

Global Lending Shuts Down; Banking Media Blame Sept. 11

by Kathy Wolfe

“The flow of private capital from the U.S., Japan, and Europe to developing nations has effectively been suspended since Sept. 11,” *Nihon Keizai News*, Tokyo’s top financial paper, reported on Oct. 29. The editorial called it “the biggest disruption of capital flows since September 1998,” when Russian bonds and the giant Long Term Capital Management hedge fund crashed, nearly melting down world markets. “What is particularly worrisome is the lack of visible support,” *Nikkei* adds, from New York and Washington. In 1998, the Treasury, Federal Reserve, and Wall Street mobilized world finance ministers and central banks, they say — but not today.

In fact, there is a credit crunch for borrowers around the globe, the latest stage of the collapse of the International Monetary Fund (IMF) system. This crunch is also hitting the United States and Europe, with all but top-rated corporations being refused capital, Robert Samuelson reported in the Oct. 31 *Wall Street Journal*.

Pundits in the financial press blame the Sept. 11 attacks for shutting down world trade, slashing the income of Asian and other Third World exporters, and Western companies alike, and “red-lining” them from lending or investment. The actual story, however, is different.

The worldwide credit crunch is real, and deadly, *but it is not new — and it’s a fraud to blame Arab terrorists*. Here, the real terrorists are the Wall Street and London banks, which were closing off credit well before Sept. 11, and are now using the attacks as their excuse. The Institute for International Finance (IIF), cartel of the world’s top banks, issued a “policy letter” on Sept. 20, warning that they have halted Third World lending, which “is at its most sobering level since the difficult years of the debt crises in the 1980s,” when \$250 billion in loans to Argentina, Brazil, and Mexico went bust.

The letter, backed by a statistical report, announces that there will be a *net drain of \$22 billion in credit outflow from the Less Developed Countries (LDCs) to the international banks and financial markets, during 2001*. It blames Sept. 11, saying the attack “significantly increased risk aversion and reduced investor appetite for emerging market assets.”

Malice Aforethought

But when questioned, IIF officials admit that Anglo-American banks began slashing LDC credits much earlier. “It was our policy decision,” an IIF official said on Nov. 1. “We projected a major lending decline for 2001, when we did our statistics in August. We rechecked the numbers on Sept. 17, but our projections from before Sept. 11 were on target.” And now? “During October, the decline has continued pretty much as we predicted.”

The IIF, also known as the “Ditchley creditors cartel,” was created at London’s Ditchley Foundation in 1982 during the Ibero-American “debt bomb” crisis, by Morgan Bank, Citibank, Hongkong and Shanghai Bank, and other megabanks, and has largely controlled world lending since.

This announcement by the bank cartel is a backhanded admission of *EIR* Founding Editor Lyndon LaRouche’s charge, that leading Anglo-American financiers had a calculated use for the Sept. 11 attacks on the United States. “This monetary and financial crisis has been foreseen,” as LaRouche told a Rome seminar on Oct. 16 (*EIR*, Nov. 9, 2001). The Anglo-American banks have run the world like “a special kind of Roman Empire” and their system “is now disintegrating. . . . You have an Anglo-American rentier-financier imperial power, which is threatened with the extinction of *its* system.”

Their problem, he said, is that *sovereign nation-states still exist*. In a financial collapse, “the sovereign state must intervene, in collaboration with other sovereign states, to reorganize the financial system to ensure the protection of the general welfare. . . . Thus, the modern nation-state, in this form, is the greatest enemy of the attempt to create a new empire,” LaRouche said, and “the enemy is well aware of this.” Thus, certain financial circles inside the U.S. would back an attempted coup d’état against the U.S. nation-state, as LaRouche has termed the Sept. 11 attack.

Reverse Blood Transfusion

In fact, under the bank cartel policy, the net drain from the Third World began in early 2001, well before Sept. 11. The Oct. 29 report “International Consolidated Banking Statistics” by the Bank for International Settlements (BIS), gives quarterly figures for 2001 which were obscured by the IIF report. It shows that global bank loans outstanding to LDCs fell from \$873.8 billion at the end of 2000, to \$855.8 billion in March 2001, and \$828.8 at end June 2001 — i.e., \$45 billion was “repaid” in the first half.

Over 50% of it was sucked from Asia; loans to Asia dropped by \$24 billion, from \$279 to \$255 billion in the first half. “The most notable changes were in Korea, where [local] banks paid back substantial amounts (over \$6 billion), and China,” the BIS reports, where Chinese banks repaid net over \$4 billion. Even starving Indonesia repaid over \$3 billion net to foreign banks.

