

# EIR News Analysis

## A larger stock market 'correction' is under way

by John Hoefle

With the 299-point drop in the Dow Jones Industrial Average on Aug. 4, the Dow had dropped 9.1% since its all-time peak on July 17, sparking much discussion among the Wall Street analysts and media pundits about whether a "correction" was under way, or whether the Great Bull Market has finally given way to the bear.

The comments of these pundits can be useful, if one puts them in a petri dish for pathological study, but they do very little to explain the forces which are controlling events—one is unlikely to forecast a storm moving into the forest, by a microscopic study of the trees.

There is indeed a correction under way, but it is a correction in a much broader sense, in which 30 years of economic policies and institutions which have defied natural law, are being swept away by forces beyond the comprehension of the financial markets.

"In the coming several months, August, September, October, there will be such changes in the world as none of you living has ever seen before," economist Lyndon LaRouche told a meeting of the Schiller Institute in Oberwesel, Germany, on July 26. "The next months and years will see the end of every financial and monetary institution, as institutionalized forms, on this planet. They will all go."

### Global stock decline

As an economic indicator, the Dow Jones Industrial Average is a hoax. The 30 stocks which make up the Dow reflect neither the stock market as a whole, nor even the U.S. industrial base. Over the years, this so-called "industrial" average has been packed with decidedly non-industrial companies; industrials such as Westinghouse and Bethlehem Steel have been pushed out, to make way for companies such as J.P. Morgan, American Express, Travelers Group, Wal-Mart, and McDonald's. While one might make a case, after close inspec-

tion of its fare, that McDonald's could qualify as a manufacturer, the Dow is now dominated by financial and other services; many of the remaining industrials, such as General Electric and General Motors, now make much of their profits through financing.

The Dow is actually an instrument of perception management, more than a measure of economic vitality—and what it hides, is more important than what it reveals. While the Dow was rising into July, the smaller stocks were declining. The Russell 2000 index, for example, peaked in April, and had declined 18% by Aug. 4. On the S&P 500, the 50 largest stocks were up about 20% for the year on that date, while the remaining 450 were up only about 5%. And on the Dow itself, 11 of the 30 stocks were down for the year, led by a 25% decline at Boeing.

Since the July 17 peak, the decline has accelerated. According to a study by Salomon Smith Barney, the average stock on the New York Stock Exchange fell 24% between July 17 and July 28, while the average NASDAQ stock fell 35% (with more than half down at least 30%), and the stocks of U.S. companies with market capitalizations of under \$250 million fell 43%.

This U.S. decline is part of a drop in stock markets worldwide, since the outbreak of the so-called "Asian" crisis last year. Many of the Asian markets remain at or near their lows of the past year, and stocks in Ibero-America and Russia are down sharply. Even the European markets, which along with the United States benefitted from billions of dollars of capital fleeing Asia, have turned sharply downward, from record highs. All across the globe, the trend is down.

### Economic collapse

Driving this global market decline, is a worldwide economic breakdown, in which problems in Southeast Asia and

the former Soviet bloc are merely the more obvious.

The problems in Asia continue to escalate, prompting many of those who until recently had declared the Asian problems “solved,” to eat their words.

Indonesia continues to disintegrate, facing 100% inflation, 25% unemployment, and a 30% contraction in economic output, according to U.S. and Asian studies. A U.S. government report predicts that serious malnutrition and starvation could appear in the next two months. “No nation has been hit harder by the financial crisis than Indonesia, traditionally a source of stability and growth within the region,” U.S. Secretary of State Madeleine Albright observed on July 30.

Albright made her statement in the Philippines, where on July 27, in his State of the Nation address, Philippines President Joseph Estrada had declared: “Our economy is in bad shape, and the national coffers are almost empty. The government cannot fill the needs of the economy. In short, the government is bankrupt.” Estrada pointed to the nation’s record \$51 billion in foreign debt and \$2.1 billion budget deficit, saying, “I thought we had a lot of money. They were saying we were economically stable, the new economic tiger of Asia. It turned out we’re not a tiger, but a puppy.”

