

## A 'rolling crash' hits global financial markets

by William Engdahl

A senior strategist with a large European bank characterized the global market falls during the first weeks of August: "We are in the beginning of what I would call a rolling crash. The international financial system is in such a state, that the wrong news at this point could crack it open." This source, who had accurately forecast the October 1987 stock market crash in May of that year, added, "We are not quite there yet. For this to turn into a global crash, we would need a free fall of the U.S. dollar, triggered by foreign liquidation of both stocks and U.S. Treasuries."

Since its all-time high in early July, the Dow Jones Industrials index, the world's most widely watched stock barometer, has declined almost 10%. On paper, the net worth of all publicly traded stocks in the United States has dropped by more than \$1 trillion in four weeks. With wild swings of 200-300 points in a single day, some Wall Street analysts predict a fall of the Dow to 7,200 in coming days. That would bring stock losses to more than \$2 trillion.

### Greater vulnerability

Complicating the situation is the fact that private American households in recent years have turned to stocks as never before, to save for retirement, their children's college education, etc. More than 43% of American households today own stock shares, and many households, believing the Wall Street myth that stock markets will "trend up" infinitely, have taken out home equity loans to buy more stock, expecting 30% per annum gains. Other families have been persuaded by their brokers to buy more stock "on margin," that is, paying only 50% of the listed purchase price, getting in effect a loan from their broker for the other half, in expectation that booming stock profits will give them the means to service the purchase

costs. Still other families have used their stocks as collateral to take out personal loans to buy cars or homes. In short, a sharp fall in the New York stock markets over the coming weeks could potentially devastate the real economy unlike at any time in history, even during the Great Depression of 1929-36.

Stock markets across Europe have plunged as well in recent days, often by 3-4% per day since Aug. 5. The largest continental European stock market, the German, has fallen 19% since its all-time high of 6,400 in mid-July. France, Switzerland, Italy, Holland, and London have all registered similar steep slides.

And, with every report of a new financial disaster out of Russia, Europe's markets plunge further. Despite the announcement in July of an emergency \$22.6 billion International Monetary Fund-led bailout of Russia's state sector, investors have headed for the exits before all is lost. "All the money from the IMF for Russia has done nothing to solve the problem," a European central banker commented to *EIR*. "The underlying problem is that the Russian government does nothing to change. No one knows where all the money is going, not even the IMF."

German banks hold an estimated \$170 billion of exposure in the Russian market, in ownership of GKO state paper, bonds, bank loans, and indirect credit exposures. The prevailing view is that a collapse of the Russian ruble or a default on Russian foreign debt would have a devastating impact on German and Swiss banks, the largest lenders in the Russian market. That would pull the French market down with it, and some say it could jeopardize the launch of the euro single currency in January 1999.

On Aug. 12, the London *Financial Times* said that the

recent free fall of Russia's stock and bond markets "threatens to wreck the government's debt-restructuring plans." The Russian banking system is reportedly suffering a massive liquidity crisis, which is forcing it to liquidate its holdings of government bonds to raise dollars, further weakening the ruble. Russian banks, according to the Aug. 13 *Wall Street Journal*, now face a liquidity crisis because "Western banks are calling on them to replenish collateral that the Russian banks have put up for dollar credits." The foreign banks are reportedly demanding cash. A collapse of the ruble would trigger an exodus of foreign investors, who have propped up the Russian financial market since Cr dit Suisse engineered a novel scheme to stabilize the banking system in 1995.

London-linked hedge fund speculator George Soros has not helped to calm the Russian markets. On Aug. 13, he told financial press that Russia's finances were "in a terminal state," and called for a 15-25% ruble devaluation, which panicked especially foreign holders of Russian bonds. Late that day, yields on GKO securities soared to 210%, up from 137% the previous day, but still there were few takers.