Actually, Asia has suffered a continuous net lending drain since the “Asia Crisis” began in 1997—despite the International Monetary Fund’s claim to have “solved” that crisis. BIS figures show that from December 1997 to June 2001, international bank, bond, and money-market credits to Asia have been repaid, net, at a rate of \$30 to \$90 billion per year, a total *net drain* of over \$200 billion (**Figure 1**). The IIF’s Sept. 20 “Capital Flows To Emerging Market Economies,” which excludes some short-term credit swings, shows a similar pattern of a net \$140 billion in credit *out* of Asia in the same period.

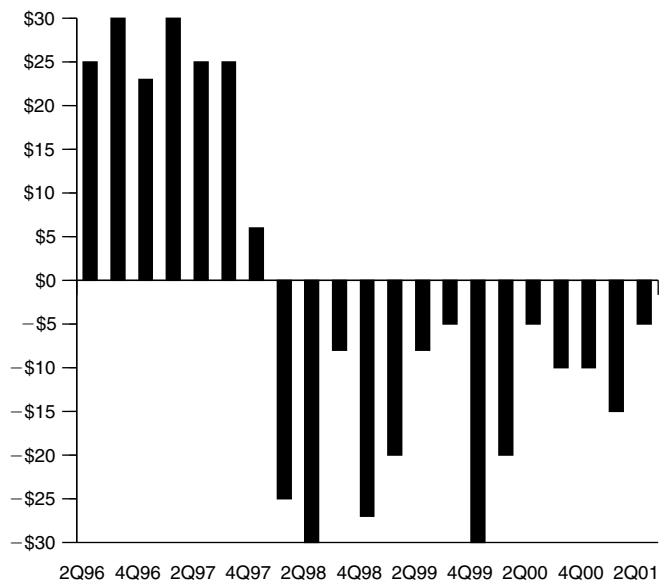
The IIF report uses Sept. 11, again, as the excuse for the collapse in the U.S. market for Third World exports, although that collapse was also under way by early 2001. IIF predicts a flat 2% net drop in total LDC exports to the United States in 2001, year-on-year (dollar value), compared with a 22% rise in 2000. They project exports from Asia in 2001 to drop by 5.3%, featuring a 15% drop for South Korea. These estimates, if anything, are too optimistic.

This collapse of exports to the United States is serving as a trigger for “red-lining” the Third World exporting countries from loans, and pulling out investments.

This year, Asia will suffer another net outflow of \$21 billion in loans and bond credit, IIF reports. South Korea, Indonesia, Malaysia, Thailand, and the Philippines combined will suffer almost \$12 billion of this outflow, most of it during the fourth quarter this year.

FIGURE 1
Bank, Bond, And Money Market Credit To Asian ‘Emerging Economies’

(Billions \$ Per Quarter)



Source: BIS Quarterly Review, September 2001, Sept. 10, 2001.

Worse, many currencies are worth so much less than when the money was originally borrowed, that the true cost to the Asian borrower in his currency may be twice to ten times as high, depending on the country.

This has been the equivalent of a reverse blood transfusion out of the world’s most populous area, and the BIS numbers also show where much of it went: to bail out Wall Street. During the 1997-March 2001 period, moving in the opposite direction, like a mirror reflection, as credit left Asia, the huge bubble of credit expansion to Wall Street and the U.S. corporate sector has been a major beneficiary (**Figure 2**).

Bringing the ‘Asia Crisis’ Home

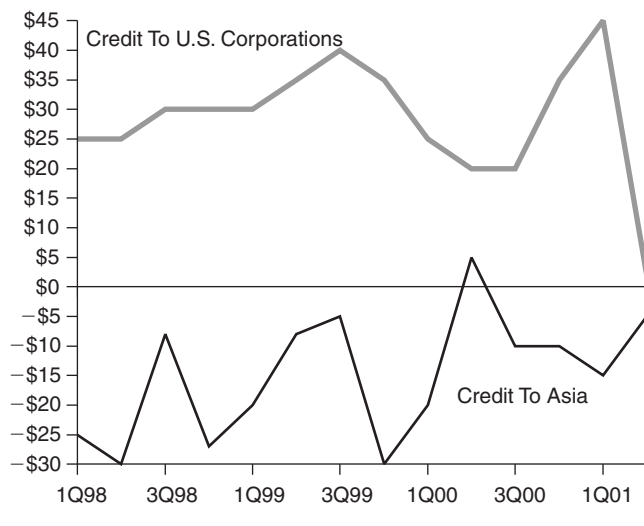
But now it’s the American economy’s turn to feel the credit freeze. Already during the second quarter of 2001, U.S. and European banks’ lending to European corporations dried up. In that quarter, credit outstanding to firms in the five biggest continental European economies fell by about \$50 billion, or about 3.5%. The drop in lending to Japanese corporations at the same time was just over 4%. Lending to U.S. corporations dropped sharply in the second quarter, too (again, Figure 2), but did proceed, while mortgages and consumer credit expanded.

