Chronology

The global financial crisis during 1998

by William Engdahl

Jan. 29: The committee of foreign creditor banks, led by New York's J.P. Morgan, together with the South Korean government, announce an agreement on rescheduling $24 billion of Korea's short-term debt for a period up to five years (this is 14% of Korea's $170 billion foreign currency debt). The announcement is timed to be made public during the Davos, Switzerland World Economic Forum. Representatives of the Group of Seven and central bankers proclaim that the "worst is over in Asia." Privately, the same officials admit that the "Asia crisis has only begun," citing alarming signs about the collapse of the International Monetary Fund (IMF) talks with the Indonesian government of President Suharto, and the deteriorating condition of the banking and economic state of Asia's largest economy, Japan.

Feb. 2: U.S. First Lady Hillary Clinton, addressing the plenary at the Davos World Economic Forum, suggests that governments might discuss "what could be done to create more of a global regulator atmosphere along the lines perhaps of a New Bretton Woods." Lyndon H. LaRouche had been calling for a New Bretton Woods system since January 1997. Some days before, U.S. Treasury Secretary Robert Rubin, at Washington's Georgetown University, had spoken of the need for a "new architecture" in international monetary affairs.

Feb. 14: Food riots in Indonesia spread across Java to the capital, Jakarta. The Suharto regime places 25,000 troops on standby. Several people are killed in the rioting. Suharto issues a statement warning of an "international plot to destroy our economic foundation. . . . There are signs that this monetary crisis has been engineered to smash our economic development of the past 30 years." At the same time, in defiance of IMF demands, Suharto announces his decision to set up a currency board in consultation with Prof. Steve Hanke. The decision brings an IMF threat to cut off a promised $40 billion emergency bailout fund package.

Feb. 17: The Japanese government of Ryutaro Hashimoto proposes to the Diet (Parliament) a record 30 trillion yen ($223 billion) fund to be used by the Deposit Insurance Corp. to deal with the seven-year-old crisis involving bank bad loans and the deepening recession being fuelled by banks cutting back on loans. The depressed Nikkei stock market fails to recover from the dangerous low of 16,200 on the news, as Japan's March 31 fiscal year end nears. At that level, the hidden stock reserves of 6 of Japan's 19 largest banks would disappear.

Feb. 23: China's Chen Jinhua, chairman of the State Planning Commission, announces that the government is launching a three-year infrastructure housing and industry investment program of 8 trillion yuan ($963 billion) as a response to the worsening global financial crisis. The project is said to be modelled on the 1930s U.S. infrastructure program of the Roosevelt administration's New Deal.

March 2: Japanese Deputy Minister of Finance Eisuke Sakakibara, in an interview with the Japanese daily *Mainichi Shimbun,* states, "I believe that many world leaders may well be starting to contemplate the idea of a financial agreement along the lines of the Bretton Woods agreement" of 1944. He adds that in view of the "current crisis of international capitalism . . . many people may now be realizing that both the International Monetary Fund's checks, and its solutions, are insufficient." Criticism of the IMF policies and their lack of positive effect in Asia grows internationally. Sakakibara's call, widely seen as a "trial balloon," is endorsed by an official of the Bank of Thailand.

March 9: The Bank for International Settlements in Basel, Switzerland, the organization of the world's leading central banks, for the first time admits the systemic threat of the Asia crisis. In a press release, the BIS states, "At the turn of the year the financial turmoil in Asia had reached systemic dimensions, requiring an immediate injection of cash and the rolling-over of maturing debts." The BIS comment followed March 3 testimony by U.S. Treasury Secretary Rubin in the U.S. Senate, in which he stated, "In Korea the situation deteriorated very rapidly and by Christmas the Korean banking sector was on the verge of systematic default." On March 12, the London *Financial Times* runs a commentary by Prof. Judy Shelton, who calls for discussion of a new Bretton Woods system with fixed exchange rates.

