Insane Fed Promises To Bail Out Bubble

by John Hoefle

"We stand ready to bail out the financial system no matter what the cost," is the essence of the message delivered in late November by the Federal Reserve, confirming Lyndon LaRouche's assessment that one cannot properly judge monetary policy without taking the insanity factor into consideration. The policy was stated by Fed Chairman Sir Alan Greenspan in a Nov. 19 address to the Council on Foreign Relations (CFR) in Washington, in which he said that, in the event of a "financial implosion," the Fed stood ready to use its "unlimited power to create money" to "provide what essentially amounts to catastrophic financial insurance coverage." To make sure that this was understood as Fed policy, a similar statement was delivered by Fed Governor Ben Bernanke to a Nov. 21 meeting of the National Economics Club, also in Washington. Bernanke promised the Fed would do whatever necessary to prevent the deflation of the bubble, including producing "as many U.S. dollars as it wishes, at essentially no cost."

While Lord Greenspin and Benny Bubbles presented this policy as something which might be implemented in the future, it is, in fact, something they are already doing. Since central bankers don't normally say such things publicly, the suspicion is raised that these statements were intended to intervene in full-blown economic crisis. That suspicion is furthered by the shift, since the mid-term elections, in the Bush economics team—which shift is an implicit admission that the economy is in far worse shape than was admitted during the campaigning.

Given that blacklists are circulating in the global derivatives market, enumerating financial institutions considered too shaky to trade with, and that J.P. Morgan Chase, the world's largest derivatives bank, is said to be at the top of everyone's list, it is likely that the Fed's statements were intended as public confirmation of private promises, that the Fed stands behind Morgan Chase and its derivatives exposure.

Derivatives Bailout

Greenspan explicitly praised derivatives and promised that the Fed, using public money, would ride to their rescue in a crisis. "Derivatives, by construction, are highly leveraged, a condition that is both a large benefit and an Achilles' heel," Sir Alan said. The benefit of derivatives, he said, is the "dispersion of risk to those willing, and presumably able, to bear it. If the risk is properly dispersed, shocks to the overall economic system will be better absorbed and less likely to create cascading failures that could threaten financial stability." Greenspan cited the "development of markets in securitized bank loans, credit card receivables, and commercial and residential mortgages" as a "major contributor to the dispersion of risk in recent decades."

While leverage is good, he said, its "Achilles' heel" is "excess speculation." "Too often in our financially checkered path, the access to such leverage has induced speculative excesses that have led to financial grief. We are scarcely likely to reform the underlying human traits that lead to excess, but we do need to buttress our risk-management capabilities as best we can to delimit such detours from the path of balanced growth. More fundamentally, we should recognize that if we choose to enjoy the advantages of a system of leveraged financial intermediaries, the burden of managing risk in the financial system will not lie with the private sector alone. Leveraging always carries with it the remote possibility of a chain reaction, a cascading sequence of defaults that will culminate in a financial implosion if it proceeds unchecked. Only a central bank, with its unlimited power to create money, can with a high probability thwart such a process before it becomes destructive. . . .

"But implicit in such a role is the assumption that the burden of risk arising from extreme outcomes will in some way be allocated between the public and private sectors," Greenspan said. "Thus, central banks are led to provide what essentially amounts to catastrophic financial insurance coverage."

'Free Money'

Bernanke made essentially the same point two days later, in a speech entitled "Deflation: Making Sure 'It' Doesn't Happen Here." Although the chance of "significant deflation" in the United States is "extremely small," Bernanke said, "I would be imprudent to rule out the possibility altogether."

With that fig leaf in place, Bernanke went on to deliver one of the most breathtakingly idiotic statements ever made by a Fed Governor: "The U.S. government has a technology called a printing press (or, today, its electronic equivalent), that allows it to produce as many U.S. dollars as it wishes, at essentially no cost." Using such methods, "the Fed would take whatever means necessary to prevent significant deflation in the United States," he claimed.

In response, Lyndon LaRouche was prompted to comment: "Hello, Rudolf Hilferding." Hilferding was the German Finance Minister in 1923, the peak of the Weimar Republic's hyperinflationary explosion.

