

Even U.S. financial press now admits: end-times for the 'boom'

by Marcia Merry Baker

Over recent months, *EIR* has periodically printed selections of media commentary from outside the United States, on the near-collapse state of the U.S. and other financial bubbles. Observers from Frankfurt, to London, to Kuala Lumpur, have compared the United States stock market mania to the 17th-century Tulip Bubble, the 18th-century South Sea Bubble, and to other historic episodes of insanity. In 1999, Japan's financial official Eisuke Sakakibara called the U.S. economy, "bubble.com."

To those familiar with the earlier forewarnings of Lyndon LaRouche, these recent commentaries are johnny-come-lately. LaRouche pointed out as of the mid-1990s, that there was a "Triple Curve Collapse Function" involved in the inter-related trends of financial and monetary valuations soaring, while physical economic inputs and outputs plunge. He said that, barring a policy intervention, the blow-out stage would inevitably be reached. Here we are.

Along with covering the blow-out state of financial markets—especially the U.S. stock exchanges, foreign observers have been asking of the United States: "Have lunatics taken over the asylum?" This question arises, because, in contrast to Europe, the talk in the United States—from election campaigns (apart from LaRouche) to the business pages, has been, until now, only of unprecedented U.S. "prosperity" and ever-rising stock values.

Now, there is a change. The Wall Street "business" press, if not the major media, is headlining the quaking state of the U.S. and global financial bubble. Below, we publish a grid of recent U.S. press items speaking of financial disasters and implications.

All the more, the question still remains, "Have lunatics taken over?" What will be the policy response to the blow-

out? The gathering support for the LaRouche Presidential nomination drive, in the continuing series of state primaries, shows the desire among some Americans to mobilize for emergency policies that will re-build the economy and provide for people, instead of provide for speculators and destruction. Motion in the direction of such a nation-building approach, is indicated by an initiative for a "New Bretton Woods" from Italy, now before the European Parliament, which we also print below.

In addition, in Asia, there is a renewed drive for a joint fund in the region, to help serve economic priorities by stabilizing financial relations. Called ASEAN+3 (the ten Association of Southeast Asian Nations members plus Japan, China, and South Korea), the nations involved are pursuing a project similar to the proposed Asian Monetary Fund of 1998, which was blocked at the time, by Fed-directed U.S. policy.

Certified lunatics

For Alan Greenspan, Federal Reserve chairman since 1987, and honorary chairman of bubble.com, the party is over. Greenspan left the punch bowl out so long, that the revelers are bathing in it, columnist John Crudele wrote in the *New York Post* on March 24, calling for Greenspan to resign. Even less polite remarks are made about Treasury Secretary Lawrence Summers.

In recent years, especially since the September 1998 Long Term Capital Management hedge fund crisis, a blatant hyper-inflationary policy of money expansion was pursued by the Fed and Treasury Department, to keep speculative bubbles of all kinds afloat—from stock markets and real estate, to exotic derivatives and other fancy futures bets. Greenspan may have wagged his tongue against stock market "exuberance," and

may have raised interest rates five times since June 1999, but since 1987, when he first came into the chairmanship, he has pursued “free market” speculation. In mid-March, the U.S. money supply (M3) was expanding at the rate of over \$31 billion per week.

In the euro zone, money supply growth in the month of February accelerated to 6.2% (annualized), up from 5.2% in January, already well above the European Central Bank’s target rate of 4.5% per annum.

In Japan, the Nikkei stock index climbed above 20,000 in the last week in March (just before March 31, the end of Japan’s fiscal year), for the first time in five years, and was projected to pass 21,000 by May. The Bank of Japan continues to print money at literally a 0% interest rate, thus contributing on a global scale to hyperinflation, almost on a par with the Federal Reserve. Banks, hedge funds, brokerages, and financial institutions around the world continue to line up in Tokyo for dirt-cheap central bank credit, which they then shove into the bubble.

