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Turkish Crisis Could Trigger Global Financial Chaos

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While, last month, all eyes were on the United States and the dangers of the world's largest economy plunging into deep recession, Turkey's currency and financial markets imploded on Feb. 19. With panic selling in Turkish bond and currency markets, and the central bank forced to spend $10 billion of its scarce dollar reserves in two days, in a vain effort to hold the lira firm, overnight interest rates briefly hit 6,200% on an annualized rate, as the political crisis deepened. A week earlier, rates were 40%.

The ostensible trigger for the latest Turkish banking crisis—the second in four months—was an open political rupture between Prime Minister Bulent Ecevit and President Ahmet Necdet Sezer, which threatened the December $11.4 billion International Monetary Fund (IMF) bailout package. As usual, to get that money, Turkey was forced to agree to savage budget cuts, economic austerity, privatization of public infrastructure—including the national telecommunications system and the national airlines—and other IMF conditionalities, which all push the economy deeper into the abyss.

Because of the fragility of the global financial and monetary system, and the fear of a full-scale worldwide crash, IMF Managing Director Hoerst Köhler rushed to reassure that Turkey's IMF emergency package was in "no danger." A week into the crisis, Turkish officials concluded that they would need to more than double the IMF bailout package to $25 billion, to avert defaults on more than $7 billion in foreign loans that come due by May, and meet the other conditionalities. The panic currency drain in Turkey is, furthermore, endangering Turkish banks, and with it, some $54 billion in mainly European bank loans to Turkey. Most of those Turkish loans come from German banks. We shall address this crucial feature of the "Turkey" crisis later.

O'Neill's Baptism in Fire

Further complicating the dimensions of the Turkey crisis was the declared policy of U.S. Treasury Secretary Paul O'Neill, who announced in the London *Financial Times* on Feb. 15, that he opposes the kind of IMF bailouts which dominated the 1997-98 Asian and emerging market crises, as a "moral hazard," which only encourages reckless bank lending. As one European banker, a seasoned veteran of the financial crises of the past 15 years, put it, "By claiming he opposes IMF rescues, O'Neill all but assured the next financial crisis," as international investors, fearing the worst, pull the plug on any high-risk investments, fearing they won't get bailed out this time.

Within days of the blowout of Turkey's "crawling peg" (to a currency basket of the dollar and the euro), O'Neill reversed his published statements, and threw his support behind an IMF bailout of America's staunch NATO ally. When push came to shove, O'Neill, as well as the gaggle of free-market ideologues behind the Bush Presidency, had to weigh in for the bailout, or face the imminent blowout of the global monetary system—an event they are in no way prepared to handle.

The Turkish crisis, despite O'Neill's about-face, rapidly spread to other parts of the globe. Turkish and other international investors panic-dumped shares in Russian stocks to cover Turkish losses, plunging the Moscow stock index by almost 9% in one day. Across fragile economies of Asia, from Thailand to Korea, the Philippines to Indonesia, currencies began plunging, as foreign investors ran for the exit doors (see coverage in this issue of currency crises in Indonesia, the Philippines, and Pakistan). One of the largest developing economies, Brazil, is a focus of special nervousness as investors fear a political crisis similar to Turkey's, endangering

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Brazil's $40 billion IMF bailout of February 1999. Similarly, in December last year, the IMF was forced to throw $39.7 billion at Argentina to try to contain that country's economic and financial crisis.

One factor, tying all these "emerging market" crises together and accelerating the spread of the infection, was the skyrocketing of J.P. Morgan's Emerging Bond Index Plus, which sets the parameters for government bond yields throughout the developing sector. By Feb. 23, four days into the Turkey crisis, the index had jumped by 2 points, to nearly 7.5%. (The index is the margin above U.S. ten-year Treasury yields that investors expect to receive for buying risky developing-sector government paper. The 7.5% index put most emerging market bond yields well over 12%—another crippling factor.)

By Feb. 26, J.P. Morgan was publicly urging its clients to sell off all of their Argentine government bonds, a clear indication that the currency panic was spreading around the globe—even as word was coming out that the U.S. Nasdaq index had crashed by 22% in February—the largest one-month collapse of American high-tech stocks in 15 years—and that Japan's Nikkei index had also plunged to a several-decade low.

