EIR Economics

GREENSPAN IN A BARREL

The suckers bet again, against LaRouche, and lose

by William Engdahl

The most bloated asset bubble in world financial history was created, in its present incarnation, last September-October, when Alan Greenspan's Federal Reserve acted with record speed to pump liquidity into the banking system, to prevent the occurrence of what is now being admitted was an imminent global systemic breakdown. The unprecedented creation of easy money by the Fed, not surprisingly, went directly into fuelling even more frenzied speculation in the already dangerously inflated stock market, in order that banks—facing insolvency, in some cases, or devastating trading losses after the September collapse of Long Term Capital Management (LTCM), in other cases—could quickly book paper profits to offset their huge losses.

The bill for that money printing by Greenspan is now coming due, or, in the words of the late President Lyndon Johnson, "the chickens are coming home to roost." The small investor, the foolish "ordinary Joe" who has been convinced by his broker or by CNBC or Internet propaganda to pour his vanishing savings into stocks, now faces the wipeout of his entire life savings, possibly in hours. As one seasoned veteran of the 1973-74 bloodbath on the New York stock market put it, "The end of the greatest suckers' rally in history is nigh."

Economist Lyndon LaRouche had clearly warned that papering over the autumn 1998 crisis was not going to work. In a Sept. 27 action memorandum circulated broadly in the United States and internationally at the time, LaRouche identified the danger of collapse of the global derivatives markets, and warned of Greenspan's folly:

"Under the rules of the game as perceived by U.S. Federal Reserve Chairman Alan Greenspan, and many other desperadoes in governments and financial institutions around the world, the only alternative is a desperation-driven, reckless hyperinflation, like that which crushed Weimar Germany in 1923. This has been the desperation-driven folly of the government of Japan, since the close of 1997. The recent proposals of circles such as Britain's Prime Minister Blair, or even the cautiously similar proposals of the circles of Germany's former Chancellor, Helmut Schmidt, will, if attempted, have similar effect to those taken by Japan's Obuchi government, or, more recently, Wall Street's hysterical Alan Greenspan.

"In such circumstances, equivocation, sometimes called euphemistically, 'crisis management,' can be fatal to entire nations.

"There is no time remaining to continue those infantile games of shilly-shallying, called 'crisis management,' which are typified by what has been just exposed, this past week, as U.S. Federal Reserve Chairman Alan Greenspan's prolonged, duplicitous, and reckless cover-up of the Long-Term Capital Management situation."

The last nine months have not seen any improvement.

The real economy is evaporating

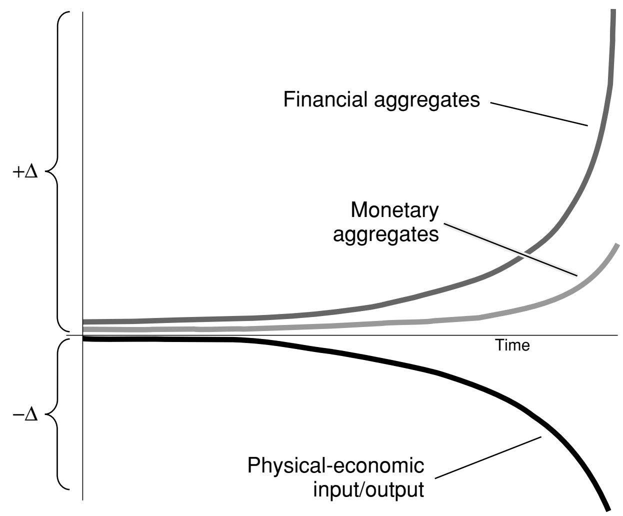
The bitter irony is that, while stock markets have been soaring to stratospheric heights, the world's physical infrastructure has been collapsing at an accelerating pace, on the model of Lyndon LaRouche's Triple Curve, or Typical Collapse Function (**Figure 1**). Since May 1997, the once-booming "tiger economies" of East Asia have been mired in the worst collapse of industrial production in history. Japan, the world's second-largest industrial economy, despite politically suspect recent Gross Domestic Product data, is in its worst economic depression since the late 1920s.