March 18: LaRouche, at a policy seminar in Washington on the need for a New Bretton Woods, attended by some 170 diplomats, government officials, political activists, and businessmen, calls on the Clinton administration to take the lead in proposing a new system based on a) periodically fixed exchange values of national currencies; b) limited convertibility, as may be required; c) exchange controls and capital controls; d) adoption of necessary protectionist measures respecting tariffs and trade; and e) prohibitions against markets which speculate against targetted currencies. The financial crisis in Japan assumes a worsening dimension as Japanese government 10-year bond yields fall to an unheard-of low of 1.5%, and the Nikkei falls to lows near 16,500, despite repeated government postal savings and state pension stock-buying "PKO" operations.

March 26: Japan's ruling Liberal Democratic Party (LDP) proposes a record 16 trillion yen ($114 billion) "economic stimulus" to try to revive the economy amid the worst

FIGURE 1
World currencies versus U.S. dollar
(percent change from July 1, 1997 to June 30, 1998)

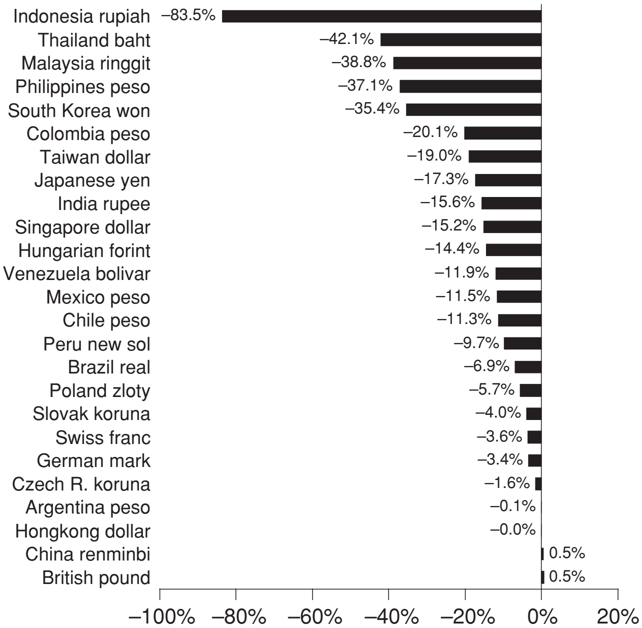
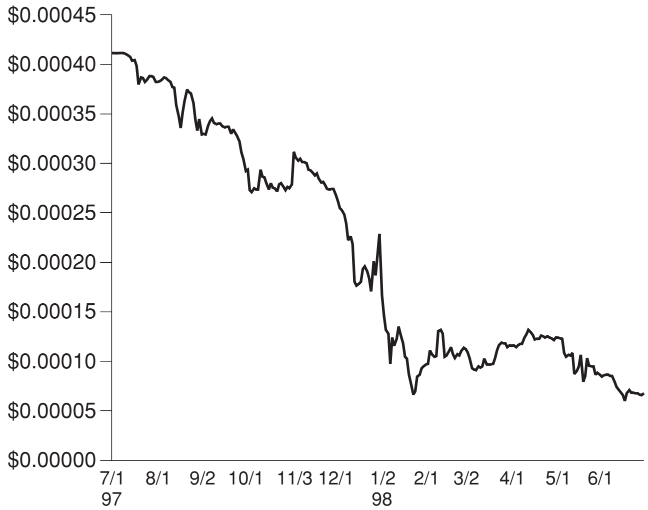


FIGURE 2
Indonesia's currency
(U.S. dollars per rupiah)



downturn of the postwar period. The package is subject to harsh criticism for its short-term effect and lack of genuine new funds. The Nikkei stock market continues to fall and the yen to weaken. On March 31, in a speech at Tufts University, U.S. Deputy Treasury Secretary Lawrence Summers admits publicly for the first time the gravity of the crisis. He says that events in Asia "pose real threats to our wages, savings, and security," and warns that "weaker Asian stock markets would also hurt our financial markets and therefore diminish our savings."

