European bankers 'are getting a bit nervous'

by William Engdahl

"Privately, I fear we're headed for a major crash in the coming weeks," a senior executive, responsible for global derivatives risk at one of Europe's largest banks, confided to this writer. Speaking during the Bürgenstock Annual Meeting in Switzerland (Sept. 4-6), a forum for discussion of international derivatives and financial futures, the banker continued: "I've just spoken with all my traders around the world, from London to New York to Asia. The next several weeks will see a frantic effort by the large Emerging Market Funds, especially out of the U.S., as well as Japanese funds, to try desperately to get out of their Asian exposure."

"Let me give you an idea how serious the problem of these funds is," he said. "Normally, a prudent fund manager would place, say, 3% of total assets in these Asian countries, and diversify the rest over Latin America, East Europe and the big markets. On average, though, these funds now are up to their ears in Asian stocks, something like 12% of total portfolio, or four times normal. They got caught up in the 'Asia Tiger' euphoria of the past years, and bought all they could get their hands on, as if the growth boom would be equal in every Asian country, and never end.

"Now, every time an Asian government is able to pump some local funds into their stock market to try to reverse the severe fall of the past several months, these funds rush to sell and get out. They're desperate to cut their holdings before the end of the Sept. 30 accounting quarter. So are the Japanese, for the same reason. This is why, for instance, the strongest market in Asia, Hongkong—where the economy is on a fundamentally sound basis and the central bank has huge dollar reserves—why the Hongkong stock market has plunged in the past two weeks. Hongkong is the only liquid market in Asia where the funds can sell to get ready cash to cover their losses in Thailand, Philippines, and such places."

According to the banker, this "unwinding" by the investment funds in Asia will increasingly put pressure as well on the bloated European and U.S. stock markets. "The problem is that the slightest added shock, at this point, can trigger panic selling. If the European markets go into a crash, this time those governments are powerless to inflate out. Maastricht [the European Monetary Union Treaty which requires stiff ceilings on government spending] means the EU economies are deflating, and are forbidden to inflate if a real crisis hits. The risk is then, that a stock market fall in these European markets could trigger a severe depression, much like in the U.S. or Germany in 1929-33. I won't even comment on the U.S. stock market, except to say it has to break soon. We bankers are getting a bit nervous; we're not taking any new positions in any markets, anywhere, until things get clearer."

A client study released Sept. 8 by Merrill Lynch underscored the European banker's concern. The study reported, after a survey of 259 investment funds worldwide that are responsible for funds worth $5.55 trillion, that "Southeast Asian stock markets are under intense pressure from funds worldwide, with selling interest greater than during the Mexican crisis in early 1995." Fund managers cited the prospect of months more of severely high Asian interest rates, today on average 25% or more for Thailand, Philippines, and other countries. The high rates are needed to deter more attacks on their currencies. But that, in turn, will plunge these economies into severe recession. That will ruin the stock markets in those places, and, with them, the huge profits of the foreign speculative funds. "The collapse in Asia is the biggest threat to this international financial market of the 1990s," Morgan Stanley economist Stephen Roach, told the German weekly *Wirtschaftswoche*. "Never in the last ten years has the house of cards been so shaky."

Reports are that the same funds are also beginning to think of getting out of Ibero-America as well, before similar crises erupt. Significant in that regard is the fall of the Colombian peso and hints of selloff of the Mexican peso by foreign investors.

If everyone wants to sell and no one is able to buy in a stock market, that is the classical ingredient for a panic. That is clearly what has international bankers and others, including Federal Reserve and U.S. Treasury officials, more than worried about the present situation in the global financial system.

The bankers' worries were underscored, in unusually stark terms for a central banker, by the governor of the Swedish central bank, Urban Bäckström. In his keynote presentation to the Bürgenstock conference, attended by some 300 of the world's leading bankers, derivatives exchange heads, fund managers, and government officials, he chose not to speak of "efficient markets." Instead, his remarks focussed on "crisis prevention." "Each crisis is unique," Bäckström insisted. "Each one is different, but steps can be taken to try to prevent or contain them before they come. In Thailand, the macroeconomic policies were clearly wrong. Governments need to follow price stability and stable economic policy."

