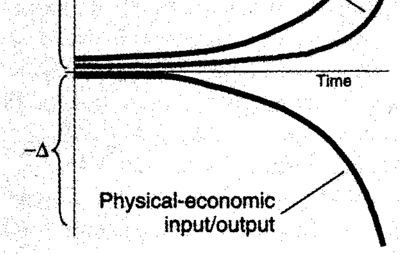
Pundits proclaim financial system 'shockproof,' as stock prices soar

by Michael Liebig

The price explosion on the world financial markets is going full steam ahead. Whereas even the official economic figures in Europe, the United States, and Japan reveal a shrinking "social product" and new record levels of unemployment, the financial markets are hitting dizzying heights. The stock indexes in New York, London, Frankfurt, and Tokyo keep reaching new "historical record levels." The price volumes on these stock markets have increased in the last nine months by about 40%. Even the rates of increase in the international derivatives trade, which had somewhat attenuated in the first half of 1995, are climbing again.

The "scissors" between monetary and financial aggregates on the one side and the real economy on the other, represented in Lyndon LaRouche's graph of a typical collapse function (**Figure 1**), has thus opened up even wider. One essential reason for that lies in the attitude of the currency-issuing central banks: In early summer 1995 there developed a "consensus" in the international financier oligarchy, which control the issuing banks and the International Monetary Fund, that the world financial system "cannot sustain a further crisis of the caliber of the bankruptcy of Barings Bank." Since then, liquidity has been frequently and covertly pumped into the financial system by the central banks. It needs to be stressed in this regard, that this liquidity is flowing into the financial system, rather than into the real economy.

FIGURE 1
A typical collapse function



This graph, showing the hyperbolic growth rate of financial and monetary aggregates, and the corresponding decline of physical production, demonstrates that a collapse of the economy is inevitable, unless current policies are changed. The graph was developed by Lyndon LaRouche, and was analyzed by him in EIR, *Jan. 1, 1996.*

On the contrary, due to budget cuts in the United States—under the watchword "balanced budget"—and in Western Europe—under the watchword "Maastricht criteria"—financial resources have been diverted out of the real economy. The Japanese issuing bank lowered the discount rate in the summer of 1995 to the historical low-point of 0.5%, which means that Japanese private banks can fund themselves with new financing from the Central Bank at practically zero interest. In the United States and Europe this reflation tactic of the issuing banks is not yet so clearly visible. But the U.S. Federal Reserve and Germany's Bundesbank, in the second half of 1995, also persistently lowered the guiding interest rate. The Bundesbank in particular brought down the so-called repo-rate for short-term credit and refinancing to private banks. On Jan. 31, the repo-rate again dropped, from 3.55% to 3.40%, and on the same day the Federal Reserve lowered the discount rate by 0.25% to 5.25%.

As we have said, the monetary liquidity which is being "fed" into the private banking system from the central banks, is not flowing into the real economy. Rather this liquidity is inflating the financial markets. The high-flying financial markets mean nothing other than a massive price inflation in the financial securities traded on these markets. The soaring course of stock prices means the exact opposite of what credulous contemporaries suppose. The price explosion in financial securities will also not be understood by many, because commodities prices are not yet significantly rising. So far, the inflation is confined to financial paper, but precisely because of that, the susceptibility to collapse of the speculative financial bubble will be even higher. The fact that this reality about the inflation of paper values is not ignored by all financiers, is betrayed by the ongoing "flight into gold." Despite the voluminous gold sales by central banks, the gold price in the six weeks since mid-December rose $35 to $416 per ounce.

Hysterical denial of the truth

The instability of the world financial system is shown by the lead article in the latest issue of *Foreign Affairs,* the journal of the New York Council on Foreign Relations. This "elite" magazine is the mouthpiece of the London/New York financial oligarchy. In open hysteria, CFR research leader E.B. Kapstein announces the "end of the financial crisis"! The world financial system is "shockproof," he claims. The roots of a conceivable systemic crisis of world finances have been "eradicated." Under relatively normal conditions *Foreign Affairs* would never let itself get carried away by such obviously absurd assertions. Even President Clinton spoke of "the seeds of potential disintegration" in the world financial system, and French President Jacques Chirac declared that financial speculation has taken on the dimension of "financial AIDS" for the world financial system. The overlap in time between the *Foreign Affairs* article and Lyndon LaRouche's 30-minute Presidential national campaign television broadcast on Jan. 27, in which he presented the inevitability of the collapse of the financial system, is also characteristic.

