World Capitalist Markets Collapse As Dollar Sucks Up Liquidity

by David Goldman

July 26 (IPS) — The world's capital markets now look like an old mattress, where a spring forced back into place provokes the spring next to it to pop up. A shifting wave of illiquidity has overtaken the U.S., West German, British, Italian, and Japanese money markets, in a general outbreak of symptoms of the crisis detailed in this column during the past week.

A renewed and unprecedented wave of collapse this week on the West German bond markets, during which the German central bank bought up an astonishing DM 1.4 billion (about $600 million) in dumped bonds, has done more than threaten German cities, states, and Federal railroads, who depend on this market for operating funds. In an emergency decision, the Federal Bank this week suspended foreign bond market lending, which amounted to DM 3.6 billion during the first five months of this year. Of this figure, Japan was the principal beneficiary.

On the same day that the Germans clamped down on foreign lending, the Japanese government announced that it would have to borrow $17 billion on its own bond markets to compensate for tax revenues flattened by the 25 per cent falloff of Japanese exports. During the first months of this year, Japan's internal credit structure drew on only one outside source, roughly $500 million of incoming credits — mainly from West Germany. Now that Japanese corporations are shut out of external markets, credit demand related to debt-refinancing within Japan, both for business and government, will swamp local bond markets. According to Japanese banking sources, the Bank of Japan will do most of the buying, printing up fresh yen banknotes to finance the government.

Dollar Sucks Up Liquidity

Up until June 30, dollars flowing into West German banks created new liquidity there, which found its way to the international lending market in "Euro-Deutschmarks." But defaults on short-term international payments to Western banks from Third World countries, totalling several billion dollars during the past three weeks, created a great vacuum for short-term funds to plug up the holes in the dollar lending sector. The result — as the German press moaned this week — is that the dollar "soaked every other sector dry of liquidity," producing the two-stage breakdown of the German capital markets, as investors dumped German bonds to place their money on the overnight-lending side of the Euro-dollar market.

Now the cycle has spilled through to Japan, via West Germany. But Japanese banks are also among the largest lenders to Third World countries on the Eurodollar market — dating from inflows during 1971 and 1972. The bankruptcy of the Third World will annihilate payments to the Japanese on this debt, compromising Japan's ability to meet its own $23 billion of short-term commitments on the international dollar market! Meanwhile, U.S. banks who hold about $20 billion in short-term trade credits to exhausted Third World treasuries have cut back their trade credits to these countries by at least $1.5 billion since May; a large part of this money financed Japanese exports to the Third World.

Onward Hyperinflation

For exporting nations like West Germany and Japan, the only short-term survival option other than moving into the Soviet economic area is to plunge into Latin-American currency devaluations and hyperinflation. The action of the West German Federal Bank against a bond-market crisis which gained intensity up to the closing of markets yesterday — purchasing municipal and other bonds fleeing the country — is a major step in that direction. So is the Bank of Japan's method of funding the Japanese treasury, straight off the printing presses.

Monetary pump-priming in West Germany, which exports 25 per cent of industrial output and relies indirectly on exports for another 25 per cent, is a fool's policy. Funds issued by the central bank to the banking system at large **cannot** go to production if export trade continues to collapse. German exports are now 25 per cent lower than last year's. Should the central bank continue this week's operations on the open market, the deutschmark sector will flood over with paper with no other use than to refinance maturing debt, and then refinancing the refinancing. The same applies to Japan. "Reflation" would turn the German and Japanese currencies to mud, and destroy their value on the international currency exchanges.

In turn, a collapse of the international value of the German mark — which has already lost about 10 per cent of its value vis-à-vis the dollar during the last month — would sharply raise import costs to the German economy in terms of the devalued local currency, generating further inflationary pressures, and turning the collapse-ratchet once again.

While West German Social-Democratic parliamentary leader Herbert Wehner argued for expanded East-West trade as the answer to this slide towards hell, the German Chancellor and the French President, Messrs. Helmut Schmidt and Valérie Giscard, met in Paris to discuss who would begin the reflation first. In a related development, the European Economic Community's Commission wrote itself out of politics this week by calling on European governments to turn this week's hyperinflationary disaster into official policy.

Slide to Oblivion

Great Britain, whose inflation rate now surpasses 40 per cent and whose currency has fallen in value from $2.32 per pound sterling to $2.17 during the last few weeks, represents a slightly more advanced stage of collapse, or, precisely, the state of collapse that West Germany and other trading countries will catch up to if their performance during the past three weeks continues. Its past sufferings, unfortunately, do not exempt the sinking island from another round of economic catastrophe.

To stop a general outflow of short-term funds, the Bank of England this week stopped lending out overnight money to banks, the central feature of its day-to-day operations. Instead, the "Old Lady" insisted upon lending only 5 to 6-day money — on the premise that "longer maturities" would stabilize the market! Since dealings in short-term sterling and dollars are so closely interlinked, overnight sterling funds are first-choice draftees for the multi-billion dollar holding operation now underway in the short-term dollar sector. Unfortunately, a short-term outflow of sterling could provoke massive speculation against the pound in its wake, bringing its market value down to its "natural" value of $1.65, according to the London chief of one international bank.

The immediate impact of the Bank of England maneuver stabilized the pound sterling, by placing overnight sterling funds in short supply. But the tightening of short-term money in London also jeopardizes British banks, whose ratio of capital (wholly-owned funds) to liabilities (borrowed funds) has collapsed from 13 per cent last year to 8 per cent this week. Shrinkage of capital among British banks is due exclusively to massive loan losses suffered on the speculative London real estate market — and due to be suffered on the oil companies speculation off-shore real estate market, the North Sea bubble.

In the midst of the worst economic crisis since the sixteenth century, this type of maneuvering is what passes in top capitalist circles for "national economy."

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