## The Asia focus

In Asia, the major target of speculation in recent days has been Hong Kong, once the pearl of the Pacific, and only a year ago considered a major capital source for China's economic reconstruction. In August 1997, as the "Asian crisis" was still an isolated problem affecting several East Asian countries, the Hong Kong stock index, the Hang Seng, stood at 16,820. By Aug. 13, 1998, it was down to 6,660, a fall of more than 60%. Stocks and real estate are the backbone of the huge Hong Kong financial system, leading to suggestions that one or more of the large Chinese Hong Kong real estate conglomerates could fail. Hopewell Holdings, one of the larger listed Hong Kong companies, headed by Sir Gordon Wu, has incurred large financial losses, according to informed Asian banking reports. This, after significant losses already in the year ended June 1997, owing to a HK \$5 billion Thai investment loss write-off.

The Hong Kong dollar is firmly pegged to the U.S. dollar, as it has been for the past 14 years. Under Hong Kong's Currency Board central banking system, central bank interest rates to banks automatically rise the moment the currency comes under selling pressure. The rising rates tend to offset the attraction of selling the Hong Kong dollar and, once the speculative attack subsides, as it did last October when rates briefly hit 300% to defend the peg, rates fall back to normal.

The problem has been, that the Asian economic and financial collapse has kept Hong Kong interest rates far too high, creating an enormous liquidity squeeze on Hong Kong real estate firms, the heart of Hong Kong's traditional Chinese financial structure. Many of the real estate giants, along with banks such as the Hongkong and Shanghai Banking Corp., form the core of the Hang Seng stock index. According to

July data from the Hong Kong Land Registry, property prices in Hong Kong are 40% lower than a year ago, and prices continue to fall despite a government freeze on land sales until March 1999. Jardine Fleming Securities in Hong Kong predicts that land prices will drop another 30-40% in the near future. As real estate assets form the collateral of the Hong Kong financial edifice, a collapse there is ominous for the future not only of Hong Kong, but also in respect to the capital China urgently needs for continued industrial development.

On Aug. 5, the Hong Kong government, in the worst economic report in 30 years, revealed that unemployment had reached a 15-year high at 4.5%, the economy had contracted 2.8% in the first quarter, and the second quarter is expected to be far worse. According to City of London sources, that report was the trigger for renewed speculative attack by major international hedge funds and banks against the Hong Kong currency and the Hang Seng. This time, however, the assault did not force Hong Kong money rates toward 300%, but to 9-11%. The result was less than hoped for by the speculative funds. At that point, the speculators' focus shifted to Indonesia, where an unnamed banker from the French Indosuez Bank told *Bloomberg News* on Aug. 11, that Indonesia had "defaulted" on its foreign debt payment due that week. Wire service reports of an "Indonesian default," on the back of already-nervous markets, triggered panic selling in many places. The Indonesian government clarified within hours that no default had taken place, that interest due that day had been paid, and the principal due would be renegotiated in September at the Paris Club creditors meeting.

## Sanity from China

The key development in Asia has been the sanity demonstrated by the Chinese government, in opposition to the insanity of such speculative assaults. On Aug. 12, the Chinese government tossed the cat among the pigeons. In a Beijing press conference, People's Bank of China Deputy Governor Liu Mingkang stated unequivocally that China would not devalue its currency, and that speculators should take warning. "Devaluation is not a good policy for China," Liu said. He stated: "I would like to tell speculators, that China is a big player, and they had best not miscalculate."

Liu Mingkang made clear, that the government policy is based on its understanding that devaluation would only undermine China's national economy. "Devaluation is a means to stimulate exports and promote economic recovery, but not the best measure," he said. "China's long-term strategy to promote exports is to increase the quality of services and the technological content of products; competition should be based on this.

"China is a responsible member of the international community; her policy must take into account other nations' interests. A big devaluation of the RMB [renminbi, China's currency] would be a blow to other economies; a small

devaluation would have no effect, because, of China's export of manufactured products, imports make up over 50% of the price. Devaluing by 10% would yield a price cut of less than 5%, but would immediately cause a domestic increase in prices and foreign resistance, and, in the end, would just cause severe damage to market confidence."

