Market volatility marks new phase of collapse

by John Hoefle

Since the beginning of the year, world financial markets have been beset by increasing volatility, with wild upswings and downswings. The most dramatic outbreak has been in Japan, where the Nikkei stock market index, which stood at an all-time high of 38,915.87 on Jan. 2, skidded to 28,002.07 on April 2, a drop of 30% in three months in the world's most productive economy.

The drop wiped out almost $1 trillion in assets, dropping Japan's market capitalization from $3.15 trillion at the end of 1989 to $2.18 trillion on March 30, according to the *Financial Times*. At the end of the year, Japan accounted for 41.52% of the FT-Actuaries index of world market capitalization, a full 10% over the second-place United States' 31.04%. At the end of the first quarter, Japan's index had dropped by 31.36%, after which Japan's market capitalization was 33.48% of the world index, compared to 34.83% for the U.S. Since then, the Nikkei has been fluctuating 2% or more a day.

The problems in Tokyo then migrated to the bond markets in the United States. Amid persistent rumors that major Japanese institutional investors were selling off large chunks of their long-term U.S. Treasury bonds to cover needs back home, the usually staid Treasury bond market began to fluctuate wildly. The market got so excited that on April 18, the word went out that Treasury Secretary Nicholas Brady had resigned (alas, it was not true). The volatility also spread into the currency markets, where the dollar danced up and down relative to the yen and the deutschemark, and other world currencies.

The swings on the highly manipulated Dow Jones Industrial Average have been less pronounced, with daily movement generally less than 1%, reflecting the massive amounts of federal money being pumped into the U.S. markets at key leverage points. In their efforts to "save" the Dow Jones, however, the manipulators cannot help but leave other flanks exposed, making it just a matter of time before their façade of control is shattered.

The increasing volatility in world markets represents a new phase of the world economic collapse.

There are three ways to destroy paper values, economist Lyndon H. LaRouche, Jr. warned recently. First, there's the "deflationary collapse—a classical depression—that's destruction of paper values." The second way is the "inflationary collapse, where the paper becomes worthless." The third is "extreme volatility, where in the ups and downs, each time the thing goes up and down violently, something is shaken out and destroyed." In their efforts to avoid the first two, the manipulators have triggered the third.

LaRouche pointed to the likelihood of such activity in the forword to his draft congressional program of July 4, 1989. Referring to that draft, he stated April 17, "During the recent months, from August through the October crisis into the middle of April, the world economy has followed the pathway which I projected in nearly all points. In terms of bankruptcies, collapse of production, increase of unemployment, and so forth, the period resembles the comparable period of 1931-32. The Soviet economy has been collapsing at an accelerating rate, as has Communist China. The United States and Canada and Britain—their economies are collapsing, the Japan physical economy is holding up, and central continental Europe and continental Europe generally are holding up fairly well. But the rest of the world is in a terrible collapse with a few small exceptions here and there: 1931-32 all over again.

"Despite some important collapses, i.e., October-January into early February," LaRouche continued, "the U.S.

financial market has not collapsed and people are wondering what the devil is going on. Well, it is known that the United States government and the Federal Reserve System have been pouring many billions of dollars into the New York Stock Exchange and the Chicago Futures Index and things of that sort in the attempt to prop up markets unofficially, for political purposes. Bush does not want to see a financial collapse on the New York Stock Exchange which would weaken his political power, at home or abroad. Therefore, he's doing everything possible to prop up that exchange, whether it means anything now or not, and is also forcing the Japanese, the Anglo-Dutch, and the Germans to pour a great amount of their money into the U. S. economy to prop up the markets. So that despite the collapse of the U. S. banking system and the greatest rate of bankruptcy since 1932, people who delude themselves that the New York Stock Exchange *is* the U.S. economy, think that the economy is sort of stumbling along, a little shaky, but nonetheless stumbling along."

