EIR Economics

Central Bankers Peer into 'Black Hole' at Wyoming Meet

by William Engdahl

At the end of August, a flurry of central bank meetings were occurring around the globe, at which many top-level officials spoke bluntly about financial "shocks" coming soon. Think of "worst-case scenarios," was the expression used on Aug. 24 by Bank for International Settlements president Urban Bäckström. Even Bank of England head Eddie George—whose banker faction wants to be on "top of the heap" of what's left in a crash—spoke on Aug. 27 of "macro-economic shocks" and "systemic financial disturbances."

On Aug. 26-27, top figures of international central banking, the International Monetary Fund (IMF), and the Bank for International Settlements (BIS) engaged in discussion about the shape and timing of the next global financial crisis. As one firsthand report said, the "discussion was nervous." There was a sense that "another big crisis might well be on the way, and that there was no clear prescription for dealing with it."

The meeting, sponsored every August at the resort town of Jackson Hole, Wyoming by the Kansas City Federal Reserve, as an informal forum to debate current global financial policy issues, included Federal Reserve Chairman Alan Greenspan, European Central Bank Council member Tomasso Padoa-Schioppa, BIS official Andrew Crockett, IMF Deputy Managing Director Stanley Fischer, IMF chief economist Michael Mussa, World Trade Organization head Michael Moore, and numerous international central bank and financial policymakers and academics.

Greenspan set the tone of an agenda nominally dealing with "Global Economic Integration." After a description of the wonders of the American information technology revolution, he added a clinically revealing caveat: "It is by no means self-evident that these trends [toward globalization] will eventually lead to world convergence of economic regimes. . . . Even among liberal democracies, one can still find deep-seated antipathy toward free-market competition and its partner, creative destruction, to use Joseph Schumpeter's now famous insight."

Greenspan's concern is that a financial crash would reverse submission to globalization, and lead to challenges to the power of the financial oligarchy. He warned, "Should recent trends in economic growth falter, it is quite imaginable that support for market-oriented resource allocation will wane, and the latent forces of protectionism and state intervention will begin to reassert themselves in many countries, including the United States."

In one of the few hints of the nervous mood behind the scenes at Jackson Hole, Greenspan took issue with the benign report of IMF chief economist Mussa. According to the Swiss financial daily *Neue Zürcher Zeitung* of Aug. 28, Mussa told the bankers that he did not believe a return to protectionism is possible. Greenspan interrupted, saying, "Also in the year 1913, on the eve of the First World War, people were convinced of the unavoidability of a globalization of trade, and no one had the slightest idea what was to come."

The Weakness of the U.S. Economy

A major concern of Greenspan and the central bankers gathered at the retreat, is the growing likelihood that the record high U.S. current account deficit, which mushroomed over the past three years since the so-called Asia crisis began, will be the ultimate cause of a global systemic crisis.

Although Greenspan was silent on the strength of the dollar, the conference featured a presentation by two academic economists, Maurice Obstfield of the University of California and Kenneth Rogoff of Harvard. They presented two options—a massive dollar devaluation after a U.S. stock market crash, or a sudden end to foreign investors' spending in the United States, which would crash the U.S. economy.

Citing the current account deficit, primarily from trade imbalances, of more than $400 billion annually, a record 4.3% of U.S. Gross Domestic Product, they asked the audience, "How long can the global economic system sustain such enormous borrowings by its largest member, and what would be the consequences, especially for exchange rates, of a sudden reversal?" With present U.S. net foreign indebtedness—that is, the obligations to foreigners who hold U.S. corporate and government bonds or extend loans to U.S. citizens or companies—now around 20% of U.S. GDP, or approximately $1.7 trillion, they argue that were, say, the hyperinflated U.S. stock market to really crash, i.e., to plunge 30% or more in a matter of days, it might force a devaluation or collapse of the U.S. dollar by some 45%, in an effort to stave off mass unemployment, as foreigners rushed to liquidate dollar assets.

The real debates at Jackson Hole, however, took place far from the ears of world media, behind closed doors. Jackson Hole is chosen as the site for the annual policy gathering precisely because of its remote location, to facilitate frank and open discussion. Yet, as one participant summed up the mood, off-the-record, there was a sense that, "while the last crisis had passed without much permanent harm, another might well be on the way, and that there was still no clear prescription for dealing with it."

'Worst-Case Scenarios'

There were similar warnings by other financial officials. In Bangkok, at a seminar on "Financial and Monetary Stability," Urban Bäckström, Governor of the Swedish Central Bank and chairman of the board and president of the BIS, spoke of bubbles bursting. On Aug. 24, he said, "If asset prices have been driven up to unsustainable levels that do not correspond to the underlying fundamentals, we are faced with a special kind of problem. We know from experience that speculative asset price bubbles eventually burst. When they do, collateral values will fall and balance sheets deteriorate, potentially threatening the stability of the banking system."