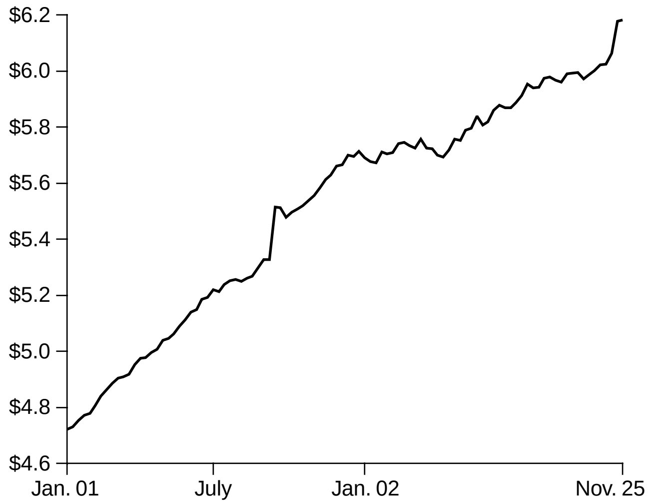
Underlying Greenspan's and Bernanke's statements is desperation, even panic, to prevent a deflationary meltdown of the global financial system, led by failures of the giant derivatives banks and giant insurance and reinsurance companies.

The most dangerous flashpoint appears to be J.P. Morgan Chase, whose stock was plummeting in early October, falling to a low of $15.45 a share on Oct. 9, well below the $20-a-share danger point cited by several market sources. It was at

FIGURE 1

U.S. Money Supply: 'Money of Zero Maturity,' 2001-02

($ Trillions)



Source: Federal Reserve.

precisely that point that the current stock market rebound began, with the Dow rising 969 points over the subsequent five trading days. Thanks to this suspiciously convenient rebound, Morgan's stock rose above the $20 level within two weeks, to $24.15 as of Dec. 10, a 56% gain in two months. Still, it stands at less than half of its post-merger high of $55.98 in January 2001, indicating that Morgan's problems are far from solved. With a $26 trillion derivatives portfolio, including $287 billion in credit derivatives, any crisis at Morgan is by definition a global financial crisis,

The stock market rebound, which also occurred in the European markets, served to buy time for the giant European insurance and reinsurance companies, whose capital bases include huge stock holdings. In recent weeks, several of these companies have announced $1-2 billion writedowns in the values of their stockholdings.

U.S. companies have also been hit hard. General Electric announced in late November that it would pump $4.5 billion into its GE Capital finance arm, in addition to adding $1.8 billion in capital to its Employers Reinsurance unit.

These problems are just the *hors d'oeuvre.* As Greenspan stated quite bluntly, the Fed is prepared to intervene however necessary to save the $300-400 trillion global derivatives market. Recent events suggest that the Fed and its European co-conspirators are not just prepared to act, but have already done so, and that the Fed's recent public statements are part of that effort. The $114 billion spike in money of zero maturity, a broad measure of monetary liquidity during the seven days ended Nov. 18 **Figure 1,** shows that the Fed had actively intervened before Greenspan's speech.

A Question of Sanity

Many Americans support the Fed's bailout policy, in the belief that the Fed is also protecting them and their money, but they are making a deadly mistake. The world is at the tail-end of the largest financial bubble in history, a bubble in which stock values, mutual funds, real estate, home equities, and virtually all other financial assets are still hopelessly overvalued. During the growth of this bubble, household "assets" have soared, led by stocks and soaring home values. The idea that the bailout of the system will protect this inflated household wealth, is the hook the international oligarchy uses to manipulate millions of Americans.

The reality, as unrivalled economic forecaster Lyndon LaRouche has emphasized with his Typical Collapse (or Triple Curve) Function, is that the inflation of these financial aggregates is the result of a process which simultaneously gouges, and loots, the physical economy. Since the early 1970s, in particular, the rise in nominal financial values has been accompanied by a collapse in production, and consumption, per capita.

The hard truth is that, in their attempt to save their system, the oligarchs plan to steal as much of what you own as they can politically get away with, and given the abysmal cowardice and greed in Washington, that is quite a lot. The only sane alternative to leaving your head on the chopping block is to accept, and organize others to accept, LaRouche's global recovery plan. You may have to write off some fictitious financial assets, but it may very well save your life.