Overall, Southeast Asia lost \$1 trillion as a result of the “Asian contagion,” Malaysian Prime Minister Dr. Mahathir bin Mohamad said on July 20, during a state visit to Mozambique. The result: Many banks and businesses have gone bankrupt, 30 million workers have lost their jobs, and there are shortages of food and medicine.

Standard & Poor’s, the rating agency-cum-economic-warfare unit of McGraw-Hill, recently issued a new report (“Asian Depression, World Recession”) through its DRI subsidiary, which warned that the “Asian” crisis could lead to a “global recession by 1999.” “We are forecasting a one-in-four chance that Asia’s problems will continue to worsen over the coming months, bringing about a 1930s-style depression that will significantly impact the world’s economies,” said S&P DRI chief economist Nariman Behraves. “We have taken a consistently pessimistic view — particularly for Japan. . . . The economic fundamentals point to a country in deep economic crisis, which is potentially disastrous for the other economies in the region, and beyond. . . . The recessionary tidal wave that swept over Japan, Thailand, South Korea, and Indonesia a year ago is now engulfing other parts of Asia, with the waters now lapping onto the shores of the United States, Europe, and other G-7 countries.”

The S&P report predicted that the Asian crisis could cause the yen to drop to 200 to the dollar, trigger 40% devaluations of the Chinese yuan and Hong Kong dollar, and cost U.S. auto makers some \$11 billion between now and 2002. “In fact,” Behraves said, “our current worst-case projections indicate a potential 25% drop in the overall value of [U.S.] stocks by 1999.”

“We’ve tried not to engage in scare-mongering. . . . People can say that if they want, but the reality is that every time

we think we see a light at the end of the tunnel in Asia, it has turned out to be another train coming at us,” Behraves admitted to the *Washington Post*.

That train is also bearing down on Ukraine, which reached a \$2.2 billion deal with the International Monetary Fund on July 31, to enable that nation to meet its August debt payments; and on Russia, which faces \$40 billion in payments during the remainder of the year.

Meanwhile, Mexico, whose financial crisis was supposedly solved in 1994, faces the disintegration of its banking system, unless the government bails out the \$65 billion Fund for Bank Savings Protection (Fobaproa) market. The Fobaproa bonds make up 30% of the assets of the Mexican banking system.

### **Above the law**

While the world crashes around them, the central bankers and finance ministers remain committed to saving the bubble, no matter what the cost.

Exemplary are the moves in the United States to protect the over-the-counter (OTC) derivatives market. In May, the Commodity Futures Trading Commission (CFTC) issued what it termed a concept release, in which it suggested that, given the rapid growth of the OTC derivatives market, a study of that market was in order.

That relatively mild suggestion triggered a torrent of protest from both the big derivatives dealers and the major financial regulators. The Federal Reserve, U.S. Treasury Department, and Securities and Exchange Commission not only opposed the CFTC’s suggestion, but submitted a joint letter to Congress, demanding that Congress enact legislation to prohibit any CFTC review of the OTC derivatives market. To make sure Congress got it right, they attached a proposed bill, which House Banking Committee Chairman Jim Leach (R-Iowa) promptly introduced as H.R. 4062, the “Financial Derivatives Supervisory Improvement Act of 1998.”

The essence of the objection to the CFTC’s proposal was clearly stated on July 17, in a hearing before the House Banking Committee. Chase Manhattan Bank director of global markets Dennis Oakley testified that “the Commodity Exchange Act requires that all commodity futures contracts be traded on a board of trade, and that since 1974, financial products have been considered commodity futures, unless they fall within the exception of the Treasury Amendment. If a product is deemed to be a future, and is not traded on a board of trade, it is null and void.” The problem, he continued, “is that some of our fastest-growing products, such as equity and credit derivatives, are not covered by the exemption.”

In other words, trillions of dollars of the derivatives sold by the banks are, according to U.S. law, null and void.

“We have no way to manage this new legal risk,” Oakley said. He added that unless the CFTC action were stopped, “Chase will be forced to move this business to another location, probably London.”