

As the old year passes, cries of 'crash' ring in the new

by Marcia Merry Baker

A year ago, Lyndon LaRouche warned that 1999 would be a year in which a "boundary condition" would emerge in the global financial system, which, dominated by overinflated stock values, derivatives, and similar instruments which are destroying the real economic activity upon which the existence of the speculative bubble depends, could not be sustained. Whatever people may have thought at the time, the accuracy of his forecasts is now being borne out in day-to-day events, and his warnings are being echoed ever more broadly.

Below, we publish some of the chorus of alarms sounded in December about what lies ahead. "Tulip mania" is the expression used by the Wall Street correspondent for the leading German daily *Frankfurter Allgemeine Zeitung*, to compare the soaring cyber-tech stock values, to the 17th-century speculation in tulip bulbs in Holland, and implying that a bust is near. Heads of stock exchanges in Australia and Britain are warning people to take cover because a U.S. crash is about to hit. A new report from the World Bank gives a scenario for a 30% crash/correction in the U.S. stock market.

In effect, these are echoes of LaRouche's warnings that a systemic collapse of the International Monetary Fund-dominated global financial is in process. The question posed now is, what next? LaRouche has been differentiating the *next phase* of the crisis—unless there is government intervention—outlining three potential scenarios: wild hyperinflation, imploding deflation, or outbreak of strife and war.

Record speculation

The year of the bubble-at-the-bursting-point is seen in the record volume of face value of derivatives contracts outstand-

ing, according to the Bank for International Settlements. The latest BIS annual survey, "Trading and Derivatives Disclosures of Banks and Securities Firms," released on Dec. 16, showed that the 71 institutions in the survey had \$130.9 trillion in notional value of derivatives at the end of 1998 (the usual reporting lag), the highest "official" derivatives figure ever reported. Among the top ten institutions with the highest level of derivatives bets (in trillions of dollars) were UBS (\$10.957), Chase Manhattan (\$10.353), J.P. Morgan (\$8.858), and on down the line.

But most of the public alarm—at least outside the United States, where financial "happy talk" continues—is focussed on the U.S. stock markets. The Nasdaq index, representing high-tech and internet stocks such as Microsoft and Oracle, has risen at a spectacular rate: It has increased by more than 65% in 1999, and by 271% over the last three years. Well over half of the stock values of companies traded on the Nasdaq were flat or negative over 1999, but among the rest, wild spikes and manipulated run-ups are notorious. The Nasdaq is driven by speculation.

The bubble that killed the economy

The toll on the real economy is seen in the form of new rounds of layoffs and dislocation, and the gutting of production potential, which have sparked protests in the streets and demands for government intervention on behalf of economic priorities. On Dec. 15, protesters turned out en masse in France against the pending Hoechst/Rhône-Poulenc chemical takeover deal, which has announced there will be job cuts of 11,000. In the Exxon-Mobil merger deal, 16,000 jobs are to be gone by the year 2002 internationally. In Seoul, South

Korea, 35,000 workers demonstrated on Dec. 10 against the industrial shutdown under way.

In the United States, for November alone, there were 50,907 corporate layoffs (all types of jobs—manufacturing, clerical, managerial). For the first 11 months of 1999, there were 630,450 corporate jobs lost.

Losses of U.S. manufacturing jobs are huge. During the 21 months from January 1998 through September 1999, there were 528,000 manufacturing jobs lost, with 21,000 gone in September alone, according to the Department of Labor.

The consequences of this process were reflected in the annual report, “1999 Status Report on Hunger and Homelessness in America’s Cities,” released on Dec. 16 by the U.S. Conference of Mayors. Although the authors ironically still paid lip-service to the boom-talk about the U.S. economy, the Mayors’ survey of 26 cities found that “hunger and homelessness grows unabated, despite an expanding national economy.” Demand for emergency food-related assistance during 1999 was 18% higher than in 1998, itself the highest level since 1992. Demand for emergency housing-related assistance grew at the highest level since 1994, up 12% in 1999 compared to 1998. An estimated 21% of requests for food are estimated to have gone unmet. Slightly more than half of the cities responding say that they may have to turn away people in need because they lack resources, and all cities said that they expect the problems to grow in 2000.

Many small towns lack the means to function. On Dec. 1, the formerly industrialized city of Hamtramck, Michigan, near Detroit, was unable to meet its \$267,00 semi-monthly payroll covering about 200 workers, including the mayor and council members, clerks, police, and firefighters. A temporary fix emerged when American Axle and Manufacturing prepaid property taxes, but shortfalls are expected to recur next spring.

Typical of the plight of towns all across the formerly industrialized Midwest, is Winamac, Indiana, a rural town in Pulaski County, with a population of 12,000 and an official unemployment rate of 7.4%. People are in despair over the economy. This year, 300 jobs were lost when the paper company Eaton Corp. shut the local plant, on top of plant closings over the last six years by Detroit Steel, Federal-Mogul, and others.

U.S. ‘consumption boom’ near bust?

Real economic activity is thus contracting at furious rates. Of course, you still hear about the U.S. Christmas retail “consumption boom” and the “wealth effect” from all the stock market gambling. As for the real story on consumption, the latest statistics on the growing deficit in the U.S. trade balance confirm how dependent the U.S. economy is on foreign production for its very existence. On Dec. 14, the Commerce Department announced that the United States is in place to register a \$320-330 billion current account deficit for 1999, which will be an all-time record. A previous record deficit of

\$270.5 billion was reported for 1998. For the third quarter of 1999, the United States hit a quarterly record trade deficit of \$89.9 billion, following a deficit of \$80.91 billion in the second quarter.

