Those Who Attacked LaRouche's Crash Forecasts Are Now Proven Insane

by Richard Freeman

Lyndon LaRouche on Nov. 4 strongly chastized those who have attacked him, for repeatedly warning that the entire global financial and monetary system is hopelessly, irreversibly bankrupt, and must be put through a bankruptcy reorganization to begin a process of global reconstruction. "The news of the past 96 hours that two of the largest financial institutions in the United States, Merrill Lynch and Citicorp, are in dire crisis and have chosen to fire their CEOs" LaRouche said, "just serves to underscore that I have been right, and all of my critics have been wrong to the point of clinical insanity."

LaRouche cited his Triple Curve Function (**Figures 1 and 2**), as the reference point for understanding the scale of the financial and physical economic breakdown process that has entered a new, accelerated phase in recent weeks. The documentation cited below, when viewed from the standpoint of Figure 2, makes the case that we have already entered a full worldwide depression, far more severe than the Great Depression of the 1930s. "Many foolish Democrats are behaving worse than Hoover," LaRouche charged, "by persisting in denying the reality of the collapse, and therefore refusing to take the emergency action that I have spelled out, as the only means of solving this crisis."

During the turbulence of the period Oct. 24-Nov. 8, as Wall Street shook from the twin firings of the CEO of the largest commercial bank in the world—Citigroup—and the CEO of one of the three largest investment banks in the world—Merrill Lynch—LaRouche's warnings that the entire world financial and monetary system is finished, were definitively confirmed. This is not the crisis of a week, or a month, but of the past 40 years, which has been gathering force during the past two years. This process, which is being increasingly acknowledged by competent financial insiders, is still hotly denied by leading Democrats and Republicans. Were they to acknowledge the crisis, they would have to muster the courage to implement LaRouche's proposal to put the world financial system through bankruptcy reorganization.

On Nov. 7, the crisis took another turn. The price of gold soared to $842 per troy ounce at the London fix, its highest level in 27 years. The price of an oil contract for December delivery on the New York Mercantile Exchange (NYMEX) reached an unprecedented $98 per barrel, headed toward $100, and beyond. The U.S. dollar fell to nearly $2.11 to the British pound; to a 60-year low against the Canadian dollar; to below $1.47 against the euro, its lowest level ever; nearly to 113 yen to the dollar.

This prompted LaRouche to declare, *"The U.S. dollar and financial system has already exploded.* There should be no talk about how the crisis of the system is 'coming,' it's already here. The crash of the dollar system will cause an explosion of the entire international financial system.... Pieces of the exploded planet, are flying around like asteroids—but only a fool would say that the asteroids are 'going to cause' the explosion! The planet has exploded!... This collapse can bring a new dark age!"

We document three processes which show that the crisis is in full force at this moment, and that those who deny it, are either fools or liars. The three mutually reinforcing processes were selected because they show the core problems.

The first process is the systemic breakdown of the past two years, which is occurring in wave after successive wave, each more deadly than the previous. The fundamental reasons for this process, which has its roots in the policies of the past 40 years, are scientifically developed in LaRouche's *The State of Our Union: The End of Our Delusion* (*EIR*, Aug. 31, 2007), where solutions for the next two generations of mankind are presented as well.

The second process is the now-ongoing "great global write-down" due to losses on subprime mortgages, mortgage-backed securities, and collateralized debt obligations, suffered at all the world's largest banks, headquartered in New York, London, Frankfurt, Paris, Geneva, etc.

The third process gets at the teetering condition of Citigroup, either the world's first- or second-largest bank. There are enormous consequences, as Citigroup stands at the heart of America's banking system, as well as of the failing world dollar-based system.

1. Chronology of Systemic Crisis: 2005 to the Present

• During May and June 2005, Standard & Poor's downgraded General Motors' and Ford's credit ratings, on the more than $450 billion of the two companies' combined debt, to just above, and then, to junk-bond status. In April 2005, LaRouche had already warned that the debt burden on the backs of GM and Ford could not be sustained. The credit rating