Under cover of the smoke from Sept. 11, however, the Anglo-American financiers are now bringing the crisis back

FIGURE 2

Bank Credits To U.S. Private Non-Bank Corporations vs. Bank Credit To Asian 'Emerging Economies'

(Billions \$ Per Quarter)



Source: BIS International Consolidated Banking Statistics, Second Quarter 2001, Oct. 29, 2001.

home, turning the Great Credit Vacuum Cleaner on the United States itself. Central bank and inter-bank interest rates in New York, London, and Tokyo may now all have been cut virtually to zero; broad money supply may be increasing at unprecedented rates (21% annually in the United States, 12% in Japan at last measure); but banks still *will not lend*, to corporations with collapsed sales and/or volumes of unpayable debt to write off.

This has reached its extreme in Asia, where non-performing loans (NPLs) are now put at over \$2 trillion (about 30% of the region's GDP) by the Ernst and Young Asia Pacific Financial Solutions Group report—which adds that even international capital willing to buy these bad loans at pennies on the dollar, is now drying up. But the deadly “inability to lend” has now struck the U.S. economy as well. The nearly \$2 trillion in U.S. consumer credit, and the more than \$5 trillion in U.S. corporate debt, are now equally unpayable. As Asians have had to repay credit, parts of the U.S. economy will now be asked to do so. *It can't work, but it can be painful.*

The “credit pinch” to the dot-com and related sectors that began earlier this year has intensified since Sept. 11, the *Wall Street Journal* reported on Oct. 29, and now “all but the highest-rated corporate borrowers” are finding the financial spigot cut off. New syndicated bank loans to the U.S. corporate sector are down 56% since Sept. 11, while 2001 has become the slowest year for new companies going public with initial

public offerings (IPOs) since 1994. Junk-bond sales are down 60%. Erstwhile blue chip companies such as AT&T have had ratings downgraded by Moody's during October from “Prime-1” to “Prime-2,” making it more difficult for them to borrow via bonds and commercial paper. Even the top-rated blue-chips are having to pay higher rates.

In “Revenge of the Credit Cycle,” a *Washington Post* op-ed on Oct. 31, commentator Robert Samuelson misses the fact that the entire system is going under, but does report on the credit squeeze's latest effects:

- Banks have toughened approval standards for commercial and industrial loans to businesses.
- Loans to businesses rated “doubtful” or “substandard” are now 15% of all business loans, up from 9% of all such loans last year.
- U.S. companies have defaulted, so far in 2001, on \$76 billion worth of bonds, 55% higher than the \$49 billion in bond defaults for all of 2000.
- A rising share of cash flow is going to interest payments on all types of corporate debt, reaching 28% this year, compared with 20% in 1996.

Business investment in the United States fell 14.6% in the second quarter (below the second quarter of 2000), and 11.9% in the third quarter, according to the Commerce Department. The decline in trade was even more drastic: Imports of goods and services in the third quarter were 15.2% below one year earlier, and exports 16.6% lower.

Standard & Poor's Managing Director Diane Vazza told a New York seminar on Nov. 2 that there has been a “record decline in global credit quality in the third quarter” during June–September this year, with 69 corporations having bonds downgraded from investment grade to “speculative.” Of those, eight were U.S. companies.

In fact, the Shared National Credit (SNC) review—issued on Oct. 5 by the Fed Board of Governors, Federal Deposit Insurance Corp., and Comptroller of the Currency—reports a “continued deterioration in the quality of syndicated bank loans, consistent with general economic, sectoral, and credit market trends,” just based on the results of this year's March to June second quarter. “The seasoning of many aggressively underwritten deals, particularly those credits booked in the latter half of the 1990s, has contributed to the increase in adversely rated credits,” the worried regulators report. “Deterioration has been particularly evident for credits to leveraged and speculative-grade borrowers that are facing difficulty generating sufficient cash flow to service their debts in the current environment.” This was clearly under way well before Sept. 11.

