

## Financial tumult: LaRouche called it right, again

by Marcia Merry Baker

After the late-March/early-April turmoil erupted on world financial markets, only lunatics and kindergarten drop-outs still question “LaRouche’s credibility.” In terms of economic/financial forecasts, his record of the last 40 years, and on the latest breaking events, shows that LaRouche called it right, again. Even so, the issue is not vindication. The question before governments and citizens, is, what policies will come to prevail during and after “the crash.” By this criterion, LaRouche’s record of forecasting and analysis, gives him unique credibility as policymaker at this time of global crisis.

In our *Economics* section this week, we review four of LaRouche’s principal forecasts, from the 1959-60 period to the present time, and we provide chronologies of what actually came to pass, exactly as LaRouche had forewarned.

Begin by looking at the financial turmoil of the past few weeks.

In late March and early April, the evidence started to become obvious of what LaRouche had earlier in March indicated as likely: the onset of a “radical phase-shift” in financial and political systems. On the surface level, stock markets registered drops in both indices and averages all around the globe. Below the surface level, even greater, seismic convulsions are in the works.

Over the two trading days (March 27 and 31) before and after Easter, the New York Stock Exchange saw a combined drop of 4.3% in the Dow Jones Industrial Average; over three weeks prior to April 1, the “Down Jones” fell some 500 points overall. When European stock exchanges reopened April 1, after the Easter holiday break, markets went down between 3% and 5%—down 3.9% in Germany, 3% in France, 2% in Great Britain, over 4% in Holland, and 4.7% in Germany. In Mexico, “Black Monday” hit the stock exchange on March 31, which fell 2.46%, at which point the central bank was forced to intervene, by law, and offered \$200 million at auc-

tion, and then, later, another \$100 million, to cover flight capital. There were similar contingencies around the globe.

In Japan, on March 31, the last day of the Japanese fiscal year, the Nikkei index ended barely above 18,000—which is considered the threshold for trouble in the Japanese banking sector—and crisis management at two major banks got under way.

Technically, the Dow Jones drop over the month of March through April 1, is the largest collapse in the stock market since the October 1987 crash. The significance of that should not be exaggerated. It was to be expected as part of the market pattern in the new period of hyperinstability now governing the financial system.

LaRouche indicated the likelihood of such a late-March/early-April stock market collapse, in response to the March 9 article in the London *Sunday Telegraph*, on “The \$55 Trillion Horror Story,” by Neil Bennett, which was a signal piece on impending financial crisis resulting from a derivatives meltdown. This view of LaRouche was a follow-on to a series of diagnosis forecasts which he had been making since June 1994, when he issued his article on “The Coming Disintegration of Financial Markets,” in which LaRouche made his Ninth Forecast, namely that: “The presently existing global financial and monetary system will disintegrate in the near term. . . . That collapse into disintegration is inevitable, because it could not be stopped now by anything but the politically improbable decision by leading governments to put the relevant financial and monetary institutions into bankruptcy reorganization” (see “The Coming Disintegration of Financial Markets,” *EIR*, June, 24 1994).

**Figure 1** (p. 7) shows the schematic, called the “Triple Curve Collapse Function,” which LaRouche devised for non-economists (first published in *EIR*, Jan. 1, 1996), to show what processes generate the inevitability of a financial blowout

collapse. On March 13, 1997, he stressed that the disparities shown on the “triple curve” between the rising financial and monetary aggregates, and the falling physical economic valuations, have attained a condition of hyperbolic acceleration and steepness, to the point that the world system has, as he said, “reached the ‘asymptotic limit’ of its possible continuation. In short, ‘Bang!’ ”

Weeks after his March 13 statement, there is widespread de facto recognition that “LaRouche was right,” coming from key financial insiders, and especially, the European press. On April 1, a Luxembourg bank official told us, “If this is not ‘the big one’ which you have been warning about in *EIR*, it is at the very least, the start of a very, very negative market. We, as a bank, have issued a client advisory to all our clients to position themselves for a significant fall in all major markets. We are telling people to go short. Greenspan’s Fed is trying to create a climate in which the Dow would fall between 7-15% or so over a period of weeks, without triggering panic sell-off. If corporate earnings reports in the next days come in far lower than expected, however, even without a new Fed rate increase, that alone could turn the sell-off into panic.”

