It's an open secret (LaRouche was right)

by Chris White

With books on the second financial quarter closed, and results in for the first half of the year, the biggest open secret going the rounds internationally is that Lyndon LaRouche's ninth financial and economic forecast is right on the mark.

LaRouche's forecast was published in *EIR* Vol. 21 No. 26 (June 24, 1994): "The presently existing global financial and monetary system will disintegrate during the near term. The collapse might occur this spring, or summer, or next autumn; it could come next year; it will almost certainly occur during President William Clinton's first term in office; it will occur soon. That collapse into disintegration is inevitable, because it could not be stopped now by anything but the politically improbable decision by leading governments to put the relevant financial and monetary organizations into bankruptcy reorganization."

Outside of top-level European banking and related officials, like Roland Leuschel of Banque Bruxelles Lambert, and senior officials from S.G. Warburg, along with certain, especially leading French newspapers, it is not being discussed publicly. However, the pattern of unfolding events corroborates what LaRouche has forecast.

Since Federal Reserve Chairman Alan Greenspan acted to increase U.S. short-term interest rates on Feb. 4, there has developed a most unusual pattern on international stock and bond markets. The pundits talk of "corrections," and ask, "When will the correction be over?" They are idiots.

Markets are tumbling

Internationally, bond markets have been tumbling since October of last year. Most severely affected has been the market for long-term British government debt, the so-called "gilts" market. This has fallen by about 20% from its peak in January. So, too, has the U.S. government's 30-year bond, from its recent peak last October. In Germany, bonds have fallen by about 10% since the beginning of the year.

Less dramatic than what has happened in the United States and Britain, that 10% decline is nonetheless the steepest in Germany's post-World War II history. This is being pointed to by bankers like Hamburg's Udo Bandow, who ask, "How can it be that bonds have suffered from their steepest fall, and no one is saying anything? What is going on?"

The world's stock markets are not doing much better. Tokyo, the exception, is up about 20% (still around 50% of its all-time "bubble era" high), but from there the slide begins: United States down about 7%, Germany down 11%, France and Britain down 15%, Argentina and Mexico down 15 and 19%, Hong Kong, Malaysia, and Thailand down between 25 and 30%. Turkey and Poland down 50 and 40%, respectively.

All this would seem to betoken a collapse in pricing valuations of so-called financial assets, the kind of phenomenon which is most easily recognized in 1987- or 1929-style stock market crashes. That's the kind of behavior people usually associate with crashes. They go on to demand, when is it going to happen? Tell us what the date will be?

They ought to know better. That is not what is going on around the world. It is not what LaRouche is forecasting. And it is not what the "open secret" is all about. With the exception of Japan, which is in the sights of the mega-currency speculators for a killing, everything is going down, more or less everywhere at the same time. The conventional wisdom is, with the exception of huge crashes like October 1987, that different markets in different parts of the world behave in different ways, at different times. But they don't. They are all doing the same thing at once.

Phase II of the Bretton Woods system, the monetary system based on floating exchange rates, futures-related speculation tied to expected behavior of currency and interest rates, offshore dollars and International Monetary Fund conditionalities, which was put into place between Nixon's decision to take the dollar off the gold standard back in August 1971, and the Rambouillet monetary conference of 1975, is disintegrating. And, it will not be put back together again.

'Shortage of capital'

The "open secret" is reflected among those who are beginning to talk about the specter of what they call a developing "shortage of capital." In the good old days they would have used the term "liquidity crisis." The idea of a "shortage of capital" describes a phenomeon which is quite closely related to LaRouche's argument in support of his disintegration forecasts.

Valuations of financial assets are not determined by the replacement costs of the physical assets which underlie the paper—or these days, electronic—property claims. Such valuations are based on estimated price-earnings multiples. LaRouche cited, in his forecast, the case of New York City slum dwellings, fully depreciated as housing assets, i.e., worth nothing, or less, on a replacement basis, but maintaining a high nominal capitalization on the basis of a multiple of the annual rent stream that can be extracted from the tenants of such properties.

The landlord doesn't buy the property per se. He buys the rental income derived from the property and pays a price based on the hoked-up fictitious capital value to do that.

Then, reinvest the income typified by the cited rental stream. Demand then a proportional increase in the income derived from such accumulated fictitious values. Soon, you have a financial bubble. Cash in, for reinvestment, the fictitious gains on the fictitious capital, and you have an out-of-control bubble. Why fictitious? Because relative to the replacement costs of the assets thus bubbled, the nominal property title form of the assets doesn't represent real wealth, but a claim to loot present income on behalf of historical, actually fully depreciated, assets.

The bubbled fictitious values must keep growing. But the only way the bubble can grow is as a cancer does, by consuming the healthy tissue from which it extracts its nutrients. The better the bubble grows, like the cancer, the more surely it will collapse, because the more inevitably is it destroying that which feeds it. And, in that collapse, the leverage by which nonexistent assets were turned into further claims against current income, and pyramided, turns against the bubble itself.

Drive to get out of fictitious assets

That's the context for the beginning discussion of "capital shortages." The drive is on to get out of bubbled fictitious financial assets and into something more real, like real money, or money equivalents.

That is what is going on behind the worldwide collapse in financial markets. It is how the quarter ended. Sweden's largest insurance company Skandia announced that it would no longer be buying Swedish government bonds, because Sweden's debt is growing out of control, an asset not considered worth anything any more.

Germany's largest banks have stopped their own account trading in derivatives while they try to work out what their losses have been over the last six months. That is the period in which calculations about the direction of interest rates, currency rates, and who knows what else turned out to be wrong, and when a succession of firms, like the derivatives-trading sports goods manufacturer Balsam, the DM 300 million company with DM 6 billion derivatives exposure, went belly-up.

In the United States, the market in CMOs, collateralized mortgage obligations, was used as an interest rate hedge, and nearly $1 trillion has disappeared as interest rates have gone up. The second quarter results will see losses turned in by most of the securities houses which trade such things, beginning with Salomon Brothers—which is already reporting $200 million down the tubes—and going through Lehman Brothers, Kidder Peabody, and Goldman Sachs. The same shows up in the so-called "super safe" money market funds (of which it is said, they are not government-insured, but no investor has ever lost anything in a money market fund), which bought the interest-only strips of CMOs in order "to enhance their yields," and lost out instead.

These are all another form of the derivatives that the German banks stopped trading for their own accounts. But, all the markets which have been collapsing around the world are presently driven by derivatives, since it is speculation in options, futures, and futures-options which largely determines spot pricing in any of such markets.

Nearly three-quarters of all derivatives traded worldwide are denominated in dollars. To flee from derivatives, as a kind of second-order form of fictitious asset, and into real money, or money equivalents, is thus also, in many cases, to flee from the dollar. No wonder that central banks are expressing such reluctance to intervene to defend the dollar. They do not have the resources to do it. Currency markets are about $1 trillion per day, of which half are spot transactions and half are futures-related; interest-rate markets (yes, you can trade interest rates) are about the same magnitude again. There is no combination of central banks anywhere in the world which disposes of the liquidity to go up against that wall of speculative activity.

Thus it may not be too long after July 9-10 meeting of the Group of Seven heads of state in Naples, Italy that a new round of collapse begins. But don't wait for it. If it is going to happen anyway, better to assume that it has already happened, and act accordingly to support the kind of banking reorganization that LaRouche has proposed.