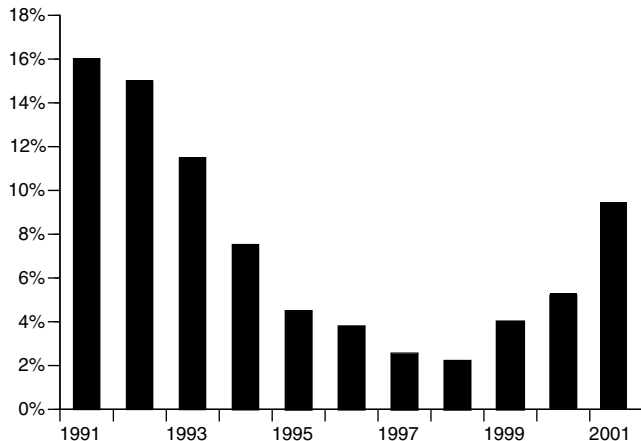
The SNC program monitors \$2.05 trillion in loans as of June 2001, and reports that “classified” (bad) loans, plus “special mention” loans (those nearly bad), were \$192.8 billion, 9.4% of the June total (**Figure 3** shows the pattern of the last decade).

All this, as the Fed is cutting interest rates. If unemployment in the United States jumped by over 700,000 during

FIGURE 3

U.S. Loans Adversely Rated As A Percent Of Total Loans

(Percent)

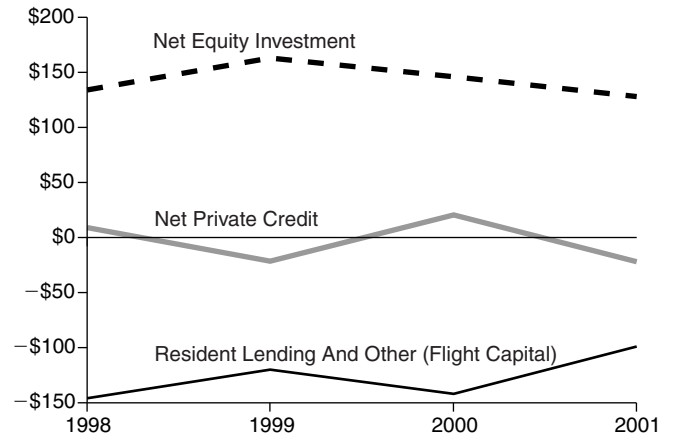


Source: Institute for International Finance, "Capital Flows To Emerging Markets," Sept. 20, 2001.

FIGURE 4

Emerging Market Economies' External Financing

(Billions \$)



Source: Institute for International Finance, "Capital Flows To Emerging Markets," Sept. 20, 2001.

October and the industrial sector has lost 1.3 million jobs since July 2000, consider what comes next.

Privatization vs. The Nation-State

Historically, most international or "cross-border" bank lending has been directly associated with the national sovereignty of the borrower, and known as "sovereign debt." Just as a bank loan in America used to mean a long-term relationship between the local banker and a farmer or other borrower, a bank loan to a country used to assume a long-term relation, such that it was in the bankers' interest that the country prosper over a 10- or 20-year time frame.

But during the 1982-85 Ibero-American "debt bomb" crisis, the IIF "creditors' cartel," at London meetings reported by *EIR* at the time, decided that such long-term relationships were too risky, and too unprofitable, because banks could also get stuck with very large bad loans. Among the many terms they dictated to borrowers, the cartel decreed that bank lending would be replaced by stock and bond buyouts.

As Alan Greenspan, then a partner at the Morgan Stanley investment bank, explained IIF strategy to this writer in a 1984 interview, bank lending would be "securitized." Sovereign nations, he said, would soon be a thing of the past, and sovereign loans thus obsolete. No longer would nations be treated as equal partners with banks via loans which stayed on a bank's balance sheet. From now on, countries desiring international funds would have to sell securities, mostly stock or bonds, to the global markets, giving the buyers *private ownership over some hard asset* such as a state oil company. Further, unlike loans, stocks and bonds are "fungible," easily

sold on the open market. This meant banks could charge a country a fee for marketing its stock, then sell the paper and walk away.

