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Financial Armaggedon Is Unfolding in South America

by Gretchen Small

The decision was made on July 23-24 by the U.S. Federal Reserve, reliable European sources report, that any and all measures would be taken to keep the U.S. stock markets from melting down before the November 2002 mid-term elections. At stake was far more than the Republican Party's election prospects, or U.S. stocks. With J.P. Morgan-Chase executives forced to call a teleconference July 24 to dispel swelling rumors that they were facing insolvency, urgent action was required. The rumors of insolvency also included Citigroup, second only to J.P. Morgan-Chase as the top holder of derivatives in the United States. Were even one big U.S. bank to go under, it would trigger "financial Armaggedon" for the already terminal global system.

The "whatever necessary" decision led to the greatest stock market intervention ever by the U.S. Federal Reserve, supported by other G-7 central banks. It succeeded in halting the meltdown . . . at least for a week.

But, while the financial establishment was riveted on the chaos on Wall Street, another part of their global speculative bubble was bursting: Brazil, and with it, the entire South American financial system.

On July 29, the Brazilian currency, the real, plummetted by nearly 5.5% in a single day, after losing 5% in value the prior week. The next day, Associated Press asked worriedly, "Is Brazil heading for an Argentine-style meltdown?" as the Brazilian currency lost another 4.6%, and its country risk soared to 23.45%. This is an index (set, ironically enough, by the bankrupt J.P. Morgan-Chase) used to indicate risk of default. The only higher country-risk ratings in the world, are those of Argentina—which defaulted on $95 billion in debt in late 2001—and neighboring Uruguay, which at the end of July had to declare a bank holiday, as it careened toward bankruptcy as well.

Officials from Brazil's Central Bank and Finance Ministry boarded planes to Washington, for emergency discussions with the International Monetary Fund (IMF), to try to scare up sufficient funds to forestall national bankruptcy—an unlikely prospect.

Most To Lose in U.S., Brazil

How big is the Brazilian foreign debt bubble? $500 billion big. That is largest foreign debt in the world. It is dwarfed, however, by the United States' $32 trillion in combined public and private debt. This U.S. debt, along with the world derivatives bubble, is by far and away the world's greatest financial bomb.

The Brazil developments caused panic on Wall Street. Top executives of the already-bankrupt Citigroup announced on Aug. 1 that they would now meet regularly to calculate how to "mitigate losses" in Brazil. Citigroup lost $2.2 billion in Argentina, but had, as of March 2002, nearly $13 billion to lose in Brazil. European exposure is even greater than American in Brazil, with Spanish interests guaranteed to go down when Brazil goes, because of enormous exposures in energy, telecommunications, and above all, banking.

On July 30, Uruguay, the "Switzerland of Ibero-America" whose economy largely revolves around its role as an international offshore banking center, was forced to declare a bank holiday, its first in 70 years. The expected next step: an Argentine-style bank deposit freeze.

Two countries in South America—Argentina and Uruguay—now have no banking system to speak of. Paraguay's system could blow tomorrow; Bolivia just suffered a damaging run on its banks. The bonds of every country in Ibero-America collapsed in the final week of July, as did many currencies, including Mexico's peso. No fewer than seven Ibero-American countries are now lining up, hat in hand, for urgent talks with the IMF.

Fools are running around calling this "contagion." It is, rather, a systemic blowout. Speaking on June 13 in São Paulo,

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Brazil, at a luncheon hosted by that city's Commercial Association, Lyndon LaRouche prophetically warned Brazilians of what has since happened, the explosion of their system under them. "Governments must act to put the system into bankruptcy reorganization. If you do not do it, you have the worst possible result," he told them. "Brazil, like every other nation on this planet, including Japan, is the victim of an Anglo-American dictate to try to perpetuate that bankrupt system. If we continue, this will blow up, and this could probably happen in the next two to three months. What is happening in Argentina is a *warning*."

Uruguay Goes Down

In collapse, Uruguay, though small both geographically and financially, poses a political problem for the IMF and Wall Street. This was their "success story" in the region, matched only by Chile. In a statement proving ironically prophetic, the State Department's pre-trip background briefing on Assistant Secretary of State Otto Reich's July 7-12 trip to South America, declared that, in Reich's view, Uruguay "represents what we hope the hemisphere will become."

