BIS bankers: LaRouche's Ninth Forecast was right

by William Engdahl

On March 8, the Bank for International Settlements, the Basel, Switzerland private organization grouping the world's largest central banks, issued its latest quarterly review, "International Banking and Financial Market Developments." The report covered the fourth quarter of 1998, from October through Dec. 31, the period of the wildest shocks to global financial and currency markets in memory. What is notable about the report, is that the normally dull-as-dishwater central bankers publicly admitted, "LaRouche was right!"

On June 24, 1994, *EIR* founder Lyndon LaRouche issued "The Coming Disintegration of Financial Markets," his famous "Ninth Forecast," in which he forecast the imminent systemic breakdown of the global postwar monetary and financial structures, if the Group of Seven and allied governments were to fail to take emergency policy measures to avert it, and to reverse the economic policies of the past three decades since the breakdown of the Bretton Woods fixed gold exchange regime in August 1971. The release of the latest BIS report confirms the accuracy of LaRouche's 1994 forecast, and perhaps indicates that among certain circles inside the BIS central banks, a hint of reality is seeping in.

'Massive deleveraging'

"The flight to safety and liquidity which developed in the wake of the Russian debt moratorium in August reached a climax in October," the Bank for International Settlements states. "Massive deleveraging and, in the process, the near-collapse of a major hedge fund added to price swings and further contributed to drying up of liquidity. . . . The unwinding of a large volume of carry trade positions may have been partly responsible for the largest daily gain displayed by the yen against the dollar since the abandonment of the fixed exchange rate regime in 1971." The report documents that on Oct. 7-8 alone, one major hedge fund, Tiger Management's Jaguar Fund, was forced to undertake a panic unwinding of "a massive $35 billion long dollar/yen position, of which around $10 billion was offloaded in the market overnight."

In plain English, the BIS is referring to the panic liquidation by hedge funds and major international banks, which shook the global financial system to its roots after the New York Federal Reserve took the unprecedented step of intervening to prevent the collapse of Long Term Capital Management (LTCM), the Greenwich, Connecticut hedge fund, on Sept. 23.

In the two weeks after the LTCM rescue by its creditor banks, global stock and bond markets went through their most severe collapse in decades as speculators tried to stop their losses in hundreds of billions if not trillions of dollars in derivatives exposure. Within a matter of days, the chairman of Europe's largest bank, UBS of Switzerland, was fired for attempting to hide the bank's exposures to LTCM from other directors of the bank. BankAmerica required emergency Federal Reserve liquidity injections when its D.E. Shaw hedge fund collapsed. The Federal Reserve moved to cut interest rates three times in seven weeks, and pumped liquidity into the U.S. banking system at levels never before seen. In Europe, Crédit Suisse and other major European banks, from Germany's Deutsche Bank to ING Bank, slashed their credit lines to hedge funds and fired traders around the world, in a panicked effort to cut losses. Fears of a global credit crunch and depression began to be expressed in major media.

The Bank for International Settlements notes that the crisis mood abated somewhat in November, after the unprecedented actions taken by the U.S. Federal Reserve, and after approval of a $42 billion International Monetary Fund (IMF) package designed to prevent Brazil from following Russia into default. Despite this soothing note, however, the BIS is forced to admit that "continuing high volatility in most market segments suggests that concerns about market and counterparty risks remain pervasive." In other words, "It ain't over yet," despite the nervous claim by the BIS report that "the fact that most major equity indices returned to near-peak levels in December suggests that the systemic repercussions of the upheaval were contained."

BIS admits: The crisis is systemic

The present situation in the global system is exceedingly fragile, and the threat of the next seismic shocks has been in no way dealt with by the extraordinary crisis management manipulations of interest rates and stocks, the BIS acknowledges.