April 1-6: Stock and currency values across Asia plunge in what is admitted to be the start of "phase two" of the Asia crisis. On April 1, the Japanese government begins a series of financial deregulation measures dubbed the "Big Bang," including easing rules for licensing securities trading companies and removing controls on investment abroad in offshore accounts by Japanese citizens, something which greatly accelerates the flight of capital out of Japan and the weakening of the yen. The chairman of Japan's Sony Corp., Norio Ohga, warns that Japan's economy is "on the brink of collapse." Tokyo Shoko Research Co. releases a report warning that Japan stands on the "brink of a domino-style series of bankruptcies," after reporting the highest number of company failures since World War II for the fiscal year ended March 31. The Bank of Japan *Tankan Quarterly* business survey shows every economic indicator as being bad. Moody's Investors Service warns of a potential future downgrade of Japan's sovereign debt to negative, the only G-7 country facing such a warning. Moody's cites the sheer size of Japan's $3.7 trillion public debt, second only to that of the United States, and in per-capita terms the highest in the world. On April 3, President Clinton, in a highly unusual step, cites a "raging battle" in Japan over economic policy, urging Japan to "take a bold course."

April 2: LaRouche addresses a Rome meeting of members of the Italian Parliament and diplomats, where he outlines his proposal to create a New Bretton Woods monetary order. Several days later, while visiting Argentina, Italian Prime Minister Romano Prodi tells an *EIR* reporter, "I personally believe that we must move toward a New Bretton Woods. And this has to be analyzed very carefully, because the risk level in the international monetary system has greatly increased in the recent period."

April 17: The newly formed Group of 22 government finance ministers and central bank governors meets in Washington, hosted by U.S. Treasury Secretary Rubin and Federal Reserve Chairman Alan Greenspan. No public declarations result, and the talks are characterized as "informal."

April 18: The G-7 finance ministers and central bankers meet in Washington during the Interim Committee Meeting of the IMF, where unprecedented public pressure is placed by IMF Managing Director Camdessus on Japan to take decisive measures to revive its economy, clean up its estimated $1 trillion in bad loans, and help in the recovery of the rest of Asia.

The U.S. Congress refuses to pass the request for an added $18 billion quota increase for the IMF, in effect blocking the entire $90 billion increase, as political criticism of the IMF's role in Asia grows.

April 29: At the annual meeting of the Asian Development Bank, ADB Vice President Bong-Suh Lee declares, "The worst is still to come this year for South Korea, Indonesia, and Thailand. The actual repercussions are yet to happen in 1998."

May 2-3: The heads of state of the 11 founding member-states of the European Monetary Union meet in Brussels to formalize the selection of the 11 and to vote in the first council of the new European Central Bank; Dutch National Bank head Wim Duisenberg is selected to head the new ECB, which will manage the euro beginning January 1999.

May 7-21: The social crisis in Indonesia spreads, with riots in Medan. Angry mobs rampage through Jakarta and student protesters demand Suharto's resignation. On May 21, Suharto steps down after 32 years, swearing in his Vice President, B.J. Habibie, as President. Days later, a panic run on deposits at the Suharto-tied Bank Central Asia PT forces the Bank of Indonesia to take over the bank. The collapse of prices in stock markets across Asia continues to gather momentum, with Korea's KOSPI index falling 7% on May 26, followed by declines in the rest of the region. Since mid-April, the Indonesia stock market has fallen 30%, and Korea's 40%. The Japanese yen hits a seven-year low, at 139 to the dollar, as Japan's official unemployment hits a postwar high of 4.1%. Economic data for Asia show most economies officially in recession or severe depression.