The most revealing index of the global physical economic reality is the state of the world's machine-tool production. In

March, new orders for Japan machine-tool builders fell 27% year-on-year. North American imports of Japanese machine tools alone collapsed 43%. Japanese machine-tool exports to South Korea in March compared to a year ago were off 75%. Germany, the world's second-largest machine-tool producer, saw new orders plunge 10% in the first quarter, year-on-year. In the United States, according to latest data from the Association for Manufacturing Technology, machine-tool consumption in the first quarter plunged 48% compared with the first three months of 1998.

Instead of a global economic growth in per-capita and per-hectare output of real physical wealth, the central bank liquidity being pumped in is going directly to prop up a rotted, brain-dead banking system that is sucking the wealth out of the real economy globally. Per-capita food consumption levels across most of the former emerging market economies, from Brazil to Mexico, South Korea to Indonesia, are dropping to alarming levels, as unemployment soars.

FIGURE 1
A typical collapse function



A consumer bubble

Since Greenspan turned on the U.S. monetary spigot full force last autumn, what Vice President Al Gore recently referred to as "our strongest economy in history" has been artificially pumped up by record levels of new consumer indebtedness. The nominally strong U.S. consumption, in turn, has been the main prop of the entire global economy.

Average American households, not grasping the point of Greenspan's bailout of his banker friends via easy money, have used the record-low interest rates to take out home equity loans. This new debt has been used to finance everything from new car purchases, to washing machines, to children's college education. Similarly, government tax incentives encourage families to pour their life savings into 401-K retirement schemes, which, in turn, invest in various stock mutual funds. Families have the illusion that they have a "security cushion" against bad times, and continue to rack up record debt, with savings at the lowest rate since the 1930s depression a result.

This unprecedented spending boom in America, at a reported annual clip of 7% growth for the first quarter, has led to record levels of imports, for everything from TVs to Japanese or German cars. Consumer installment debt in April reached the record high of 22% of personal disposable income. In turn, this debt-driven consumer spending binge has led to a soaring balance of payments and trade deficit for the United States. At the present annual rate, the trade deficit in goods and services will be an estimated $204 billion for this year. Once the stock market cracks, and the paper wealth in it simply vanishes into thin air, interest rates will soar and home mortgage loans will end, all bringing the illusory U.S. economic boom to a screeching halt.

A secret Fed talk?

The global financial edifice is now at the edge of collapse. The red warning signal flashed on June 11, when the U.S. Treasury bond market went into free-fall. A TV news item on June 10 reported that the world's second-largest hedge fund, Julian Robertson's Tiger Management LP, was in secret talks with the Federal Reserve about its insolvency crisis. Market reports are that Tiger, a hedge fund with $13 billion in assets, had to pay $3 billion out in redemptions. One year ago, Tiger Management was listed at $20 billion.

A Tiger official denied as "nonsense," rumors that the Fed had organized a secret meeting to rescue the fund. Reportedly, Tiger had bet heavily on the direction of the Japanese stock and bond markets in the past month, and got it wrong. The Tiger Fund (incorporated in the Netherlands Antilles, where George Soros also hides his money), also had losses of more than $1.5 billion last October, in the wake of the collapse of the LTCM hedge fund and a sharp rise in Japanese yen interest rates.

The mere rumor of the Tiger Fund's distress triggered a panic selloff in 30-year U.S. Treasury bonds on June 11. Interest rates soared above 6.12%. A month earlier, the rate had been 5.5%. A Fed spokesman issued a cryptic statement: "As a matter of policy we don't respond to rumors." The following week, the U.S. Labor Department released data for the Consumer Price Index which showed a suspiciously low 0.1% rise in core inflation from the month before. That dramatically eased fears of inflation, and interest rates eased slightly, ahead of the next Federal Open Market Committee meeting of the Federal Reserve on June 29.

