

Debt, Deflation, And Depression

by John Hoefle

For years, many in the Establishment, and their poodles in the press, insisted, in response to the warnings of Lyndon LaRouche, that “it can’t happen here.” Their head-in-the-sand mindset echoed the wishful thinking of Yale economics professor Irving Fisher, who just days before the 1929 stock-market crash, claimed that “stock prices have reached what looks like a permanently high plateau.”

Reality has a way of dealing with such axiomatic blindness, and the august Professor Fisher has become the punch line to a not-so-funny joke, in a harbinger of the future reputation of Federal Reserve chairman and chief bubble builder, Sir Alan Greenspan. Such fools are useful to the oligarchy before people catch on, but not after.

As we head into the third year of plunging down the backside of the stock-market bubble, with its visible evaporation of trillions of dollars of financial assets, it has become increasingly clear to the more erudite observers that the game is over, and that the aftermath will be bloody. The talk of returning to the prosperity of the past is increasingly giving way to expressions of fear about a future dominated by debt, deflation, and depression.

Derivatives a ‘Threat’

In contrast to the blathering of Lord “Greenspan” about the wonderful benefits of the derivatives markets—so beneficial, he insists, that the public is expected to bail them out (if they were so useful, would a bailout be necessary?)—the German central bank, the Bundesbank, has issued a report citing the dangers derivatives pose to the stability of the financial system.

The Bundesbank commentary, published in its January monthly report, cites the enormous risks of the over-the-counter (OTC) derivatives market, which is dominated by a handful of giant financial institutions such as J.P. Morgan Chase, whose gambling in the interest-rate and foreign-exchange markets dwarfs their business in loans and other traditional banking activities.

“In particular, the OTC derivatives trading” is posing a “possible risk for the stability of the financial system,” the Bundesbank states. “By far, the biggest part of OTC derivatives trading takes place between international banks and other financial institutions. More than half of all OTC transactions are being traded between 60 institutions, out of which

seven are German. In several segments, there are just a handful of actors which account for the majority of the total turnover.”

LaRouche has long warned about the dangers inherent in such a concentration of gambling bets, and the Bundesbank is clearly worried, too, citing the “possible consequences of the sudden collapse of an important marker of the stability of the financial system.”

There are “indications,” the report states, that the financial system might have enough liquidity to survive the “sudden dissolution” of the derivatives bets of a single large institution, but it is not clear what would happen were “several institutions” to go under at once. “Experience from September and October 1998 shows that under such circumstances, markets could soon reach the limits of their resistance capacity.”

‘Depression Looms’

Another serious warning was issued in the Danish daily *Politiken* on Jan. 18, under the headline “Depression Looms,” in which Copenhagen University economics professor Jakob B. Madsen warns that the global economy is in imminent danger of entering a real depression, with mass unemployment in the United States, Europe, and Japan. Madsen cites the similarities of the present period with 1929.

“I am very pessimistic,” Madsen stated. “There are very large imbalances in the global economy.” Citing in particular the large U.S. current-account deficit, he said that people could soon lose confidence in the U.S. economy, at which point “uncontrollable fluctuations could hit global stock and currency markets.” That, in turn, could trigger more mass unemployment worldwide, he said.

Madsen noted that the discrepancy between stock prices and corporate earnings had never been greater than they were in 2000, when the stock markets began their crash, and that just because they have been going down for three years, it doesn’t mean they can’t fall much farther. If so, he concludes, the stock-market crash could be the harbinger of depression, just as it was in 1929.

The specter of depression was also raised in the Jan. 20 issue of *Barron’s*, the weekly sister of the *Wall Street Journal*. In an article entitled “The Debt Bomb,” author Jonathan R. Laing cites “what may be the biggest bubble of them all—the huge ballooning of total debt in the U.S.,” noting that some observers “fear that this debt surge could be edging the U.S. economy toward the abyss of a bust—and then into depression.”

Citing the growing level of defaults and delinquencies, *Barron’s* notes that the debt is becoming an even greater burden as financial market asset-valuations deflate, and concludes that the only thing standing between the nation and “a detonation of the debt bomb,” is the sky-high residential home market. If the housing bubble blows, the whole thing goes.