

Depression Is Hitting All The G-7 Economies

by Lothar Komp

“World On Verge of Depression,” the Nikkei Press headline for Oct. 7, was a dramatic statement for the financial press, but already out of date. That weekend the Group of Seven Finance Ministers met in Washington under strong, public pressure from the International Monetary Fund and Federal Reserve to cut, cut, cut interest rates, pump new liquidity from every central bank, and buy dollars in desperation to hold off collapse of the world’s reserve currency.

In earlier times, the cut of interest rates by a leading central bank was somehow an extraordinary event. On the stock markets, it would be celebrated with frenetic buying. And businessmen were expected to take advantage of the lower financing costs, and crank up their investment plans, creating new jobs. Within one or at most two quarters, according to the rule of thumb, a cut in interest rates was supposed to lend the economy new impetus.

This time, everything seems to be quite different. On Oct. 2, the Federal Reserve, for the ninth time this year, lowered its key interest rates. Almost all of these interest rate cuts were “double portions,” in that they were a half-percent, not just a quarter. Thereby, the interbank overnight rate dropped to the lowest level since the Cuban missile crisis of 1962, and the Fed’s discount rate for emergency credits to commercial banks was down to 2%, the lowest level in 43 years.

Nine months have passed since this unprecedented round of interest-rate lowering was introduced. On top of this, the U.S. administration promised huge tax cuts and already paid out \$40 billion in refunds to households. Regardless, the downward spiral of the economy has only gained in speed.

Even prior to the Sept. 11 attacks, U.S. consumer confidence had hit its lowest point in 11 years. Industrial capacity

in August reached its lowest point in 18 years. And there have never been so many employees laid off in nine years, as in the month of September. The dynamic of worldwide economic decline leaves only one conclusion to be drawn: We are not dealing this time with a cyclical recession, but with a self-aggravating crash dynamic. For the first time in more than 70 years, the world economy is tumbling into a depression.

U.S. ‘Stimulus’ Failed In Japan

Now, the new stimulus packages in the United States are supposed to breathe new life into the economy. On Oct. 3, President Bush reckoned the dimensions of the first such package at \$60-75 billion, in addition to the \$40 billion voted up after Sept. 11 for fighting terrorism, and for rescue and cleanup operations, as well as the \$15 billion for the airline industry. The expected, drastic increase in defense expenditures is not contained in these figures. And in addition, there are the \$110 billion in planned tax cuts for the fiscal year which has just begun.

Good evidence, to show how ineffective even a dozen such stimulus packages of this type are, in the absence of a thorough “Chapter 11” bankruptcy reform of the rotten financial substructures, is provided by the example of Japan. Eleven years have passed since the speculative bubble burst there, in which the government and the Bank of Japan, the central bank, pumped trillion-dollar figures into banks and the economy. Despite this, the Japanese banks are more bankrupt today than they were 11 years ago, even though they are not allowed to formally announce it.

According to the Tankan report issued by the Bank of

Japan on Sept. 28, the collapse of the economy, officially characterized as “recession,” was further aggravated in the last quarter. An analyst at the Japan department of the British bank HSBC commented: “This is no longer a recession, it is a depression.” The Japanese stock market, after 11 years, is still falling further, and market values have reached one-fourth what they were in 1990.

In Western Europe as well, the direction is downhill, and not only on the stock markets. In the first eight months of the year, 270,000 jobs have been lost in big companies in the European Union. The indices for business climate in Germany, France, Great Britain and Italy are at their lowest levels in 3-5 years. In September, the Reuters purchasing managers index, which measures industrial activity in the euro-zone, the countries using the single European currency, fell for the sixth month in a row. Particularly hard hit were Germany, Spain, France, and Italy, where the index reached its lowest point since it was established in June 1997. Indicative of the economic activity in all of Europe, are also the new orders for the German machine-building sector: Orders have been falling since February, and in August they dropped by 21%, with an 11% fall in domestic orders, and 28%, from abroad.

