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BIS central bankers admit, they can't solve the crisis

by William Engdahl

On June 8, the governors of the world's leading central banks, among them German, French, British, American, and Japanese, issued their public consensus view of the global financial situation at the annual Basel, Switzerland meeting of the Bank for International Settlements. The BIS view, made public the same day in its *Annual Report,* demonstrates clearly that the mighty central bankers, assumed to hold all the world under their control, in fact have no idea how to deal with the global financial crisis. They are whistling past the graveyard, filled, in this case, with the bones of the bankrupt postwar International Monetary Fund (IMF) system, from Ibero-America to Russia to Indonesia, South Korea, and, now, Japan, and threatening Hong Kong and China, if the policy of key governments is not radically altered.

In his summary in the *Annual Report,* BIS Managing Director Andrew Crockett's claims that "in spite of the traumatic events in Asia, . . . the economic prospects for the rest of the world are thought to look generally positive." He adds, "Events in Asia have even been interpreted positively by some, as a confirmation of the dominance of the market-driven model of economic growth that has become increasingly fashionable since the 1970s," a reference to Margaret Thatcher's "free market" model.

But, aside from the unworkable declarations that BIS rules for sound banking must be implemented to prevent future crises, a bit of the reality of the present situation emerges from between the lines of the Crockett report. He admits that the governing authorities are in effect canoeing white water rapids with no paddle. The BIS chief says that the Asian situation "was the first crisis in the postwar period featuring the combination of banks as the principal international creditors, and private sector entities as the principal debtors. Principles of how to manage and resolve a crisis of this sort were not known in advance and, indeed, are still under discussion."

While the BIS fiddles . . .

While the world's leading central bankers continue their "discussions," reality is unfolding with ruthless efficiency. During the week of June 8, the currencies of all Asia began a new descent. The nominal trigger for sharp currency declines across most of Asia, was the plunge in the Japanese yen to its lowest level in eight years, at 144 yen to the dollar.

Indeed, so extreme has the fall of the yen been in recent weeks, from 123 yen to the dollar in February, that the South Korean won is now 20% higher against the Japan yen compared with the beginning of the year! This, despite the severe problems that have hit Korea since late last year. In April, Korean industrial production fell by an annualized rate of 10.8%, the sharpest decline since the end of the Korean War in 1954. Many debt-ridden Korean companies are operating at 62% or less of capacity. If Korea is unable to make major export gains in the coming months, the entire economy of the world's 11th-largest industrial nation is threatened with oblivion.

Korean President Kim Dae-Jung, in the United States on June 6-13 in an effort to win U.S. investment in salvaging Korean industries, has ordered his Minister of Economy and Finance, Lee Kyu-Sung, to prepare measures to try to minimize damage to Korean exports from the falling yen. Estimates are that were the yen to reach 150, the competitive advantage that Korean exports now have over rival Japanese goods would disappear entirely, and Korea would be forced to consider another damaging devaluation to survive. Some 40% of all Korean exports to the United States, including cars, electronics, and semiconductors, compete directly with

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similar Japanese exports.

Already, according to estimates by Morgan Stanley-Asia, part of the U.S. investment firm, the economies of Korea, Thailand, and Malaysia have slid from severe recession conditions, into full-blown depressions. Analysts define depression as negative economic growth and sharp production cutbacks accompanied by a price deflation. By that definition, Indonesia already has sunk far beyond depression, with its annual Gross Domestic Product expected to collapse by 20% or more this year. The further collapse of the yen threatens to turn the East Asian crisis into a new chamber of economic horrors. In 1997, fully one-third of all East Asian exports went to Japan. Since January, given the depressed Japanese domestic economy, those exports have fallen markedly, at a time they urgently need to rise.

Thailand's Deputy Prime Minister Supachai Panitchpakdi, commenting on the effect of the falling yen on June 11, said that it "might trigger a second crisis" of competitive currency devaluations in Asia that would be much stronger and more serious than the first wave. "It would pull the whole world into it. It would be like a black hole. The second Asian crisis would mean the first worldwide depression. Asia's second crisis . . . would become the world's first financial crisis. And so, recession in Asia could be turned into a worldwide depression."