An additional factor this spring, is the looting of Japanese private savings from the government Postal Savings Fund, about to commence as waves of “Big Bang” financial deregulation measures take effect on March 31. On April 1 will come the first maturities, since Big Bang began three years ago, of certain large-volume long- and medium-term postal savings deposits. For the first time, many of the consumers involved will be encouraged to put their money into the stock market—even into foreign stock markets—rather than roll it over to the government postal account. This could turn out to be a multibillion-dollar goose-up for the Nikkei—a very short-term one, following which, millions of citizens could suddenly lose their savings, creating social chaos in Japan.

From Tiger to pussy-cat

Anyone think this is a workable policy? Perhaps some Wall Street backers of Al Gore might, who want the crash to wait until after the November elections. Then there are the Wall Street backers of George W. Bush, who might like a “nice little crash” before the elections, to knock out Gore. They’re in for a nasty surprise.

Already, there is bubble trouble, whatever manipulations may be tried to stall or hasten the crash. Most conspicuous is the “dot.com” bubble popping, both in the United States and Europe. Mid-March saw big-name, big-size losses and swings posted on the Nasdaq, on the German Nemax (the “New Market” Nasdaq equivalent), and elsewhere in Europe.

Then, from the rumblings heard earlier this winter of huge, but unnamed entities in trouble, we now get details. The announcement was expected March 31, that the Tiger Fund, until recently the second largest hedge fund in the world, will shut down. From a high point of \$22 billion in assets as of August 1998, the Tiger Fund went down to \$6 billion or lower this year.

Apart from famous-name corporate and individual losses and troubles, whole sectors of speculation are on the edge. Take the U.S. real estate market, both residential and commercial. There are questions about what the Fed may be trying to cover over in the way of trouble at Fannie Mae (FNMA), the largest lender for home mortgages. The debt issued by Fannie Mae constitutes about one-third of total bank capital in the U.S. The question arises, is there a pattern of so much lending, that debts can’t be paid?

On the commercial real estate side, the commercial mortgage-backed securities (CMBS) market is having real problems. These CMBS instruments are generated as follows: a real estate financier, such as Warburg Dillon Read or Goldman Sachs, makes several real estate loans, and then repackages these loans into a bond, which is called a commercial mortgage-backed security. Various firms then buy these CMBS bonds.

But sales of commercial real estate are falling. The March 29 *Wall Street Journal* reports, “declining demand for loans by property owners has sent the business into a slump, raising the specter of an industry-wide shake-out. With the volume of loans and underwritings down sharply, firms that flocked to the business when times were good have been reduced to fighting over a shrinking pie.”

In 1998, the volume of CMBS bonds was at a peak, reaching nearly \$80 billion. Last year, it was down to \$67.3 billion, and it has fallen lower this year. The firms that buy CMBS bonds from the dealer companies are having rough times. Criimi Mae Inc., the largest such buyer, sought bankruptcy protection in 1998. Amid a shake-out, the number of buyers has shrunk, and they are demanding 30% rates of return before they will buy a CMBS bond. The large originators of CMBS bonds, such as Warburg, Goldman Sachs and J.P. Morgan are having to warehouse and keep for themselves billions of dollars of the riskiest commercial real estate loans which they can’t resell. Watch out for the real estate bubble.

As these vignettes imply, the chain-reaction effects of what’s happening in all these sectors—from real estate to Internet dot.coms, to hedge fund speculation and multi-trillions of derivatives gambling, adds up to epic crash potential. Some 48% of all U.S. households are involved in the stock market bubble, as is a rising percent in Europe and elsewhere. The effects of the liquidity pumping itself has created the preconditions for Weimar Germany-style hyperinflation of commodity prices and basic consumer goods—fuel, food, lumber, minerals, etc. The global inflationary take-off is evident in many of these goods. But already in the here-and-now, national economic functioning is undermined.

This point is underscored in the import dependence of U.S. consumption levels on foreign production. The U.S. trade deficit on goods and services was \$28 billion for January 2000, the first time the deficit on goods and services ever exceeded \$26 billion in a single month. For the year 1999, the trade deficit in goods and services reached \$267.6 billion.

Were the rate of January to continue, the U.S. trade deficit in goods and services for the year 2000 would hit \$336 billion. Even worse, was the January surplus of \$6.73 billion on services put aside, then during January 2000, *the U.S. trade deficit on physical goods alone was \$34.74 billion*. Oil imports are a factor, but only a small part.

