

financial crisis. That means lower standards of living, poverty, starvation, and death for a growing portion of the world's population.

The only way out of this crisis, is to build our way out. If we are to survive 1999, we must put this virtual financial system through bankruptcy, and launch a crash program to build the Eurasian Land-Bridge and other great projects.

## Greenspan sets off hyperinflationary time bomb

by Richard Freeman

During the last three months, U.S. Federal Reserve Board Chairman Alan Greenspan has been injecting giant volumes of liquidity into the banking and financial system. Greenspan has taken two parallel actions: First, he has "minted" new physical dollar bills; second, he has pumped in liquidity-reserves through the Federal Reserve's federal funds window. Greenspan's immediate objective is to rescue several large commercial and investment banks and hedge funds. He is also attempting to liquefy the derivatives, junk bond, collateralized securities, and several other markets. The banking system has heavily lent to or taken derivatives positions in these markets, and saving them, many of which are filled with speculative paper, has become Greenspan's top priority, as the way to "save" the banking system as a whole.

Greenspan believes that by propping up the bankrupt banking system, he can preserve a world economic order based on "post-industrial" utopianism, "free trade," and "globalization." Because of his fixation on this goal, Greenspan is blinded to the reality that, in its essentials, his pump-priming is following in the footsteps of the 1921-23 Weimar Germany hyperinflation. Economist Lyndon LaRouche has forecast that it is this hyperinflationary policy which, during the first months of 1999, will accelerate a blow-out of the financial system.

Two events spooked Greenspan and Europe's central bankers, and hastened his course of reckless action. On Aug. 17, the Russian government suspended payment on its Treasury debt, and there was a parallel payment suspension on categories of Russian corporate and bank debt. Negotiations on stretching out and writing down substantial parts of the debt are ongoing, but already Western banks have taken heavy losses, and the Russian payments suspension defined a new geometry for the world financial system. Second, in September, the Long-Term Capital Management hedge fund blew out. LTCM typifies the levels of speculation in the economy: By mid- to late-September, LTCM had a capital base of \$600 mil-

lion, against which it had a derivatives position of \$1.25 trillion, a 2,083 to 1 leverage. From August through early October, while LTCM rocked the financial world, many other hedge funds took heavy losses or went out of business; the Dow Jones stock average in the United States and the stock indices in several leading Western countries fell by 20-30%; and, the Brazil crisis became more intense as flight capital reduced the country's foreign currency reserves by almost half.

The world financial disintegration was now roiling in a new phase of hyper-instability. On Sept. 29, just six days after the Federal Reserve had arranged an emergency private-sector bailout package for LTCM, Greenspan cut the federal funds rate by one-quarter of a percentage point, to 5.25%. On Oct. 15 and again on Nov. 17, Greenspan further cut the federal funds rate, each time by one-quarter of a percentage point (the operational points of this will be explained below).

### Cranking up the printing press

Greenspan began running the printing presses full tilt in late August, shortly after the Russian payment suspension. Between the week ending Aug. 29 and the week ending Nov. 30 (the latest reporting week), Greenspan and the Fed printed up \$13.8 billion worth of new dollar bills. The physical dollar bills are called the "currency in circulation." During this 13-week period, the U.S. currency in circulation has grown at an explosive compounded annualized rate of 11.4%. During the same period, U.S. M1 money supply, of which currency in circulation is one part, has grown at a 12.4% annualized rate; M2 money supply has grown at a 10.8% annualized rate; and M3 money supply, the broadest measure, has grown at a 13.5% annualized rate.

For the first nine months of 1998, the flawed measure of U.S. Gross Domestic Product, *unadjusted for inflation*, has grown only at a 4.52% annualized rate; consider, then, that the new currency in circulation—the printing of dollars—is growing more than twice as fast as the rate of GDP. Some 60% of the increase in currency in circulation is not used to circulate Gross Domestic Product; it's being used to save Greenspan's banker and hedge fund operator allies internationally.

**Table 1** shows the Aug. 31 and Nov. 30 outstanding levels for currency in circulation and for the different primary measures of money supply; it also shows the growth rate for the 13 weeks ending Nov. 30, put on a compounded annualized basis.

The growth of currency in circulation—physical, dollar bills—is significant, because it occurs through what are called "Treasury pass-throughs," that is, the Federal Reserve purchases U.S. Treasury debt, by monetizing the debt, i.e., printing new bills. There have been several "Treasury pass-throughs" in the last few weeks.

