New Bretton Woods Advances As Dollar Faces 'The Coming Storm'

by EIR Staff

In his webcasts and public addresses during February, Lyndon LaRouche emphasized in the strongest terms that the American and world political situation is now dominated by a systemic economic-financial crisis, and due to suffer outright collapse of financial institutions in the time-frame leading to the Presidential elections in the United States. As LaRouche described it in detail in his major Feb. 14 speech ("I Stand at the Bedside of a Doomed Empire," *EIR*, Feb. 27), an intense power struggle is now underway over who will control the inevitably necessary reorganization of the disintegrating financial system. Will international bankers prevail and refuse to "eat" their worthless debt paper mountains, making populations pay to salvage that debt with catastrophic consequences for nations and the world economy? Or will LaRouche's New Bretton Woods policy, in the tradition of Franklin Delano Roosevelt, gain the upper hand?

EIR reported on Feb. 27 that a motion was introduced by 50 representatives into Italy's Chamber of Deputies on Feb. 18, calling on the government to promote a reform of the international financial and monetary system along the New Bretton Woods model. The same motion, co-authored by LaRouche representative in Italy, Paolo Raimondi, has been introduced into the Italian Senate by Senator Oskar Peterlini, with 17 Senators from various parties co-sponsoring. The opening paragraph of the motion states that "after the collapse of LTCM, Enron, and the Argentina bonds; as well as Cirio, Parmalat, and Finmatica [three large Italian companies which have crashed over the past year]; . . . it should be clear to everyone that we are faced with a global systemic crisis."

And the LaRouche policy for a new monetary system may soon be introduced into the European Parliament. On Feb. 11, Cristiana Muscardini, an Italian member of the European Parliament, cited the same evidence of financial bubbles blowing out, and called on the European Union "to face seriously all the possible and new disastrous consequences which could be provoked by the enormous divide between the real and the financial economy. Until we take measures to reduce this divide, the risks will always be threatening."

Waiting for the Other Dollar To Drop

LaRouche's assessment of the current conjuncture—he called it "the moment of silence before the storm hits" on Feb. 18—was echoed repeatedly from within the international financial elite during the third week of February.

In a Feb. 17 article headlined "The Coming Storm," the London *Economist* warned that the world's financial markets are now in a condition like that before the 1998 collapse of Long Term Capital Management (LTCM) nearly melted down the whole banking system. The article noted that, as in 1998, top banks around the world have again massively exposed themselves to hedge funds and high-risk bets, trying to raise profits in times when traditional investments, like government bonds, generate low yields. "Have they learned nothing?" In Autumn 1998, "Bets went spectacularly wrong after Russia defaulted; financial markets went berserk, and LTCM, a very large hedge fund, had to be rescued by its bankers at the behest of the Federal Reserve. Afterwards, top bankers stood up at dinner parties and delivered a breathtaking *mea culpa.*" They're likely to do the same again "before the year is out. The reason is simple: the size of banks' bets is rising rapidly the world over."

The *Economist* quoted Michael Thompson of RiskMetrics that the present situation "is not dissimilar" to the one that preceded the collapse of LTCM. Like LTCM, banks are building up huge high-risk positions, in the expectation that markets will remain stable—"walking themselves to the edge of the cliff." One indicator is the so-called value-at-risk (VAR) parameter, which the banks calculate to determine the amount of capital they must set aside against their trading positions. In the case of Goldman Sachs, as an example, the VAR figure has more than doubled in the recent period. But of course, all the models to determine the VAR parameter are fraudulent, because they vastly "underestimate the savage effects of big shocks, when everybody is trying to wriggle out of their positions at the same time."

The *Economist* named several examples at top banks—including Goldman Sachs, UBS, Citigroup, Hongkong and Shanghai Banking Corp. (HSBC), Credit Suisse First Boston, JP Morgan Chase, Deutsche Bank, Lehman Brothers, and BNP Paribas—documenting the recent rush into high-risk bets. But, the crash is coming: "There are any number of potential flashpoints: a rout in the dollar, say, or a huge spike in the oil price, or a big emerging market getting into trouble again. If it does happen, the chain reaction could be particularly devastating this time."

Fears of a crash: Some central bankers, including Fed. Chairman Greenspan in his Congressional appearances Feb. 24-25, are talking nervously about having to try to prick the hyperinflated bubble of asset prices. In Greenspan's case, the focus of apprehension was the huge mortgage companies known as Fannie Mae and Freddie Mac.