FIGURE 1

LaRouche's Typical Collapse Function

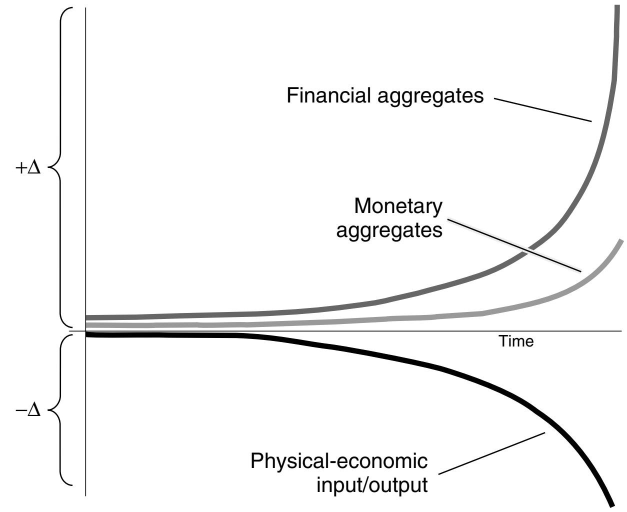
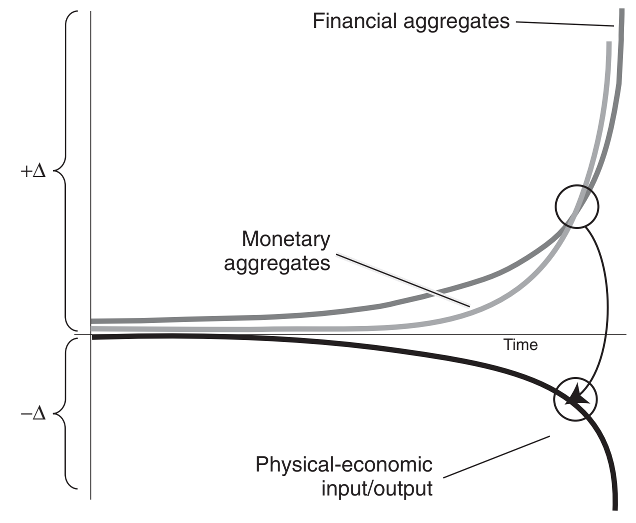


FIGURE 2

The Collapse Reaches a Critical Point of Instability



downgrade set off a Summer 2005 implosion of collateralized debt obligations (CDOs)—a form of highly speculative instrument—which caused hedge funds to lose tens of billions of dollars, nearly causing a meltdown of the world financial system.

LaRouche proposed Congressional action to neutralize this debt collapse, by putting a wall of protection and Federal credit around the auto industry's unused and underused machine-tool capacity, giving it a new mission for production of modern economic infrastructure. This became known as the Economic Recovery Act of 2006. When Congress did not move to implement this Act, the auto sector lost 160,000 jobs in two years.

• In September 2006, the Greenwich, Connecticut-based Amaranth Advisers hedge fund, which had $9 billion under management, went bust, the largest hedge fund failure in history. This caused a debacle in the natural gas market (where Amaranth speculated), and strong reverberations among other hedge funds, which scrambled for liquidity, although the deniers of reality shouted that "the event wasn't as big as LTCM" in 1998.

• During January and February 2007, the subprime mortgage crisis, which had been festering since the last half of 2006, erupted full force, as banks began to acknowledge sizeable subprime defaults. The $20 trillion U.S. housing bubble began to shake. On March 13, New Century, the second-largest subprime lender (after Countrywide) and once a hot property, was delisted by the New York Stock Exchange, and effectively ceased to exist. New Century's market capitalization had evaporated from $1.75 billion to a mere $55 million at the point it was put out of its misery.

• During the period between mid-Summer 2006 and Nov. 1, 2007, some 178 U.S. mortgage-related lending companies went out of existence. According to projections based on data provided by Foreclosures.com, during 2007, U.S. home foreclosures will reach 2.02 million.

• During July 2007 in the United States, banks rang up spectacular losses in asset-backed securities (ABS), particularly mortgage-backed securities (MBS). Then, on Aug. 9, France's BNP Paribas, one of the world's largest banks, announced that it was suspending all transactions in three of its "dynamic investment funds," which all held mortgage-backed securities. German banks announced that five similar funds were being shut down. The crisis had now hit Europe, and expanded globally, causing markets to freeze up—ranging from junk bonds to commercial paper, far beyond the subprime mortgages and MBS. Between late July and the end of the October, the Bank of England, the U.S. Federal Reserve, and the European Central Bank frantically pumped in more than three-quarters of a trillion dollars in short-term and medium-term funds, to prevent markets from melting down, and banks from folding. This set the ground for Weimar-style hyperinflation.

• During September and October, the U.S. banks recorded $35 billion in third-quarter write-downs and loan loss provisions, capped by these banks losing nearly a quarter trillion dollars in market capitalization. But the losses were only a fraction of the actual losses that the banks carry on their books. During the last week of October and first week of November, the crisis entered a new phase. With the more than $1.5 trillion in structured investment vehicles (SIVs), conduit, and CDO markets frozen, Merrill Lynch announced an $8.4 billion third-quarter write-down, and Citigroup a $6.5 billion write-down. But there were much worse financial convulsions going on inside these two companies, behind the scenes. Stanley O'Neal and Charles Prince III were forced out as CEOs of Merrill Lynch and Citigroup, respectively.