"Disruptions are inevitable," the Swedish Riksbank head continued. He ticked off a list of such "disruptions" in the past. "The bursting of the 'tulip mania' in 1636, which in fact was caused by the steep rise and fall of tulip bulb options, proves that derivatives crashes are older than we might think." He then cited the crash of the South Sea Bubble in 1720, the failure of the French Union Générale in 1881, Barings Bank in 1890, various U.S. banking panics, the collapse of the Austrian Kreditanstalt in 1931, "and, of course, Black Thursday in October 1929."

With that in mind, he added, "Supervisors face a great challenge. International cooperation such as exists through the BIS [the club of mainly industrial-country central banks, based in Basel, Switzerland] is key, as contagion between different national markets in the globalized economy is now far more likely. Our financial system is in the midst of rapid transformation." He concluded, "The industrial revolution began in the 19th century. The late 20th century will be seen in history as the beginning of the financial revolution, I believe."

Jackson Hole crisis management

Bäckström's comments reflected an effort at a new "crisis containment" consensus among central bankers and governments, as a result of several days of off-the-record discussions in the resort area of Jackson Hole, Wyoming. According to discussions with several participants at Jackson Hole, an annual informal meeting where leading central bankers, private bankers, and government officials meet to compare notes on global financial developments, this year's meeting had one overriding theme: "financial crises and how to contain them."

Among those present at the Wyoming meeting were Federal Reserve Chairman Alan Greenspan and numerous regional Fed presidents; Lawrence Summers, the deputy treasury secretary who "managed" the 1995 Mexico crisis; central bank heads from the Bank of England, Bank of France, and German Bundesbank; Bank for International Settlements General Manager Andrew Crockett; and International Monetary Fund (IMF) Deputy Secretary Stanley Fischer, the person responsible for the recent controversial $18 billion Thai bailout package. Sweden's Bäckström was also present.

The top agenda issue was "how to contain the East Asia crisis." In addition to a heated debate over the Thailand IMF bailout—where the Bank of England reportedly argued that Thailand should have been let to its own devices, regardless of the consequences—the Jackson Hole discussion took up the prospect of a world computer malfunction in the present global derivatives markets.

Crisis management in Asia?

Only hours after the Jackson Hole and Bürgenstock meetings, both of which intensely discussed the crisis in Asia, signs of "damage control" measures emerged. In Malaysia, where the Kuala Lumpur Stock Exchange had plunged 37% from its highs earlier this year, along with its currency, the ringgit, suddenly, on Sept. 5, the market began a dramatic reversal. It rose by more than 12% that day, as the Malaysian government announced that it had lifted restrictions on stock market speculation put in effect only days before.

According to senior sources inside the City of London financial community, two factors were responsible for the improvement on Kuala Lumpur's stock market. The Mahathir government struck a quiet deal with Prudential Assurance, one of the largest fund managers in the United Kingdom, with more than $160 billion in funds to invest around the world. Malaysian officials also met privately with their close ally, the Sultan of Brunei. "The Malaysians agreed to lift the controls if Prudential agreed to come in and buy, which it has done," said a well-placed British banker to *EIR,* in off-the-record remarks. "As well, the Sultan of Brunei, one of the closest of British allies, whose fortune is tied to Royal Dutch Shell oil concessions, agreed to help stabilize the ringgit. The two were enough to reverse the fall in Kuala Lumpur. At least for the time being. But the question is, where the next crack will emerge in these fragile markets. Already, I see signs that Latin America could be next, with Colombia and Mexico possible targets."

Similar manipulations have been evident in recent days in Hongkong and Singapore, two other markets traditionally close to City of London interests. But the markets of Thailand, Indonesia, South Korea, and Philippines all continue their fall, as funds there desperately scramble for the exit. Well-informed financial circles in Europe calculate that this will intersect a major European and possibly U.S. stock market crisis and currency crises sometime in October or soon thereafter.