May 19: The Russian Central Bank suddenly raises its benchmark repo refinancing rate from 30% to 50%, triggering a 12% collapse of the Moscow stock index in one day. Russian interest rates had been kept extremely high since the crisis on Russian bond markets in October, in a desperate effort to defend the ruble, on the assumption that Asia would soon calm, easing Russian rates with it. The failure of the Asian crisis to abate, forces the Russian government into a desperate "debt trap" of short-term refinancing which reaches its apparent limits by the end of May. A national strike of unpaid Russian miners had blockaded the economically vital Trans-Siberian Railway. In private discussion with *EIR,* a prominent European central banker expresses alarm that Russia's short-term GKO government debt problem is "out of control." By mid-May, the Moscow stock index has fallen 50% since October, 14% in just three days, as the Central Bank is forced to hike interest rates to prevent foreign bond sell-off. In testimony before the U.S. House Agriculture Committee, Federal Reserve Chairman Greenspan admits, "We do not as yet fully understand the new financial system's dynamics. . . . We have tried to confront the current crisis with the institutions and techniques that we have."

May 22: Auto production data released by the Japanese Automobile Manufacturers' Association reveal a 19.3% year-on-year drop in output for April. Japanese steel production is down sharply, with estimates of a fall of at least 10% likely for 1998, as steel exports across Asia continue to collapse. Statistics on Japanese trade with Asia are equally grim. Overall exports were down year-on-year by 18.1% in April. Exports to select countries were even more damaged: to Indonesia down 53%, Thailand 43%, and Korea 41%. In turn, imports by Japan from those Asian economies were down more than 14%, further delaying any prospect of stabilizing Asian economies, let alone starting a recovery.

For first quarter 1998, the Bank of Korea announces the first decline in Gross Domestic Product since 1980, an annualized fall of 3.8%. Korean new machinery investment is off 41%, and total investment in plant and equipment is down 23%, the worst decline in the postwar period. Construction is down 39%, and official unemployment, at 6.7%, reaches a 12-year high.

May 31: The London *Economist* writes that the Union Bank of Switzerland's Singapore branch is reported to have incurred financial losses across Asia over the previous 12 months, including in South Korea, "in the billions of dollars." According to the *Economist,* the losses are so great "that there is a danger that the regulatory approval of the planned fusion of UBS with the Swiss BankCorp might be in danger." The report of losses comes on top of admitted UBS derivatives losses in London and Hong Kong of "at least $1 billion."

June 2: In an economic symposium in Tokyo sponsored by Japan's Institute for International Monetary Affairs, Malaysian Prime Minister Mahathir bin Mohamad articulates the thoughts of many Asian governments in issuing a call for global financial system reform: "Our task is to focus on the remedies . . . if we are to ensure the revitalization of Asia," he states. "The present system, if there is a system at all, is messy, unreliable, and destructive. . . . I believe the time has come to deal with the entire issue of reform of the international financial system to ensure currency stability and contain the activities of those who buy and sell money for no other purpose than to make profits. . . . We feel threatened. We are told if we don't do those things, then our currency would be depreciated further. . . . And so we try to follow the IMF, and it is very damaging to us. When you raise interest rates and squeeze credit and increase taxes, which is the standard formula for all countries having problems like that, the only result is that companies go bankrupt. And when companies go bankrupt, governments eventually go bankrupt. I think there is some basis for fearing the medicine being doled out by the IMF."

June 8-9: The world's leading central bankers and finance ministers meet in emergency session to discuss the global unravelling crisis. On June 8, central bankers of the Organization for Economic Cooperation and Development assemble in Basel for the BIS annual meeting. No public statements are issued, beyond the admission by BIS Managing Director Andrew Crockett that "the Asian crisis is not yet definitively over," confirming the failure of the months-long efforts at "crisis management." Crockett states, "This was the first crisis in the postwar period featuring the combination of banks as the principal creditors and private sector entities as the principal debtors. Principles of how to manage and resolve a crisis of this sort were not known in advance and, indeed, are still under discussion."

