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Asian financial storms hit Germany

by Lothar Komp

The February 1998 euphoria on the Frankfurt stock market, which led to new historic records of the DAX index, is based on three fatal illusions: First, the financial meltdown in Asia is being presented to the small investor as a geographically limited phenomenon, and not as a symptom of fundamental flaws in the global financial system. Therefore, apart from discussing minor reforms of International Monetary Fund (IMF) policies, "business as usual" is supposed to resume after a few billion deutschemarks in loans to Asia are written off. Second, even in respect to a geographically limited "Asia crisis," the propaganda line of IMF Managing Director Michel Camdessus, that "the worst is over," is being echoed by the vast majority of economic media. Third, what happens in Asia is suddenly being portrayed as having almost no relevance for Germany's economic future. For more than a decade, neo-liberal (free trade) theorists had praised the Asian "tiger" economies as the globalization-age alternative to the "out-dated" postwar German success model of a machine-tool-driven economy with large per-capita investments into labor, production facilities, and infrastructure. During the same time period, the Asian nations, with their populations of about 4 billion, correctly had been described as having gigantic potential for the German capital goods industry (see **Table 1**). Now, for the sake of the "no impact on Germany" theory, Asia has been removed to a different planet, in public opinion. However, as 1998 continues along, all three illusions are ready to burst.

Contrary to some ludicrous announcements by German Economics Minister Jürgen Rexrodt (Free Democratic Party), the German government is indeed very concerned about the possible consequences of the Asian financial storms on Germany's export industry, particularly in view of the upcoming Federal elections in autumn. One indication of this was the one-week visit by the president of the German savings banks association, Horst Koehler, a former Assistant Finance Minister of Germany, to Indonesia, starting on Jan. 19. The Koehler mission, which included negotiations on a debt rearrangement between German creditor banks and their Indonesian debtors, was initiated, at least in part, by Chancellor Helmut Kohl. Another signal of the German government's concern, was an internal paper prepared by the German Finance Ministry for Finance Minister Theo Waigel's Feb. 16-20 visit to South Korea, Indonesia, and Thailand. According to press leaks, the paper warns of a "collapse of trade and trade financing," as the Asian financial meltdown continues.

New risks for the budget

The default of creditors, or even of entire nations, would have an immediate effect on the German national budget, because of the Hermes instrument of Federal guarantees for exports and export credits. A spokesman for the Hermes desk of the Economics Ministry told *EIR,* "We are not reacting hysterically, but there are obviously new risks for the Federal budget."

Since the early 1960s, the so-called Hermes guarantees for exports and export credits of German companies to primarily developing countries have played a crucial role in the buildup of the German high-tech capital goods industry, covering, until the early 1980s, approximately 10% of all German exports. Since then, this figure has been reduced to about

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TABLE 1
German exports to East Asia
(billions of deutschemarks)

	1990	1996	change
China	2.494	7.255	+191%
Hong Kong	1.954	4.241	+117%
Indonesia	1.515	2.657	+75%
South Korea	2.922	6.558	+124%
Malaysia	1.034	2.810	+172%
Philippines	0.601	1.311	+118%
Singapore	2.040	3.861	+89%
Taiwan	2.429	4.456	+83%
Thailand	1.406	3.514	+150%
Vietnam	0.148	0.341	+144%

Source: IFO, *EIR*

TABLE 2
German budget exposure, for the top 10 countries, as of year-end 1996
(billions of deutschemarks)

CIS (excluding Russia)	23.0
Russia	19.1
Brazil	17.4
Iran	12.9
China	12.7
Indonesia	12.1
Argentina	10.2
Turkey	8.9
Iraq	7.7
India	7.7

5%. Nevertheless, by the end of 1996, the overall volume of outstanding export deals covered by Hermes guarantees had reached DM 189.9 billion (more than $100 billion, at today's exchange rate). On top of this, there is another DM 62.6 billion in outstanding Hermes guarantees on interest rate payments of export credits.

Therefore, the total underlying volume of Hermes risks by the end of 1996 stood at DM 252.6 billion. Out of this, DM 65.7 billion belongs to Asian developing countries, DM 42.0 billion to the successor states of the former Soviet Union, DM 33.2 billion to Ibero-America, DM 23.2 billion to Africa, and DM 9.3 billion to eastern and southern Europe (see also, **Table 2**).

Preliminary figures for the Federal exposure due to Hermes guarantees for the end of 1997 have already been announced by the German Economics Ministry: DM 14 billion for Indonesia, DM 6 billion for Thailand, DM 2.8 billion for the Philippines, DM 2 billion for South Korea, and DM 2 billion for Taiwan. When the Finance Ministry presented a report on the Hermes guarantees to the German Parliament's Budget Committee on Dec. 22, 1997, which concluded with a rather optimistic view on the projected impact on the 1998 budget, the report was flatly rejected by the committee as "unrealistic." Since then, the Dec. 23-24, 1997 near-default of South Korea, and the debt moratorium in Indonesia in January 1998, have added further confirmation of that assessment.

