

## Bankers yearn for 'just one success' in Asia

by William Engdahl

As the systemic crisis continued rocking financial and currency markets across Asia, a senior European central banking source told *EIR*, "At this point it is very important that we be able to stabilize one country; so far, that has eluded us."

The Indonesian rupiah is dropping like a stone, down as much as 48% on just one day, Jan. 22. The currency in that country of 200 million people has been devalued 84% since last August, when the International Monetary Fund (IMF) demanded that it float freely against the dollar. South Korea's negotiations with its creditor banks, led by J.P. Morgan, for restructuring that country's \$150 billion foreign debt, are at an apparent impasse on the issue of rollover of some \$25 billion of unpayable short-term debt. Japan is enmeshed in endless faction fights over whether or how to deal with the world's most mortally wounded banking system, and Thailand faces bloody riots protesting IMF-dictated austerity.

Looking at all this, the central banker's wish for "one success" appears as probable as a journey to the Moon was at the time Jules Verne wrote his science fiction fable at the end of the past century. In short, "None of the usual remedies seem to be working," as one European banker expressed it. And for good reason.

### No cyclical crisis

"We are in the process," commented Lyndon LaRouche in a Jan. 14 radio interview with "EIR Talks," "of, shall we say, the worst systemic financial collapse in modern history, much worse than anything that we have seen during the 20th Century, or even the 19th Century. But this is not a cyclical crisis like that, say, of the 1930s. The present system, which has been developing over the past thirty-odd years, is not a viable system. It is a system which is, by its very design, inherently doomed to a permanent collapse."

The latest developments regarding the Indonesian rupiah bear out this analysis. Despite a high-profile visit from IMF Managing Director Michel Camdessus on Jan. 15, during which Indonesian President Suharto signed an agreement with the IMF which calls for draconian budget cuts and other severe economic measures—moves aimed to please, above all, foreign investors—the rupiah continued to collapse. During Jan. 20-22, the currency fell from 8,400 rupiah to the dollar, down to an all-time low of 17,000, before heavy Indonesian Central Bank intervention brought it back to 12,000.

If the rupiah stays at that level—and all signs are that it is going even lower—that would mean that an Indonesian company needing, for example, imported machine parts from the United States to run its factory, would need to come up with six times the rupiah funds they needed only last August, when the rupiah was at 2,600. Needless to say, few Indonesian companies are able to pay such a hefty price. Recent estimates by financial analysts in the region are that of the 280 companies listed on the Jakarta Stock Exchange, only 22 are still solvent with the rupiah at present levels. The rest have a net worth in rupiah terms below the value of their dollar debts, a legal state of bankruptcy.

Why is the rupiah plunging? "The simple answer is that Indonesian companies are in a panic rush to grab every dollar they can to repay foreign debts coming due," explained one European banker involved in the region. "We estimate that before Jan. 31, Indonesian companies have to come up with about \$10 billion. Total foreign debt is maybe \$140 billion, and of that, half, or some \$70 billion, comes due in the coming 12 months. With the rupiah in free-fall, either default or debt moratorium in some form looks inevitable. Unlike South Korea, there is no discussion of a coordinated bank rollover of the debt."

To make matters worse, the recent record drought has made the autumn rice harvest a disaster, forcing Indonesia to import huge volumes of rice and other foodstuffs since last month. The collapsing rupiah makes the import price for such necessities prohibitively high for most Indonesians. The falling rupiah in the import-dependent economy, and the soaring food costs, have pushed the country to the very brink of a Weimar-style hyperinflation. Current annual price inflation in the country is more than 60%, according to estimates by Deutsche Morgan Grenfell.

Little wonder in this situation that reports are surfacing by the day that Indonesian banks are unable to honor forward foreign exchange contracts, and that several private companies had simply defaulted on foreign debts.

### What next?

The illusion prevalent in international banking circles is that a “fence” can be erected around Indonesia, allowing the IMF and banks to focus on making South Korea the “success” the central bankers so urgently require. Nothing could be further from reality.

The largest financial market in Asia outside Japan is Hong Kong, the former British colony which since July has been part of China. One of Asia’s largest investment banks, Peregrine Investments of Hong Kong, was forced to declare bankruptcy early in January, when Zurich Insurance Group broke off talks intended to inject fresh capital into the troubled group. Peregrine claims it was forced to go under because of the fall of the Indonesian currency.

