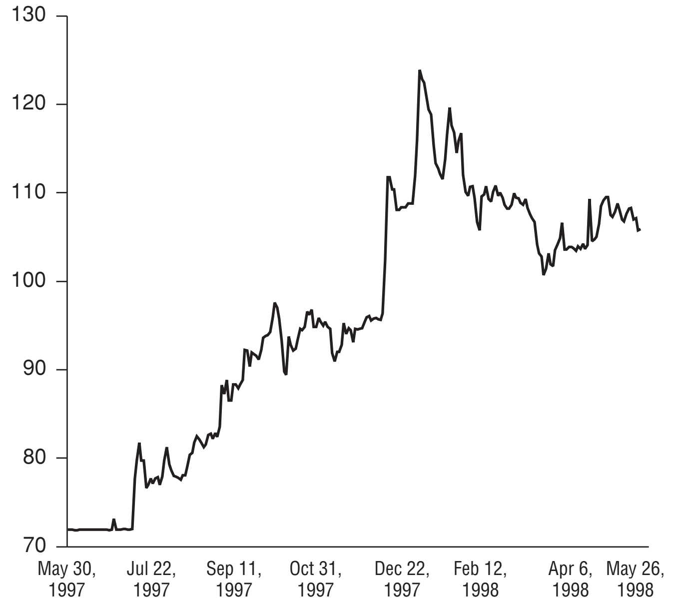


FIGURE 6

Philippine pesos required to repay U.S. bank debt, May 1997-May 1998

(billions)



Documentation

What LaRouche said

Proposal for a tax on derivatives, March 9, 1993:

Some form of nominal, but otherwise significant, universal tax must be placed on individual derivative transactions, not only in the U.S., but abroad. The included purpose of this taxation is not merely to derive a new source of revenue . . . but also to bring into the light of day, under penalties of law for non-payment of this tax, the magnitude and structure of a derivatives bubble as a whole. . . . [The derivatives bubble] is a financial bubble in the tradition of the more primitive, more rudimentary, and far less dangerous bubbles of the 18th Century, such as the John Law bubble in France, and the South Sea Island bubble. . . . This is a John Law bubble gone mad. The vulnerability to the entire financial system, the chaos and destruction of actual physical processes of production, distribution, employment, and so forth, is of incalculable potential.

From "The Coming Disintegration of Financial Markets," (LaRouche's "Ninth Forecast"), *EIR,* June 24, 1994:

It comes as no surprise that the name of the Bank of England's Eddie George is added to the list of which it must be said that "whom the gods would destroy, they first make mad." During the course of the current London meeting of the International Monetary Conference, Eddie joined the ranks of those greed-maddened public fools of finance who insist that the danger from the now metastatically cancerous financial bubble in derivatives speculation is being exaggerated by some critics.

It is a matter of some urgency that responsible governments subject all incumbent and prospective economics and central banking officials to the sanity test which Eddie George would have flunked gloriously. Among the probable benefits of this, the least would be creating suddenly many encouraging vacancies for the sane unemployed. The test consists of but one crucial question: *Prove conclusively that the near-term disintegration of the presently bloating global financial and monetary bubble is unstoppable by any means alternative to governments acting to place the relevant institutions into bankruptcy reorganization.*

Those officials about to be examined so could look up the answer in the back of the book, so to speak. We supply it here and now. Would that be cheating on their part? Not at all; it would be becoming sane. . . .

About my qualifications: I have introduced relatively few forecasts of critical events during my 40-odd years as an economist (not counting my repetitions of some of those warnings). To date, every forecast which I have made on the basis of my LaRouche-Riemann method has been confirmed by timely developments. I now present a summary listing of those forecasts, for the purpose of identifying my authority for designing the indicated test of economic sanity.

1. During late autumn 1956, in connection with a marketing study, I forecast the imminence of a major U.S. economic recession, triggered by the over-stretching of a post-1954 credit-bubble centered in financing of automobiles, housing, and analogous consumer goods. This recession broke out in February 1957 statistics, and was generally, if reluctantly acknowledged to have occurred several months later. The recession-spiral lasted into mid-1958, and was followed by a prolonged stagnation until an upturn appeared under the Kennedy administration.

2. During 1959-60, I made my first long-range forecast: that near or shortly after the middle of the 1960s, we would see the first of a series of major monetary disturbances, leading toward a collapse of the existing Bretton Woods agreements. I forecast that this collapse would see increased looting of what were then termed developing sector nations, and that the breakup of the Bretton Woods agreements would lead rapidly to austerity measures modelled upon those of fascist regimes, in international economic relations and in the U.S. domestic economy.

All of my economics forecasting and related activities of the 1960s, through spring 1971, were premised upon that same judgment. The first of the series of major monetary disturbances of the period occurred with the collapse of the British pound during November 1967, followed by the dollar crisis of January-March 1968. The break-up of the Bretton Woods agreements occurred beginning Aug. 15, 1971, and was consolidated by the Azores monetary conference of 1972. In immediate response to the August 1971 development, the U.S. government instituted the radical austerity measures known as Phase I and Phase II.