Banks preparing for huge write-offs

Meanwhile, the German private banks are preparing for huge write-offs. Deutsche Bank has announced that it will set aside DM 1.4 billion in reserves for non-performing Asia loans. Similar measures have been taken by Commerzbank (DM 1 billion), Bayerische Landesbank (DM 500 million), and other banks. In mid-January, Bayerische Landesbank fired the head, as well as other leading employees, of its operation in Singapore. The Singapore office is the bank's biggest operation in all Asia, bigger even than its Tokyo office; in 1996, it had 73 employees running a business volume of DM 9.8 billion. The activities of Bayerische Landesbank in Singapore not only cover investment banking and export and project financing, but also real estate trading and foreign exchange and derivatives transactions.

The degree of nervousness of German bank managements is underscored by the charges that they have leveled recently against the U.S. rating agencies Standard & Poors and Moody's, accusing them of "complete failure" in not foreseeing the outbreak of the financial crisis in Asia, up to allegations of "political conspiracy."

There are conflicting estimates on the overall loan exposure of German banks in the troubled Southeast Asian countries, including: a report by the French bank Paribas from November 1997; the official figures by the Bank for International Settlements (BIS), which, however, are for the end of 1996; and, the January 1998 study by the Munich-based economic research institute IFO. However, the rough dimension of these loans is now beyond doubt: about DM 200 billion, and, most probably, a few billions more (see **Table 3**). And, roughly 60% of these loans on average are short term, whereas in the case of South Korea, the short-term loans comprise as much as 75% of the debt portfolio.

The IFO institute estimates the East Asian loan exposure of German banks, excluding loans to Japan, at DM 218 billion (roughly $122.7 billion), which is more than that of U.S. or other European banks, and is only topped by the exposure of the Japanese banking system. It was emphasized by the IFO that the German loans to Indonesia, Thailand, and South Korea started to rise sharply beginning in 1995, a rise which further increased during 1997. In a scenario published by the

TABLE 3
Loans of German banks as of September 1997
(billions of deutschemarks)

Country	Total	Short-term
China	15.1	6.1
Hong Kong	63.3	38.0
Indonesia	13.9	4.3
Malaysia	5.0	2.2
Philippines	2.1	0.2
Singapore	80.0	69.3
South Korea	19.9	11.4
Taiwan	5.0	4.4
Thailand	14.4	5.5
Vietnam	0.5	0.1
Total	**217.8**	**141.5**

Source: IFO

Schroeder Muenchmeyer Hengst (SMH) bank, 10% of the German bank loans to Asia would become non-performing, causing 1998 profits to fall by 60% at Deutsche Bank, 51% at Dresdner Bank, 70% at Commerzbank, and 67% at Bayerische Vereinsbank.

In early February 1998, the chief economist of Deutsche Bank, Norbert Walter, who in the past had downplayed the impact of the Asian disaster on the European economies, was correcting himself, now saying that we are probably heading into a world economic crisis. He warned that if efforts to "prevent a meltdown of the Japanese financial sector" failed, or if the political stability provided by the "China anchor" broke its mooring, the Asian crisis would "grow into a development of real world economic chaos." A particularly worrisome factor was emphasized on Feb. 13 by Deutsche Bank board member Josef Ackermann, whose responsibility is for Asia. Among the primary factors which are playing an escalating role in the financial disasters of Thailand, South Korea, and Indonesia, he mentioned the huge derivatives exposures. Ackermann noted that the volume of derivatives contracts has sharply risen during 1997 all over the Asian markets, "more than ever before."

German banks in the derivatives trap

Also, the lawsuit between the South Korean brokerage house S.K. Securities and J.P. Morgan, involving failed derivatives contracts (as we show in an accompanying article, only the tip of the iceberg of the effects of the Asian currency collapse on the gigantic derivatives bubble), is pointing toward a much bigger risk for the German banks than just their Asian loan business.

While the German banks have essentially frozen their loans to the domestic industrial sector at about DM 320 billion between 1991 and 1996, the nominal volume of outstanding derivatives contracts by German banks skyrocketed in the same time period.

