'Starting a Run on the Bank Of a Bankrupt System'

by Paul Gallagher

The $150 billion outflow from the dollar and U.S. investments in August was called "stunning," and "incredible," because it reversed a mass influx of the world's money into U.S. dollar investments which often reached $100 billion a month throughout the whole "globalization" era.

But the U.S. Treasury released data Nov. 16 showing that the outflow from U.S. investments continued in September as the dollar continued to fall. Although this time the net loss from U.S. investments was only $14.1 billion, it included, again, net liquidation of U.S. Treasury and other securities by China, Japan, and the "Caribbean banking centers" of London jurisdiction and control. The British offshore centers' net liquidation was about $5 billion in September. The China and Japan net liquidations, about $3.5-4.0 billion each, are a very small fraction of those countries' dollar reserve holdings, but it is clear that their massive support of the dollar by absorbing vast quantities of U.S. debt, has stopped.

It had to. The dollar debt assets foreigners were buying included trillions in speculative mortgage-bubble and related securities which are now illiquid, and whose value is collapsing. That's why the July-August so-called "credit crisis"—actually the collapse of a vast U.S.-centered bubble of unpayable debts—appeared to begin with major losses and failures of banks in continental Europe and Britain.

Even though foreign central banks as a whole, in September, were back trying to slow the dollar's fall by buying U.S. securities—this "official" capital flow went the United States' way to the tune of $13.1 billion for the month, whereas central banks had dumped $70 billion net in August—the dumping of dollar securities by private corporations and investors was much stronger, a @ms$27.8 billion outflow.

The dollar has fallen 9% during 2007 against a basket of 16 other major currencies, to record lows. Major dollar dumping by Asian central banks and investors in July and August was the trigger—though not the cause—for the current systemic collapse which is falsely called a "subprime mortgage crisis," emphasizes economist and *EIR* founding editor Lyndon LaRouche. LaRouche was warned by Chinese representatives at a reception in June, that the combination of U.S. Senate strategic provocations against China over the Taiwan Strait, and relentless pressure from bankers and Treasury Secretary Henry Paulson for a reckless floating of the Chinese currency, could lead to such a reversal for the dollar. The warning was conveyed by LaRouche, but not heeded. Those who want to call this crash a "subprime crisis," LaRouche says, are denying the urgent reality that it is not cyclical, but an irreversible reverse-leverage collapse of a globalized financial system based on deindustrialization, destruction of infrastructure, and on huge bubbles of unpayable, illiquid debts. The $20 trillion mortgage bubble was the latest, and by far, the biggest bubble. These provocations against China merely triggered the process of its collapse, LaRouche says.

CNBC reported Nov. 16 that on state television programs in China, expert investment advisors are telling individual Chinese to get rid of investments in dollars, and go into those in other currencies. This advice is coming along with unofficial forecasts in these media, according to CNBC's report, that the Chinese currency, the yuan—which has risen 10% against the dollar since 2003—will now appreciate against the dollar by 4-5% a year.

LaRouche noted that this advice is like "starting a run on the bank of a bankrupt system." The globalization ideologues of Wall Street oligarch Peter Peterson's International Institute of Economics are getting their constant wish—and it is a chaotic dollar crash.

Threat of a Global Collapse

In response to a question from *EIR*'s William Jones at a Nov. 14 Washington forum, on whether and how the drastic fall of the dollar was influencing the decisions of the People's Bank of China (PBOC), the Bank's assistant governor Dr. Yi Gang reasserted the PBOC's commitment to the dollar. Yi was speaking at a conference on "Monetary Arrangements in the 21st Century" sponsored by the Friedmanite Cato Institute, at which Fed chairman Ben Bernanke had spoken earlier. Yi said the dollar had to continue as a key component of the country's $1.4 trillion reserves, because it was "the largest currency that we use" in terms of trade and foreign direct investment, as well as financial clearances and settlements. "It is also a very firm policy for China that the U.S. dollar will be the major currency in our reserves and that policy is very firm."