(M1 money supply consists primarily of currency in circulation plus the funds in checking accounts. M2 consists of M1, plus savings accounts, money market funds, and small-

TABLE 1

### Growth rate of the money supply (13-week period on an annualized basis)

(billions \$)

|                       | Currency in circulation | M1      | M2      | M3      |
|-----------------------|-------------------------|---------|---------|---------|
| Aug. 31, 1998         | 444.1                   | 1,076.3 | 4,255.0 | 5,727.8 |
| Nov. 30, 1998         | 457.9                   | 1,112.7 | 4,380.8 | 5,940.1 |
| Thirteen-week average | 11.4%                   | 12.4%   | 10.8%   | 13.5%   |

Source: Federal Reserve Board of Governors

denomination time deposits that are smaller than \$100,000 [these are usually Certificates of Deposit of less than \$100,000]. M3 consists of M2, plus large-denomination time deposits, institutional money market funds, Eurodollar deposits, and corporate repurchase agreements.)

### Opening up the federal funds window

In addition to the Federal Reserve's printing of new dollar bills, the Fed is also adding reserves to the banking system through the federal funds window. The Fed does this through what are called "repurchase agreements," through which it buys U.S. Treasury bills from U.S. banks, giving the banks cash. The Fed usually buys T-bills from the banks on a 24- to 48-hour basis; after that period, the banks purchase the Treasury bills back (hence the name "repurchase agreement"). However, the Fed can keep rolling over the repurchase agreements, thereby pumping liquidity-reserves into the banking system on a semi-permanent basis.

When Greenspan successively lowered the federal funds rate (the rate at which banks can borrow money from the Federal Reserve's federal funds window) on Sept. 29, Oct. 15, and Nov. 17, he was announcing to the world that he would make it cheaper for commercial banks to obtain liquidity-reserves. The lowered interest cost would increase the availability of such funds to the banks.

For the week ending Dec. 9, the Federal Reserve System held \$4.897 billion in repurchase agreements outstanding, that is, it had pumped \$4.9 billion of reserves into the banking system, through repurchase agreements.

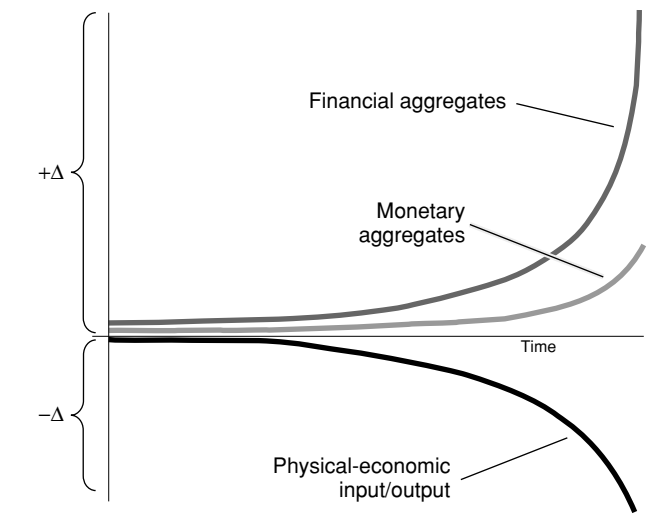
Taken together, Greenspan's actions of the increase of new dollar bills, and all measures of money supply, plus the injection of new liquidity-reserves through the federal funds window, vastly enlarges the banking system's "core" base of liquidity, which the banks and financial system then effectively multiply.

### The historical case

LaRouche's Triple Curve, or Typical Collapse Function (Figure 1) situates what Greenspan is now attempting to do.

FIGURE 1

### A typical collapse function



The upper-most curve in the function represents the financial aggregate, which is the categories of speculative financial paper. The middle curve represents the monetary aggregate, the currency in circulation and money supply. As the curve representing the financial aggregate has zoomed upward, the monetary aggregate curve has had to increase, *to liquefy the financial property titles, and prevent them from collapsing*. The faster the upper curve grows, the faster the middle curve must also grow.

The lowest of the three curves represents the physical economy. The increasing cumulative rates of return on the expanding financial aggregate are sucked from the physical economy, causing the lower curve to contract.

Figure 2 shows, for 1960 through November 1998, the three basic measures of U.S. money supply: M1, M2, and M3. Since 1992, M2 and M3 money supply, in particular, have increased. However, since the period spanned by the Aug. 17 Russian suspension of payment, through to the end of November, including the failure of LTCM, the money supply has entered a new domain of increase. The breakdown phase of the financial system has ratcheted the increase of the monetary aggregate up another notch.