On the latter point, Bäckström spoke with foreboding. "A second and related risk is that high asset prices might lead to complacency about debt levels. . . . Rising levels of household and corporate indebtedness in some industrial countries, as well as rising levels of external indebtedness in a number of emerging market countries, are based on expectations of continued strong growth in income and production. . . . Volatility is intrinsic to financial markets. Our experience during the 1990s clearly demonstrates the danger of basing decisions solely on a single central scenario, rather than on a range of possible—including worst case—scenarios."

More "shock talk" was forthcoming from the Governor of the Bank of England, Eddie George, in an Aug. 27 speech to the Association of Professional Bankers in Colombo, Sri Lanka, the day after a conference of Asian-Pacific bankers, also in Colombo. George said, "The importance of strengthening our defenses . . . against systemic financial disturbances can hardly be over-emphasized."

BIS Worries

Only 48 hours after the close of the Jackson Hole gathering, the Basel, Switzerland-based Bank for International Settlements, the organization of the world's major central banks, issued its view of potential detonators of a systemic crisis in the financial system. (Recall that the BIS warning in June, that "a hard landing" would hit the United States, was blacked out by U.S. media, with the exception of this news service and a very few others.) In its *Quarterly Review* of global financial developments, the BIS expresses significant concern over the recent explosion of bank lending to international telecommunications companies, as well as new evidence of an alarming bubble in real estate in parts of western Europe, but especially in sections of the U.S. market.

"Recently, much attention has been focused on the high valuations in global equity markets. Yet," the BIS central bankers warn, "real property prices have also registered significant gains over the last few years in many countries." Noting that a collapse of a real estate speculative bubble led to the banking crises in the U.K., Scandinavia, Japan, and the United States over the past decade or so, the BIS adds, "Historically the extensive use of real estate as collateral has been the main source of losses for banks." The BIS points to price increases in excess of 40% in major U.S. cities as cause for worry.

"What concerns me is the leverage based on real estate as collateral today," commented S.J. Lewis, a prominent City of London bond strategist and economist at Monument Derivatives Ltd. "The new element is especially worrisome in the U.S. real estate banking market, where banks are 'bundling' groups of commercial or home mortgages into new securities, so-called asset-backed securities, insuring them through an insurance company, and reselling them at a discount to investors. But, unlike in the late 1980s real estate bubble, today, high-risk or sub-prime mortgages are being bundled and sold. The amounts run in the hundreds of billions of dollars. Should there be a new real estate collapse, for whatever reason, this one could get very nasty indeed."

The Telecoms: 'Staggering Debts'

The second major worry reflected by the latest BIS review is the staggering amount of recent bank loans tied up in highly risky telecommunications activities. "The most striking development in the international banking market in the first quarter of 2000 was a surge in cross-border lending within developed countries," the BIS reported noted. "The main impetus was a strong demand for financing by borrowers in Europe, particularly by telecommunications firms." The BIS cites a "spectacular surge in cross-border bank lending in the first quarter, to $404 billion from $117 billion in the final quarter of 1999." The funds, they say, went "to support mergers, acquisitions, and bids for third-generation mobile phone licenses."

The latter licenses are being "auctioned" off to the telecoms by various European governments. It is the focus of the latest phase of global Internet mania, with European telecommunications firms desperate to build networks of cell phone customers for the next-generation high-speed mobile units.

One small problem is that the UMTS technology, as it is known, is at least several years away. In addition, after landing an expensive license from the governments of Britain or Germany, the telecom firm has to spend huge sums on building an entirely new UMTS infrastructure across Europe. Some industry sources estimate that that will add another $150-200 billion to the cost of UMTS.

The auctions themselves are reaching absurd heights of speculative bidding. In the first auction, the British international telecoms paid a combined $41 billion for licenses there. But in Germany, where the bidding ended in mid-August, the sum topped $50 billion. The telecoms now have to go to the international bond markets or to their private bankers to get the cash to pay the licenses, and France and Italy have yet to hold their auctions. A major borrower in international bond markets has been Deutsche Telekom, which in addition to paying billions for its UMTS license, is bidding $52 billion to take over the U.S. mobile phone operator VoiceStream.

"The debts of these once-staid telecoms are becoming staggering," warned Lewis. "This is the equivalent of the rush of capital into the emerging markets in the mid-1990s. Only, unlike with Thailand, there is no provision for an IMF bailout of AT&T or Deutsche Telekom or Vodafone should they collapse. I see this as perhaps the most alarming factor in international debt markets over the coming months. Mr. [Lyndon] LaRouche may well get his October crash from this."

(Actually, LaRouche's formulations are more precise, and he is not "predicting" an October crash. In "Regional Reorganization Under a New Bretton Woods" [*EIR,* June 16], for example, he wrote: "As I have warned, repeatedly, no one can predict the exact hour of the day the present system's bankruptcy will be made official. Since the fateful blunders of the October 1998 Washington monetary conference, the system as a whole has entered fully into its terminal phase of collapse. Exactly how it will collapse—whether by deflationary chain-reaction, by hyperinflationary explosion, or by being placed in bankruptcy-reorganization by governments—is a 'Utah death-sentence' style of choice, still to be made by relevant governments; but the collapse is now inevitable, and will occur soon—very soon, perhaps before November, perhaps before the August U.S. Democratic Party nominating convention.")