"Securitization" deals began in Brazil and other Ibero-American nations with large natural resources in the later 1980s, with banks making what looked like normal loans, but demanding that some sort of "hard-commodity" income stream be written into the loan contract as attachable, such as the revenue from the state electricity company. By the early 1990s, Third World countries generally had to pay much higher interest on loans, than on issuing bonds or stock, such that the "choice" was increasingly being dictated by "the market." Mexico's near-default in 1994, the 1997-99 "Asia Crisis," and the 1998 crash of the Russian debt helped the banks make their argument: We don't like "sovereign loans."

By September 2000, the IIF was able to write a letter to world governments warning that "fundamental changes in the volume and structure of private capital flows to emerging markets" have been made "since the beginning of the 1990s," such that borrowing nations will now need "new approaches to managing market access. . . . [G]reater focus on (stock and bond) underwriting, asset management, and insurance-related products *has reduced the role of traditional balance-sheet lending* by banks. Reflecting the growth in the newer activities, non-interest [i.e., non-loan] income among U.S. banks increased 160% in the past five years, while net interest income [i.e., loan income] rose only 65%. . . .

"Commercial bank lending to emerging market economies is likely to account for less than 8% of private flows for 2001," the IIF was already forecasting *a full year before Sept.*

Argentine Default Brings Collapse A Step Closer

Call it what you will, Argentina has defaulted on its foreign debt. The country was brought to default by a long and painful policy of looting and destroying Argentines' living conditions—supposedly to generate debt payments and avoid default! Argentina's real foreign debt (including domestic debt denominated in dollars, and therefore really foreign debt) is approximately \$222 billion, making this the largest sovereign default in history.

President Fernando de la Rúa and his Finance Minister Domingo Cavallo are jabbering about the “voluntary” restructuring they announced in late October, to exchange \$95 billion in public debt bonds, bearing interest rates above 20%, for longer-term ones at rates of no more than 7%.

Combined with deeper austerity—Cavallo intends to shut down the entire federal government in December—the duo say they will save \$4-5 billion annually on interest

payments and thus be able to meet their foreign obligations.

Not a chance. In comments made Nov. 2, U.S. 2004 Presidential pre-candidate Lyndon LaRouche said the real story here, is that Wall Street and the Anglo-American financial vultures are doing the same thing with the Argentine “restructuring” that the U.S. Treasury tried to do the week before, when it announced it would stop issuing 30-year Treasury bonds. It's a desperate ploy to postpone a blowout. “It won't work in Argentina, and it won't work in the United States either,” LaRouche warned.

Even former Israeli Central Bank Governor Jacob Frenkel, now the president of Merrill Lynch International, who is advising Argentina on the restructuring plan, admits that while he wouldn't call the scheme compulsory, it really is a deal bondholders don't have the option of refusing. “If you have a tree that only grows fruit at the rate of 5%, the option of 10% is not feasible. So you take the 5% voluntarily,” he told London's *Financial Times*.

On Nov. 6, Standard & Poor's called the Argentine debt-swap plan a “selective default.” Fitch, Inc. followed suit, calling the plan a “default event,” and dropped ratings on Argentine bonds to junk bond status.—*Cynthia R. Rush*

11, 2001. “By contrast, commercial banks provided nearly two-thirds of private flows to these economies in the early 1980s. Emerging market [loan] exposures of U.S. banks, for example, dropped from 12% of assets at end 1982, to about 2.5% by March 2000.”

While bank loans (“cash you can use”) were being shut off, as described at the outset of this article, the IIF statistics show instead an enormous influx of equity investment (“we buy you”) from the banks into the Third World. **Figure 4** shows that equity in the Third World now dwarfs private credit such as bank loans. But note the line marked “Resident lending and other” in Figure 4. This “flight capital” is an outflow, back into global financial markets, as large as the equity inflow.

In the latest phase of the financial collapse, even equity sales are drying up, and prices for Third World equity are collapsing. Korea's giant Daewoo Motor Co., which would have sold for \$2 billion in 1997, brought under \$500 million in a recent sale to General Motors after GM waited three years for the stock to drop. “Many countries don't want to sell their industries at today's low prices,” a U.S. Treasury official told *EIR* in late October, “but we say, ‘Better to sell it now at 20¢ on the dollar, than later at 10¢ on the dollar,’ because the longer they wait, the less they will get.”

Even the IMF at a recent internal conference said it would ease up on its standard poison—pressuring nations to privatize all their national assets. The reason? There are no buyers now for these assets.

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