Derivatives cancer claims more victims in Europe

by William Engdahl

On Dec. 17, the head of the Frankfurt-based non-ferrous metals manufacturer Metallgesellschaft AG, Heinz Schimmelbusch, was forced to resign along with the entire top management of the company's New York subsidiary, MG Corp., as a full-scale investigation into reported losses in the New York oil markets began to leak out. Then, on Dec. 28, Mario Conde and the entire board of directors of the fourth largest bank in Spain, Banco Español de Credito (Banesto), was fired and the bank seized by the Bank of Spain, as a run on deposits threatened collapse of the "entire Spanish banking system," according to central bank authorities.

The two events are linked, according to European banking reports, by the thread of off-balance-sheet speculation in financial derivatives, the new high-risk financial paper which is spreading across the global banking system at trillion-dollar multiples. Both events underscore the foolishness of recent remarks by leading European bank spokesmen such as Deutsche Bank's Rolf Breuer, who recently publicly urged German banks to go full-tilt into the growing international derivatives speculation. Deutsche Bank is the bank with the largest exposure to the Metallgesellschaft derivatives debacle.

Wild speculation encouraged

According to U.S. petroleum industry sources, MG Corp. in New York had established itself as the "preeminent" trader in U.S. financial markets, in what is said to be perhaps the highest-risk speculative investment today—10-year derivative contracts on domestic gasoline. It traded oil and gasoline futures on the New York NYMEX futures markets, whose rules require a trader to "settle up" or "meet a margin call" periodically at the end of each contract, typically 30 days.

"MG was careless, no, insane! They were, in effect, selling gasoline over a 10-year contract period at a guaranteed price," commented one U.S. oil industry source who asked not to be identified. "As long as the oil price inched up, they made a huge profit rolling over the derivatives into the future. The problem came when the bottom fell out of international oil prices this past summer. No one expected as sharp a fall. But MG got caught in a whipsaw, holding on in vain hopes that prices would rise again before the margin call date." The price of North Sea Brent crude oil fell 30% in the past year, and no end is yet in sight, according to industry estimates.

Industry reports are that MG's New York traders were encouraged by Schimmelbusch to try to make huge speculative profits in derivatives, in order to make up for large losses of Metallgesellschaft in its traditional metals and commodity trading. At a Jan. 5 Frankfurt meeting with its creditor banks, new Metallgesellschaft president Kajo Neukirchen stunned the banks by announcing revised estimates of group losses for the 12 months ending Sept. 30, 1993, at a staggering DM 1.9 billion ($1.2 billion). The estimate of Schimmelbusch last November had been DM 347 million. The company "is effectively now in the hands of the banks," noted one of the bankers present. But those losses do not yet count any of the huge New York derivatives losses, which may take weeks to sort out.

Metallgesellshaft's annual turnover is DM 26 billion, and it owns a number of subsidiary engineering and industrial companies, such as the Lurgi plant engineering group, whose future is now endangered by the speculative derivatives folly. Ironically, Schimmelbusch was given the German "Manager of the Year" award two years ago for his "aggressive non-German" management style.

But the problems of Metallgesellschaft also lie at the doorstep of its two largest shareholders and bank creditors, Deutsche Bank and Dresdner Bank, Germany's two largest

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banks. Within days of the late November margin call, the two banks rushed to inject a reported DM 2 billion into the company, and Deutsche Bank Chairman Hilmar Kopper issued reassuring comments that the losses were not "life-threatening." Subsequent events confirm that the real situation may be otherwise. A planned meeting between bank creditors and Metallgesellschaft's new board was suddenly moved up 10 days to Jan. 5, as the urgency of the situation turned out greater than originally thought.

Some U.S. oil industry estimates say that Metallgesellschaft's ultimate loss liability on its oil derivatives gambling may reach "potentially to $10 billion," in a worst-case scenario, but certainly huge by any account. Deutsche Bank called one of the top oil derivatives specialists, Morgan Stanley's Nancy Kropp, out of retirement last month to help wind down MG's huge derivatives exposure as rapidly and cheaply as possible. Early estimates leaking out in the financial press are that MG losses in derivatives may force the elimination of 20,000 of the group's 53,000 jobs worldwide, most in Germany—that is, if the company survives at all. Metallgesellschaft stock shares were suspended from trading on Frankfurt's stock exchange as of Jan. 6.