The lack of any visible consensus on June 9, in the emergency G-7 finance ministers meeting in Paris, further underscores the policy disarray among leading governments. Unconfirmed reports are that the growing Russian crisis and the Japanese banking and yen crises were the major topics discussed in Paris. Germany's *Der Spiegel* reveals that Russian President Boris Yeltsin had just telephoned his "friend Bill Clinton" to discuss the Russian debt crisis.

June 10: The Japanese yen falls to a seven-year low at 140 to the dollar, a drop of 8% since April 1. Global attention is drawn to the probability of a yen free-fall, triggering possible devaluation of the Chinese yuan and Hong Kong dollar and competitive further currency devaluations across Asia. Official Japanese government data reveal the effect of a new law which has allowed Japanese capital flight abroad since April 1 without restriction: For the first time, the amount of Japanese savings being invested abroad exceeds that invested in domestic savings. The stock price of a major Japanese bank, the Long-Term Credit Bank, plunges, amid a report in a Japanese magazine, *Gendai,* that the LTCB faces a "liquidity crisis." The Japan Ministry of Finance pressures Sumitomo Bank to agree to a merger with LTCB. The Japanese government releases first-quarter data which reveal an annualized GDP decline of 5.3%, far worse than predicted, and confirming that the economy is in deep recession, the first since 1974-75. The Hashimoto government avoids using the term "recession" to describe the crisis, however, and predicts that by the second half of the year Japan will return to positive growth.

June 11: The government of China makes an unprecedented public call on Japan to show "courage and wisdom" to stop the falling yen. Foreign Ministry spokesman Zhu Bangzao declares, "We hope Japan and the relevant countries can face the reality and use courage and wisdom in taking effective measures to stop the further devaluation of the yen to create necessary conditions for the recovery of the economy." The previous day, stock prices on the Hong Kong exchange had fallen to three-year lows because of growing fears that China and Hong Kong would be forced to devalue, in response to the cheaper Japan and Asia rival currencies. China reveals that first-quarter exports to Association of Southeast Asian Nation member-nations are down 10%, and to South Korea 24.5%. Hong Kong's official interest rates of more than 11%, needed to defend the fixed dollar peg, are cited as the major cause for the continuing fall of the HangSeng stock prices and Hong Kong real estate, the two pillars of the island economy's credit system. On the same day, the Taiwan Central Bank calls an emergency meeting to discuss the continuing fall of its currency.

June 16: A senior World Bank economist uses the word "depression" to describe the effects of the Asian crisis. At a conference of the UN Economic and Social Committee for Asia and the Pacific, in Melbourne, Australia, World Bank Asia/Pacific Vice President Jean-Michel Severino declares, "We are probably at the end of the first cycle of the Asian crisis, and we are entering into a deep recession, or you could even use the term, 'depression.' This depression may be very long-lasting if one does not manage it very, very carefully." He adds, "Since the beginning of this crisis, about $115 billion has fled out of the five major crisis countries—Korea, Thailand, Indonesia, Malaysia, the Philippines, about 10% of the GDP of these countries. In addition, banking credits have also been reduced by about $88 billion, which is about another 8% of GDP." Severino points out that 40% of all credit to the five Asia countries had come from Japanese banks, as well as being the market for more than 20% of all Japan exports. "The depression thus is being communicated from one country to the other."

June 18: A surprise, concerted intervention by the Bank of Japan together with the New York Federal Reserve, acting on behalf of the U.S. Treasury Department, succeeds temporarily in halting the yen free-fall, which had reached 147 yen to the dollar. The yen rises to 137. The intervention is timed with the arrival in Tokyo of a high-level Clinton administration delegation consisting of Deputy Treasury Secretary Summers, New York Federal Reserve President William McDonough, Federal Reserve Board member Roger Ferguson, and, little-publicized, a Special Presidential Envoy, former Federal Deposit Insurance Corp. head William Seidman, to discuss details of the early-1990s U.S. bank rescue operations. The surprise U.S. action to support the yen reportedly is taken after telephone assurance to Clinton by Prime Minister Hashimoto that Japan will now take aggressive action to clean up its bank bad loan problems and to restart the Japanese economy. The Chinese pressure on Washington to intervene to support the yen, coming one week before a planned Presidential visit to Beijing, is reported to have been a major factor in the surprise U.S. intervention.