2. World's Largest Banks Take Huge Write-Downs

During the past two months, the world's largest financial institutions' third-quarter earnings reports had a recurring theme: massive write-downs and/or losses, from subprime mortgages, mortgage-backed securities, leveraged loans for leveraged buy-outs that did not materialize, CDOs, etc. Some examples: Merrill Lynch, $8.4 billion; Citigroup, $6.5 billion; UBS (Union Bank of Switzerland), $4.4 billion; Deutsche Bank, $3.12 billion; Credit Suisse, $2.16 billion; Bank of America, $2 billion; Countrywide, $1.62 billion; Dresdner Bank, $1.09 billion, Morgan Stanley, $940 million; Bear Stearns, $700 million; Société Générale, $550 million; Commerzbank, $500 million; JP Morgan Chase, $339 million; and BNP Paribas, $337 million.

Total write-downs of the 14 banks: $32.66 billion, of which seven Wall Street banks wrote down $20.50 billion; seven European banks, $12.16 billion.

Such uniformly high write-downs across the spectrum of major banks are unprecedented in recent decades, and bespeak major crisis. The Nov. 12 *Business Week* reported that, altogether, Wall Street banks had taken during the third quarter, "$35 billion in subprime related write-downs and lost more than $220 billion in stock value."

After the third-quarter reporting period ended, Morgan Stanley abruptly discovered that for the fourth quarter, it would have $3.7 billion in write-downs, which could "rise to $6 billion." For the same fourth quarter, Citibank projected $7-11 billion in new write-downs; and Merrill Lynch, $4 billion. However, the banks report only a fraction of their true losses, and are still carrying many troubled financial instruments such as MBS and CDOs, at or near their original value, when these instruments' real value has already fallen 20-50%.

Further, the Securities and Exchange Commission (SEC) is reportedly investigating banks that illegally hid losses. The Nov. 2 *Wall Street Journal* cites the case in which Merrill Lynch sold an unnamed hedge fund "$1 billion in commercial paper issued by a Merrill-related entity containing mortgages." This would have allowed Merrill to get the troubled commercial paper off its books and thereby avoid a loss, a potentially serious crime. Reportedly, the SEC is also investigating the books of Citigroup.

3. Citigroup Problems Radiate Through the Financial System

On Nov. 4, Citigroup held an emergency, all-day Sunday meeting. Its board selected former U.S. Treasury Secretary Robert E. Rubin as interim chairman, replacing chairman and CEO Charles Prince III, who was forced to resign. Former Schroder PLC head Win Bischoff became acting CEO.

The Citigroup shake-up followed a deepening crisis, in which it scrambled to cover up the fact that it is thoroughly bankrupt. Under Prince and his mentor and predecessor Sandy Weill, the bank wildly expanded, increasing its total assets from $1.09 trillion in 2002, to $2.35 trillion at the end of the third quarter of 2007, more than doubling in less than five years. Often, it invested heavily in financial markets shaped by, and under the domination of the City of London financiers.

Citigroup possesses the following speculative investments, at minimum:

- $83 billion in radioactive, off-balance-sheet SIVs. Altogether, Citigroup has seven SIVs, with names like Dorada and Sedna Finance, four of which, *EIR* has discovered, were created in and are steered from Britain's Cayman Islands.
- $60 billion in off-balance sheet conduits, which are also speculative vehicles, operating under slightly different rules.
- At least $20 billion in collateralized debt obligations.
- More than $70 billion in asset-backed securities, based on credit card cash flows.

All of these markets are facing serious problems. The most problematic are the SIVs. An SIV must, by law, have sufficient paid-in equity (the value of the stock that it sold), such that the equity represents "stored funds" which could cover those losses/write-downs suffered on the SIV's senior debt. Were the losses on the SIV's senior debt to exceed the value of its paid-in equity, the SIV must effectively be shut down. It appears that some of Citibank's SIVs might have crossed that line, had strict accounting principles been in force.

The collapsed state of Citigroup's SIVs makes the super-conduit, or master liquidity enhancement conduit (MLEC), proposed by Treasury Secretary Hank Paulson, dead on arrival.

On Nov. 1, Canadian Imperial Bank of Commerce analyst Meredith Whitney stated that Citigroup would have to increase its capital by $30 billion to cover problems. (The amount of capital that Citigroup would need is actually substantially more.) This statement underlined Citigroup's weakness and *already-in-progress collapse.* It sent tremors through the international financial system, and there was a mass dumping of Citigroup stock on Nov. 1, dragging the Dow Jones average down 362 points. Amid widespread collapse fear, the U.S. Federal Reserve injected $41 billion in short-term liquidity into the U.S. banking system—all on Nov. 1, the largest one-day intervention since September 2001, after the 9/11 attacks.

Any deeper ruptures at Citigroup could detonate its derivatives holdings of $34.9 trillion in notional value, which would bring down the world's $750 trillion-plus derivatives market, and the entire world monetary system.