At the beginning of 2002, Uruguay had a minimal country-risk rating of just over 2%; today it stands at 31%, rated second worldwide only to Argentina. Its bonds were rated investment grade as late as May 2002; today, they are six levels below investment grade.

Over the course of 2002, bank deposits dropped by 40%. On June 20, Uruguay floated its currency for the first time in 20 years. Since then, its peso has dropped almost 40% against the dollar, and the bleeding of bank deposits, and consequently central bank foreign reserves, has escalated. The nation's reserves dropped by over 70% from the beginning of the year, 27% in the first 16 days of July alone. The $500 million loan disbursed by the IMF in mid-June was gone within two weeks; $100 million a day left the banking system over the course of July; and by July 31, reserves were reported at $665 million.

The government suspended operation at two banks on July 30, and declared a general bank holiday, first for a day, then for the rest of the week. Depositors are permitted only to withdraw a limited amount of pesos, and no dollars, from ATM machines.

The same IMF and U.S. Treasury which have strangled Argentina of credit, quickly stepped in to bail out bank haven Uruguay. The government has already secured an increase in the IMF bailout arranged only in June, and is to receive an emergency disbursement of $1.5 billion on Aug. 5, followed (they say) by another $2.1 billion to be disbursed shortly thereafter. The total bailout package under way for Uruguay, $4.7 billion, equals one-quarter of its GDP.

The Bicycle Has Stopped

There has not been a similar massive run on the banks in Brazil yet, but that is coming. On July 29, as the real plummeted, rumors began to circulate that Brazil might declare a bank holiday. According to the daily *Folha de São Paulo* of July 30, an extreme scarcity of dollars relative to panicked buying, created a $2-3 billion "hole" in Brazilian bank accounting on July 29, as the banks tried to cover the demands of their clients for dollars to pay their debts.

In the 1980s, the speculative financial pyramids built around the national debts in Ibero-America, were dubbed "the bicycle." A bicycle remains upright, as long as you keep pedaling. So, too, in the debt game, debts were paid as they came due, by taking on new, bigger debts. The debt piled up, but as long as the money kept coming in, the speculative game stayed "upright."

Brazil's late July blowout is occurring because the bicyclist has stopped pedaling for Brazil. Foreign direct investment (FDI) has dried up, as global financial capital evaporates in the global crisis, or is sucked into the United States to keep the stock market bubble from exploding. In recent years, FDI was one of the principal mechanisms by which Brazil secured a sufficient inflow of capital to provide the liquidity to cover debt payments. Privatizations have ground to a near-halt, as the U.S. energy companies go under, which were expected to buy what Brazil hoped to sell this year.

The Brazilian private sector, which owes over $150 billion in foreign debt, has found that it can no longer roll over its loans. Between January and May 2002, only 58% of private foreign obligations were rolled over, whereas 96.5% were renewed in 2001. In June, the figure dropped to 22%, which means that Brazilian companies have only the option of raising the cash to pay off three-quarters of their loans—or default.

This is no small thing. The estimate is that Brazilian private firms have $10.6 billion in foreign debts coming due by Dec. 31. And, because every devaluation of Brazil's real makes paying off dollar debts more expensive, by late July companies began panic-buying of dollars, to try to pre-pay debts before the currency dropped lower. The panic accelerated the devaluation, as the dollar's value soared because of the scarcity.

Worse, Brazil has found that its *trade credits* are being cut off, usually the last thing to go in a crisis. Since March, international credit lines available to Brazil for imports and exports, have dropped by almost half, from $10.8 billion, to $5.7 billion.

The even more explosive charge lying under the Brazil debt bubble, however, is the government's domestic debt—the 1 trillion reals worth of government bonds, of which around 150 billion come due by the end of 2002. This government debt has quintupled since 1994, when President Fernando Henrique Cardoso came into office. It has been paid by the same "bicycle" principle as the private sector, but as investors became more nervous about the mounting debt, the financial team running the show enticed investors to keep "pedaling," by offering dollar-indexed domestic bonds, and floating interest-rate bonds.

The "solution" of yesterday's crisis, has become the

nightmare of today's. Some 40% of Brazil's trillion-dollar domestic public debt is now dollarized. That means that every time the real devalues, Brazil's debt increases. By Bloomberg News Service's calculation, every percentage point devaluation increases Brazil's government debt by $1.4 billion. To see the absurdity of the situation, consider that on July 29 alone, the run on the real due to panic about Brazil's ability to pay its debt, increased Brazil's debt by a whopping $7.56 billion, without the country receiving a single loan.