The looming danger at this point is the impact of the yen collapse on the economies of China and Hong Kong. Dai Xianglong, governor of the People's Bank of China, told a seminar on June 9, "The depreciation of the Japanese yen has had very unfavorable effects on China's imports and exports and inflow of funds." In May, China's exports fell for the first time in 22 months.

On June 11, Zhu Bangzao, a Chinese Foreign Ministry spokesman, stated, "We hope Japan and the relevant countries can face the reality and use courage and wisdom in taking further measures to stop the further devaluation of the yen, to create the necessary conditions for the recovery of the economy." Such blunt statements from senior Chinese officials are highly unusual. Until recently, Japan was looked to as a model of centralized, government-steered economic prosperity by many Chinese planners.

Fears that the yen's fall will force China to devalue in order to keep its exports competitive, grow by the hour. Intimately linked to China's course is Hong Hong, the largest financial market in Asia outside Japan. The Hong Kong dollar has been pegged to the U.S. dollar for more than 14 years, and last October, Hong Kong officials resisted speculative attacks, at great cost to the domestic economy.

In Hong Kong, stocks plunged to new lows in the Hang Seng stock market every day of the week of June 8. High short-term interest rates, set automatically by the Hong Kong Monetary Authority to defend the peg to the U.S. dollar, have forced large selling of stocks to cover losses, with the Hang Seng down to 1995 lows.

The problems in Hong Kong are being severely aggravated by the sharp pullback of the area's largest foreign bank lenders. Debt-strapped Japanese banks are cutting credits and calling in loans there. "We have seen a substantial curtailment of activities of the Japanese banks," Hong Kong Chief Executive Tung Chee-hwa told the *South China Morning Post*. "Japanese banks' withdrawing from Hong Kong really does not help us at all."

In 1997, Japanese banks were the largest lenders across Asia, with more than $253 billion in bank loans as of December 1997. Fully 8% of all bank loans in Hong Kong in 1997 came from Japanese banks in search of high returns overseas. As the yen continues to fall, Japanese direct investment into the troubled Asian economies, which is vital to save many firms from bankruptcy at this point, is drying up. Japanese banks are dis-investing across Asia, to shore up their huge, worsening problems at home.

With rising interest rates caused by lack of Japanese bank credit in Hong Kong, that economy, too, is now plunging into recession, further threatening the stock market, the heart of Hong Kong's financial system, and a vital adjunct of China's economic restructuring plans.

"There is obviously pressure for devaluation on the Chinese authorities," said Steve Wright, Crédit Suisse First Boston's Asia strategist. A devaluation by China would, in turn, put unbearable pressure on Hong Kong to devalue, threatening a panic capital flight by Hong Kong's wealthy investors. "That would be pretty destabilizing," Wright said. "A lot of companies have dollar-denominated debts. It would unsettle the whole region."

G-7 votes with their feet

Against this backdrop, deputy finance ministers of the G-7 nations (the United States, U.K., Canada, Germany, France, Italy, and Japan) held what was billed as an "emergency" meeting on June 9 in Paris to discuss steps to stabilize the yen. Indeed, on the eve of that meeting, Japanese Vice Minister of Finance Koji Tanami announced that the United States would "cooperate" to stop an excessive yen fall. That caused a 24-hour hesitation in the yen's fall.

However, the G-7 Paris talks passed without a word said publicly about the yen, or, for that matter, on the alarming situation in Russia. The yen immediately resumed its fall. French Finance Minister Dominique Strauss-Kahn said on June 11, "There is no decision on concerted action on the yen." He added, "The Japanese situation continues to be worrying."

Yet, many are asking, if the yen fall is threatening to unleash such global horrors at this point, why does the Clinton administration, Japan's most important economic ally, not simply state that it will intervene with the Bank of Japan to stabilize the currency? "At this point the United States can't give ground," S.J. Lewis, a City of London economist familiar with the Japanese problem, told *EIR*. "To intervene now to stop the [fall of the] yen, without any concessions by Japan

to finally deal with their domestic banking crisis and the lack of real economic stimulus, would be to throw good money after bad. It most likely would only make a bad situation worse."