“Babylon Is Tumbling,” was the headline of the April 2 lead editorial of Germany’s economic daily, *Handelsblatt*, referring to the recent “mini-crashes” on Wall Street and in the German financial center, Frankfurt. The author, Jens Eckhardt, a New York-based economist and investment adviser, wrote, “The mighty financial tower of Babylon, which had been built up in the last three years, is tumbling.”

## Beneath the surface

What’s keeping the stock markets up? Firstly, they are not, “up.” And secondly, they are not stable.

The Dow Jones “Industrial” Average, is well-known to be hokum. It consists of only 30 companies, deliberately chosen (and replaced as desired), for the purpose of boosting the index. Standard & Poor’s “500” index is similar. It consists of the Dow 30, plus another 470 stocks, to add up to 500, and lend an aura of breadth; but the performance of the S&P 500 is concentrated in just 25 of the largest stocks, which account for one-third the value of the index. In 1996, for example, the select 25 rose 37%, and the other 475 stocks in the index lost value; so, in terms of how the index is weighted and calculated, the overall S&P index registered a “gain” of 23%.

In fact, whatever the contrived Dow or S&P 500 indices may claim to show, based on a select number of about 50 stocks, prices are falling for the rest of the approximately 7-8,000 stocks in the United States. On the NASDAQ, the largest U.S. exchange (with 4,708 companies, not traded on the New York or American Stock Exchange), nearly one-third of all stocks are trading at 40% or more below their one-year high. This is a notable meltdown.

The chief stock strategist for a large Wall Street bank told *EIR* on April 3, “I’ve looked back at the last 25 years. The only times when you had a few large stocks going up and the

rest of the market going down were March 1973, July 1987, and May 1990. You remember July 1987? That was not a good time. This has reached its limit. Such a divergent market can’t continue. Either most of the smaller stocks go up in price, or the big stocks are going to come down in price.”

The money flows into the stock markets from mutual funds have significantly dropped. The monthly volume in January was over \$21 billion; February dropped to \$18 billion; March is expected to be still lower. As of the last week in March, mutual fund inflows were down to \$2.5 billion weekly, from a previous rate of \$5 billion a week.

These are just a few aspects of the hyperinstability in the financial markets. All talk of stock exchange “corrections, adjustments, or re-groupment” is thus lunacy, not to mention the quivering mass of \$55-80 trillions of derivatives outstanding worldwide (notional value, depending on estimates), and other features of the bubble, such as unpayable national debt burdens, and bank insolvency. The banking crisis in Japan is a result, and a symptom, of what is happening globally. On April 1, both Nippon Credit Bank (assets \$160 billion) and Hokkaido Takushoku Bank (assets of about \$110 billion), announced sweeping restructuring plans, to deal with billions in bad loans. Finance Minister Hiroshi Mitsuzuka, speaking at the April 1 Tokyo press conference along with NCB President Hiroshi Kubota, said that the move was “important for the stability of financial systems both at home and abroad.”

## The ‘Hamlet problem’ in government policy

What the record of LaRouche’s “Four Forecasts” over the last 40 years shows, is not only accuracy, but commitment to provide direction for policies which, if followed, would minimize the chaos and suffering. Already, the mobilization started by LaRouche in February, for international support for the United States to convene a “New Bretton Woods” conference to institute financial stability measures in the service of the nation-state, has won the backing of dozens of national leaders around the globe. That’s where LaRouche’s credibility comes into play. Still, some want to stick to “re-forming” the doomed system, not changing it.

LaRouche referred to this latter stance as a “Hamlet problem.” In an April 1 radio interview with “*EIR Talks*,” he explained: “What we have is, among governments, behavior by heads of state and others which reminds us—or should remind us—of *Hamlet*, especially from the famous soliloquies at the end of Act II, and the beginning of Act III, of a man who was faced with two realities: One, with which he was familiar, which assured him doom; a second reality was the option of getting out of the old sinking ship and getting into a new ship.” LaRouche asked, “When are the governments going to come out of this Hamlet-like behavior; take the bull by the horns; and realize we must get out of the sinking ship and get onto a new ship, otherwise we go down with the *Titanic*? That’s the reality.”