Capital Controls Now!

In this situation, the fixation on getting another $10-20 billion in new money from the IMF is ludicrous. It cannot solve the problem, even temporarily. And, given the IMF's conditionality, that all the candidates in the October 2002 Presidential race sign on to any agreement the Cardoso government might reach with the IMF, a new bailout is not likely to come quickly, if at all.

Brazil's debt is unpayable, and everyone in the know, knows this, and is planning accordingly. The "big money" is pulling out now, only hoping that the IMF kicks in enough capital to ensure that foreign looters can get all of their money out before Brazil goes bust, and its banking system implodes as in Argentina and Uruguay. The issue is, will Brazil let the game continue until it is stripped of everything but its debts, and then default like Argentina? Or, will it heed LaRouche, and stop the bleeding now?

Brazilian Central Bank President Arminio Fraga, mega-speculator George Soros' old employee, assured investors on a teleconference arranged by UBS Warburg on Aug. 2, that he ruled out any imposition of capital controls to defend the currency. But that is precisely what needs to be done, immediately, as the Ibero-American Solidarity Movement (MSIA), LaRouche's movement in Brazil, emphasized in a statement issued July 30. Brazil must break with the "rules of the game" of the failed international financial system. It must dump Fraga; impose capital controls, as Malaysia did in 1998; and use its considerable weight in the global arena to initiate an international movement for convening a "New Bretton Woods Conference," to discuss the reorganization of the world financial system. This was proposed in numerous international forums since 1997 by LaRouche, and since echoed by others. That, combined with concrete measures to promote Ibero-American integration, is Brazil's only option for survival.

As LaRouche told Brazilians from São Paulo, the issue is: "Can we survive? Can civilization survive? Can Brazil survive? Isn't that the question here? . . . You see what is happening to Argentina? . . . And where can you find the leaders who will avoid denial? To look the ugly truth in the eye, to look the dangerous truth in the eye, and say, 'I'm going to do whatever is necessary to save this nation, and civilization, this nation being my immediate responsibility.' "

Michael Steinhardt's 1991 Corner of the U.S. Treasury Market

by Richard Freeman

In 1991, Michael Steinhardt, in coordination with Salomon Brothers, conducted one of the biggest corners of the U.S. Treasury market in U.S. history, turning America's sovereign debt into a speculative plaything. It was an attack on the sovereignty of the United States.

Steinhardt is the son of the notorious Sol "Red" Steinhardt, a leading figure in the Meyer Lanksy National Crime Syndicate (see "The Real Scandal: McCain and Lieberman," *EIR,* July 19, 2002). Michael Steinhardt fronted his father's ill-gotten gains into several financial vehicles and Wall Street investments, which eventually evolved into his Steinhardt Management Co., one of the world's largest and dirtiest leveraged hedge funds. During the 1980s and 1990s, Steinhardt used his hedge fund to enforce a major transformation: building up the U.S. speculative bubble, and destroying the productive economy and necessary economic-financial institutions in America and around the world.

Meanwhile, Steinhardt became critical to the election of Joe Lieberman (D-Conn.) to the U.S. Senate. In the mid-1980s, Steinhardt helped create and finance, and then chaired, the Democratic Leadership Council (DLC), as a vehicle to crush both the legacy of Franklin D. Roosevelt and any support for the Constitution's General Welfare clause inside the Democratic Party. The DLC helped finance and steer Lieberman's career. When Steinhardt stepped down as DLC chair in 1995, Lieberman took over that post. In 1991, Steinhardt formed the secretive Mega group of approximately 50 billionaires, which supports the war drive of the fascist Ariel Sharon government of Israel, and is a major force behind the "Clash of Civilizations" policy that was advanced with the Sept. 11 attacks. The Mega group both finances and sets a good deal of the policy for its empty, but dangerous vessel, Joe Lieberman.

Steinhardt's menacing 1991 Treasury corner offers a clinical study of the thinking and criminal behavior of those who would use Lieberman to destroy America today.

Strategic Implications

In his 1991 Treasury raid, Steinhardt made as much as hundreds of millions of dollars, and paralyzed a portion of the U.S. Treasury market. *EIR* is investigating other strategic functions this raid might have had, given that it was launched at a time when the U.S. banking system was collapsing, and