Indeed, one of the most blunt declarations by BIS manager Crockett, was on Japan. Attacking Japanese governments for "a decade of temporizing," Crockett urged Tokyo that it was "still not too late to restructure the banking system . . . and above all to stimulate the economy further through permanent tax cuts." In March, the Japanese Diet (Parliament) passed an unprecedented 30 trillion yen bank-restructuring package, amid great fanfare that it would end the decade-long problem of some $1 trillion or more in bank bad loans which have choked Japanese growth and are now plunging the world's second-largest industrial economy into a deflationary depression. To date, little more than 1 trillion yen have been spent. The fund remains almost untapped, with rules for its use not yet defined, even as the Japanese economy contracts.

Unless Japanese banks and the government finally resolve an effective way to remove the albatross of the $1 trillion of non-performing debt on banks' books, to allow banks once more to lend and restart the economy, Japan will continue its plunge toward deflationary depression, with soaring unemployment, collapsing production, and record bankruptcies. That, in turn, will threaten the entire global financial system, including the U.S. economy, where Japanese investors hold several hundred billion dollars of U.S. Treasury securities, which they would be forced to quickly liquidate to raise cash at home. This global dimension is the real danger behind the yen's current plunge.

Documentation

'The crisis is worse than we thought'

Mexican Finance Minister Angel Gurria was asked about the Asian crisis and Lyndon LaRouche's policies, by TV journalist Architect Benavides of Channel 12's broadcast, "Cambios," in Monterrey, Mexico on June 7:

Benavides: Seeing what is happening in Japan, seeing what has happened with us, and what is happening in the last 48 hours—

Gurria: In Korea, in Indonesia, in Malaysia, etc.—

Benavides: Seeing all of this, we could be witnessing the shattering of the international financial system. And there are some gurus out there, such as Mr. LaRouche and those people—

Gurria: Noooo! Well, the international system is under enormous pressure, but there is a common denominator: the need, in order to prevent such things from happening in the future, for us to strengthen regulation, strengthen supervision, modernize the system of controls over the banks and the financial system. In fact, there is talk about creating international institutions to support countries. . . .

***Far Eastern Economic Review* editor Philip Bowring wrote in the *International Herald Tribune* on June 9:**

"This time, Malaysian Prime Minister Mahathir bin Mohamad has it right. Asia (excluding Japan) is being crippled by extraordinarily high interest rates that threaten to turn a necessary short, sharp recession into a depression. Policy must be changed, regardless of the IMF. . . .

"It is impossible to imagine any Western government imposing the kind of monetary policies now being faced in much of Asia. . . . Inflation is nowhere to be found. Deflation is everywhere. Prices of everything except money have collapsed. . . .

"The IMF pretends to be lender of last resort, and dictates policies as if it were. But it has neither resources nor the will to require major shareholders to address the international problems caused by their banks. . . .

"Asian resentment of Western prescriptions will escalate dramatically if output keeps falling. For everyone's sake, countries should start now to mitigate recession by reinvigorating domestic demand, whatever the views of the IMF or of the fashion houses of finance."

Aloysio Biondi, in Brazil's *Monitor Mercantil,* June 4:

Why is it, asks Biondi, that the Brazilian currency, the real, has not yet fallen through the floor, nor its markets collapsed in a financial crisis, as happened in Asia? "Answer: Because the Brazilian government, since last year, has carried out a gigantic and indecent intervention into the financial markets, using, in an illegal and authoritarian manner, pension funds, the Banco do Brasil, the National Economic Development Bank (BNDS), and 'friendly bankers.' "

Biondi charges that the Central Bank has thrown "billions and billions of dollars and reals" into the markets to cover up problems, only ensuring that they will be much worse when they become uncontrollable, which will happen in the near future.

Ronaldo Sardemberg, Brazilian Secretary of Strategic Affairs for the Presidency, in *Folha de São Paulo,* June 8:

After visiting Malaysia, Singapore, and Thailand, civilian intelligence chief Sardemberg said: "The crisis is more complicated and more profound than we imagined. The crisis, in addition to being a financial one, is also an economic crisis. . . . The solution to the crisis does not depend only on a correction of financial problems. In Thailand, for example, they closed 60% of the financial institutions, but that did not solve the problem."