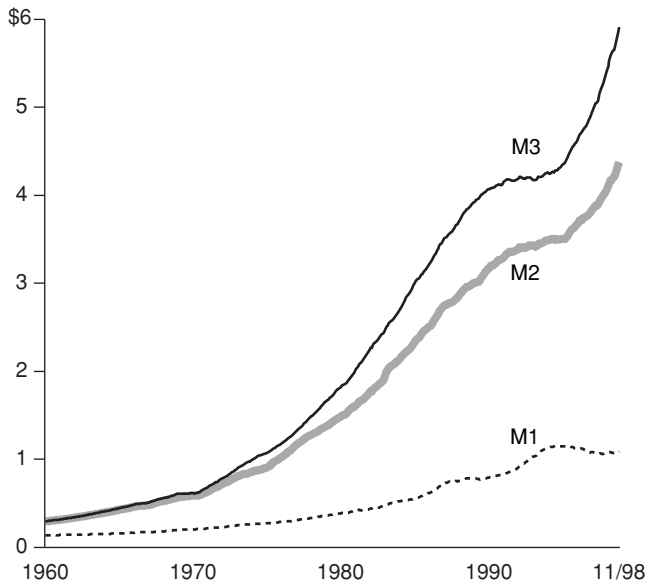
Greenspan, in addition to bailing out the banks, is bailing out every speculative market in which the banks have made a large investment. Were the speculative markets to fail, the banks' losses would bring down the banks as well.

Meanwhile, Greenspan is fighting to stop the adoption of a policy that offers a rational solution out of this insanity: LaRouche's proposal to write off the speculative paper, and issue new credit based on participation in a Eurasian Land-Bridge-vectored New Bretton Woods monetary system. Ultimately, the objective financial problems, as daunting as they

FIGURE 2

## Money supply skyrockets, 1960-98

(trillions \$)



Sources: Federal Reserve Board of Governors.

are, are not as determining in the situation as the subjective problem: Greenspan's disordered state of mind. He has worked for 11 years as Federal Reserve Board chairman propping up this speculative bubble. His recklessness in implementing a policy of hyperinflation to "save the system," if it is not stopped, will, as in Weimar Germany, cause the system's explosion, and through associated looting, finish off the physical economy.

## Testimony to Congress

### Don't regulate derivatives market, but eliminate it!

*The following testimony by John Hoefle, EIR banking columnist, was prepared for a Senate Agriculture Committee hearing on over-the-counter (OTC) financial derivatives on Dec. 16. It was entitled, "Don't Just Regulate the Derivatives Market, Eliminate It! Assert National Sovereignty Over the Financial Markets."*

Since the spring of 1993, *EIR* and its founder Lyndon LaRouche have been warning of the dangers posed to humanity by the explosion of financial derivatives. On Sept. 8 of that year, I testified before the House Banking Committee hearing on the financial aspects of NAFTA [the North American Free Trade Agreement], warning of the consequences of allowing the derivatives bubble to continue. On Oct. 28, under the leadership of Chairman Henry B. Gonzalez, the House Banking Committee held its first-ever hearing on derivatives, to which *EIR* submitted written testimony advising Congress to implement LaRouche's proposal for a 0.1% transaction tax on all derivatives transactions in the United States, as a way of drying out the derivatives market, while raising badly needed tax revenue. At the derivatives hearing, the Comptroller of the Currency revealed that the U.S. commercial banks alone had nearly \$12 trillion in off-balance-sheet derivatives, some \$3.20 in derivatives for every dollar of assets, and \$40 in derivatives for every dollar of equity capital.

These figures, which seemed huge at the time, now look conservative. As of June 30 of this year, according to the Federal Deposit Insurance Corp., U.S. commercial banks had \$28.8 trillion in derivatives, or \$5.56 in derivatives for every dollar of assets, and \$64.66 in derivatives for every dollar of equity. Today just two banks, Chase Manhattan and J.P. Morgan, have more in combined derivatives than the entire U.S. banking system did in 1993 (Chase's derivatives holdings are larger than the GDP of the United States, while Morgan has \$26.71 in derivatives for every dollar of assets, and \$640 in derivatives for every dollar of equity!), and U.S. financial institutions as a whole, have some \$45 trillion in derivatives. Worldwide, we estimate the total of derivatives and related financial claims to be in the range of \$150 trillion—figures from the Bank for International Settlements put the derivatives holdings of just 78 financial institutions at more than \$103 trillion at the end of 1997.

Earlier this year, the Commodity Futures Trading Commission suggested in rather mild language, that it might take up the question of whether some form of new regulation of the over-the-counter derivatives market were advisable. Given the staggering growth in the OTC market over the past few years, such a review was long overdue, but the CFTC's concept release triggered a firestorm of protest from not only the derivatives dealers, but from the regulators as well. The Federal Reserve, the Treasury, and the Securities and Exchange Commission going so far as to demand that legislation be enacted prohibiting the CFTC from touching the OTC market, agreeing with the derivatives banks that just raising the issue of increased derivatives regulation, could blow up the market.

The derivatives market should be left to regulate itself, they claimed, saying that any attempt by the government to impose controls, would constitute "regulatory burden."