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Global Financial System: It Was Bankrupt Before Sept. 11

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Worldwide, there is a state of financial emergency. In the horrible events in Washington and New York of Sept. 11, not only were an unknown number of currency and derivatives traders killed, but also an important part of the physical infrastructure of the financial system was destroyed. Computer files and hard copies documenting numerous foreign exchange and derivatives transactions of many financial institutions, are gone.

Innumerable derivatives contracts, for a value of many billions of dollars, are therefore hanging in the air, because one side of the bilateral agreement, for example in Frankfurt, does not know if the counterparty will promptly fulfill its obligations or if it still exists. Already, the disappearance of one big player could trigger a global chain reaction. Rumors of the illiquidity of big hedge funds are making the rounds. The large settlements systems of international banking concerns are showing signs of malfunctioning. Furthermore, the central banks fear that in the next days or weeks, a dollar panic could break out, which would mean the sudden sell-off of American stocks, and a run on the banks.

Among the big financial companies, the hardest hit appears to be Cantor Fitzgerald, one of the leading traders of government bonds in the world. About 700 employees of Cantor Fitzgerald were still missing three days after the terrorist attack. U.S. investment bank Morgan Stanley had rented more office space in the World Trade Center than any other company. According to Morgan Stanley, the "vast majority" of its 3,500 employees got out safely, but several hundreds are still missing. Fuji Bank from Japan has stated that probably 700 of its employees were killed. Many other banks had operations in the Twin Towers and the neighboring buildings that also collapsed, including Merrill Lynch, Lehman Brothers, American Express, Crédit Suisse Group/Crédit Suisse First Boston, Deutsche Bank, Commerzbank, Charles Schwab, Asahi Bank, Sumitomo Bank, Dai-Ichi Kangyo Bank, CNA Insurance, John Hancock, the Municipal Assistance Corp. (Big MAC), Oppenheimer Management, Northern Trust, Citigroup's Smith Barney, and Yamaichi International America. The New York Board of Trade, America's biggest exchange for trade in cocoa, coffee, and sugar, was also located in one of the World Trade Center towers.

Another imminent threat to the global financial system is posed by the demolition of the Clearinghouse Interbank Payment System (CHIPS), the private telecommunications system operated by the New York Clearinghouse Association for banks in the New York area. Some of its physical infrastructure was destroyed, so that the whole CHIPS system was non-functional after the terror attack.

The dimensions of CHIPS is huge. Its computer system is used to settle the payments of both domestic and international inter-bank obligations. The biggest banks in the world, including Citibank, J.P. Morgan Chase, Bank of America, Deutsche Bank, UBS, and Bank of Tokyo Mitsubishi, own and operate CHIPS. CHIPS transfers an average total value of $1.2 trillion daily—equal to the amount of the total daily value of payments that passes through the entire Federal Reserve System. It clears and handles 242,000 transactions on an average day. It handles 95% of all U.S. dollar payments moving among countries worldwide.

Chain-Reaction Mega-Failures

All of this has led to very serious worries among central banks about a chain-reaction of mega-failures in the international financial system. In order to prevent an immediate collapse of the system, the leading central banks began pumping massive amounts of liquidity into the system. In an unprecedented, coordinated action, within the 24 hours beginning

Sept. 11, they made available at least $120 billion in liquidity for the financial markets.

The Federal Reserve announced already on Sept. 11 that it would deliver as much liquidity to the system, as needed. The first step was to open the money faucets, pouring $38 billion into the banking system, about ten times the amount the Federal Reserve normally would make available. The Fed declared, that it had also "substantially expanded" its discount window for further emergency loans to banks.

While the Nikkei index in Japan on Sept. 12 fell to its lowest level since December 1983, and in that one day roughly $170 billion in paper went up in smoke, the Bank of Japan poured 2 trillion yen ($17 billion) into the system. The central banks of South Korea, Thailand, Singapore, Australia, and New Zealand, as well as the currency authorities in Hong Kong, made known that they were ready to act in a similar manner at any time.