Liu Mingkang emphasized that China has very large foreign exchange reserves, and has carefully managed its foreign currency investments. Also, he focussed on China's potential for internal development of its huge economy. "There are," he stated, "the huge central and western regions of the country, whose capacity for absorption of investment is huge, and, apart from this, in many sectors of the domestic economy, the adjustment of structure of production can also stimulate the demand for investment. These are important factors determining the decision not to devalue the RMB."

Chinese economists are rapidly learning the lessons of the crisis destroying their Asian neighbors. An article published in the *People's Daily* on Aug. 13, described how currency devaluations had destroyed, rather than increased, other Asian nations' ability to export. Moreover, the real reason for the collapse of their exports was not their currency rates, but the financial crisis and credit crunch which has crippled their capacity to produce.

These policies in Beijing are being closely coordinated with the government of Hong Kong. On Aug. 13, Hong Kong Financial Secretary Tsang Yam-kuen was categorical: "I am certain that if anyone is speculating against the Hong Kong dollar peg, we have the skill and strategies to handle it easily," he said. "If speculators want to attack the Hong Kong dollar, they will be punished as usual." On the renminbi, he said: "There is no reason . . . to devalue. . . . Most of the so-called threat of devaluation speculation has emanated from speculators themselves."

### **Japan is still the number-one problem**

"These are very thin volume markets at this time," said the European central banker. "That always adds to volatility as smaller trades have a magnified impact either up or down. But the most important element of instability now is the uncertainty. No specific steps are being taken, not in Japan, not in Russia, not in the G-7. And that makes financial market investors extremely prone to sell. But in my view, the number-one problem in the world today, is Japan. The entire world central banking community of the BIS [Bank for International Settlements] is pushing Japan finally to move to clean up its banking problems and restart its economic growth. If they do not succeed to make any significant move on this, it is indeed quite possible, as some have suggested, that the yen will go to 200" to the dollar.

Japan is viewed not only by the Clinton administration, but by the rest of Asia, as key to the stabilization of the Asian crisis. It is at this point more likely to become the detonator

to the worst global financial crisis in history, if the recent actions of the new Obuchi government are indicative.

Barring some domestic political miracle, or a rapid new election which breaks the present grip of the banks on LDP policy, the world is on a short fuse to a generalized explosion as early as this autumn. Well before then, relevant governments would do well to adopt Lyndon LaRouche's proposal for a New Bretton Woods system.

## **China makes clear: No devaluation of RMB!**

by Jonathan Tennenbaum

In early August, while the world financial press was full of rumors that the fall of the Japanese yen and domestic economic problems would trigger an "inevitable" devaluation of the Chinese renminbi (RMB), leading Chinese officials and economic experts stepped forward to reaffirm China's commitment to maintain the value of its currency, providing very credible reasons to back up their policy.

Commenting on the recent discussion on the RMB, Lyndon LaRouche stated, "The currently widespread, mistaken opinion is, that a continued collapse of the market-price of Japan's yen would oblige China to devalue its own currency. This mistaken opinion is being encouraged by the same powerful, London-centered financial interests which organized the 1997-1998 collapse of the financial systems of Southeast Asia. Contrary to such opinion, the attempt to price China's, or any other currency, in competition with a collapsing yen, would be the worst possible response. The result of such a policy, would be to set off a spiral of competitive price-cutting, and an accompanying spiral of collapse of the total U.S.-dollar-denominated volume of China's net foreign-exchange earnings from exports. The disastrous consequences of the blunders of Japan and the IMF, in both Japan itself, and the recent and continuing spiral of collapse in Southeast Asia, are the result of the same kind of wrong thinking which now proposes that China must devalue its currency to compete with the effects of a falling price of Japan's yen."

The statements by Chinese officials, reaffirming the policy *not* to devalue the RMB, are coherent with LaRouche's points. Contradicting the rumors of "inevitable devaluation," both the Chinese and international press reported that Chinese President Jiang Zemin had told the Japanese Foreign Minister (in Beijing to prepare Jiang's coming visit to Japan), that "China has no intention to, nor will it devalue its cur-