EIR Economics

G-7 plays the world's biggest 'confidence game'

by William Engdahl

Leading governments and private banks of the Group of Seven industrial nations are now engaged in what only can be called the world's biggest confidence, or con game. Since this publication identified the secret G-7 efforts in June to prevent a new blowout of the global financial system by getting the Bank of Japan to pump at least $25 billion into the U.S. Treasury market ("G-7 Central Bankers Hold a Tiger by the Tail," *EIR,* July 16), the governments and major financial houses of Japan, the United States, and the European Union have turned to even more bizarre methods, to try to pump "confidence" back into a system that is in a terminal stage of breakdown.

Only three weeks ago, the consensus among financial currency traders was that the euro was doomed to fall well below the 1:1 parity with the U.S. dollar. Only two months ago, the consensus was that the severe economic problems in Japan, the world's second-largest industrial economy, made a weaker yen a serious danger both to the struggling Asian economies and to the world economy. By the end of July, events had been turned on their head. Today, financial commentators, government officials, and central bank heads in Japan and Europe proclaim that those "sick man" economies are in a miraculous recovery, and that it is instead the U.S. dollar and the United States which is the sick one.

Faking Japan's turnaround?

On July 23, a leading Japanese weekly, the *Shukan Post,* ran an interview with an unnamed Japan Ministry of Finance official, who let the cat out of the bag. According to this report, the ministry official told the magazine: "It was a faked gift we gave to the June 18 G-7 economic summit in Cologne. We manipulated the growth data." He referred to data released on June 10 by the Japanese Economic Planning Agency, a division of the Ministry of Finance, which reported a surprisingly strong Japanese Gross Domestic Product (GDP) growth of 7.9%, annualized. Most economists had expected data to show severe depression, as the country continued in the worst crisis of the postwar years.

That surprise growth data triggered an avalanche of foreign funds flowing into the Japanese Nikkei stock market. U.S. mutual funds and other large money managers, as well as Europeans, took the strong data as evidence that, finally, after nine years of depression, Japan's economy had begun a turnaround. Money flooded in at record levels to buy up stocks while they still were "cheap." The flows have become so huge, that the weak yen suddenly has become a too strong yen.

On June 28, the Ministry of Finance announced plans to sue *Shukan Post* for the story and, later the same day, the Economic Planning Agency released growth data for June showing another strong advance—this time 2% year-on-year, adding to the bullish sentiment of global investors over Japan.

The real Japanese economy, official data notwithstanding, is a disaster of unprecedented proportions. Japan is essentially caught in a debt trap. Over the past nine years, in a desperate effort to stimulate the economy out of the crisis, the government has spent a whopping sum on public works. Between August 1992 and April 1998, the government spent yen 107 trillion, almost $1 trillion in public works and tax stimulus cuts. Often, this has been simply political pork to line the pockets of rural party voting bosses, with construction contracts to build bridges that go nowhere, or streets that end abruptly.

The Organization of Economic Cooperation and Development (OECD) reckons that by next year, Japan will exceed Italy as the most heavily indebted G-7 economy, with gross public debt at 118% of GDP. Japan's total public debt today stands only behind that of the United States, at $2.6 trillion. Only official interest rates artificially held to near zero have

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kept the government budget outlays for debt service from exploding into the stratosphere.

Japanese corporations, for their part, face staggering burdens in unfunded pension costs for their employees. Lifetime employment is still the pillar of Japan's postwar social order. Estimates are that, in total, Japanese companies face a bill of yen 80 trillion (about $700 billion) in unfunded pension obligations. With payrolls still bloated by far too many workers for the present economic depression, these costs will only increase in coming months, further erasing net corporate profits that are urgently needed to spur real net new investment. Belying the official GDP data, another government agency, the Bank of Japan, released data showing that industrial production fell a sharp 1.8% in April and May.

