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Speculation-fever and fear become explosive mixture

by Lothar Komp

The phase of outward stability, which has prevailed since the near-collapse of the world financial system in the fall of 1998, has petered out. There was no dearth of dramatic financial events, even in 1999. But, as in the case of the $30 billion yen-dollar central bank intervention in June 1999, which saved such mammoth speculation funds as Tiger Fund at the last moment, the crisis managers refrained from spectacular rescue operations in this phase in order not to make investors nervous. A generalized panic, which was imminent in 1997 and 1998, was to be avoided. But, since massive interventions were still necessary—for example, when the stock and bond markets took a dive in August and September 1999—the leading central banks orchestrated a lot of noise around the "Y2K" problem. With computer problems as a cover-story, they were able to pump gigantic volumes of excess liquidity into the markets.

Such manipulations have now run their course. Although most investors are hyped to keep their money flowing into the markets, so they don't miss out on the latest rise in their stocks, everyone basically knows that the big crash is imminent. This schizophrenic attitude leads to extreme imbalances on the stock markets, which take on two forms. First, it is now a common occurrence for the Dow Jones, Nikkei, or Dax to shoot upward by 200 points in a single day, and then plunge into the cellar the following day. On the other hand, stock purchases are increasingly concentrated in the narrow segment of so-called "technology values," while the majority of stocks have been falling since the beginning of 1999. The rush of Germany's Dax to record heights in January 2000 was based on only four firms (Telekom, Siemens, Mannesmann, and SAP), while the remainder of the 26 titles on the index booked considerable losses. Stocks which promise less than 20% profit in a single year are being sold off. Today's gambler concentrates on Internet and other fashionable stocks which—so he hopes—can give him 500% growth in a year, with a little luck. With that target in his sights, the gambler is willing to incur credit debts in whatever volume seems necessary. So, in January 2000 in the United States, the outstanding volume of credit taken for purchasing stocks rose by 7% to $243.5 billion, while the value of all stocks fell by 4%. Stock market strategist Gary Dugan from J.P. Morgan remarked: "I've been watching the stock markets for 17 years. I have seldom experienced the investors as nervous as they are today. The probability that there will be a correction on the American and then the European stock markets has increased since the beginning of the year." When he says "correction," Dugan means a 3,000 point drop in the Dow Jones and an average drop in Nasdaq stocks by 40%.

Summers spreads panic on the bond market

While insecurity is mounting on the stock markets, the bond and raw-materials markets are being shaken by unusual developments. First of all, these markets are being hit by the general expectation of a worldwide financial catastrophe coming soon. On the other hand, they attest to the fact that the inflationary effects of the unbridled monetary policy of the central banks from 1995-99 can no longer be swept under the rug.

U.S. Treasury Secretary Lawrence Summers proclaimed on Feb. 3 that, on account of the expected budget surplus, not only would there be no new issues of long-term government Treasury bonds, but that the buy-back of government bonds to the tune of $30 billion would be largely restricted to 30-year bonds. Since many investment funds, especially pension funds, are required by law to invest a certain portion of their capital in long-term government bonds, this announcement

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led to a rapid rise in prices of the 30-year bonds, which will be even scarcer in the future. As a result, the yield which the government has to offer buyers of these bonds, fell. But the price yield of 30-year U.S. Treasury bonds is a benchmark, including outside the United States, for the general level of interest rates. Computer programs at large banks and funds use the price of the 30-year bonds to decide whether the purchase of a stock might not be more profitable. The lower the benchmark, or the profit which can be reaped without any risk, the larger the move into the stock market becomes. And, to be sure, the Treasury Secretary had his sights on supporting the fragile stock markets when he made his announcement, since his aim is to prevent a stock market crash from occurring prior to the U.S. Presidential elections.

The move boomeranged. The bond market went out of control. Panic-buying of 30-year Treasury bonds set in, the strongest since the October crash of 1987. The yields on 30-year bonds dropped to 6.18% (mid-January 6.75%), although the margins for two-year bonds held at 6.71%—a rather unusual reversal of normal conditions on the bond market, where margins usually increase with the length of term of the bond. Some large banks and hedge funds became desperate. With their financial bets on interest-rate derivatives, they stood to suffer losses in the billions. One rumor chased the other. Deutsche Bank claimed that Goldman Sachs and Merrill Lynch had big problems. Crédit Suisse claimed that Deutsche Bank had suffered heavy losses. Rumors flew that some hedge fund was on the brink of collapse. It was claimed that the U.S. Federal Reserve had called an emergency meeting of the heads of the largest central banks, just as it had done in September 1998.

Ultimately, Summers had to appear in public to retract his announcement of Feb. 3. The government would indeed buy back bonds, he claimed, but there was to be no restriction to 30-year bonds. The bond markets remain nervous, nevertheless. The auction of government bonds on Feb. 10 met with the "lowest demand of all time," according to observers.

Flight into equity

A number of raw materials, especially precious metals and oil, have gone through spectacular price rises in the past weeks. Each of these raw materials has its own history, which could explain why the price rises have occurred. But there is no doubt that there is a common factor, which is responsible for the dramatic shifts in prices: the expectation of a rise in inflation and the flight into investments which would still be worth something following the implosion of the financial bubble.

On Feb. 3, South African Goldfields Ltd. announced that it would no longer sell its gold production in advance on the futures markets. One day later, the second-largest gold producer, Canada's Placer Dome, announced a similar deci-

Milan is urged to back New Bretton Woods

On Feb. 14, Milan City Councilman Aldo Brandirali and nine other members of the City Council belonging to the Forza Italia party, introduced a motion which would commit the city to help create a New Bretton Woods global financial system. Forza Italia is the majority political party in the Milan City Council, and Mayor Gabriele Albertini also belongs to Forza Italia. Milan is the industrial and financial capital of Italy.