J.P. Morgan 'irreparably harmed'

The collapse of Spain's large Banesto bank, coming only days after the shock of the Metallgesellschaft debacle, has created a significant shift of mood among international banks and financial fund managers, according to reports from leading European bankers. But the affair is clearly far more than a simple "Spanish" bank problem. Banesto involves the most respected ultra-conservative American bank, J.P. Morgan and Co. Morgan had come into the picture several years ago as financial adviser to the troubled Banesto. Last summer, Morgan gave its seal of approval to a new stock issue by Banesto, and invested $17.5 million of its own money through a fund, Corsair Fund, that Morgan manages, and another $175 million from its clients and various American pension funds which had relied on Morgan to make sound long-term investments. For its "help," Banesto's board gave Morgan Vice Chairman Roberto Mendoza a seat on Banesto's board of directors.

But the real dimensions of the Banesto debacle, as is that of Metallgesellschaft, are shrouded in secrecy, and reportedly also involve what one knowledgeable banking source termed "huge derivatives exposures." According to these reports, J.P. Morgan in New York, through its then-director of corporate finance, Violy de Harper, had built a strong position inside the booming Mexican financial markets over the past several years, at the same time that the same De Harper built up Morgan's position inside the "booming" Spanish market via Banesto.

"It is rumored that Morgan virtually ran all key decisions at Banesto in the past months," said one source. "Look at the role of Morgan in issuing Eurobond financing to large Mexican companies like Cemex in order to buy large cement companies in Spain. Then look how much of these Mexican bonds Banesto is now holding." According to this unverified account, Morgan had constructed an elaborate international "triangle" between New York, Mexico, and Spain.

"The Banesto affair has done irreparable damage to the name of J.P. Morgan," City of London bond dealer S.J. Lewis told *EIR*. "This is far more damaging than damage to Banesto per se." That Morgan's role is far more than it is yet willing to admit, and perhaps as extreme as the above report hints, is indicated by the bizarre actions of Mendoza and Morgan's chairman, Sir Dennis Weatherstone, who pleaded with the Bank of Spain as late as Dec. 28, the day the bank was seized, that Banesto not be nationalized. Ironically, in light of the reports of huge derivatives exposure by Banesto, J.P. Morgan and Co. lent its prestige to a blue ribbon committee of the Washington-based Group of Thirty in July 1993, called the "G-30 Derivatives Project." The chairman of that study was Morgan's Weatherstone, and the report whitewashed any danger from the multitrillion-dollar international bank derivatives exposure. Represented on that working group, as well as co-financing the study, were Deutsche and Dresdner banks.

The crises in Banesto and Metallgesellschaft are the loudest warnings yet as to the danger of a spreading international collapse of confidence in financial markets. "The derivatives have become so complex in the past months that no one often knows which bank, say, Banesto, might be responsible for payment of a given derivative, especially if it is for a 5- or 10-year term," noted Lewis. "This is what is really frightening everyone. Now everyone will draw in their horns, be more cautious, and the effect will be that the international financial system becomes highly illiquid. It is not yet clear whether MG or Banesto have triggered it, but we can say the risk is today quite substantial of triggering such an international collapse feared by [Bank for International Settlements head] Lamfalussy and others."

LaRouche's warnings unheeded

On Jan. 3, Lyndon LaRouche stressed, "If we were in a *cyclical* monetary disorder, we would treat the combined collapse of the creditworthiness of Metallgesellschaft in Germany and Banesto bank in Spain as something equivalent on an international scale to the October 1987 crisis in the New York financial market. However," LaRouche added, "we are not in a *cyclical* process, but in a *systemic decline*." He stressed that the real effects of both disasters will take months before they are realized, something potentially far worse than a normal cyclical downturn, and that the longer-term impact depends fully on political factors. "If the political process breaks down, then we can have an almost immediate chain reaction throughout the international monetary system. Both crises were caused by exposure to the international derivatives trading out of New York and London, the result today of the failure of institutions to act upon the derivatives crisis three to six months ago."