In October 1997, the Bundesbank (German central bank) published a report, entitled "The Off-Balance-Sheet Business of German Banks," which gives a detailed account of the overall derivatives activities of the German banks. By the end of 1996, the bets by German banks on future interest rates, foreign exchange values, stock prices, and indices reached the unbelievable amount of DM 16.8 trillion. This was a growth of 61% compared to the year before. By June 1997, the off-balance-sheet liabilities of German banks already stood at DM 21.7 trillion, more than six times the yearly Gross

FIGURE 1

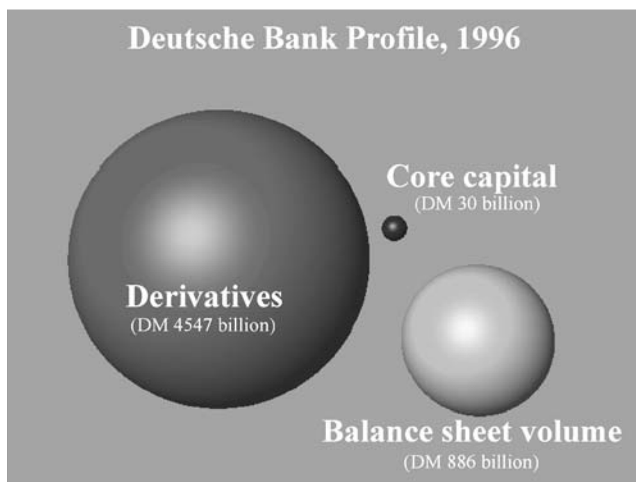


FIGURE 2

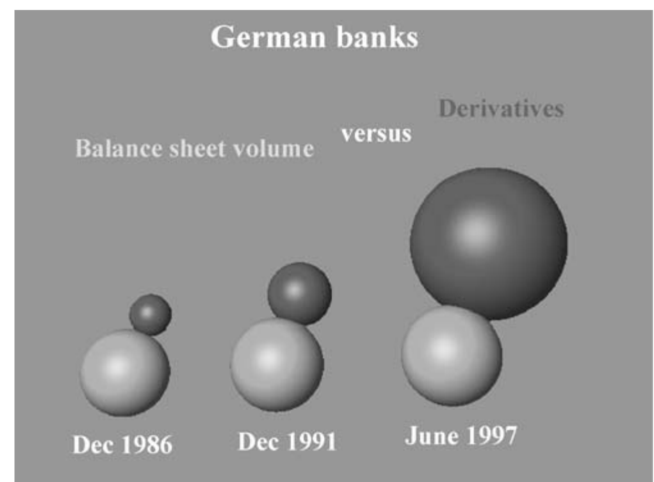
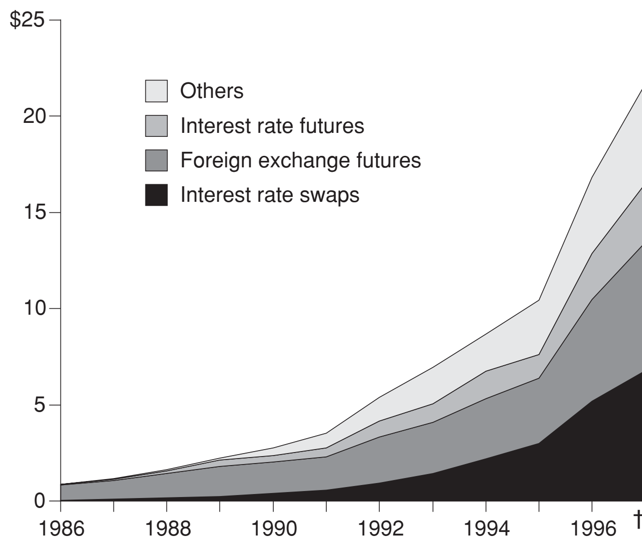


FIGURE 3
German banks' off-balance-sheet liabilities*
(trillions of deutschemarks)



* Nominal value of outstanding contracts at year-end.
† June 1997.
Source: Deutsche Bundesbank.

TABLE 4
Derivatives (D), balance-sheet volume (B), and core capital (C) of German banks at end of 1996
(billions of deutschemarks)

Bank	D	B	C	D:C
Bankgesellschaft Berlin	642	337	8.3	77
Bayerische Hypo	377	339	14.6	26
Bayerische Vereinsbank	447	404	10.8	41
Commerzbank	1,683	448	13.5	125
Deutsche Bank	4,547	886	29.7	153
Dresdner Bank	1,388	561	15.2	91
Westdeutsche Landesbank	716	471	12.6	57

TABLE 5
Derivatives volume of German banks
(billions of deutschemarks)

Bank	1994	1995	1996
Bankgesellschaft Berlin	147	316	642
Bayerische Hypo	176	229	377
Bayerische Vereinsbank	447	651	958
Commerzbank	608	1,112	1,683
Deutsche Bank	2,186	2,367	4,547
Dresdner Bank	733	919	1,388
Westd. Landesbank	534	510	716
Total	**4,831**	**6,104**	**10,311**

Source: BIS, IOSCO.

Domestic Product, compared to a balance-sheet volume of only DM 8.7 trillion.