But the Peregrine bust was only the beginning of what a number of European banks and investment managers predict will be escalating speculative pressures against Hong Kong’s long-standing peg to the U.S. dollar, and with Hong Kong, the peg of the Chinese renminbi itself.

On Jan. 22, the *Hong Kong Morning Post* reported that angry customers were in line outside Hong Kong stock brokerages demanding their money, after a second large brokerage, CA Pacific Securities, filed for bankruptcy. Recent real estate auctions indicate that land prices have fallen by 20-30% since last October. The *Morning Post* called the situation a “crisis of confidence.” If that crisis grows, the consequences for the world payments system could be enormous.

“The large offshore hedge funds like [George] Soros’s Quantum Fund have now turned their attention to Hong Kong,” noted a London hedge fund source. “The only two liquid markets left in Asia where it is easy to speculate are Hong Kong and Japan.”

Indeed, in a full-page interview in the Hamburg weekly *Die Zeit*, which was picked up as a news wire and run on financial trading computers from London to Tokyo to New York, Soros put the spotlight on Hong Kong and China. In a Jan. 15 interview, Soros said, “The situation in Hong Kong and China is extremely precarious. China is already being impacted. The largest part of its foreign investment comes

from overseas Chinese, and these have already lost—in Thailand or Indonesia—already half their assets or more.” Soros should know. It was his Quantum Fund, together with another aggressive Netherlands Antilles hedge fund, Julian Robertson’s Tiger and Jaguar funds, which, according to trade sources, led the attack on the Thai baht last May, which began the financial avalanche across Asia.

Hong Kong and China are far different from Thailand or Indonesia in vulnerability to a speculative attack. China’s renminbi currency, which last devalued in 1994, is not freely convertible. Further, it is backed by China’s estimated \$130 billion in dollar reserves, the world’s largest outside Japan. Hong Kong, with some \$80 billion in dollar reserves, also has a currency board system, the Hong Kong Monetary Authority. Under its rules, the board automatically calls in liquidity from the overnight bank lending system the moment the currency is under pressure. The resulting high interest rates—in October, rates briefly hit 300% on one day—keep Hong Kong’s dollar fixed.

But, it defends the peg at a heavy price. High interest rates have devastated prices of Hong Kong land, as well as stocks. “Hong Kong banks lend against property as collateral, like the old British banking system,” commented a City of London banker. “When land prices fall, banks are under pressure to foreclose on loans. As long as the authorities are forced to keep interest rates high, now about 12%, companies and individuals with high debt will face bankruptcy as time goes. However, were the Hong Kong Monetary Authority to abandon the dollar peg, given the falls in the rest of the region’s currencies, it would trigger a panic capital out-flight by Hong Kong residents; that would be a disaster scenario. For that reason, it is highly unlikely that the peg will fall. But that means they must keep these high interest rates, and that will force bankruptcies and add to bank bad debt problems.”

A European central banker told *EIR*, on background: “Hong Kong and China are very difficult cases. They both suffer from strong upvaluation of their currencies relative to the rest of Asia. That means their economies lose competitiveness. The impact will hit the process of Chinese restructuring of State Enterprises, unemployment will rise, export earnings will fall. If that lasts, it will be serious. A crisis in China and Hong Kong would trigger further problems not only in Asia, but across the entire system.”

Nothing has been resolved in the seven-year-old Japanese banking debacle, where estimates of bad loans left from that country’s 1980s “bubble economy” bust range as high as \$1 trillion. The Japanese Diet (parliament) is soon supposed to get a final version of the Hashimoto government’s proposals for the economy and bank restructuring. The hope is to pass the program before the end of Japan’s fiscal year on March 31.

But Japan is no financial island. It also has been the world’s most aggressive lender across Asia. Japan’s Ministry of Finance just released figures for total Japan bank lending to Asia, including Hong Kong and China, Thailand, Indonesia,

South Korea, Malaysia, and the Philippines. The total exposure is a staggering \$253 billion, as of June 1997. Most likely it is now beyond \$300 billion. While not all of that is in default, the odds grow by the day that, under present conditions, a large part of it will be before long.