Documentation

U.S. financial press discovers bubble trouble

Fortune magazine, “Market Madness: What the Hell Is Going On?” by David Rynecki, April 3:

“The Leuthold Group, a Minneapolis market research firm, reports that some 30% to 60% of the cash flowing into equity mutual funds each week has gone into funds concentrating on tech stocks—even though such funds account for less than 5% of total domestic equity fund assets.” Fortune poses two viewpoints of the tech stock inflation: “Limitless potential vs. reasonable valuations.” Saying that in the past there have been run-ups (e.g., once upon a time, “ITT attracted Internet-like valuations”), but “this time is different. The valuations have never been quite this outlandish.” The writer gives credit to Paine Webber’s chief market strategist, Ed Kerschner, for coming up with useful categories of outlandishness, which were publicized in advertisements in late March. At the top of the three-level pyramid, are the “new” new-economy stocks like Amazon.com; then in the middle, new-economy aristocrat stocks like Dell; and then the old-economy stocks.

Washington Post, “End of the Boom?” by Robert J. Samuelson, March 28:

Samuelson says that “We may have gotten a small foretaste last week of the endgame of the Internet investment boom,” in the drastic downward revision of 1999 sales and profits by MicroStrategy, which “suggests that the high-tech frenzy has created an ethical quagmire,” in the use of stock options, conflicts of interest involving IPO underwriter-analysts who hype the issues they are underwriting, and other such things. “The anger and outrage going down, may be as exaggerated as the indifference going up. Other deflated booms have followed this cycle: the 1920s’ U.S. stock boom; the S&L scandal of the 1980s; Japan’s recent ‘bubble economy.’ In good times, people often do things that—with hindsight—look less than upstanding. The MicroStrategy case may be misleading. Or it might portend a larger reckoning.”

Wall Street Journal, March 27:

The first of a package of articles in the paper’s “Money and Investment” section is titled, “Pins and Needles: What Catalyst Can Deflate Stocks? It’s Tough to Spot Culprit Before Shares Start Tumbling Down.” “How will you know the end is near?” it begins, adding that the trick is to be able to spot “the pin that pricks” the bubble.

A second article describes how Americans are pouring increasing amounts of money into risky stocks, and that stocks now constitute a higher percentage of the average investment portfolio than previously. Some 48% of American households now own stocks, up from only 12% in 1975.

A third article is titled “Crash? A Generation Says: Whatever.” It focusses on the generation now in its 20s, who knows nothing about crashes; the word isn’t even in their vocabulary. They have no recollection of 1987, much less 1929. And they say, “What’s scarier is not to be in the market, than to worry about a downturn.”

New York Times, article by Louis Uchitelle, March 26:

“Public recognition of the bubble” might ignite a debate about “market fever,” the author argues. While Federal Reserve Chairman Alan Greenspan said in 1996 that “irrational exuberance” *might* be driving up stock prices, perhaps it is time for him to say that it *is* doing so: “Public recognition of the bubble might finally propel America into vigorous debate about ways to control the market fever.”

“Some of us believe that the speculation has gone so far that there is no easy or painless way out,” said Wall Street economist Albert Wojnilower. “The question is whether to acknowledge this and open the floor to other solutions. That is what Greenspan would be doing if he declared that speculation is driving up stock prices.”

Uchitelle says that “the Clinton administration, in an election year,” and “most Wall Street traders” would resist such frankness, and notes that some “worry that it is already too late to prevent a damaging market crash or painful sell-off—the denouement in the past of speculative bubbles that have gone unrecognized for so long.”

Barron’s, March 27:

The issue contains both a guest commentary by Morgan Stanley Dean Witter chief economist Stephen Roach, and a lead column by Alan Abelson, referencing Roach, calling for the Federal Reserve to raise the margin limits on stock purchases, rather than continue to raise interest rates. Abelson calls the \$270 billion in official margin debt “only the tip of the iceberg. It doesn’t include the doubtless formidable aggregate of loans taken out by venturesome types on other assets—like their houses. . . Nor does it include the extremely leverage-friendly stock-index futures contracts.” Abelson claims that Greenspan also “has to fight a nasty little guerrilla war the Treasury has launched against him” to stop him from raising interest rates.