# LaRouche was right

### Forecast, 1959-60

In the fall of 1959, Lyndon LaRouche projected that if the existing economic and monetary policies were continued, they would lead to the eruption of a series of major monetary disturbances during the second half of the 1960s. These crises would lead toward a collapse of the Bretton Woods monetary agreements, and probably lead to a drift into austerity policies, echoing those of the early 1930s Germany, and the Hitler regime's looting of neighbor countries.

**What happened:** A series of monetary crises erupted, beginning October-November 1967. In November 1967, there was a run on the British pound; in 1968, a run on the U.S. dollar, and a run on the French franc—which was devalued in April—and other currency turbulence. In March 1968, President Lyndon Johnson devalued the dollar. The continuing crises in major currencies led up to Aug. 15, 1971, when President Richard Nixon decoupled the dollar from gold; this and related actions constituted the repeal of the existing Bretton Woods currency agreements, and marked the period of introduction of austerity measures echoing those of the 1930-32 Brüning regime and the Nazi looting policies of 1933-45. In the United States, President Nixon introduced austerity measures, known as “Phase I, II, and III,” under the rubric of wage and prices controls. In particular, as of the 1969-72 period, investment flows into U.S. infrastructure development dropped below the net maintenance level, and the resource base of the entire economy entered a process of deterioration.

### Forecast, October 1979

In October 1979, LaRouche forecast a devastating recession, beginning in early 1980, as a result of Federal Reserve Chairman Paul Volcker's credit-strangulation policies.

On Oct. 6, 1979, Volcker (who had been sworn in on Aug. 6) convened an extraordinary session of the Federal Open Market Committee, which adopted his high-interest rate policy. On Oct. 10, President Jimmy Carter stated: “The number-one threat to our national economy is inflation. Whatever it takes to control inflation, that's what I will do.”

LaRouche commissioned a computer-based analysis from his staff, of the near-term consequences of Volcker's measures. LaRouche released the results in his statement of Oct. 16, 1979, saying of the computer study, “Those results,

coinciding with the estimates of other analysts reporting independently, indicate that the measures already enacted by Volcker will cause a 15% recession in the U.S. economy, probably putting the United States into a recession twice as severe as that of 1974.”

On Oct. 29, LaRouche sent an open letter to Congress, titled “Emergency Credit Action Required to Save the Economy.”

Excerpts from LaRouche's Oct. 16, 1979 statement follow:

“I herewith submit a demand for the prompt impeachment of recently appointed Federal Reserve Chairman Paul Volcker.

“Yesterday, appearing before a committee of the United States Senate, Volcker either lied or manifested gross incompetence in the course of a reply to Senator Paul Sarbanes, Democrat of Maryland. He stated, falsely, in his response, that the Federal Reserve System could not channel the flow of constricted liquidity in such a way as to ensure adequate credit for maintaining the operating capital of business employers.

“In fact, the Federal Reserve System has the capability, with the consent of the Executive branch and Congress, to conduct precisely the sort of anti-depression measures which Senator Sarbanes proposed.

“Mr. Volcker either knows this, in which case he committed perjury in sworn testimony before the Senate, or he does not know this, in which case he is impeachable for incompetence.

“In earlier public statements, Mr. Volcker has stated himself to be a supporter of a doctrine of ‘controlled disintegration’ for both the United States and the world economy. Now, under the semantic pretext of ‘anti-inflation’ ‘fiscal austerity,’ Volcker has abused his powers as Federal Reserve chairman to implement measures which constitute an efficient effort to plunge the U.S. economy into misery, chaos, and confusion of the sort ultimately worse than the conditions experienced during the Great Depression of the 1930s. In light of the evidence of a conscious intent behind Mr. Volcker's attempts to ruin the U.S. economy, his conduct in office must be regarded as no better than treasonous in character, if not formally treason by the strict language of the U.S. Constitution. . . .