The European Central Bank (ECB) also displayed unusual generosity, making available $63 billion in short-term credits for the banking sector. The Swiss National Bank said that it would also provide additional liquidity, should this be necessary.

Furthermore, on Sept. 13, the Federal Reserve and the ECB sealed a bilateral currency-swap agreement in the range of $50 billion. According to the Federal Reserve, the main purpose of the measure is to secure the urgent liquidity needs of European banks operating in America. In summary, leading central banks are preparing for mega-catastrophes in the financial sector, erupting in the next few days.

"The real danger lies in the matter of derivatives settlements and counterparties," one London financial source told *EIR* on Sept. 13. "If settlement problems snowball, this could bring down the whole financial system. The danger is not negligible. That is why you see the central bankers pouring in the liquidity now, to head this off. That is why the U.S. Treasury bond market was opened today. The options are maturing today, and if they had left this alone, that could have led to dangers that would have toppled the whole system."

According to this source, "There will be a problem, if the central bankers are not very careful in how they manage this liquidity pumping that they are doing to avoid a seizing up. The danger would be like what happened ahead of Y2K, when the liquidity pumped in, created a giant bubble in the months to come, and put an end to the bull market in equities. There are dangers in creating a bigger bubble now. And, of course, there is the danger of hyperinflation."

Governments and central banks of course were desperately trying to play down the threat of a systemic breakdown crisis. Meanwhile numerous representatives of banks, economic research institutes, and media suddenly discovered the threat of a "world recession." In particular, as their argument ran, the collapse of the stock markets, would shatter the confidence of the American consumers, the last bastion of the U.S. economy, and with this, a worldwide economic collapse would ensue.

Collapse In Confidence Was Already Under Way

This thesis is completely misleading in a very important point: The collapse of American consumer confidence and its consequences for the U.S. and world economy, was already in process and would have continued, even without the terror attacks against the World Trade Center and the Pentagon. In fact, as a result of the giant economic and financial imbalances, not the least in the United States, the greatest worldwide financial and economic catastrophe in at least a century had already started quite a while ago. This disintegration process—which cannot be stopped unless radical emergency recovery measures, as proposed by U.S. Democratic Presidential pre-candidate Lyndon LaRouche, are implemented—was only further accelerated through the recent dramatic developments.

For example, University of Michigan's preliminary index of U.S. consumer sentiment, based on a survey that was finished before Sept. 11, dropped sharply from 91.5 in August to 83.6 in September, the lowest level since March 1993. The preliminary index of future expectations among consumers plunged from 85.2 to 77.2 points. The U.S. Labor Department reported that the number of new claims for unemployment benefits rose to 431,000 in the week ending Sept. 8, the highest level since July. The total number of Americans receiving unemployment benefits in the week ending Sept. 1 rose to 3.35 million, the highest since August 1992. U.S. industrial production fell in August for the 11th consecutive month. Production at factories, mines, and utilities dropped by 0.8% during August, much more than in the previous month (0.1%), and much bigger than economists had forecasted. The string of monthly declines is the longest in 41 years (since February to December 1960). The capacity utilization fell to 76.2% in August, the lowest since July 1983.

Also, the crash on stock markets is not a phenomenon exclusive to the post-Sept. 11 world. In the first 12 months after the first quarter 2000, the market capitalization of stocks held by American private households and corporations, has fallen from $20.15 trillion to $14.88 trillion. The loss in value of $5.27 trillion, or 26.2%, corresponds to more than half the American Gross Domestic Product. But in the second and third quarters, the situation worsened. In the last week of August 2001, there was the biggest market collapse in American stocks since the markets began to fall in March 2000. And then, the first week of September turned out even worse. All together, the Dow Jones fell 800 points from Aug. 20 to Sept. 10.

On the European markets, too, the month of August 2001 ranked among the worst since the financial storms of Summer-Fall 1998. Some big European firms, including Deutsche Telekom and Bayer AG, experienced the biggest monthly market fall in their history. However, while the German DAX index needed the whole month of August to fall 700 points, it managed to achieve the same amount of collapse in just the first two weeks in September.