BIS Crash Warnings Remain Blacked Out in United States

by Marcia Merry Baker

As of the time this issue of *EIR* goes to print, there has been no significant coverage in the United States of what properly made headline news June 5 and thereafter in Europe and worldwide. The Bank for International Settlements (BIS) warned in its 70th annual report released that day, that the U.S. running trade deficit, combined with the U.S. rate of speculation and indebtedness, means there will be a "hard landing" in the near future. (Below are excerpts from the BIS 200-page report, whose release we covered in the last issue.)

In effect, the BIS report said that the U.S. financial bubble is about to pop. BIS president Urban Bäckström, speaking in "bankerese" at a June 5 press conference, warned that the current U.S. expansion was "unsustainable," and that "a soft landing is by no means assured." His point was immediately picked up in the major European financial press on June 6. "Warning of Global Hard Landing," was the headline of the front-page article in the London *Financial Times*. "Dangerous Dynamic on Financial Markets," and "The World Economy Is Threatened with Shock," were the headlines of articles in Germany's financial daily *Handelsblatt* and France's daily *Le Monde,* respectively.

International coverage of the crash warning continues. On June 11, the London *Sunday Observer* ran the story, "The Bubble that Has To Be Burst." Writer William Keegan summarized the BIS report, noting that the BIS was one of the few official institutions that sounded the alert about the so-called Asian crisis in 1997. But, the article says, "its biggest worry now is the continuing euphoria about the U.S. economy, and the dangers of a hard landing via a collapse of Wall Street and the dollar."

In the United States, there has been a blackout. The very extent of the cover-up reveals intervention by Wall Street and the White House. The politics of that, are clearly the attempt to try to "manage" the timing of any blow-out until after the November elections—an insane goal in itself. Moreover, the pervasive lunacy in the United States is typified by the slant of the very few commentaries that were eventually published on the BIS crash evaluation. A June 8 CBS MarketWatch online newswire, by Paul Erdman, ridiculed the BIS report for being anti-United States and pro-Europe! He sneered, "Where would you rather have your money? New York or Paris?"

Then, on June 13, Alan Greenspan, chairman of the Federal Reserve Board, came out with an unprecedented, "What, Me Worry?" formulation in a speech to the New York Association for Business Economics. Making reference to alleged productivity gains of U.S. workers, Greenspan said that the U.S. economy is in a new paradigm, where henceforth no harm can ever occur. He attributed productivity gains to the Information Age, saying that "information technology raises output per hour in the total economy principally by reducing hours worked on activities needed to guard productive processes against the unknown and the unanticipated."

Apparently assuring financial marketeers that they need not worry about an unanticipated systemic meltdown, Greenspan claimed these alleged productivity gains are "irreversible"! "Having learned to employ bar code and satellite technologies, for example, we are not about to lose our capability in applying them," he said.

Take Cover

Back on Earth, as of mid-June, the signs are everywhere that the present financial *system* is soon going to be history. In the United States, you see the hyper-volatility on stock markets, the inflationary run-up of gas, food, and other commodities prices, the prospects for a near-term dollar plunge, and the unprecedented U.S. current-account and trade deficits.

In various regions around the globe, the impetus for new

Federal Reserve Chairman Alan Greenspan. Don't worry, says Greenspan, the "New Economy" is invincible.

regional initiatives to cut loose from the Washington, D.C. insanity, and start up national-interest measures to protect economic priorities, are being strengthened. Earlier this spring, the 11 member-nations of the Association of Southeast Asian Nations, plus China, Japan, and South Korea (known as ASEAN Plus Three), made a mutual currency-defense pact, and other pledges. In Europe, France and Germany have re-asserted certain national prerogatives over Euro-banking policy, and other "European reflex" moves are under way. There are similar impulses in Ibero-America and elsewhere.

However, in the blacked-out, lunatic atmosphere currently enforced in the United States, many U.S. Congressmen and Administration officials are still groping around for supply-and-demand "explanations" for what is occurring sector-by-sector: soaring gas prices, health care breakdown, housing costs, and so on.

LaRouche: 'At the Boundary Condition'

Democratic Presidential pre-candidate Lyndon LaRouche emphasized on June 14, that the best way to understand the scale and timing of what we face, is to take a look at history, at the period of hyperinflation, March through November 1923, in Weimar Germany.

At that time, after a period when financial categories of values (debts, war reparations, credits, etc.) grew to unpayable, unsupportable levels, moves were made to simply vastly expand the money supply. At a certain point, the volume of money even *exceeded* the volume of unpayable financials! The system blew out. This episode is documented in detail in this section by Richard Freeman.

LaRouche made the point: "In summary, the present IMF [International Monetary Fund] system as a whole, is presently caught in a global hyperinflationary spiral whose only near comparison is, presently, that peculiar to Germany of March-November 1923. This spiral, which has been set into motion through the continuation of hyperinflationary policy-decisions made during the Washington, D.C. monetary conference of October 1998, has now reached the threshold of a global hyperinflationary commodity-price inflation.

"The current trends in petroleum prices have nothing to do with supply-demand or costs of production of petroleum for world markets; these current inflationary trends, flanked by parallel price-rise trends in primary-materials and real-estate categories, are entirely a result of the effects of nearly two years, since the August-September 1998 Wall Street bail-out of the Long Term Capital Management (LTCM) scam, of monetary pump-priming efforts to prevent a deflationary chain-reaction collapse of the world's bubble of financial-asset-price inflation." He noted that 22 months of such insanity have brought us to the point of "a terminal boundary condition" of the whole system itself.

Price Shocks in the U.S.