“There are two immediate measures which would ameliorate the present crisis. First, the U.S. gold reserves must be valued at an adjusted current world market value, a value to be negotiated with both the European Monetary System member-nations and the OPEC ‘petrodollar’ holders. This would stabilize the value of the dollar, and take the worst pressures off dollar liquidity. Second, the Federal Reserve must immediately implement the kind of selective credit-flow controls which Senator Sarbanes proposed. This would not solve our nation's problems, but would give us breathing-

room for developing a comprehensive, long-term set of monetary and investment-incentive measures.

“A depression is not necessary. Any official who adopts a policy of ‘controlled disintegration’ of the United States economy is engaged in a treasonous undermining of our nation’s overall security at this juncture. . . .”

**What happened:** In February 1980, recession hit the United States: Declines wracked agricultural and industrial production, the housing industry, and other sectors. For example, annual U.S. steel output per capita fell, in spring 1980, to 0.4910 tons, the first time it had been below one-half ton per capita since the Great Depression. Within two years, it fell to 0.3207 tons per capita, and over the 1980s and 1990s, output per capita never again hit the half-ton mark. In 1981, new housing starts were 1.084 million units, the first time since 1946 that fewer than 1.1 million units were begun.

In January 1981, when Volcker’s interest rate for prime lending hit the level of 21.5% (the highest since the Civil War), an all-time high of 363,847 U.S. firms and individuals declared bankruptcy. Chrysler Motors (Jan. 14, 1981) averted bankruptcy only by federal bailout. The farm sector was devastated. By the mid-1980s, there were record rates of farm bankruptcies and foreclosures across the farm belt.

### Forecast, May 1987

During April-July 1987, LaRouche made repeated forecasts of a collapse of the New York stock market, to erupt about the first week of October. This was LaRouche’s first and only stock-market forecast.

Here are excerpts from a statement issued by LaRouche on May 27, 1987 (published in *EIR*, June 5, 1987):

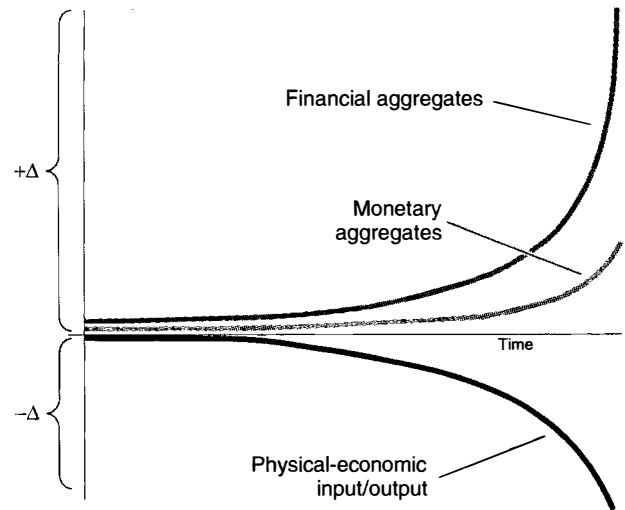
“Leading European financial officials have warned my associates, that we should expect to see the beginning of the world’s biggest financial crash by October of this year. My comment on that forecast: It might not occur in just that way, but, if the Reagan administration continues its present policies, it is certain that the world’s economic situation will become much worse than it is today over the summer months. . . .

“Whether the great financial crash of 1987 erupts by October, or later, will depend upon what leading governments do at the international monetary ‘summit’ held in Venice on June 12. Those bankers who are expecting a crash by October, make that forecast on the basis of assuming that the U.S. government’s role at Venice will be a continuation of the foolish international monetary policy which the Reagan administration has followed over the past five years. In that case, a crash in October would not be absolutely certain, but it would be, at least, a very good guess.

“This forecast is based on the observation, that even now, President Reagan is clinging stubbornly to belief in a

FIGURE 1

### A typical collapse function



‘Reagan economic recovery’ which never actually occurred. . . .

“Technically, on any day that the U.S. government came to its senses, this crisis could be brought under control. The crash of 1987 is not inevitable. However, unless the governments come to their senses, it is inevitable. During the Venice monetary ‘summit,’ and during the weeks following that, we shall see whether the crash occurs as leading European bankers now suspect it will.”