Mr. Kapstein does not trouble himself in the slightest to present any grounds for his categorical assertion of the "end of the financial crisis." He simply asserts that the "international regulatory structures" in the last 20 years have been so "strengthened" that no systemic dangers threaten the financial system any more. *Foreign Affairs* is not a bit disturbed by the fact that over the last 20 years, the financial markets internationally have been radically deregulated and that this has made the present scale of international financial speculation possible. The undeniable financial crises of 1995—Kapstein mentions the Mexico crisis, the Barings Bank collapse, and the Japanese banking crisis—were merely local phenomena and the work of lone "criminals." Derivatives speculation is harmless, he says, and only "scared little rabbits" would see in them a danger for the financial system.

In fact, Mr. Kapstein reminds one of the loud speech of little Peter in the dark woods, when he announced, "We have found the way, to stem the [financial] crisis." The deeply entrenched fear of the near-term collapse of the world financial system has obviously grown so greatly in the financial oligarchy, that it is believed that one can no longer afford to even talk about the condition of the world financial system. So, such discussions will be deliberately throttled and made taboo, because it is feared that the financial collapse might be hastened by it. But unwittingly, *Foreign Affairs* has unveiled the mistrust and inner panic about the state of the financial system, in the financial oligarchy itself.

Kapstein's curious hoax

This comment was issued by Lyndon H. LaRouche, Jr. on Feb. 4:

The current, January/February edition of the New York Council on Foreign Relations' *Foreign Affairs,* features a curious piece of whistling-in-the-graveyard fiction, authored by one Ethan B. Kapstein, Director of Studies for that Council. Kapstein's curious concoction, which appears under the title, "Shockproof: The End of the Financial Crisis," will go down in the history of the arcane, as the celebrated "Kapstein Hoax of 1996."

His myth argues, that the world has emerged successfully from what was, for many, a series of critical episodes in international financial crisis. He giggles, "Many Chicken Littles had predicted during the late 1980s and early 1990s that trading in derivatives—futures, swaps, and options—would trigger the next global financial crisis. But they overlooked the important role that derivatives have played in moderating systemic risk, providing banks with increased opportunities to diversify their portfolios and protect themselves from sudden market shifts. . . . The international financial markets have not suffered because the roots of the disease have largely been eradicated."

Undoubtedly, either the high price of paper has impelled *Foreign Affairs* to cut what it deems not-essential passages from its contributors' articles, or author Kapstein did not think the empyreal elegance of rhetoric as wildly absurd as his own, should be marred by reference to relevant facts.

The only serious issue posed to a reviewer by Kapstein's hoax, is why would *Foreign Affairs* publish such obviously hysterical rubbish at this time? On that account, two facts readily available to anyone travelling in the Washington, D.C. orbit, are outstanding. There is a currently escalating fight within the Democratic Party (and the government) over two issues: Whether or not the President and Democratic Party should pretend to believe in an "economic recovery" which it knows does not exist, for the duration of the 1996 primaries; and whether it is not advisable for the Administration and Party leadership to avoid as much as possible, the charge by certain Bush-league and other Republicans, that the Democratic Party is listening altogether "too much" to the ideas of Lyndon LaRouche.

No one of influence, excepting some Yuppie parasites of the type swarming in the unfumigated corners of the *Wall Street Journal,* actually believes the sort of fairy-tale peddled by Kapstein's hoax. In no part of the world—for example, France, Italy, Germany, the former Soviet bloc, Japan, the U.S.A.—are economic and financial conditions anything but becoming worse by the week. Only the stock-market and financial indexes continue to rise, as one might expect of any creature in the terminal stage of feverish infection.