Yi also referred, without naming him, to the much-publicized comments of National People's Congress standing committee chairman, Cheng Siwei, to the contrary, by saying, "There is some discussion or comment from, maybe, scholars, maybe other persons in China in terms of 'There is a huge amount of adjustment of reserves.' I think that probably is opinion.... If they want to express their opinion, that will be fine, we consider it, we listen [to] it, but that does not change our policy."

Yi did, however, say that the Bank would continue to diversify to other currencies' holdings. "The point is, the principle for our diversification and the principle that guides us for these reserves, is that it should be proportional to our real economic transactions—meaning trade, FDI [foreign direct investment] and clearance and settlement."

Since the dollar crash, which had not previously been touched upon in Yi Gang's own comments, was really the elephant in the room at this conference, which devoted much time to the issue of the renminbi, it was picked up widely by the Chinese and international press.

Two days earlier, Japanese Prime Minister Yaseo Fukuda issued an alarmed warning that "the yen is rising too fast" against the dollar, and threatened large-scale interventions by the Bank of Japan. Behind the great concern of both Yi and Fukuda at the dollar's crash, is the threat that it will soon cause inflationary blowouts in Asian economies which are hooked on exporting goods to the United States and buying U.S. Treasury debt securities.

An analysis in the Nov. 13 *Financial Times* by a senior Barclays Bank economist, Tim Bond, noted that the U.S. Federal Reserve is in an impossible bind. On one hand, "U.S. monetary easing [that is, the Fed's two emergency rate cuts in the last two months] is provoking an almost immediate acceleration in inflation" worldwide. The reason, Bond notes, is that the dollar's fall is so steep already, that Asian (and Ibero-American) central banks are having to keep their interest rates low, or lower them, and to print more of their own currencies in order to buy dollars and slow down the dollar drop: The net effect, is that the hyperinflation the Fed is creating is pumped directly into those other economies, forming speculative bubbles on top of their export growth. So the Fed is threatening these economies with the same super-bubble collapse which has already hit the U.S. dollar and economy. But, wrote Bond, the Fed is, at the same time, under tremendous pressure to do more of the same, because of the credit collapse and banking crisis. So it is pulled hard, in opposite directions, simultaneously.

Bloomberg reports that central banks in Colombia, India, and Korea have already tried to create barriers to dollar investments in their countries, because the dollar is falling so fast.

An Echo of Weimar Germany, 1923

But feeding the panic of the big banks and hedge funds, the Fed continues to stoke a hyperinflationary outcome. On Nov. 15, with the most recent big credit write-downs and losses among the big banks coming from HSBC and Barclays, and Citigroup now having to pay 2% above the Treasury interest rate in order to borrow, the Federal Reserve made another huge injection of short-term money into the banking system. It was the second-largest one-day injection of Fed funds into the banking system, in U.S. history. Attempts in the financial press to claim that "the worst bank losses may be behind us," were swept away by the signs of urgent need for Fed money-pumping.

"This a 'free-fall' level of money printing," LaRouche commented of the Fed's actions. "This is an echo, though under different circumstances, of the desperate money-printing efforts of the Reichsbank in Weimar Germany, during the hyperinflationary blow-out year of 1923."

According to Reuters, the Fed's $47.25 billion bail-out injection Nov. 15 was the biggest since Sept. 19, 2001—after the terror attacks—when markets were nearly in free-fall, and short-term lending rates were shooting upwards. Reuters reported that overnight lending rates were rising again in recent days in both the United States and Europe. Citicorp had to pay the highest interest rate in its history, 6.125%, to issue a bond.

The following day, Goldman Sachs chief U.S. economist Jan Hatzius issued a chilling estimate of the fall in the banking system. He forecast that U.S. bank losses in the next year or so would be $400 billion (a very similar estimate had just been made by Deutschebank's chief economist). Just assuming that half of these losses are in highly leveraged assets (where there was a 10:1 ratio of borrowed dollars in the money used to buy the assets), Hatzius forecast that the total drop in the ability of the banks to lend, will be $2 trillion. For comparison, in 2006, the total lending of U.S. banks to households and non-financial corporations was $3.24 trillion, according to the Federal Reserve.

In dramatic understatement, Hatzius called the result "a substantial recession."