The motion, entitled "Instability of Financial Markets," states:

"The Milan City Council, considering, that the beginning of the year 2000 was marked by total instability of the world stock exchanges, including the Mibtel Index in Milan which registered gigantic variations; that the present process of financial globalization is characterized by deregulation of the markets, particularly in the most aggressive and speculative sectors, such as derivatives. . . .

"Considering further that this situation can only be faced by convoking a conference of heads of state and government like the one held in Bretton Woods in 1944, with the aim of creating a new international monetary system and taking all necessary measures to eliminate the speculative bubble, including:

"Introduction of measures such as the Tobin Tax, aimed at limiting speculative short-term operations such as derivatives; creating new credits explicitly aimed at investments in the real economy; defining great infrastructural projects on a continental level;

"Commits the Mayor and the City Council to take all necessary measures to circulate information on the urgency of a new Bretton Woods, and to solicit the Italian government to promote this initiative at the European and international level."

Councilman Brandirali was among the speakers at the conference on a New Bretton Woods held by the Italian Solidarity Movement at the Milan Catholic University on Dec. 15, 1999, and subsequently endorsed Lyndon LaRouche's Presidential campaign with a statement connecting LaRouche's initiative for a New Bretton Woods system to the initiative of Pope John Paul II for debt remission in the Jubilee Year 2000. The endorsement was reported in the daily *Il Giorno* on Jan. 14, in an article entitled "Brandirali Endorses LaRouche," and in the Jan. 28 issue of *EIR*.

sion. Almost all of the gold mines had previously attempted to secure themselves against a drop in gold prices with deals on the futures markets, which usually resulted in a more rapid fall in the price of gold. The effect of this signal of a sudden reversal of policy on the part of gold producers unleashed a rush into gold, so that the price of gold rose sharply. A number of banks and hedge funds, which had bet on the previous trend of falling gold prices, were suddenly caught on the wrong foot. To limit their losses on derivatives contracts, these investors had to cover themselves as quickly as possible with gold. As a result of this panic buying, the gold price rose still further, from $285 to $320 within a few days. Since the financial bets on a falling price of gold involve a volume of several thousand tons of gold, an additional increase in the gold price could bring disastrous losses for the banks involved.

There has been upward pressure for about one year in the prices for precious metals such as platinum, palladium, and rhodium, all of which are needed for the production of catalytic converters in the automobile industry. The reason usually cited is the contracted exports of the dominant producer, Russia. In January 2000, there was an acceleration of the price rises. The price for palladium shot over the threshold of $500 an ounce, the highest mark of all time, in comparison to $300 a year earlier. At the beginning of February, the $600 mark was reached, and on Feb. 17, the $700 threshold was broken. At the same time, platinum prices reached a nine-year high. Rhodium prices doubled from December 1999 to the beginning of February 2000, to more than $2,000 an ounce. Nickel reached a four-year high in February.

In the meantime, the price for crude oil went over $30 a barrel for the first time since the Gulf War in January 1991. At the end of 1998, the price of crude oil had sometimes dropped below $10 a barrel.

Even the retiring Manging Director of the International Monetary Fund (IMF), Michael Camdessus, is suddenly seeing dark clouds gathering for the future of the financial system. It is high time, he now says, to sound the "alarm bells" among IMF member-nations, and they should prepare themselves as quickly as possible for a new financial crisis. There are "reasons for concern" everywhere in the world, especially on the U.S. financial markets. The world economy has entered a "dangerous period of twilight."

Camdessus, who bears considerable responsibility for the regrettable condition of the world economy, ought to know what he's talking about.

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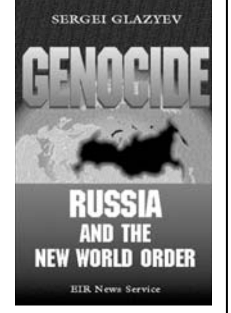

Russia in the 1990s: "The rate of annual population loss has been more than double the rate of loss during the period of Stalinist repression and mass famine in the first half of the 1930s . . . There has been nothing like this in the thousand-year history of Russia." —Sergei Glazyev

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Economist Dr. Sergei Glazyev was Minister of Foreign Economic Relations in Boris Yeltsin's first cabinet, and was the only member of the government to resign in protest of the abolition of Parliament in 1993.

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Commentaries

Warnings of coming crash proliferate

Günther Robol and Helmut Kartner, founding members of the "Föhrenberg Circle" in Austria, *Die Presse,* Feb. 15, 2000.

We are very close to an "inevitable financial crash," as the derivatives market is fully out of control, Robol and Kartner said at a public event sponsored by the Vienna "Economic Publishers Club" on Feb. 14. It's only a matter of time as to when the speculative bubbles will burst. Alarm signals can no longer be overlooked, such as the decoupling of the financial sphere from the real economy, the increase of financial income versus labor income, and the explosive growth of the derivatives market. There is only one alternative, they stated, which is "a controlled elimination of financial assets." They also called for the introduction of a global tax on speculative stock trading and on derivatives transactions.

Frank Mella, the inventor of the German stock market index DAX, in an editorial for the German daily *Die Welt,* Feb. 14, 2000.

"I will now sell my stocks," wrote financial expert Mella. He stressed the likelihood of a "sharp, perhaps crash-like correction on the stock market," which would trigger a flight into investments, which are being perceived as being more safe than stocks. Once Wall Street is hit, European stock markets