EIR Economics

Interest rate rise drives U.S collapse

by Steve Parsons

Something much more terrifying than the generalized weakening of the bond and stock markets is now stalking Wall Street. And it's not simply the rekindled fears of "recession," nor that the much-heralded "soft landing" is looking a lot harder. The specter is that foreign investors, particularly the Japanese, are beginning to turn their backs on U.S. financial markets. On Jan. 23, the Japanese virtually boycotted the $5 billion issue of 40-year Resolution Funding Corporation bonds, the government-backed securities marketed to raise capital for the savings and loans bailout.

In recent years, and especially the last two, the Japanese have spearheaded a veritable boom in foreign investments in U.S. markets, and have provided a kind of "floor" for block purchases of U.S. securities. Foreigners have purchased as much as 40% of U.S. Treasury issues, while providing an increasing amount of funds underpinning the real estate and junk bond markets. Furthermore, Japan's big banks have furnished 40-60% of the bank funds for leveraged buyout acquisitions in the U.S. All of this is about to be sharply curtailed.

Some brokers have dismissed the Japanese abstention from the Refco auction as simply confirmation of what the Japanese themselves have been saying for months: that they have no interest in 40-year securities and "regard Refco bonds as a glut on an already full U.S. bond market," to quote one European investor. Others might point to Refco's general lack of appeal among all bidders.

But it's not merely the Refco bond issue that is at stake. Fears of another Japanese boycott at the $30 billion U.S. Treasury quarterly refunding auction in mid-February are reportedly at near-hysterical levels at such prestigious investment houses as Goldman Sachs and Salomon Brothers, which face potentially catastrophic losses if the recent plunge in bond prices continues.

Technical factors? Or is it political?

On one level, the reason for foreign investors pulling back from U.S. government securities is straightforward. Until a few months ago, U.S. bonds enjoyed a 3-4 percentage point differential over Japanese and continental European securities. But now, Japanese interest rates on long-term bonds have risen to near 7%, about 1.5 points below that for U.S. long-term Treasuries. West German rates are well above 7%. There simply is no incentive to continue pouring money into U.S. issues, especially when even a mild slide in the dollar could easily nullify the small differential.

Analysts and so-called experts point to a variety of technical factors for the interest rate boosts by Japan and Europe, ranging from concerns over rising domestic inflation to changes in accounting and reporting practices in their own nations. But are these the only reasons, or is there something even more fundamental?

The sharp boost in foreign interest rates was initiated by the Swiss, just two days after a meeting of European central bankers in mid-December. West Germany had already significantly raised its rates during the fall. And two weeks later, on Dec. 25, the Japanese unexpectedly boosted their key discount rate one-half point to 4.25%.

It is no secret that the Bush administration, along with Mrs. Thatcher's government, are bent on stifling all European initiatives centered around the European Monetary System and the creation of a new banking facility to facilitate the huge lending requirements for the myriad development deals involving Central Europe. Everything coming from the U.S. is designed to balkanize Europe through its condominium with Moscow. No other Western government has been so hasty—as shown by Secretary of State James Baker's astounding rush to meet East Germany's Hans Modrow on Dec. 12, immedi-

© 1990 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

ately after the Bush-Gorbachov "seasick summit"—to reassure East Germany's Communists of its support for "stability."

The U.S. political insanity toward Europe has been matched only by its idiocy in economics and finance. It should be recalled that last spring's report of the Bank for International Settlements castigated the market and currency manipulations of the United States, fueled by reckless lending and credit policies. Such games, it warned, provide only the illusion of financial health; what is needed are more "traditional" policies like old-fashioned investment and real production.

The Bush administration and its Wall Street controllers have not only spurned such admonitions, but have been more determined than ever to keep the American shell game going—despite the near blowout of the junk bond market in September, the near-crash of the stock market in October, and a rising tide of bankruptcies and falling profits throughout the fourth quarter.