"The whole financial system could go bust very easily; it is one gigantic Ponzi scheme," a London fund manager told *EIR* on Feb. 23, calling the *Economist* warning "obviously right. The banks are doubly and triply leveraged, and involved so massively in leveraged hedge funds, that they are in for a lot of trouble." He and another informed London financial source cited sharp swings in the value of the U.S. dollar on Feb. 20, after a week of apparently strong interventions by both the Japanese and European central banks to try to drive the dollar up. "There were a panicky 1-2 hours on [Feb. 20]," said one, "which showed how sensitive the markets are to a shift in exchange rate of the dollar. The derivatives market is very much at stake if the dollar suddenly rises, because there has been such a massive move to 'short' the dollar, that all the assumptions are thrown off if the dollar rises; and there would be a big move for the derivative holders, to cover themselves. I think the derivatives market is very volatile, and that makes more LTCMs likely.

"That same day, JP Morgan Chase started massively buying Brazilian bonds and equities. They have a lot at stake in Brazil. It reminded me, what J.P. Morgan did right after the Wall Street crash of 1929, when it started buying up stocks. But this time, something else is involved. JP Morgan Chase is the most heavily involved in derivatives, and the situation with derivatives could rapidly become very dramatic, and it's all very much interconnected with the derivatives crisis."

On Feb. 17, the German daily *Financial Times Deutschland* ran an article headlined "Preventing Catastrophes" by Josef Ackermann, chairman of the huge Deutsche Bank and also of the International Institute of Finances in Washington. Ackermann expressed great nervousness concerning the fallout from the Argentina default, the various financial bubbles which are ready to burst, and the prospect of very ugly surprises in the near-term future. He called, uncertainly, for "strengthening the international financial architecture."

Ackermann, like the other observers of the tense financial markets, noted that due to the extremely low yields on G-7 government bonds, much of the "ample liquidity" on worldwide capital markets was invested last year in risky, and therefore high-yield bonds, including "emerging market" bonds, and in so-called risk management through hedge funds. "Here, there is reason to worry," Ackermann wrote, "that a tightening of U.S. money and credit policy, or an unexpected event on world markets could lead to a reversal. Every market participant—whether creditor or debtor—should be warned." Investors, creditors, and sovereign debtors should hurry up and put together new "voluntary agreements for emerging markets in order to minimize the risk that negative events escalate into crises, or that regional crises lead to a global problem due to snowball effects." as happened in 1997 in Asia.

Concerning the special case of Argentina, Ackermann called for a "truthful and systematic dialogue"—whatever that is supposed to mean in the wild battle currently underway between Argentina's bankrupt government, and desperate bankers and vulture funds ranged around the International

Monetary Fund. And the leading creditors of emerging market countries should urgently form a "voluntary partnership in their own interest and in the interest of everybody, in order to create a more flexible and more calculable global financial system."

Central Bankers' Fears

Obviously, any concerted move to start raising interest rates, among major central banks, can unleash the storm that LaRouche—and now many others—has seen coming. That sore subject was raised by European Central Bank chief economist Otmar Issing in a Feb. 18 *Wall Street Journal* commentary, which tip-toed in the most fearful manner around the possibility that now is the time for central banks to try to "prick the bubble" of wild real estate and other asset inflation, by raising rates.

A week later, two British bankers issued a warning on Feb. 23 that British house prices—the world's second-largest bubble after the monster of U.S. mortgage-based debt—are about to crash. In a report entitled "Bubble Trouble," David Pannell at the London-based investment bank Durlacher said that house prices in Britain will crash by 30% from their peaks, and this crash will be "sharper but shorter than in the 1980s." He added: "Our pessimism is based on international and historic experience—for example, the UK housing market has never experienced a soft landing. . . . Our analysis suggests a correction will take place even if interest and unemployment rates remain at their current levels."

Capital Economics, an independent research company in London, came out the same day warning of a 30% fall of British house prices before the year ends.

And U.S. Federal Reserve Chairman Alan Greenspan pointed, very apprehensively, to an even bigger central bankers' worry: the huge, Federally-backed mortgage corporations known as Fannie Mae and Freddie Mac, sitting uneasily at the center of the vast American housing-price bubble which these corporations have deliberately blown up over the past decade. They are borrowing too much and they could fail, threatening the whole financial system, Sir Alan told the Senate Banking Committee on Feb. 24. He asked Congress to remove the mortgage giants' Federal loan subsidies and thus curtail their borrowing; and to give greater regulatory powers to the Office of Federal Housing Enterprise Oversight, to take over Fannie or Freddie if they do fail. Such warnings about Fannie Mae and Freddie Mac, blandly as Greenspan tried to express them, have nonetheless not been made before, outside the pages of *EIR*, and the mortgage giants immediately counterwarned that Greenspan would "alarm their investors."

These are the triggers for the crash LaRouche has foreseen. His New Bretton Woods bankruptcy-reorganization of the international monetary system, will be the only response able to hold off chaotic collapse, and restart real economic growth driven by large, modern infrastructure investments.