The point is not whether fudged Labor Department statistics helped keep the bubble in the world stock markets intact a few hours longer. "There is no smoke without fire," noted City of London bond strategist S.J. Lewis of London Bond Brokering Ltd. "The Fed knows the state of hedge funds. It is highly likely Tiger and perhaps other hedge funds had huge losses from the recent swings in the Japanese market. If so, we could see a repeat of last September-October when the Fed stepped in to prop up the system with large liquidity to the banks. That would mean no rate hike, maybe even more covert liquidity pumping by the Fed."

The danger has not passed

The illusion of calm in world financial markets, amid the deepening global depression, is beginning to show cracks. No less prominent an authority than the president of the Basel-based Bank for International Settlements (BIS), the world's central bank, has issued a stark warning of the fragility of the global financial system.

In a speech to the June 7 BIS annual meeting, Swedish Riksbank Gov. Urban Baeckstroem referred to the widespread view that Brazil and other major crisis spots have been "contained." "These favorable developments should not lead us to conclude that the danger has passed," Baeckstroem warned. "Indeed, the principal risk at this point is that the sense of urgency in the need to both manage current problems and to prevent the emergence of new ones, will be lost. This would be irresponsible, since there remain some evident threats to international financial and economic stability, and, perhaps more importantly, there may well be vulnerabilities that are not so evident. . . . At this meeting last year, no one had anticipated the extent of the turmoil in financial markets that would be generated by the Russian devaluation and moratorium."

Baeckstroem focussed special attention on the balance of payments vulnerability of the United States, expressing "concern that equity markets, particularly in the United States, but also elsewhere in the industrial world, might fall back rapidly and in a disorderly manner."

Referring to the trend of central bank easy money since the collapse of Russia and the LTCM hedge fund last August-October, Baeckstroem said, "Such policies can themselves contribute to turbulence in financial markets. Easy and low-cost financing over an extended period may drive up the price of financial assets, even at times when the rates of return on the underlying real assets are declining. . . . The buildup of excessive leverage sets the stage for the type of market turbulence seen in the wake of the Russian moratorium."

Baeckstroem is not a lone voice expressing alarm at the precarious state of global leverage. In an interview with the German daily *Frankfurter Allgemeine Zeitung* on June 15, International Monetary Fund Managing Director Michel Camdessus warned, "We must be able to react rapidly and decisively in the case of a systemic crisis." The IMF's new financial emergency mechanisms, the Special Reserve Facility and the "pre-emptive" credit line, are very important, said Camdessus. "However, there still exists a big hole in our toolbox. *For the extreme emergency case, for a global credit crunch, we are not prepared*" (emphasis added).

This admission by the head of the IMF is even more significant as it comes just seven months after the IMF got an added $100 billion fund increase to contain future crises. It warranted barely a peep in world media.

Camdessus continued, "Last autumn, shortly after Russia's unilateral debt moratorium, the situation had been very, very serious. Once again we were able to overcome that, but in the future we should be better prepared." He said, "The catastrophe last October was so close, the shock so deep, I am convinced, the responsible persons will act very rapidly in the case of a temporary liquidity crisis."

The voice everyone in the financial markets is listening to most carefully, however, is the chairman of the Fed, Alan Greenspan. In testimony before the U.S. Congress's Joint Economic Committee on June 17, Greenspan declared that to keep the overall economy growing, "It is useful to pre-empt the forces of imbalance before they threaten economic stability. When we can be pre-emptive, we should be." Greespan was signalling that the Fed is going to raise interest rates. At that point, by all accounts, the $14 trillion speculative bubble called the U.S. stock market will go into reverse leverage, as Wall Street firms and investors rush for the exits. Once the process starts, the size of this bubble is such that the entire global system is likely to come down with it. One can only imagine Alan Greenspan standing on the bank of the Potomac watching the system sink, muttering under his breath, "*Après moi le déluge*."