Moreover, in a rare moment of central bank honesty, the BIS report admits that indeed this is a systemic crisis. "Events in Russia reversed the bias toward excessive risk-taking. However, by causing a massive unwinding of positions in a broad range of markets and instruments, *they created the risk of a systemic failure,* prompting official action aimed at restoring market confidence. This has heightened the dilemma faced by the authorities in letting private players bear the cost of their own investment decisions, while preserving the stability of the system as a whole. *The improved management of future crises will depend on the resolution of this dilemma"* (emphasis added).

Over the course of the past 20 months since the onset of the first Asia crisis in May 1997, there has been a heated debate, both inside the U.S. Congress and around the world, over whether the unprecedented $180 billion in IMF-led "emergency" aid to Thailand, Russia, Brazil, and other crises was nothing but a veiled bailout of reckless foreign bankers who had poured billions into markets with faulty regulation and weak banking systems. This aid has been given the curious name "moral hazard"—although moral considerations presumably were low on the list of concerns of the banks pouring money into, and then out of, these high-risk markets. The BIS comment that future crisis management depends on the "resolution of this dilemma," i.e., to give the aid or risk collapse, is an extremely revealing admission on the part of the world's most powerful central bankers, after almost two years of a deepening financial and economic crisis which has already plunged large parts of this planet into depression.

The BIS report concludes that despite all the emergency measures by Federal Reserve Board Chairman Alan Greenspan, and a significant rate cut by the new European Central Bank in December, "there was continued anxiety regarding the health of the Japanese financial sector, the sustainability of Brazil's exchange rate policy, and the valuation of global equity markets. Financial flows appear to have become more volatile as a result of the larger volume of cash market transactions and the ease with which positions can be reversed."

Japan's desperate bid

A look at Japan confirms that the crisis, far from being over, has only just begun. The decision in the first two weeks of March by the Japanese government to flood the market with yen, bringing interest rates to near zero, indicates the level of desperation among Japanese authorities over what is already a banking, financial, and economic depression deeper than any experienced since 1945.

The bizarre decision began to emerge on Feb. 12, when the Bank of Japan announced that it was cutting its overnight money rate to banks from 0.25% down to 0.15%. Today, rates stand at 0.02%, meaning that banks are in effect able to borrow unlimited yen from the central bank, use it to invest in long-term state Japanese Government Bonds yielding almost 2%, and do it apparently risk free, which is a huge gain for the troubled banking system.

A similar tactic was used by the U.S. Federal Reserve in 1991-93 to deal with America's worst bank crisis since the 1930s. The Japanese banking system, according to private estimates, is holding some $2 trillion or more of bad debts accumulated since the collapse of the Japanese real estate and stock bubble in 1990. The collapse of Asian growth in the past months has added a deep economic depression onto the banking crisis, as Japanese export markets have vanished in a cloud of bankruptcies across Asia and in other emerging markets.

Japan's central bank is now lowering interest rates and ballooning bank reserves, to counter an out-of-control economic deflation in which prices have been collapsing and unemployment soaring as the world's second-largest industrial economy goes into depression. Over the 12 months following the start of the fiscal year which begins on April 1, the Japanese government must sell at least $600 billion of Japanese Government Bonds to pay for the huge costs of the various economic stimulus programs, as well as bank restructuring costs voted by the Diet (Parliament) late last year.

This collossal sum of new debt, added to the record-high Japanese public debt, by some measures already more than 100% of Japanese Gross Domestic Product, many seasoned financial observers predict, could trigger a crisis of confidence in the ability of Japan itself to honor its sovereign debt. The consequence of a near-term panic sell-off in Japanese bond markets, which are currently in a temporary lull with the approach of the fiscal year-end on March 31, many fear, could be the forced liquidation by Japanese banks and insurance companies of an estimated $250 billion in U.S. Treasury securities. At that point, the dollar would go into free fall, as foreign holders of U.S. stocks and bonds head for the exit gates, forcing U.S. interest rates to double-digit levels, collapsing the $12 trillion in U.S. stock valuations—and with it the dreams of 43 million American households whose life savings have been invested there.

Little wonder the BIS is hedging its bets.