In this context, it appears that Washington is having difficulty finding a way out under present “rules of the game” of IMF conditionalities. On Jan. 16, U.S. Treasury Secretary Robert Rubin told a television reporter, “We will not spend one nickel to help investors or bankers.” What he did not say, however, is what he is prepared to do to solve the crisis, before it engulfs the financial stability of the United States and the rest of the world. A serious debate on LaRouche’s proposal for a New Bretton Woods Conference, is clearly required.

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## Documentation

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### Rubin reiterates: ‘Not one nickel . . .’

Speaking at Georgetown University in Washington, D.C. on Jan. 21, U.S. Treasury Secretary Robert Rubin argued for the importance of U.S. involvement in the Asia financial crisis, saying, “We cannot afford to stand back and gamble that the crisis will resolve itself.” Rubin said that the first job is “to help stabilize the immediate crisis,” but that “we must also modernize the architecture of the international financial markets that we helped create and that has served us so well for the last 50 years.”

“The United States has enormously important economic and national security interests at stake in promoting restoration of financial stability in Asia,” Rubin said. “When we act to resolve the Asian crisis, we act to protect and benefit the American people.”

Rubin outlined the international response and the program being supported by the United States as focussing on four key elements: “supporting reform programs in individual nations; providing temporary financial assistance when needed; encouraging strong action by Japan and the other major economic powers to promote global growth; and, fostering policies in other developing and emerging economies to reduce the risk of contagion.” He elaborated each of the four elements—which included arguing that the IMF “is the right institution to be at the center of these support programs,” and that the IMF “internationalizes” the burden, instead of putting it all upon the United States.

As to investors and lenders, Rubin underlined, “Let me just say that I would not give one nickel to help any creditor or investor. And, in fact vast numbers of investors and creditors

have taken large losses in Asia.”

During the question period, Bill Jones of the Schiller Institute asked, “Is there not a danger that present attempts to create a bailout of the financial system, which, as it develops, seems to become greater and greater—the cost of this bailout—that there is a danger that this could lead to a hyperinflationary explosion, especially if the crisis in Asia is combined with the outbreak of crises in Brazil, in Russia, or other places?” And secondly, “In light of this crisis, there have been proposals from a wide variety of different places about returning to a Bretton Woods-like system, with fixed exchange rates backed up by gold. How do you deem the feasibility of doing something like that as an alternative to the present situation?”

The following colloquy then took place:

**Rubin:** Was your first question hyperinflation or hyperdeflation?

**Q:** Hyperinflationary—printing money—

**Rubin:** Oh. Okay. Everybody else is afraid of deflation, so you get together with them, and then you sort of average out. . . . Look, you’ve raised a very serious question, which we have been extraordinarily—which we’ve been very strongly focussed on. That is the question, if you create a lot—I assume this is what you’re driving at—if you create a lot of additional money in the system, and you don’t, so to speak, sterilize it, isn’t there a risk of creating inflation? I must say there is an acute sensitivity to that problem, and I don’t think that there is a risk—any risk, for that matter—of these programs being operated in that fashion, if for no other reason [than] because there is such focus on the issue.

The greater—I shouldn’t say “the greater risk”—but the problem that many people are now focussing on is: Will this create a deflation? And my instinct is that that is a very, very low-probability event.

On the question of Bretton Woods, with fixed exchange rates—look, fixed exchange rates are a very complicated and very important subject. The problem with fixed exchange rate regimes, as you know, is that if you’re going to make them work, you then have to have monetary and fiscal regimes that will support them. And while this is a debate we could all have, I don’t think—we could all have, it seems to me, at least, in the context of a stable and healthy economy—my own view, for whatever it’s worth, is that we’re better off with a fluctuating exchange rate than a fixed exchange rate, because when you start to have a weak economy, what you don’t want to have to do is to raise interest rates to keep your currency up.

But leaving that debate aside, if you try to establish a fixed exchange rate in a context of a crisis which is—such as we have now, I think what you almost surely would have to do, particularly if you’re talking about trying to fix the exchange rate substantially above where it is today, is to raise interest rates to levels that these weak financial systems couldn’t sustain.