The Brits Yelled 'Fire'

High-level financial industry sources in the United States and continental Europe have confirmed to *EIR* that, within moments of the Feb. 19 public spat between Turkey's President and Prime Minister, two of the biggest City of London financial institutions, HSBC (formerly Hongkong and Shanghai Bank) and Standard-Chartered, began dumping Turkish lira, and simultaneously pulling out of the Turkish stock market. This double-whammy attack, launched before anyone had a chance to assess the seriousness of the political crisis, created a snowball effect, with other international creditors soon joining the flight. Within days, $8 billion in capital had fled Turkey, the currency had crashed by a third, and the lira "crawling peg" had been busted.

Turkey's currency and banking system, already weakened by the effects on the real economy of the 1999 earthquake, and even more devastated by the IMF program imposed as the "solution" to the post-earthquake disaster, was ripe for the picking. But the targetting of Turkey also had geopolitical implications that the banking mavens of the London Club of the Isles were perfectly aware of, and anxious to exploit.

With the French political institutions torn apart by several high-profile corruption scandals, a targetted hit on the weak underbelly of Germany's banking system—its heavy exposure in Turkey—would create severe problems for the "core" of Euroland. Seventy percent of Europe's $54 billion in bank exposure in Turkey is held by German banks, led by Deutsche Bank, Dresdner Bank, Commerzbank, and HypoVereinsbank. What's more, there are an estimated 3 million Turkish guest workers and residents in Germany. Any social explosion inside Turkey has immediate, severe ramifications for Germany's political and social stability.

Britain must decide over the next six months whether to join the European single-currency system, which goes fully into operation on Jan. 1, 2002. The Brits do not wish to enter Euroland as late-comers and second-class players. By destabilizing the Franco-German power center of the continent, Britain retains the prospect of joining the European Monetary Union (EMU) as a "white knight" commanding a large share of power. Furthermore, if Britain decides to pass on euro-club membership, it will have even greater interest in seeing the continent weakened financially, economically, and politically.

The City of London geostrategists were deeply disturbed by the emerging "strategic partnership" between Germany and Russia, that was highlighted by last year's series of meetings between Russian President Vladimir Putin and German Chancellor Gerhard Schröder, where long-term energy-for-technology agreements were signed. Given President Putin's recent Eurasian diplomatic outreach to India, China, and the Koreas, the Russian moves to simultaneously integrate with continental Europe, via the traditional German partnership, pose an existential threat to Britain's global power games. It was precisely because of the emerging Eurasian Land-Bridge of the late-19th Century, which enjoyed American backing as well, that Britain's King Edward VII (formerly Prince Edward Albert) launched a series of destabilizations, that ultimately triggered World War I. The parallels to the current situation could not be more evident.

The fear of a new continental Eurasian alliance was acknowledged explicitly on July 31, 1999, when the prestigious London *Economist* magazine, in a special feature on "The New Geopolitics," wrote that "the part of the globe to keep your eye on is Eurasia. The great stretch of land between Brest and Vladivostock is where the interests of all the big powers will chiefly rub up against each other. Here is where the front line will run, not in Africa, or the Americas, or the South Pacific." A year later, in June 2000, Oxford University sponsored a closed-door event, co-sponsored by the Britannia Naval War College, to revive the "Great Game" Central Asian geopolitical doctrines of Sir Halford Mackinder.

From this British geopolitical standpoint, the attack on Turkey's currency and markets also had the added benefit of spreading crisis into Russia and Central Asia. The impact on Russia's stock market was already noted. Turkey and Russia are months away from opening a major natural gas pipeline, Blue Stream, which will establish a new level of energy cooperation and integration between the two 19th-Century rivals. In January, Turkey entered a joint naval agreement with Russia, Ukraine, Georgia, Romania, and Bulgaria, to protect tanker traffic on the Black Sea and to ensure the security of the Blue Stream pipeline. The treaty is scheduled to be formally signed this month in Ankara.