EIR Economics

Tokyo shock threatens U.S. financial markets

by William Engdahl

The sharpest one-day fall in the Tokyo Nikkei Dow stock index since the October 1987 stock market crash, the 1,160-point or 3% drop of Feb. 21, has left many people thinking that everything may not be as healthy with certain financial centers as government officials claim. The Tokyo Nikkei, at some $4 trillion total market capitalization by far the world's largest stock market, reacted to rumors of an imminent Bank of Japan increase in its discount rate, the central interest rate which determines all other rates for the economy. Despite the relatively positive election results of Feb. 18, which stabilized the rule of the Liberal Democratic Party, Tokyo investors began to sell immediately on the following Monday and into mid-week.

The Tokyo shock is being felt around the world. But nowhere is the shock hitting more severely than in New York's financial market, by far the world's most dangerous financial center at this time.

In a rare forecast on financial markets, American economist Lyndon LaRouche, on Feb. 15, before the latest tremors hit world markets, declared that "by the March 10-April 10 period there will be a 95% probability that the major crash of this round will have occurred." LaRouche added, "This next shock, many people project will be launched in or around the Tokyo market and will involve pressures on the Tokyo financial system from the inflated Japan real estate market. But actually, the cause of the crisis will not be internal to Japan but will be the condition of the international financial markets."

LaRouche emphasized that the fundamental problem of recent years, creating ever greater uncertainty and global instability, is the collapse of the economic infrastructure and industrial capacities of the United States. "Behind the scenes there has been a steady drop in the physical economy since 1970. . . . This collapse in infrastructure, agriculture, manufacturing has continued over 20 years to date, without respite," LaRouche stressed.

European views

LaRouche's forecast of a severe collapse or contraction in financial markets centered around the United States in the coming weeks is being tacitly endorsed by very senior European financial insiders. On Feb. 19, writing in the London *Financial Times,* Anthony Harris commented from Washington, under the headline "A clear view into the financial abyss," that the looming financial catastrophe "is being revealed in slow motion, like a free fall in a nightmare—and in an eerie silence, since it is all too technical for the news programs. . . . The strangest spectacle of all is the financial apocalypse which is being revealed by increasingly frequent installments. . . . At first sight the U.S. economy may appear to be shrugging off these disasters with comical unconcern, like one of those characters in a cartoon film who keeps walking for several strides after they have stepped off the precipice."

Harris is not the only one who has concluded that the United States has reached a dangerous conjuncture. In a meeting over the Feb. 17 weekend at Britain's Ditchley Park, former West German Chancellor Helmut Schmidt told a private group including former British Prime Minister James Callaghan and former French President Valéry Giscard d'Estaing, that "the U.S. economy is getting out of hand and serious disruptions" in the financial markets are imminent. Schmidt signaled out the U.S. internal debt and overall budget deficit as being at the heart of the problem, but stressed that "no financial market is under control whether stock or bond or currency." He pointed to the critical impasse which has presently locked Alan Greenspan and the Federal Reserve into paralysis. Rather than dramatically lowering U.S. interest rates to ease the bankruptcies and economic decline, the Fed is forced to consider even "raising U.S. interest rates in order to continue to attract additional foreign capital" to finance its debts.

The Ditchley gathering appears to have signaled a shift in European attitudes regarding the U.S. situation, which could precede a series of dramatic moves in Western Europe to insulate European economies from the coming shocks across the Atlantic. The ingredients which led to Schmidt's pessimistic presentation include:

- the Drexel Burnham Lambert bankruptcy filing on Feb. 13;
- the growing worldwide rise in interest rates which threatens the U.S. bond and stock markets;
- increasing hostility between Japan and Washington over trade and other relations.

The bankruptcy of Drexel, the "creator" of the high-yield $200 billion market in junk bonds which has propped up profits on Wall Street and been the key to the soaring Dow Jones Industrial Average since about 1985, means that not only is "junk" dead, but that hundreds of billions of dollars of paper assets which back up large U.S. and London banks, as well as some in Tokyo, will come crashing down, just as the Vienna Kreditanstalt collapse of 1931 set off chain reaction collapse in Germany and across Europe.

The British, and Germany

But the factor which threatens to give the Drexel collapse explosive new dimensions, is the alarming trend of rising worldwide interest rates in recent weeks. This rise began in early February, with reports coming out of London that imminent monetary union between East and West Germany, the first step toward political reunification, will collapse the careful West German Bundesbank effort to control inflation. Since German bonds become less profitable as inflation rises, nervous speculators began to doubt the wisdom of German bond investment. As a result, to attract buyers, bond interest rates were forced to rise.

The problem is that the entire German inflation fear was "made in London," as part of an overall British financial establishment financial warfare effort to sabotage the emerging continental European investment and industrial reconstruction possibilities. Why? As a participant at Schmidt's Ditchley Park talk stated, "The reunification of Germany will mobilize German capital for East Germany and there will be no German capital left to absorb the U.S. budget deficit."

What this person did not say, is that one reason London is a major financial and banking center today, despite its collapsing industrial base, is its ability to attract West German savings, which until now had no productive possibility to invest inside Germany. From London banks, for a commission, German funds financed U.S. deficits along with Japanese savings.

This is the real reason that key City of London financial institutions, including big British and U.S. banks as well as large futures brokers such as S.G. Warburg and James Capel and Co., launched a calculated attempt to force West German interest rates up by more than 2% in three weeks. They reasoned that the speculation would force growing German unemployment and currency friction with France and other European economies and thus damage Chancellor Helmut Kohl's reelection chances.

But the game has backfired. According to senior City of London economist Stephen Lewis, Germany is simply ignoring the London attacks, which is blunting the impact intended.

"We are very close to a strategic turning point," Lewis says. "The attacks on the German bond market has about reached its limits. The Bundesbank is simply ignoring it, so it is having little of its intended effect. There is total lack of alarm in Frankfurt.

"Very soon investment will start to flow into the German market again. Continental European markets will start to rise and with it we will see a collapse of Japanese bonds and especially U.S. bonds. Strategically we already see the beginnings of an important shift. The world's most important industrial economies, Japan and Germany, are converging around the industrialization of Eastern Europe. This could help to stabilize the non-English speaking financial world, as the U.S. and U.K. markets contract. The view here is that everyone expects a serious fallout in the U.S. financial markets."

The reality is that, since global financial markets have deregulated in recent years, what hits one hits all. The soaring German rates have threatened dollar flight, as German interest returns offer far more profit to global investment managers. Thus, U.S. bond interest levels as well have been forced to soar in the past week to retain investors. That has been the detonator, sending shock waves through both the New York and Japanese stock market.

As Lewis points out, however, while Japan's financial markets are backed by a dynamic and growing industrial infrastructure, similar to that of West Germany, the U.S. financial markets rest on a pile of $12 trillion of public and private debt, and more than $8 trillion in speculation. Every 1% rise in U.S. interest rates forces the interest cost of debt in the U.S. economy to rise by some $120 billion per annum! The United States right now is sinking into depression economically, while being forced to maintain the highest interest rate levels since the 1982 depression. Such is the folly of "free market" Adam Smith economics, as taught in today's American and British universities.

According to well-placed Tokyo financial sources, while there are questions of uncertainty for the Japanese export economy and year-end financial market pressures before the close of the fiscal year on March 31 in Japan, the real issue motivating the volatile Japanese stock market in recent days is their gloomy view of the United States' economic prospects.