"Back in February," LaRouche said, "some people, knowing of my forecast and forecasting, asked me what I would predict on markets and dates. I said, well, except for predicting the period March 15 to April 15 to be in the period of extreme volatility, I would make no particular prediction on the financial markets as such, day to day or week to week during this period. There are too many factors of manipulation coming in from the government and others. But what I would predict was *increased volatility*. That is, either a straightforward collapse of the type which people expect when you say collapse, or collapse translated into a different kind of phenomenon: increased volatility.

"That's precisely what we've seen on the Tokyo markets during this period—increased volatility. In the *simplest* terms, without looking at some of the secondary effects—approximately a trillion dollars of the world's liquidity has been wiped out. We've had a wipeout of liquidity in the United States and the banking system, a similar phenomenon in other parts—the bond market is wiping out a lot of liquidity implicitly. We're headed toward, say, $10-12 trillion of world liquidity being wiped out during this present Depression, and we've had a few trillion already wiped out, led by the Japan Nikkei Index wipeout of about a trillion dollars of liquidity.

"To understand this volatility phenomenon which we've had in the U.S. markets as opposed to a straightforward simple collapse, you have to look at the two main phenomena that effect a financial market of this type. The main thing is the inflow and outflow of liquidity. Well, liquidity has been outflowing at a great rate. On the basis of the outflow of liquidity, one would expect a great financial collapse—that is, of a straightforward, simple stock market collapse type. And, everything in terms of outflow of liquidity has indicated just that.

"What has happened, however, at the same time, is that the Federal Reserve System has been pouring in billions virtually per day to prop up the stock markets—particularly some stock market indexes even more than the stock markets as a whole—and has been armtwisting the Anglo-Dutch, and Germans, and Japanese, to continue propping up the U.S. dollar, and propping up U.S. markets. So, in the U.S. markets as such there has been a vast outflow of liquidity, as a result of the growing spread of bankruptcies—classical 1931-32 waves of bankruptcies—but paper has been pouring in at a rapid rate (that is, liquidity), from the other side. These two movements—the pouring out of liquidity through ever-larger punctures in the market, liquidity punctures *out*, and the matching increased flow of liquidity *in*—have caused the instability in the international markets as a whole, an instability which is most clearly manifest recently up to now in the Tokyo Nikkei. So, that's the nature of the situation."

Market crash or hyperinflation

"But what this means, is that we're headed either toward a worse collapse of the classic stock market type than we would have had a short way down the pike, or we're headed into a South American-style hyperinflation. The testing point will come very soon on the question of interest rates: Either the markets, particularly Japan at this moment, will react with a dramatic increase in interest rates to channel some of this borrowing and to force a triage among the weaker firms in order to save what remains, or the continued pumping in of liquidity to meet an increasingly voracious demand for liquidity caused by dropout of liquidity on the other side, will result in setting off something analogous to what happened in Germany in 1922-23, when the German government banking system kept pouring in liquidity to try to maintain the value of German debt obligations to foreigners arising from the Versailles reparations agreements. That's what we're heading toward.

"The United States is bankrupt . . . The continental European economy is in fair shape; Japan as an economy is in excellent shape; the Soviet economy is collapsing; the Communist Chinese economy is collapsing; and the Third World is in a state of genocidal ruin as a result of IMF conditionalities. And on top of this, somebody's trying to prop up the U.S. and other markets with a flow of artificial liquidity which has brought this tremendous instability, so far reflected in the Tokyo market, but preparing to spread elsewhere.

"If that volatility increases and continues, then it will express itself not only as volatility, but as an inflation tending toward hyperinflation, which could be a new variant on what we've experienced so far. But, in any case, the net result is the same, whether by straight-out bankruptcy of financial institutions, increased volatility which blows out institutions as well as bankruptcy does, or hyperinflation. The world as we have known it, the liberal economic monetarist policies of the past 20-25 years, that whole system is now doomed and is collapsing. It's gone. And unless we replace it, we're gone, too."