Yet, as the Japanese economy sinks further into real depression and an impossible debt trap, the Nikkei soars to new highs for the year, near 18,000, almost 50% higher than in January. Virtual reality triumphs over actual reality—at least for the moment.

The rebound of the euro

The second surprise in the global monetary swings of the past weeks, has been the remarkable revival of the euro. Only two weeks earlier, most currency traders polled were convinced the euro would fall below the 1:1 parity with the U.S. dollar. The euro started life in January at $1.17 to 1 euro. Since then, the ever-weaker Euroland economies, especially that of Germany, led to a crisis of confidence in the new currency. The expected flood of foreign investment into euro bonds and stocks, instead became a net liquidation over the past months.

Then, as if by a miracle, in mid-July the Munich economics institute, IFO, released a monthly survey of "business confidence." It was widely hailed as proof that the German economy was finally rebounding. Within hours of the IFO report, the euro made a stunning recovery, going from 1.01 up to 1.03. By July 26, the euro topped 1.07, and predictions of a 1.10 euro were heard.

The euro recovery is just as fake as the Japanese recovery.

"Large European banks hold huge sums in euro options contracts, which expire August 31," explained S.J. Lewis of Monument Derivatives Ltd., a London finance specialist involved in the global derivatives business. "If the euro had gone below 1.01, it would likely have gone into a free-fall. If that state held on Aug. 31, those banks stood to lose huge sums in their derivatives contracts. The moment they had the slightest bit of optimistic news, however little, those same banks began buying euro in a big way. That, in turn, forced speculators, who had taken bets the euro would fall further, to cover those short positions by buying euros. That in turn triggered the euro rally of the past days, all in very thin summer trading."

There is much to bear this out, according to Lewis. The minute that banks began to buy euros after the IFO report, various Euroland officials began going out of their way to hail the "recovery" of the once-mighty German economy. European Union Commissioner Yves-Thibault de Silguy told a London audience that the euro had "appreciation potential." European Central Bank member Otmar Issing declared on July 26, that he didn't rule out a hike in European Central Bank interest rates, a statement which predictably increased the buying of euros.

"The problem is that the IFO data are hardly proof of German recovery," noted Lewis. "The 'good' June results only brought business confidence index back to the very depressed levels of last November. That is hardly a recovery."

Further underscoring Lewis's sober view was the release of German machinery industry results for the first six months, through June 30, by the machinery association, VDMA. New orders for this vital sector of the German industrial economy fell by a significant 11%, compared with the same half year in 1998. New export orders for the period were down by 15%, and in June, new export orders were down 18% from June 1998.

Prospects for German economic growth are depressed further by the demand by German Finance Minister Hans Eichel for DM 30 billion in budget austerity in the coming fiscal year, to control the debt levels. The huge cuts will severely affect public spending and economic growth. On July 24, Eichel announced that his DM 30 billion cut was "just the beginning" of planned austerity budgets. The state sector is fully 43% of the total German economy, far more than in the United States. Spending cuts here will severely damage German economic growth well into next year and beyond.

"I see no convincing proof of the economies either of Japan or of the European Union having any real sustainable growth," commented Lewis. "I cannot recall an earlier period where the divergence has been so great between what people say about the state of the world economy, and what it actually is."

The world's great confidence game is but another desperate step in the latest G-7 crisis-management manipulations to try to get to the next period without reorganizing the manifestly bankrupt global system.

"The Japanese are trying to keep foreign confidence and foreign funds coming into the Nikkei to push the stock index above 18,000 by their Sept. 30 accounting half-year deadline," Lewis concluded. "That would give the troubled Japanese banks a major boost. The Euroland banks are trying to prop the euro comfortably above 1.01 until the options expire on Aug. 31. The powers that be in the various G-7 governments and financial establishment fear that if we don't 'believe' and share the confidence, the world economy will go into depression or worse."

The reality is that the world economy seems preprogrammed to do just that, together with the greatest financial meltdown of inflated paper assets in history, perhaps all as early as September-October.