The collapse of Barings was inevitable and spontaneous

by Richard Freeman

Over the weekend of Feb. 25-26, the Bank of England placed Barings Bank into administrative status, that is, bankruptcy. Barings, whose founder Francis Baring pioneered the China opium trade during the 19th century, and which until recently was a prime banker to England's Queen Elizabeth II, carried its insatiable addiction to derivatives one step beyond solvency: Barings now stands with a loss of at least $1.2 billion on a staggering $27 billion investment that it placed on derivatives contracts in the Singapore and Osaka futures markets. The loss wiped out Barings' equity of $855 million.

All during the weekend, government officials and bankers, terrified by the Barings crisis and its spillover, held emergency meetings, in especially London, Washington, and Tokyo. In London, the Bank of England was either unwilling, or more likely, itself too bankrupt to undertake the bailout of Barings to the extent of its potentially enormous liabilities.

But the British oligarchy would not disclose the seismic nature of the Barings failure. The oligarchy wishes to maintain the axioms, postulates, and speculative procedures by which it has enriched itself for centuries, even if the procedures destroy the world. Thus, it stood truth on its head. From core London institutions emerged a unified line: The Barings failure had nothing to do with the worst systemic financial disintegration in 600 years. It had nothing to do with London's 30-year project of creating a gigantic speculative financial bubble which is now obliterating the physical economy. Rather, it derived solely from a "loan assassin," 28-year-old Nicholas Leeson, Barings' Singapore-based director of Asian and American derivatives trading operations who executed the fatal Barings' derivatives trades.

By Feb. 27, the London *Financial Times,* the mouthpiece of the British oligarchy, rushed this viewpoint into print. In a box on its front page, entitled "Countdown to Collapse," it summed up the key step in the process with the entry, "Mid-February: Trader [Leeson] agrees further derivatives contracts. . . ."

On Feb. 28 the *New York Times* ran a feature entitled "For Rogue Traders, Barings Becomes Yet Another Victim." The article put an end to history as we knew it; henceforth, all developments in the financial world are a succession of actions by "loan assassins." It lists a myriad of financial crises over the last few years, blaming each primarily on a single individual. The case of the Dec. 6, 1994 bankruptcy of Orange County, California, stemming from derivatives losses now placed at $1.69 billion, was almost solely the work of former Orange County Treasurer Robert Citron, the *Times* said, not the danger inherent in derivatives. The 1994 liquidation of America's 12th-largest investment bank, Kidder Peabody, was the work of "rogue trades" by lone trader Joseph Jett. Kidder's dominant role in the multihundred-billion-dollar market for collateralized mortgage obligations (CMOs), exotic instruments so unstable that they blew out, causing most of Kidder's problems, was left out of the account.

The denial of reality intensified. On Feb. 28, a spokesman for the Federal Reserve Bank of New York, the most powerful branch of the British-controlled U.S. Federal Reserve System, told a reporter that the failure of the 233-year-old Barings Bank "doesn't represent a phase in the systemic breakdown of the financial system. There is no breakdown." Simultaneously, Bank of England Governor Eddie George continued to insist that any attempt to regulate cancerous derivatives would be blasphemy.

On Feb. 27, Peter Baring, the chairman of the bankrupted institution, deflected blame from himself. Instead he charged a conspiracy by Leeson to deliberately bankrupt the bank.

In a March 1 radio interview with "*EIR* Talks," Lyndon LaRouche dismissed all "lone trader" and conspiracy theories. LaRouche, the world's leading economist and a 1996 presidential candidate, has an authority on economic forecasts over the past 30 years that is unchallenged. Conspiracies and mistakes may indeed occur, he said, but they are subsumed, fifth-rate features of the larger breakdown process. "The fact is," LaRouche stated, "that this crash in this phase *was inevitable and spontaneous*. Nothing really was done by Barings or others to bring this crash about, *except not to change the whole policy*. It just had to happen.

The reality of the crash

"People are confused on this. I've been forecasting this kind of event for years, and the one to follow. This is not the big shoe, there's a bigger one, a bigger crash yet to come after this chain—Mexico, Barings, and so forth—collapses.

