Warnings of 'Grim October' Multiply

Since the Sept. 22 near-meltdown of world financial markets, temporarily stopped by the sudden intervention of the biggest central banks in the world that afternoon, new warnings have proliferated of an imminent dollar crash. The sources of the alarms range from Bank of Japan officials to mass-circulation newspapers in Europe.

Most notable was a letter sent by the world's top banks represented in the Institute for International Finance (IIF), to world finance ministers, warning of a "sharp fall" in the dollar unless impossible new levels of austerity are implemented via "increasing reforms."

Sept. 23: Ditchley bankers warn of dollar crash. IIF Managing Director Charles Dallara sent a formal warning letter to the world's finance ministers and central bank chiefs at the International Monetary Fund meeting in Prague, the Czech Republic. The warning was co-authored by Sir John Bond, chairman of Dope, Inc.'s Hongkong and Shanghai Bank and chairman of the IIF, on behalf of the 315 major banks which make up the IIF.

The letter warns of a "sharp fall" of the dollar, and says, "G-7 governments should signal their readiness to adjust policies in response to any incipient signs of a hard landing in the U.S. economy. . . . A sharp fall in activity associated with abrupt exchange rate changes or significant asset price corrections remains a risk, in light of the outsized U.S. current account deficit and the prospect of further earnings disappointments. . . .

"The concerns about the U.S. current account position are underscored by the increasing dependence on foreign equity inflows for financing a deficit on the order of $450 billion this year and next. In the first half of this year, portfolio equity investment alone amounted to $87 billion, equivalent to 42% of the deficit during that period. Policymakers should be prepared for the contingency of a reversal or even of a significant slowdown of these funds and a consequent fall of the dollar."

Sept. 23: On Friday, Sept. 22, the world was close to a "stock market crash of incalculable dimensions, followed by tectonic clashes on international foreign exchange markets," stated the German financial daily *Frankfurter Allgemeine Zeitung* on Sept. 23. That was the main reason, the daily quotes unnamed financial strategists as saying, that the leading central bankers acted together to push up the euro on Sept. 22. After the Intel profit warning on Sept. 21, the chain reaction of stock market plunges already was in full motion on Friday morning in Asia, and then in Europe. Therefore, the central bankers had to act immediately. In addition, the U.S. government announced the release of 30 million barrels of crude oil from its strategic reserves. After all, says the daily, the very least thing the U.S. administration wants to see before the Presidential elections on Nov. 7 is a "Black October" on stock markets.

However, the futures outlook on stock markets, despite these actions on Friday, still looks rather grim, states the daily. With their Sept. 22 intervention, the central bankers have publicly committed themselves to intervene again and again, whenever the euro starts to sink. If they don't, "the foreign exchange markets could turn into a madhouse." But even if they do, and are successful, there is a real danger that they set into motion an extended downfall of the U.S. dollar, which would be a bad omen for future trends on Wall Street, where the "miraculous money-multiplying machine has, for quite some time, been being fed decisively by flight capital from the euro zone and Japan."

Sept. 28: Bank of Japan warns that "non-linear reverse leverage could evaporate" world markets. Deputy Bank of Japan Governor Yutaka Yamaguchi, speaking at the Sept. 28-29 conference on "Recent Developments in Financial Systems and Their Challenges for Economic Policy," hosted by the Bundesbank and the Bank for International Settlements in Frankfurt, at first appeared to praise "the development of financial technology such as derivatives and securitization" for increasing world market liquidity. But he concluded that these and galloping bank deregulation could produce a "reverse leverage" which could "evaporate" the markets.

"Technological innovation and globalization might have had a tendency to amplify such crises. . . . Stress will not only affect the country in which it emerges initially, for example, Thailand in the case of the Asian crisis, but also be transmitted immediately to markets in other countries. Stress will not only be transmitted to those countries perceived to have similar economic structures, but also could significantly affect markets, which are not directly related to the stress, through the global adjustment of highly leveraged positions.

"Thus, once a financial crisis occurs, the depth and liquidity of globalized financial transactions that should absorb the shock immediately disappear. While it is true that high leverage contributes to improving efficiency as long as forecasts turn out to be accurate and the financial system is smoothly operating, once an unexpected shock hits the market and profit opportunities are lost, a sudden reversal of prices could occur through position rebalancing and leverage rewinding."

Sept. 30: London *Economist* says dollar is overvalued. The City of London mouthpiece wrote, "Many economists think the dollar is overvalued, and vulnerable, because of America's huge and growing current account deficit. Market sentiment can change very quickly. Rather than worry about a weak euro, Mr. Summers might do well to contemplate

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the real possibility of a weak dollar. It may be closer than he thinks."