3. In November 1979, during my campaign for the Democratic Party's presidential nomination, I warned that the measures which the Carter administration and Federal Reserve had just taken, at the urging of newly appointed Federal Reserve Chairman Paul A. Volcker, would lead to the outbreak of a devastating recession, beginning early 1980. Every detailing of that forecast by *EIR* magazine's quarterly projections through 1983 was the most accurate forecast issued publicly by any agency; in fact, most, including Chase, Wharton, Evans, and Data Resources, were absurd in their sensing of the direction of the trends.

4. In February 1983, in the course of an exploratory back-channel discussion I was conducting with Moscow in coordination with the Reagan administration, I informed the Soviet government, that if it were to reject what later became known as the Strategic Defense Initiative of March 23, 1983, the strains on the Comecon economy would lead to a collapse of that economic system in about five years. This forecast was

repeated in an *EIR* Special Report, *Global Showdown,* issued July 1985. The collapse occurred during the second half of 1989.

5. In spring 1984, in my renewed campaign for the Democratic Party's presidential nomination, I warned, in a nationwide half-hour TV address, and elsewhere, of the outbreak of a collapse in a large section of the U.S. banking system: the savings and loan and related sectors.

6. In May 1987, I forecast, as published in *EIR* magazine and elsewhere, the outbreak of a major collapse in the stock market beginning approximately Oct. 10, 1987. This was my first and only stock-market forecast.

7. During my renewed Democratic candidacy of 1988, in a nationwide half-hour TV address, I described the "bouncing ball" phenomenon as the key to following the continuing collapse of the U.S. economy through the course of apparent, short-term fluctuations relatively up or down. That has continued to the present day.

8. During my renewed Democratic candidacy of 1992, I warned that we were already gripped by a global financial mudslide, "down, down, down."

This is a record of nearly 40 years, a record which cannot be even approached on the public record by any currently living economist, even by France's (and *Le Figaro*'s) eminently sane Nobel Prize-winning Maurice Allais.

Out of that same unequalled competence, I say to you now, as I informed various relevant scientific institutions of Russia during the last week of this April past: *The presently existing global financial and monetary system will disintegrate during the near term. The collapse might occur this spring, or summer, or next autumn; it could come next year; it will almost certainly occur during President William Clinton's first term in office; it will occur soon. That collapse into disintegration is inevitable, because it could not be stopped now by anything but the politically improbable decision by leading governments to put the relevant financial and monetary institutions into bankruptcy reorganization.* That is LaRouche forecast No. 9—the addition to the list of eight, above. . . .

From a speech in Rome, April 10, 1997:

There is nothing in the history of Europe to compare with what is happening right now, since the middle of the 14th Century. You may recall that with the collapse of the great Lombard banks, Europe went into a Dark Age for some period of decades. That is the nearest approximation of a precedent for what is happening right now. But what we are facing right now is far worse, and it is global; it is not restricted to one part of the planet.

This is not a matter of a recommendation, it's a matter of fact: that, contrary to all debates and discussions of policy within governments and elsewhere, it is not possible for the present international monetary and financial systems to outlive the months ahead. If no one decides to destroy it, Maastricht shall be destroyed in the process. There is nothing to debate. That which ceases to exist, ceases to exist. It is beyond the power and will of man to save this monetary and financial system. . . .

Apart from that decision to put the system into bankruptcy, there's nothing that any government or combination of governments on this planet can do to stop this system from disintegrating. And all discussion to the contrary is a pure waste of time. The system is dead. It is finished. It is over. Thirty years of the greatest insanity ever wrought by man are coming to an end.

From an interview with "EIR Talks," June 17, 1997:

The expectations at this point are that sometime between June and October—and the talk now among leading circles is more on the September-October side, in other words, the end of the third quarter. Either during or at the end of the third quarter, we are likely to have another blow-out. . . .

The talk is, the recognition now, is that this past crisis, the March-April and the upcoming one which will land here, expectedly, from Mars or something, between June, late June and Oct. 31, the end of the third quarter kind of thing—that that will be a lollapalooza. Not necessarily the big one, but it forces us to look at the fact that the big one is coming. If we're getting the small hurricane, the small tornado, we're getting the big one down the line. It's that sort of thing.

From an interview with "EIR Talks," Jan. 14, 1998:

The first quarter, into March, is going to tend to be a period of one major strategic blunder by the Clinton administration, and others, after another. This series of blunders is going to set forth a series of reactions from the economic and related processes. That is, the situation is going to become impossibly worse. So, as we enter the second quarter, or as we enter March—one can not predict a precise date on this, but you get the general picture of how things are going—by the time we're approaching, or entering the second quarter of 1998, we're going to be in the most hellish crisis we've ever imagined, something far more hellish, more profound, than anything that has been seen so far in the 20th Century.

For example, you see the implications of the threatened spread of this crisis out of Southeast Asia, and Asia generally, not only into Brazil and Argentina, Chile and so forth; but, also, they're already beginning to hit New Zealand, which means, next, Australia. And, we can see, very rapidly, particularly when you look at some of the figures of the debt ratios, who is owed what, you see that Europe is going to be hit *very* hard, much more difficult than the United States, within a very short period of time.

So, if you think things are bad now, wait until March or April come around. It's going to be impossible. At that point, I think there's going to be a tendency for people to scream "Help us! Help us! Help us!" And, that's what I have to prepare for. . . .