The Federal Reserve policies of money-pumping, raising interest rates, and other maneuvers to save the expiring system, have created hyperinflationary conditions, empirically manifest for anyone looking.

A new U.S. Department of Housing and Urban Development report released a first-ever compilation of home cost trends, which the agency said showed "staggering jumps." The cost of buying a house has gone up more than 18% since 1995, in seven of the top ten hot "high-tech," "info-tech" regions.

Gas pump prices are soaring. In Michigan, for example, a gallon cost $1.65 in late May; as of mid-June, it is $2.07. In the Bay Area in California, gas is around $2.10, after reaching $2.17 in March. In many locales, pump prices change by the hour, and radio stations have started new segments, broadcasting which gas stations have the lowest prices. Internationally, crude oil is over $32 a barrel (July futures), rising a full $1 on the New York market on June 14.

The latest U.S. Bureau of Labor Statistics report shows price spikes in various food products. These are not prices paid to farmers, but rather cartel-controlled high prices charged to consumers. The May Consumer Price Index, released on June 15, shows food prices were up overall 0.5% in the month, after also rising in April. Beef, poultry, vegetables—all highly cartelized in processing, and marketing—went up for the biggest jump since October 1998.

Then there are the specialty minerals and metals. On June 13, the price of gold suddenly soared by $7 an ounce in both London and New York; it did the same on June 15.

What does it all mean? As LaRouche summarized the situation on June 14, "The point is, that such symptoms, like a fever of 107°F, warn us that the patient exhibiting these circumstances may soon be dead. In any case, the present IMF system is already as bad as dead. The only important question to be deliberated, is, how shall a decent interment be arranged, if anyone cares to undertake that venture?"

Documentation

'The Quicker the Bubble Deflates, the Better'

Excerpts from the BIS Annual Report, released June 5 in Basel, Switzerland, from section "VIII. Conclusion." A subhead has been added.

There seems to be a widespread perception that the global economy now stands on the brink, but the brink of what remains the question. . . . Many now see better economic prospects than at any time since the early 1980s. . . . Yet, even if this longer-term vision is accepted, policymakers can still expect a few bumps along the way. Consistent with previous historical episodes of structural change and associated new promise, the last decade has been characterized by rapid credit expansion in many economies, and a growing appetite for risk among lenders. Concentration ratios have risen in financial markets while liquidity has sometimes fallen noticeably. These developments imply not only that the global economy may have become more exposed to macroeconomic shocks, but also that the dynamic response of markets to such shocks may be harder to predict than in the more regulated past. Finally, it must also be asked whether, with a more globalized financial system, policymakers have all the tools required both to avert problems and to manage them should they arise. This is never an easy task since liquidity injections, which may be needed to help manage one crisis, can also encourage imprudent behavior, simply leading to the next. . . .

The principal macroeconomic vulnerabilities are well known, not least among them the possibility of rising inflation in the countries most advanced in the business cycle. But it is the potential interactions between these vulnerabilities that may require more attention. Stock prices in many countries still seem high by historical standards, even after stripping out "new era" stocks, for which new valuation criteria could conceivably apply. The U.S. dollar also appears to be stronger than is compatible with the stabilization of longer-term external debt ratios. Given the increased extent to which projected returns on equity have driven international capital flows in recent years, the possibility of a simultaneous adjustment in both markets would seem greater than historical correlations might indicate. The likely implication of such an outcome would be slower demand due to wealth effects, even as inflation rose in response to both internal and external pressures. Whether the former would be judged useful or not, since it would help offset the inflationary pressures, would of course very much depend on how big and orderly the wealth adjustment proved to be. Neither a hard nor a soft landing could logically be ruled out. . . .

'This Could All Go in Reverse'

The market dynamics conditioning the response of the global financial system to a continued tightening of policy rates also deserve attention. Higher policy rates have for the most part been viewed as helpful in sustaining economic growth while heading off inflation. Growth has been positive for stock prices and for credit spreads, and low inflation has perhaps constrained the upward movement in bond rates. Yet, if the authorities were suddenly judged to be "behind the curve," this could all go into reverse, with potentially contractionary effects. In addition, equity price movements could be exaggerated by the growing use of leverage and margined debt, portfolio insurance strategies, and the increased dependence of blue-chip profits on stock gains in the high-tech area. These are all interwoven elements with potential for mischief. Similarly, fixed income markets might also react uncharacteristically, given the changing status of benchmarks in both the U.S. and European bond markets, and the growing reluctance of large firms to commit capital to a market-making function. . . .

One point on which virtually everyone would agree is that the current rate of expansion of domestic demand in the United States is unsustainable and potentially inflationary, and that a similar, if less extreme state of affairs prevails in some of the other English-speaking countries. With all talk of fiscal action in the United States moving resolutely in the other direction, the recent trend towards monetary tightening is most welcome even if some asset prices currently look quite vulnerable. Were monetary policy to back off at the first signs of declining equity prices, the risks of moral hazard would be great. In any event, if we really have entered a "new era," the likelihood of a sharp and sustained reaction in equity markets would be much reduced. And if we have not, then it could be argued that the sooner the bubble deflates, the better.

This is not to say that a significant reaction in the stock market, or in financial markets more generally, should not elicit a measured policy response. Disinflation can go both too far and too fast. This danger is not inconsequential in the United States, nor in a number of other countries advanced in the cycle. Given recent low rates of saving and heavy investment in housing and durable goods, it would now be very easy to postpone prospective expenditures. But once it has become apparent that certain investments will never yield their expected rates of return, the misguided investors should be allowed to pay the price, and quickly, so that capacity can be reduced and longer-term profitability rapidly restored. This may be the principal lesson from the 1990s in Japan.