Oct. 1: Former German Finance Minister Oskar Lafontaine says, "The next crisis is inherent in the system." LaFontaine told the *Frankfurter Allgemeine Zeitung,* "It was possible to avert the collapse of the LTCM [Long Term Capital Management] hedge fund two years ago at the last minute. But the next crisis will come because it is inherent in the system.

"Yet, the American President is concerned about Wall Street, and the British Prime Minister about the City of London. Thus, all proposals for the stabilization of the world financial markets have failed, because of the approach . . . [of] the U.S. government and the British government. They believe they must protect the short-sighted interests of their banks and speculators. . . . Exchange rates must be stabilized, and short-term capital flow must be regulated again."

Oct. 1: *Stern* magazine cover story: "When Will the Stock Market Bubble Burst?" Reporting on the recent speculative boom, the cover story poses the question, whether "such stock value gains are normal," or whether they are rather evidence of the fact "that a dangerous, speculative bubble has emerged at the exchange."

"As a matter of fact, you only know that afterwards—when the bubble has burst. As in Japan, which at the beginning of the 1980s lost 70% of the stock value of its economy in virtually no time. An elimination of property, from which the country has not recovered, to this day."

The *Stern* story mentions warnings of a bubble crash by Bundesbank Gov. Ernst Welteke, by Deutsche Bank, by HSBC Trinkaus & Burkhardt, among others, in recent days. The story also says that the term "casino," which at least implies some rules that have to be observed, is no longer appropriate for a description of what is going on at the markets right now: Sheer gossiping is what is determining the ups and downs these days. Or, as German economist Leonhard Knoll is quoted as saying about the traders: "All of them should be declared incompetent to carry out their own affairs."

Oct. 2: Economist Robert Samuelson: "The U.S. is not immune to this disruptive process." Writing in *Newsweek,,* Samuelson warned that "unpredictable capital flows loom as a constant threat," and that "the U.S. is not immune to this disruptive process. The flows that now favor America could slacken or reverse. . . . Last year foreigners bought $332 billion in U.S. stocks and bonds, and spent $276 billion on direct investment in the U.S. Foreigners now own $1.4 trillion (7%) of U.S. stocks, $900 billion (20%) of corporate bonds, $1.2 trillion (35%) of Federal debt, and about $1.2 trillion of direct investment. . . . In 2000, the U.S. current account deficit will exceed $400 billion. This is a modern record.

"Why worry? Capital flight is a grim phrase that Americans associate only with corrupt Third World countries or creaky Europe. But it could happen here. Foreigners could slow new U.S. investments, or even withdraw funds. Market moods and exchange rates can shift abruptly. Capital outflows could worsen a stock slump. Confidence would decline in the U.S. The magnitude of capital inflows into the U.S. ought to give us pause. . . . Hardly anyone understands today's rapidly changing global finance. Even for the U.S., what goes around could come around."

Oct. 2: The London *Guardian* warns of crash, caused by United States consumer credit bubble. In its lead economic editorial, the daily wrote that "the dramatic events in the world economy during the past two weeks may have lulled governments into a false sense of security."

Everything looks fine, after that intervention on the oil prices and the euro, but the plunge protection team forgot one thing, the *Guardian* noted: "What they didn't do was to address the biggest single economic problem of them all—the prospect of a hard landing for the U.S. economy."

Many experts believe in the "miracle economy" of the United States, based on the alleged productivity boost through the U.S. pioneering exploitation of technologies related to the Internet. "The less fashionable view is that the U.S. expansion has been driven by an unsustainable consumer binge, financed by credit and shares, that has drained consumers of all their savings and led to a massive $400 billion deficit on the current account of the balance of payments. The alarm bells are already starting to ring amid fears about what could happen if the U.S. stock market boom—which has encouraged people to draw down their savings—suddenly goes into reverse thrust," the *Guardian* wrote, referencing another article on the same subject, published in the latest issue of *BusinessWeek*.

The *Guardian* concluded: "The case against the Cassandras is that they have been warning about an imminent U.S. collapse for so long that they are being treated like the boy who cried wolf. But this doesn't alter the fact that, once confidence flags, the doomsday scenario could happen—and if it does, there will be plenty of people pontificating about how inevitable it all was.

"The last thing that the Democratic government will admit in the closing weeks of a Presidential campaign is that the almighty dollar ought to be devalued back to reality. That's why the U.S. contribution to last week's currency intervention was so modest. But the incoming President may have to deal with a totally different scenario. He had better have a contingency plan in his brief case."

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