The Gold Derivatives Time-Bomb

Yet the danger of an imminent dollar crash triggered by a U.S. stock collapse, a collapse of the U.S. and European real-estate-leveraged bubble, or a bankruptcy of a major telecom conglomerate are not the only possible detonators. There are countless others out there, according to bankers familiar with the slippery slopes of international finance. One is the prospect of a derivatives-led collapse of the "gold carry trade" bubble.

A study recently released by the private gold market research and lobby organization, Gold Anti-Trust Action Committee (GATA), warns of an imminent derivatives-led debacle in gold. The study, which was prepared for submission to members of the U.S. Congress, argues that the decade-long fall in the price of gold, from near $500 per ounce to current levels of $275-280, can only be explained by a derivatives-led manipulation of gold markets.

Documenting in detail the fact that year after year, world consumption of gold has been significantly higher than production and reuse of scrap gold, they make the obvious point that that normally would argue for a booming rise in gold prices. The opposite has been the case.

While the exact volume of gold derivatives contracts is impossible to ascertain, GATA estimates, conservatively, that "short positions" on gold, obligations to buy physical gold at some specified future date, already exceed the equivalent of 10,000 tons of gold. This is some four times world annual gold mine production.

Clearly, the GATA study argues, should any event cause a sharp rise in gold price, the huge size of the derivatives "short" positions, that is, bets that the price will continue to fall, could "threaten the international financial system." The authors cite the Sept. 26, 1999 surprise announcement by 15 European central banks, of plans to control future gold sales, which caused an $84 per ounce rise in the price of gold within hours, as indicative of such an unexpected event. "Should it leak out in public how huge the short position of even one large bank is," GATA says, other banks would rush to buy physical gold, "knowing that the short position is too huge." That, in turn, could trigger a drastic panic buying of gold as "short-covering" by other banks.

The GATA report cites the giant Swiss bank UBS, Deutsche Bank, and J.P. Morgan as three of the largest speculators in this gold derivatives game. UBS and Deutsche Bank have also been among the leading lenders to commercial real estate as well as to telecoms in recent months. Interesting coincidence, eh?

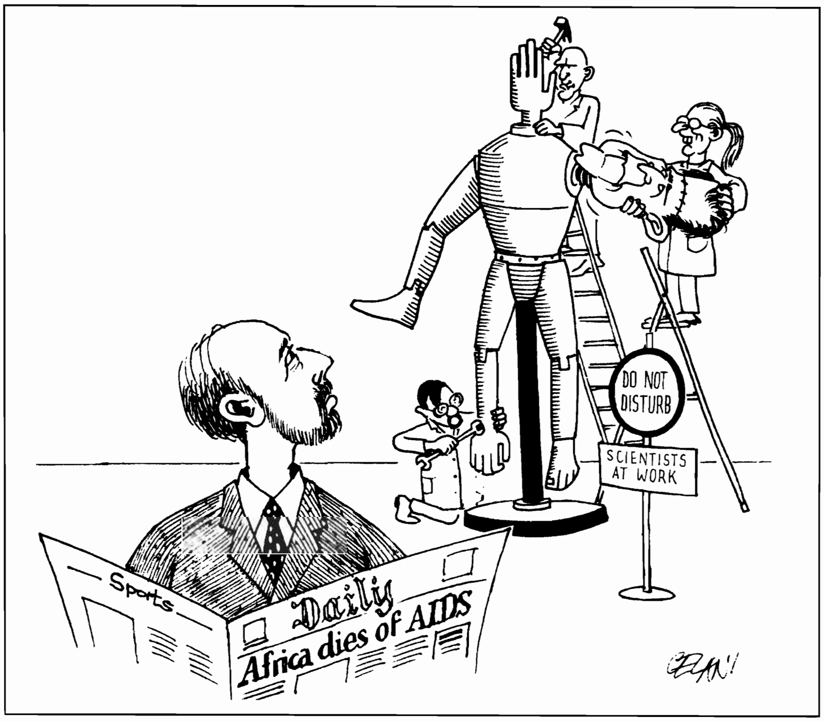
EIR SPECIAL REPORT

THE 'NEW ECONOMY' IS DOOMED

The Fraud of the Information Society

The Group of Eight heads of state, meeting in Okinawa in July 2000, proclaimed as its major accomplishment, the establishment of a task force aimed at giving the Third World access to the "Information Revolution." In a parody of Marie Antoinette, they said of the world's poor: "Let them eat laptops!"

EIR's Special Report rips apart the fraud of the Information Society, and tells what must be done to restore economic health to nations where billions of people face hunger and death by infectious disease, while transport, power, and water infrastructure is collapsing.



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