Derivatives losses: the tip of the iceberg

by John Hoefle

Lyndon LaRouche and *EIR* have warned, since the spring of 1993, that the attempt to prop up the bankrupt international financial system through the use of off-balance-sheet derivatives would lead to a catastrophic collapse of virtually all of the world's financial and monetary systems. At the time LaRouche issued his first warning, there were some $50 trillion in derivatives outstanding worldwide, of which about $15 trillion were held by U.S. institutions. Today, there are some $125-150 trillion in derivatives worldwide, three to four times the gross world product (or world GDP), of which about $40 trillion are held by U.S. institutions, five times the U.S. GDP. To feed this bubble, has required enormous amounts of capital, much of which has come from the cannibalization of the productive sector of the U.S. and other national economies. Pools of capital have been systematically identified and looted by the international financial oligarchy, to feed the bubble; it is this combination of theft and diversion of capital from productive investment, which has led us to the brink of disintegration, and what has triggered the so-called "Asian contagion."

While the effects of this systemic crisis on the Asian countries has been widely publicized, the damage done to the global financial institutions is only slowly percolating into view, through year-end financial reports and a host of "reorganizations" at financial institutions.

Losses mount

Take J.P. Morgan & Co., for example. In January, Morgan announced a huge jump in its non-performing derivatives holdings in the fourth quarter of 1997, designating $587 million of assets—primarily in a type of derivatives known as swaps—as non-performing, and raising its credit-related non-performing assets to $659 million, from $84 million on Sept. 30, 1997. Morgan's proprietary trading unit saw its total return drop to $22 million for the fourth quarter, compared to $228 million in the fourth quarter of 1996, with 30% of that drop attributed to problems in Indonesia, South Korea, and Thailand.

"Losses from managing equity derivatives during a period of significant market volatility were primarily responsible," the bank stated.

Those losses are only the tip of the iceberg. Morgan, which had $6.2 trillion in derivatives holdings as of Sept. 30, 1997, has admitted to $900 million in derivatives exposure in Indonesia, $3.4 billion in South Korea, and $1.1 billion in Thailand, and is currently embroiled in a legal fight with S.K. Securities of South Korea, over $300 million in derivatives losses.

Chase Manhattan Corp., with $7.9 trillion in derivatives as of Sept. 30, is also feeling the heat. Chase reported $160 million in trading losses in October, and a sharp drop in trading revenues in the fourth quarter, noting that "losses in emerging markets securities offset strong foreign exchange revenues."

Citicorp, which had $3 billion in derivatives as of Sept. 30, also reported problems. "It was anything but a normal quarter," Citicorp Chairman John Reed stated. "The Asian turmoil reduced our pre-tax profits by about $250 million."

The losses are also mounting in Europe, where National Westminster Bank and the Union Bank of Switzerland have been hard hit, with market rumors that UBS had lost as much as $1.3 billion.

More losses are certain to surface. The Korean newspaper *Hankook Ilbo* said on Feb. 12 that South Korean financial institutions may have lost as much as $5 billion over the past few months, and the *New York Post*'s John Crudele noted on Jan. 9 that the best guess is that Koreans have invested some $48 billion in derivatives.

The dispute between Morgan and S.K. Securities is indicative. While the particular details are the subject of legal suits in Korea and the United States, what is clear is that S.K. Securities and two partners borrowed millions of dollars to set up funds to speculate in Southeast Asian currency derivatives, investments which produced some $300 million in losses. S.K. Securities has filed suit in Korea, claiming it was victimized by Morgan, while Morgan filed suit in New York, demanding payment and asserting that U.S. law, not Korean law, should apply.

The derivatives losses are growing so rapidly that even the *Washington Post,* which economic coverage is mainly designed to brainwash the government about the "fundamental soundness" of the U.S. economy, was forced to admit on Jan. 21 that problems do indeed exist. "There is a theme emerging," Mitchell Securities analyst Charles Peabody told the *Post*. "Derivatives are a potential problem. How big, we don't know. . . . There is more fallout to come."

"This is just the beginning of the problems related to Asia for the banks," added Marc Perkins of Perkins Capital Advisers. "People have to realize that these derivatives expose the banks to credit risks if people on the other side of a deal decide they don't want to pay up. Credit risks to these banks are rising."

Reality is even starker: The problem facing the derivatives markets is that the derivatives debts *can't* be paid, because the money to pay them doesn't exist. That puts the big derivatives institutions—in the United States, Japan, Germany, France, England, Switzerland, Canada, the Netherlands, Sweden, and Australia—sitting at ground zero of the largest financial explosion in history.

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