The United States reports that the April trade deficit increased 9.5% over March, as exports to Asia dropped sharply and imports rose. Mexico announces it expects a trade deficit of $7 billion for 1998, because of the Asian crisis and falling oil export earnings.

Russian debt negotiator Anatoli Chubais announces that Russia needs $15 billion from the IMF in order to stabilize its financial crisis. On June 22, an IMF team arrives in Moscow for talks.

June 20: In an article in the *Minneapolis Tribune,* "Falling Yen Raises Questions about Floating Currency," researchers at the Minneapolis Federal Reserve District are quoted arguing that "fluctuations in international currencies are a cost that governments, businesses, and consumers should not have to bear. They think they have a better way, a path that was tried and abandoned earlier this century: fixed currency exchange rates." The article quotes Catherine Mann, an economist at the Washington Institute for International Economics. "We need something on the order of a new Bretton Woods, a top-down serious reassessment of what the exchange rate system should look like," she says.

June 22: Ministers from the Organization of Petroleum Exporting Countries (OPEC) convene an emergency meeting in Geneva, in the third attempt this year to slash output to try to stabilize falling world oil prices. As OPEC met, average prices for crude oil were down 49% since October 1997. Despite formal agreement for large additional output cuts, oil prices fail to rise, owing to expectations of weakening demand from Asia and the rest of the world, combined with record-high inventory.

June 24: President Clinton departs for a nine-day trip to China, the first by a U.S. President since the 1989 Tiananmen Square massacre. Clinton is joined by Treasury Secretary Rubin and some 1,000 U.S. business leaders. Despite extensive talks with the Beijing leadership, no public announcement regarding the need for a new monetary order is issued during the visit, confirming reports of Washington's desire, for the present, to adhere to crisis management.

July 2: The ruling Japanese LDP issues its long-awaited proposal to clean up Japan's banking sector and its estimated $1 trillion in bad loans. The "Bridge Bank" plan is unveiled by the Hashimoto government, which will present it to the Diet for ultimate passage following the July 12 Upper House elections. The financial markets react negatively, with the yen again falling below 140 to the dollar, as the fine print of the proposal leaves most critical questions unclear. Among other items, it is revealed that finances to fund the Bridge Bank are to come from the March vote by the Diet of 13 trillion yen ($93 billion) for the Deposit Insurance Corp., far less than the $500 billion or so deemed necessary. There are no indications that the LDP is prepared to go for a Chapter 11 reorganization of the financial system, and liquidation of the bank bad debts which are paralyzing the Japanese economy and most of Asia.

July 13: Japanese Prime Minister Hashimoto resigns following disastrous results for his party in the July 12 Upper House elections. Intense back-room political faction fights over who will succeed Hashimoto as LDP leader and, thus, as Prime Minister, fail to resolve the financial and political crisis. All attention focusses on the July 24 announcement by the LDP of the new leadership choice.

On the same day that Hashimoto resigns, the IMF and the Russian government announce a record $22.6 billion two-year debt restructuring package to ease the Russian crisis. In order to raise its $11.2 billion share for this year, the IMF announces that it must resort to provisions of its General Agreement to Borrow, a procedure last used by the IMF in 1978, when the Carter administration used it in a vain effort to stabilize the falling dollar. With stock markets in Europe and the United States inflated to historic highs, largely from the inflow of flight capital out of Japan and Asia, Morgan Stanley's chief investment strategist, Barton Biggs, predicts a 20-30% fall in the U.S. stock market in the coming months, which would spread to Europe.