Entire Economic Sectors Crumble

What is characteristic for the worldwide downward economic spiral, is that, with every new wave of disaster, another sector starts to disintegrate, and is hit by mass layoffs or bankruptcies. In the beginning, in Spring last year, it was the highly praised “tech” sectors, which dropped from one day to the next, from euphoria into depression. The telecom sector played a leading role in this, once the New Economy illusions vaporized and the incredible telecom debt mountains were suddenly recognized as a problem.

The ensuing dramatic breakdown of investment activity of the biggest telecom companies terribly hit the telecom equipment producers. John Chambers, head of the market leader Cisco, described it as a “flood of the century,” and the biggest crisis “that we have ever seen.” The meltdown in this sector continues unabated. On Oct. 2, Nortel Networks announced, that, in addition to the 30,000 layoffs decided in Spring, that it would fire another 20,000, thus halving its workforce since the beginning of the year. The formerly showcase company Lucent Technologies, has also eliminated 50,000 of its 100,000 jobs this year.

The chip sector is also going through the greatest crisis of its existence. New horror announcements were regular agenda items in August and September, particularly with memory chips.

Infineon fired 5,000 workers, cut investments and announced short work. As a result of the collapse in demand, prices for 128-megabyte DRAM chips fell to less than \$2, whereas production costs at Infineon were \$7. Infineon stocks, since July, have lost further two-thirds of their value, and there is no relief in sight; the specter of insolvency is on the

horizon for next year. Competitor Micron Technology in the United States, reported a drop in sales for the third quarter, in the order of 79% compared to last year. Hynix in South Korea, another leading representative of the sector, would have declared bankruptcy long ago, had the government and banks not rushed in with a bailout package.

In August, worldwide, chip turnover was 42% below that of the previous year, and the collapse was even worse in the memory chip segment.

Now, it is the airline industry that is being hit. The crisis in the U.S. airline industry had begun quite a while ago, but since Sept. 11, the sector is in free fall. Within two weeks U.S. airline companies announced 100,000 layoffs. In Europe and Asia, the same game is starting: British Air lays off 5,000, Dutch KLM fires 2,500 and puts another 12,000 employees on short work. From the United States, to New Zealand, Switzerland, South Korea, and Belgium, governments are being forced to come to the aid of their threatened airlines, something which at least in the case of the first three nations, would have been unthinkable.

Despite this, a wave of bankruptcies is inevitable. The London *Financial Times* is calling for the “culling” of the European airline industry, whereby only a handful would survive of the three dozen or so that now exist. The bankruptcy of SwissAir unleashed a chain reaction among branches in Belgium, France, and Germany.

SwissAir: Is Anything Too Big To Fail?

From another point of view, as well, the collapse of SwissAir is very important. It is not only, as the Swiss media say, a matter of “the biggest bankruptcy case in Swiss financial history,” but also the first case of state intervention in favor of a Swiss private company, since the Second World War.

The banks, UBS and Crédit Suisse, had declared their willingness to take over two-thirds of the airline operations of SwissAir, but they did not want to have anything to do with the mountain of debt which has built up, through SwissAir’s international takeovers in the past years. Thus, SwissAir had to declare a debt moratorium on most of its 17 billion Swiss francs debt. From then on, SwissAir had to pre-pay for all of its jet fuel. When the banks stubbornly refused to approve a bridge loan for these purchases, the government had to advance the fuel money.

Innumerable shareholders or bondholders of SwissAir have lost a fortune in the bankruptcy. Once above SFr 500, SwissAir stocks were trading for SFr 41 on Friday, Sept. 28; then, after trading in the firm re-opened on Oct. 3, they crash-landed at a bit more than one Swiss franc.

The depression, meanwhile, is moving ahead, looking for new victims. Leading candidates are insurance companies, banks, and the automobile sector. If the flagship airline of the most serious financial center of the world bites the dust, is there any bankruptcy of any firm that still seems impossible?