Since 1986, the ratio between off-balance-sheet to balance-sheet activities of German banks has thereby risen from 25% toward 250%.

While these are accumulated figures for the whole German banking sector, every November the BIS publishes an estimate of the derivatives exposure of top international banks, including seven German banks. For Deutsche Bank, the BIS gives a derivatives exposure of more than DM 4.5 trillion for the end of 1996, which is 153 times the bank's core capital (**Figure 1**). In other words, if Deutsche Bank were to face an average loss of 1% on all its outstanding derivatives, the entire core capital of the bank would be wiped out (see also **Figure 2**).

On Feb. 5, German S&L association president Koehler, confronted with an intensifying campaign by the German private banks and the European Commission to fully privatize the S&Ls, urged German bankers, at a conference in Frankfurt, to learn the lessons from the financial crisis in Asia. This means, he explained, that Germany should not copy the "Anglo-American financial system," which is dominated by "short-term thinking" and "off-balance-sheet business." It seems, such requests are coming a few years too late (see **Tables 4** and **5,** and **Figure 3**).

Documentation

Tietmeyer: systemic risks, but no 'cure-all' possible

On Feb. 5, Bundesbank President Hans Tietmeyer spoke at a conference in Hamburg, on the theme "Money and Currency in the Age of Globalization." After presenting an alarming picture of the world financial crisis, he concluded that nothing can be done about it, that there is no *Patentrezept,* or cure-all, for the crisis. The speech provides a clinical insight into the mental self-paralysis of those leading finan-

cial figures who are not engaged in the ideology-driven total denial of reality.

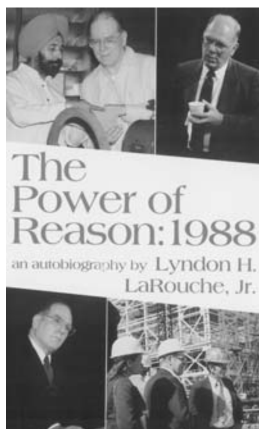
Tietmeyer admitted that there are very serious problems associated with "the ever more globally operating financial markets." Due to the full convertibility of almost all currencies, and the liberalization of capital transactions, "the flow of capital and the volume of foreign exchange transactions have rapidly increased—much more strongly than the trade of goods." The volatility on financial markets has, even more, been fostered by the huge liquidity available internationally and by "new instruments," i.e., derivatives. The recent disasters in Southeast Asia, he said, "have demonstrated again, how fast the international investors are withdrawing their capital, once the confidence in the currency and the domestic policy of a country begins fading away. Within days, even hours, dramatic movements and dangerously contagious processes can take place."

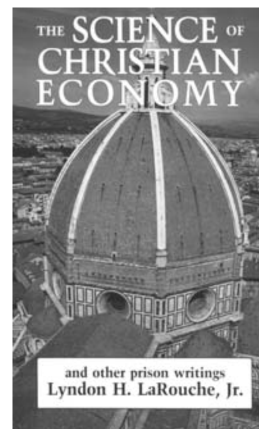
Tietmeyer also acknowledged the "herd instinct" of market participants, which leads to all sorts of "short-term exaggerations." He added, "The strong worldwide interconnection of financial markets is nowadays causing the danger, that even local 'fires' could rapidly spread and 'inflame' other troubled financial markets. Out of this, systemic risks with regional, in the worst case, even global dimensions, could emerge."

Tietmeyer also emphasized the need for "re-thinking the fundamental role of the IMF." In a rather sarcastic way, he said that he would not want to comment on the recent IMF "rescue" programs, and whether the programs and the attached conditionalities had always been appropriate. "In any case, we cannot allow international organizations like the IMF to turn into a life-preserver for reckless private investors," he said.

However, said Tietmeyer, "there is surely no magical cure." He noted that, "due to volatile foreign exchange values and burst speculative bubbles, calls for re-regulation" of the global financial system have become "remarkably loud" in recent times. In particular, he mentioned "three proposals" for financial market regulation: "A deliberate restriction of the convertibility of currencies; different foreign exchange ratios, for trade-related transactions, and for pure financial transactions; or, a taxation of worldwide financial flows." All three proposals were clearly rejected by Tietmeyer. In most cases, he claimed, "excessively volatile foreign exchange prices" are "caused" by flaws in domestic economic policy. "But, such dissonances cannot simply be managed by a worldwide system of fixed exchange rates or by setting up reference zones for foreign exchange values," he said.

Books by Lyndon H. LaRouche, Jr.





The LaRouche case "represented a broader range of deliberate cunning and systematic misconduct over a longer period of time utilizing the power of the federal government than any other prosecution by the U.S. Government in my time or to my knowledge."

—Former U.S. Attorney General Ramsey Clark

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