How can Americans have such global buying power? *Betting fever*, until the bubble pops.

Documentation

Commentaries on the financial crash

***Frankfurter Allgemeine Zeitung*, weekly “Letter from Wall Street” column entitled “Tulip Hysteria,” by Heiko Thieme, Dec. 13:**

Thieme points to all the stock market records which have been broken this year: The Nasdaq index in the United States on Dec. 10 was up 65% for the year, which is the highest yearly increase since its establishment in 1971; the Dow Jones Index will now, for the first time in its entire history, mark a yearly increase of at least 15% five years in a row; the turnover on the New York Stock Exchange reached a new all-time high the week of Dec. 6-10, with 5 billion stocks traded in one week; and Wall Street brokers will this year receive the highest premiums ever.

Thieme comments: “The investment fever has risen to worrisome record temperatures. Initial offerings have been traded at fantastic prices, which can only be compared to the tulip hysteria in the Netherlands some centuries ago. What is going on at this moment, no longer bears any resemblance to traditional investment.”

As an example, Thieme points to the U.S. software company VA Linux, which went public on Dec. 9. During the first day of trading, the VA Linux stock price skyrocketed from \$30 to \$320, and later closed at \$240. The market capitalization of the company thereby increased to \$10 billion. This is a huge sum for a company which last year had a turnover of only \$30 million, and posted a \$24 million loss. However, says Thieme, experience tells us that most such stocks sooner or later go down as rapidly and far as they went up. If people are comparing the internet sector today with the automobile sector a hundred years ago, he concludes, they should realize that out of the original 300 U.S. automobile companies, only three have survived to the present day.

***London Financial Times*, commentary by Tony Jackson, Dec. 14:**

The *Financial Times* expresses its worries that “hostility

to big business is mounting, and the resentment could worsen if there is a stock market collapse.” Jackson writes: “Consider the following three events: the collapse of the world trade talks in Seattle; Europe’s rejection of genetically modified crops; and the exclusion of Railtrack, the U.K. transport company, from part-privatization of the London Underground. These events range from the global to the parochial. But they seem to me to exemplify a common theme: hostility to big business.”

After going through why the stock markets so far have not reacted to these recent setbacks for the globalization process, Jackson concludes: “But there is one risk that does worry me. This is the outside possibility of a real old-fashioned stock market collapse. In one sense, this would be nemesis: a come-uppance for capitalist triumphalism. But it could also be damaging to companies themselves. At present, they are widely disliked despite bringing home the bacon. A market collapse could produce real resentment. And if I am unsure what practical form that might take, I am very sure I do not want to find out.”

World Bank, “Global Economic Prospects and the Developing Countries 2000,” December 1999 (probably the last World Bank report written under the direction of Joseph Stiglitz, a critic of the International Monetary Fund):

The World Bank outlines a scenario for an imminent 30%

crash on Wall Street. The report notes, that there are still significant risks to the world economy even if the situation seems to have stabilized compared to the worldwide 1997-98 financial crises. In this respect, the report points to present “volatility of the international environment,” and also to the “forecasting errors . . . in relation to the . . . crisis in East Asia,” which “illustrate the significance of these risks in an environment of deeper financial integration.” The biggest threat for the economies in the developing sector is the “prospective unwinding of large imbalances in the industrial countries.” The report adds: “Chief among these risks are the consumption boom (which is being driven by the stock market) and widening external deficit in the United States, and the continuing uncertain outlook for Japan.”

The World Bank report then presents a “plausible” scenario in this respect: “In the early months of 2000, the Federal Reserve responds assertively to the potential upturn in inflation by increasing the Fed Funds rate by 100 basis points. Market participants overreact in their reassessment of equity valuation levels in light of changes in the prospective growth environment, and equity prices fall by some 30%. In a second and ensuing response, the Federal Reserve lowers rates by some 200 base points to restore market confidence, and the dollar falls by 15% against major partner currencies. In consequence: These developments are transmitted rapidly to equity markets, and the effect on economic activity in Europe and in Japan is immediate. Wealth effects in all three blocs dampen consumption growth, especially in the United States, and investments slow sharply.”

Maurice Newman, Managing Director, Australian Stock Exchange, Dec. 8, as reported by the *Frankfurter Allgemeine Zeitung*:

Newman warned Australian investors of an upcoming crash on the U.S. stock market, which will have worldwide consequences, including for Australia. He noted that international stock markets have now been going through the longest boom phase in history, which simply cannot continue. Newman pointed to the flood of new stock issues by new telecommunications or internet companies. While the quality of this paper is very questionable, investors are buying it up anyway. Many of such stock prices are therefore excessively high, and the fate of the stock markets now depends on the performance of these telecom and internet titles.

Howard Davies, Chairman, Britain’s Financial Services Authority (FSA), joint statement with the Securities and Futures Authority, Dec. 9:

Davies warned private investors about the dangers of speculating on small and so-called “high-technology” stocks. Christine Farnish, FSA director for consumer relations, explained: “Consumers investing their money in smaller company shares need to know that the prices of those shares can be very volatile—both up and down. They need to think carefully about the risks involved before deciding what shares they buy and how many.”

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