Washington Post, editorial, March 25:

So far, “Greenspan’s attempts to deflate Wall Street have failed to do the job,” and “even more troubling. . . the Fed’s interest rate hikes are not even raising interest rates.” In fact, the *Post* says, we have the “paradox” that “higher Fed rates make for lower market ones,” since the bond markets believe Greenspan will keep inflation under control and thus are willing to accept lower interest rates on their bonds. . . . Some-time, somehow, the party will have to end.”

New York Times, guest commentary by Paul Krugman, March 26:

A long time ago, people used to care about the U.S. trade deficit, but no more, says Krugman. In January, the United States “set a new world record: the biggest monthly trade deficit ever. . . . But the markets couldn’t have cared less.” The situation where we “pay for many of our imports by attracting inflows of capital—in effect by selling the rest of the world claims on our future exports—cannot go on forever. And as the late economist Herbert Stein declared, ‘If something cannot go on forever, it will stop.’ ” Right now, with a strong dollar, foreign investors are willing to hold Treasury bonds, but the dollar may decline. So, foreign investors (and the value of the dollar) “are arguably doing a Wile E. Coyote—one of these days they will look down, realize that they have already walked over the edge of the cliff, and plunge. And when they do, it will come as a rude shock not only to them, but also to American financial markets that have become accustomed to big inflows of foreign money.”

New York Post, “Why Greenspan Should Quit,” by John Crudele, March 24:

“If Greenspan has been doing his job right he wouldn’t have had to raise rates this frantically. He wouldn’t have made the U.S. economy into a lab experiment that could bounce like Disney’s flubber or blow up like some terrorist’s home-made bomb.

“Today’s economy is that unpredictable.

“And it is unpredictable because Greenspan permitted Americans to become addicted to the bubble. Bubble money drives today’s real estate prices. Car sales live and die by bubble money. . . . And try as he may, Greenspan now can’t wean Americans out of their speculative habits. No amount of predictable rates hikes will do it. The Fed not only left the punch bowl at the party too long, it permitted revelers to bathe in the refreshments.”

Crudele uses Japan as an analogy to argue his case, thus missing the big picture. “Japan’s amazing success story of the last decade—built entirely on a stock market bubble—turned into an awful nightmare for the country. Japan now has had 10 years of brutal unemployment and civil distress and may only now be getting out of the hole. Greenspan is headed down the same road. As much credit as he gets today, he’ll reap an equal amount of blame when it all ends.”

European Parliament to discuss proposal for a New Bretton Woods

by Paolo Raimondi

On March 16, four Italian Members of the European Parliament in Strasbourg, France introduced a resolution calling on the European Commission to propose a new Bretton Woods conference. While Europe is being shaken daily by turbulence on the financial markets, mega-mergers, the downsizing of the physical economic sector, and workers’ protests against plans for massive layoffs, this initiative puts discussion of an alternative to the crash directly on the agenda in European institutions.

The resolution, presented by Hon. Cristiana Muscardini, Hon. Mauro Nobilia, Hon. Vitaliano Gemelli, and Hon. Mario Mauro, is a shorter version of the motion for a New Bretton Woods presented by Sen. Riccardo Pedrizzi and 22 others in the Italian Senate on Jan. 12 and Feb. 16. The same issue has also been raised by a group of parliamentarians in the Italian Chamber of Deputies and in the Milan City Council.

In the past few weeks, the proposal has been informally discussed in the parliaments of several nations in Central and Eastern Europe, and in many developing nations.

Text of the resolution

The European Parliament:

Whereas the 1944 agreement of Bretton Woods mechanisms contributed to the realization of monetary stability and to postwar economic reconstruction;

Whereas there is a divergence between the real economy and the financial economy since the decoupling of the dollar from the gold reserve system;

Whereas financial crises have exploded in different parts of the world since 1997;

Whereas the international monetary and financial institutions in carrying out their tasks are malfunctioning;

Whereas it has been ascertained that the “speculative bubble” has had devastating effects for the economies of the developing countries, completely transforming the structures of the world economy, and reaching the level of at least \$300 trillion, compared to the world GDP of about \$40 trillion,