"But what people don't understand, is the following. They think that somehow, if this trade goes sour or that trade goes sour, or somebody steals or something, and they try to explain crashes in those terms, or they say, 'It couldn't happen again, we have this, we have more sophisticated markets, more sophisticated people.' Bunk!

"The issue here is that, for years, we have been building up a gigantic bubble in these swindles, these derivatives and other kinds of similar doubtful instruments. At the same time, the economy, the real economy underneath, has been shrinking globally. . . . Our productivity, our wealth per capita, per household, per square kilometer of territory in the United States and generally around the world, has shrunk.

"Now, this derivatives bubble, which depends upon getting a small margin of highly leveraged profit into the system, a so-called income stream, comes out of *shrinking* the real economy.

"So what happens, in that way, throughout the system, is that the economy shrinks in order to keep the bubble alive. Now the bubble is growing, and the economy is getting smaller. So obviously there is no way in which you can avoid a total collapse, a pricking of the bubble.

"There is a financial bubble, a parasite, which survives by sucking the juices from a victim, and the victim is weakened at each turn, and as the bubble gets bigger (which it must to survive), its demands upon the victim increase. Thus, simply in that dynamic relationship between the parasite and its host, you have the inevitability of the virtual death of both.

"We are in a great collapse. In this period, we only have two choices: Either governments act to put the financial markets, including the central reserve system, like the Federal Reserve Bank system, into bankruptcy reorganization, or this thing will go past the kind of chain-reaction bankruptcy you've seen in Mexico, Orange County, Barings, and so forth, into an actual disintegration collapse . . . of the whole system."

Barings' breakdown

While more will emerge about the Barings failure, some is already known. During the recent past, Leeson executed what is called a "straddle" or "strangle strategy" on the Japanese Nikkei-225 stock index. The strategy depends on the Nikkei index remaining within a certain trading band. In simple terms, it obligated Barings to sell the Nikkei-225 index when it neared 20,000 and to buy it when it fell close to 18,000, positions that would generate large losses if the index moved sharply beyond the limits, which it did. Reportedly, Leeson bought at least 20,000 contracts on this position, worth over $7 billion, in late January. The principal notional amount that these contracts controlled was many times that.

At the same time, Leeson bet that Japanese interest rates would go up, and bought $20 billion worth of contracts on Japanese government bonds and short-term Euro-yen securities (whose yields closely mirror Japanese interest rates).

On each set of contracts, Leeson bet stupendously wrong. As the positions moved against him, he borrowed money to cover margin calls. Leeson's Nikkei-225 contracts don't close out until March 10, and were the Nikkei index to fall more, the contracts would incur still greater losses. By March 2, the Nikkei was trading at 16,963, despite concerted efforts by most world financial centers to hold it up.

The official story on the Leeson affair has many problems. For example, it was reported that Leeson was trading secretly, perhaps using dummy corporations, so that nobody, including Barings, knew of his trades. But, the Osaka Securities Exchange, where many of the trades were executed, reported outstanding Nikkei-225 index purchases on a daily basis, and showed that by Feb. 17, Barings had half of all such market purchases, a fact known by everybody in Asia. Moreover, the March 2 *Financial Times* reported that Barings itself, which supposedly knew nothing of Leeson's activities, had spent more than $700 million covering Leeson's margin calls since late January.

But the systemic implications are far more interesting. The Singapore International Monetary Exchange, where deals also were executed, is legally obligated to make good on any contracts Barings defaults on. More fundamentally, there is a worldwide liquidation process, with $2-3 trillion in bonds, futures, and other positions dumped in the last year. Now, with the Mexico, Argentina, and other so-called "emerging markets" in significant trouble, there is a liquidation of that paper. With massive selling all over the world—which itself may eventually have something to do with the timing of the Barings crisis—the Barings shake-out creates even more panic and liquidation both in the Asian markets and London.

The British oligarchy may not talk about it, but as the process of liquidation accelertes and the world physical economy contracts further, as LaRouche warns, the disintegration is all too real.