Europe will not go down with the American ship of fools. It is thus quite likely that, technical factors notwithstanding, at least certain integral members of the international financial elite have moved to cool out the U.S. economic excesses through what they hope will be a slow attrition, using as the wedge rising interest rates and a curtailment of loose foreign capital into U.S. markets. As Federal Reserve chairman Alan Greenspan told Congress Jan. 25, foreign investment in the U.S. has soared from just $221 billion in 1975 to $1.8 trillion in 1988. Even more incredibly, foreign purchases of Treasury securities had risen to more than $3 trillion in 1988, from a level of only $100-200 billion in the early 1980s!

Rising interest rates abroad have certainly precluded the Fed's bowing to the increasingly shrill demands of the administration for lower rates and looser credit as the hyperinflationary "solution" to an economy careening more and more into deflationary collapse. While there is no doubt that such a shakeout in U.S. markets is both necessary and inevitable, there is no preventing the collapse that is inalterably under way.

The final phase of bankruptcy

When the junk bond market and the leveraged buyout empires created with it began to collapse last September with the defaults on debt by the Campeau retail conglomerate, jailed physical economist Lyndon LaRouche denoted this as the onset of what would later become a domino-like fall of the banking system itself.

No matter how much banking authorities, Wall Street cognoscenti, and Bush administration spin-artists try to portray the imminent demise of Campeau and Bank of New England as "isolated problems" or "market corrections," these failures do mark a sharp turning point in the banking and market collapse.

"Naturally," said LaRouche on Jan. 16, "the Bush men around Washington and their fellow travelers around the world are coming up for anything but the truth as the explanation for today's financial panic.

"Since the Bush administration's existence depends upon avoiding a financial crash, in which case Mr. Bush would become the new Mr. Hoover . . . no Bush man will admit . . . that a financial crisis has finally arisen, that the Great Depression is actually in motion. . . .

"The reason for the bankruptcies is very simple. The Anglo-American system is bankrupt. As we have said before, the United States is more than $20 trillion in debt, amd the debt service on this debt approaches the magnitude of the nominal gross national product of the nation. Technically . . . every penny we make has to go into paying debt service. . . .

"Lo and behold! A financial crisis occurred in a bankrupt system! And the Bush administration would have you believe that there is no connection between the fact that the U.S. economy is bankrupt, and that the international financial system is having crises. . . . They believed that if they could stop the *perception* of the crisis in the United States, they could stop the crisis. The crisis is, however, ongoing."

In just the first weeks this year, the combination of rising interest rates, falling corporate performance, and worsening business indicators has generated a 250-point stock market drop, while bond prices have tumbled. Following the 77-point tumble in the Dow Jones index and the bond market plunge on Jan. 23, LaRouche observed:

"The breaks in the bond market are a symptom of the avalanche sooner or later to come. It is possible that we could be sliding into the abyss of the great financial crash of 1990 now; it is possible this might be merely a warning shock before the big shock yet to come. It is possible that these matters could be delayed as late as late March or even later, under very unlikely circumstances but possible circumstances; it is also possible that the big crash could hit this week or next.

"Whenever this crash hits, it is the end of every policy—economic policy, monetary policy, financial policy—to which George Bush and his co-thinkers have been committed for over 25 years. It is those policies which the Bush administration continues to defend with such stubborn commitment, which have caused the collapse of the United States economy, into almost a rust-bucket, and the ultimate collapse of the financial system, as a result of the collapse of the economy.

"What we need now is a rapid and fundamental change in policy to organize an economic recovery. Undoubtedly, this will have to come from the Democrats, from Democratic leadership, a Democratic leadership which believes in investment in scientific and technological progress, as did Franklin Roosevelt when he organized the recovery from the Great Depression of the 1930s and as did Sen. John Kennedy, when his space program, his investment tax credit program, and other programs organized a recovery from the deep recession of 1957-1959. I offer such a program, and certain conclusions follow from that."