Alan Greenspan, chairman of the U.S. Federal Reserve, June 10 testimony before the Joint Economic Committee of Congress:

"The current economic performance, with its combination of strong growth and low inflation, is as impressive as any I have witnessed in my near half-century of daily observation of the American economy." U.S. economic growth, he said, is "still enjoying a virtuous cycle." Greenspan concluded: "Our economy has remained strong this year, despite evidence of substantial drag from Asia, . . . the economy continues to perform more impressively than it has in a very long time." Regarding Asia, Alan-in-Wonderland admitted that as "the events of the past few weeks have demonstrated, the restoration of normally functioning economies will not necessarily go smoothly." Still, he chirped, Asia's problems do "not seem likely to threaten the expansion of this country's economy."

Malaysia's Mahathir slams hedge funds

Malaysian Prime Minister Mahathir bin Mohamad spoke in Tokyo at the Fifth Symposium of the Institute for International Monetary Affairs on June 2. A summary follows.

What is the worth of a nation, if someone can devalue it, and bankrupt it? In a scathing attack on the "analysts" who claim that weak "fundamentals" are the reason for rapid currency movements, Dr. Mahathir posed very directly that it is the speculators and hedge funds that are destroying the economies of Asia. He noted that, even immediately prior to the onset of the attacks on the Asian currencies last summer, international organizations, including the IMF and Michel Camdessus, were praising Malaysia "for our sound economic management, for our superb economic fundamentals. . . . On June 17, 1997, just two weeks before the currency hurricane struck, the IMF gave Malaysia not just a clean bill of health but the IMF in fact praised Malaysia's economic fundamentals. . . . And the IMF commended Malaysia to investors as an economy that 'justifies the confidence of the markets.'

"I cite all this in order to address all those extremist 'market fundamentalists' who believe that the market is always right and that the reason why so many of us are in desperate straits today is because we mismanaged our economies and because all our 'fundamentals' were rotten to the core."

"The analysts and all those who are obviously cleverer than us simple elected leaders must know that we have had not ten years, but 40 years of economic growth unparalleled in human history. Since some of them are young enough to be our grandchildren, perhaps we should remind them that many of the things that they complain about and which they say are the reasons why we are in such difficulties today, were things that we ourselves started complaining about when we ourselves were their age. So many of the so-called fundamentals which are now listed as the main causes of the currency and financial turmoil of the last 12 months—corruption, monopoly, crony capitalism, inadequate human resources, very far from perfect banking systems and practices—have always been with us. Yet, we were able to grow faster and longer than anyone before in human history. . . . But the true causes of why our currency plummeted and why we are facing an economic crisis must be sought elsewhere."

After describing areas in which measures must be taken, Mahathir continued: "At the international level, I believe that the time has come to deal with the entire issue of reform of the international financial system to ensure currency stability and to contain the activities of those who buy and sell money for no other purpose than to make profits.

"Let me say once again that currencies need to be changed if there is going to be international trade. That is why the leaders of the western nations met to draw up the Bretton Woods Agreement, the purpose of which was to agree on a mechanism for determining the value of one currency against another." But, then, Mahathir said, "some countries in the West decided to devalue their currencies in order to enhance competitiveness," and quickly "a currency market emerged which took advantage of the mildly unstable exchange rate. . . .

"With the invention of arbitrage and futures trading, the need for exchange rate stability for the purpose of trading gave way to the desire of currency traders to make massive amounts of money in the shortest possible time. An artificial system of devaluation and revaluation of currencies was devised which enabled currencies to be appreciated or depreciated literally within seconds. Thus the Indonesian rupiah was, at one time, devalued by more than 600%, then in the space of a few days recovered by 200%. It is still moving up and down by 100% to 200% in the space of one day or even half a day. . . .

"Can it be that all the assets of that huge country, with 220 million hard-working people, are suddenly worth only one-sixth of its previous value? What, indeed, is the worth of a nation, if suddenly someone can devalue and even bankrupt it? . . .

"All in all, the present system, if there is a system at all, is messy, unreliable, and destructive. Can world trade depend on these shadowy market forces, whose methods are not known to anyone except themselves? But, again, this hedging profits only the hedge funds, adding to the cost of goods and services.

"There is nothing to indicate the need for currency trading other than the vast profits that can be made by currency traders. On the other hand, we now know the extent of the damage to the economies of whole countries and regions that currency trading can inflict.