**What happened:** The financial blowout forecast by LaRouche began on Oct. 6, when the New York Stock Exchange’s Dow-Jones Industrial Average index (or, as LaRouche called it, “the Davey-Jones Index”) dropped by more than 91 points. The crisis culminated in Wall Street’s 508 point crash on “Black Monday,” Oct. 19, which represented a fall of 22.6%, the largest loss in its history, and twice the size of the 1929 collapse. Some \$1.5-2 trillion worth of equity in U.S. markets was wiped out from Aug. 25 to Oct. 19, 1997.

### Forecast, December 1995-February 1997

**Forecast:** In December 1995, at an international conference in Germany, and over the subsequent months through February 1997, LaRouche repeatedly made diagnosis forecasts of a series of seismic events to be expected in financial and monetary collapses, each and all generated by the convergence of the “triple curve” collapse function (**Figure 1**), upon its relatively steepest region of the hyperbolic relations among the three determining factors—rising financial and monetary valuations, and falling economic aggregates.

On March 9, 1997, LaRouche's initial response to the "signal" article in the London *Sunday Telegraph* by Neil Bennett ("\$55 Trillion Horror Story" on prospects of a derivatives blow-out), indicated the likelihood of a late-March/early-April crisis in financial markets.

Here are excerpts from some of the relevant statements by LaRouche:

In a Dec. 2, 1995 speech, he explained: "For reasons I'll indicate to you, generally speaking and overall, *there has been no economic growth on this planet, since the end of the 1960s*. None; if you measure in the right magnitudes.

"If you measure in magnitudes per capita of labor force, per household, per square kilometer of used land area: If you measure in those terms, the physical product which is consumed either by households, consumed by productive industry, or consumed in the form of maintaining infrastructure or improving it, those components, and you measure them in these per-capita, per-household, per-square-kilometer terms, you then find . . . [t]here has been a secular tendency toward a 2 to 3% annual contraction in economy around the world, with some variations in that, over the past quarter-century. The system is collapsing. . . .

"We have here [Figure 1] . . . a summary of three curves which are characteristic of the process of monetary and financial disintegration of the world economy. . . .

"The bottom of the three lines represents the decline in productivity, in physical terms: that is, physical product. It also includes things which are essential, as services, to physical productivity. . . .

"Now the second of the three curves, although the per-capita output, physical output, and consumption around the world have declined over . . . *especially* the past 25 years, there has been an *increase* in per-capita monetary turnover, monetary emission. The money supply has been growing while the physical output and consumption per capita in all the categories—production, infrastructure, and households—have been declining.

"At the same time, a new process has entered in, which is the growth of financial turnover relative to monetary turnover. . . .

But, the worst part is the financial one (the top-most of the three curves). If we include the best estimates on the off-balance-sheet portion of financial turnover, the financial turnover of this planet per day, now, is probably around \$3 *trillion a day*. . . .

"As I shall indicate, whenever a process such as this, this three-phase process, goes into a hyperbolic ascent, which is what's happening on the financial side now, in any kind of process, what you would have to say is, we are entering a *phase shift*. We are entering a *discontinuity*. The very fact that these ratios are changing the way they are, individually, and with respect to one another, indicates that the whole system has now reached the edge of the cliff. It is

going to *end*. That does not mean that it's going to fall off the cliff. It *could* fall off the cliff, if we don't do the right thing. . . ."

Responding to the Neil Bennett column, in a radio interview with "EIR Talks" on March 11, LaRouche said: "It is suspected, that something has either already happened, or is expected to be *about to happen*, which will be a very, very big disaster on the London market, with possible international ramifications, and, of course, in the area of derivatives.

"We already have notice of derivatives catastrophes, recently, in the order of magnitude of a reported \$100 million, and that is referenced here simply as typifying what *might* happen. . . . But, we could be looking at anywhere up to a couple of billion dollars, or more, in something which is going to blow things out."

**What happened:** Financial crises, including in banking, derivatives, debt payments, etc., break out all over the world: Chemical Bank (1989), Orange County, California (1994), Mexico (1994), Barings (1995), Sumitomo (1995), Crédit Lyonnais, France (in its third bailout as of 1996), Japan (1996-97), Thailand (1996-97), Korea (1996-97), NatWest Markets (1997), Belgian government (1997), Germany (1996-97).

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