

BIS Warns of Stock Market Crash

by Lothar Komp

On the evening of May 29, something monstrous happened in the old Elysée Palace in Paris. The top managers of the largest European, Asian, and American banks were gathered together at the French Presidential mansion, with the most powerful central bankers in the world, to celebrate the anniversary of the Banque de France. It was, of course, the role of French President Jacques Chirac to open the ceremonies. But there was a problem: Chirac was not there. The assembled bankers had to bide their time for an hour until the President finally arrived.

As it later turned out, there was a prior meeting between Chirac and the heads of the Group of Seven central banks, where there was such a heated argument between Chirac and U.S. Federal Reserve Chairman Alan Greenspan, that the timing of the whole affair was thrown off track.

Chirac had characterized the speculative bubble on the U.S. stock market, as well as its exploding current account deficit, as a danger for the world financial system. Greenspan responded with a laudatory on the economic and financial situation in the United States.

The episode underscores once more, that the Trilateral consensus among the members of the three large currency blocs is falling apart. The situation resembles the last hours on the *Titanic*, as the ship was forging full-speed ahead toward the iceberg. In Europe and Asia, some of the decision-makers have recognized that they have to get into some lifeboat as soon as possible, or steer clear from the site of the impending disaster. U.S. Treasury Secretary Lawrence Summers and Fed chief Greenspan are desperately trying to keep everyone on board in a good mood, with heavy dosages of liquidity or other concoctions until the last party on the *Titanic* finally comes to an end, i.e., until either Al Gore or George W. Bush have been crowned the new President of the United States.

But, amid the high spirits on the financial markets, which had been sustained to the end of May—which had everyone believing that the figures on the performance of the American economy guaranteed a “soft landing,” and that a “summer rally” would soon take hold on the stock markets—the central bank of central banks raised its voice with unmistakable warnings.

Those who are familiar with the traditionally cautious

evaluations of the Bank for International Settlements (BIS) in Basel, Switzerland, will be astonished at the clarity with which the sources of danger for the world financial system and economy are called by their real names.

The Worst Case Could Happen

When the BIS presented its annual report on June 5, its president, Urban Bäckström, said that there are two things which worry him: “external imbalances and asset prices.” He added: “We have witnessed too many crises in the last decade not to know that market confidence can shift suddenly. A soft landing is by no means assured. If there were problems on the stock markets, the whole pyramid of debt would be endangered.”

Bäckström pointed in this connection to the fact that “loans to finance equity purchases have risen sharply in a few major countries.” He said, “Ensuring that investors are not sheltered from the consequences of their sometimes misguided investments is important for maintaining prudent lending standards. Investors should not expect that monetary policy will underwrite any particular valuation of equity markets. A second and related risk is that high asset prices might lead to complacency about debt levels. Household and corporate balance sheets may look healthy when asset prices are stable or increasing, but what will they look like if prices fall?”

Just as there are “rising levels of household and corporate indebtedness in the United States and some other industrial countries,” the “rising levels of external indebtedness in a number of emerging market economies are based on expectations of continued strong growth in income and production.” Bäckström warned: “Volatility is intrinsic to financial markets. Recent turmoil in stock markets as well as earlier crises in emerging markets demonstrate the risks of basing decisions on one central scenario, rather than allowing too for a range of possible—including worst case—scenarios.”

The annual report that Bäckström presented, devotes a separate chapter with the economic and financial situation in the United States. The BIS draws an interesting comparison between the United States today and Japan at the end of the 1980s, just before the speculative bubble on the stock and real estate markets there burst, and the entire banking system became dependent on government rescue packages. The objection might be made, the report says, that stock prices rose in the United States in the 1990s, but real estate prices did not rise as dramatically, as they did in Japan. “However, unlike Japan before, the United States is an external debtor with a large current account deficit. Thus, the balance of risks remains difficult to assess.”

‘Without Advanced Warning’?

Prices on all of the stock markets in the world, not only in the United States, are moving at record high levels relative to the fundamental parameters of the respective firms. The price-

earnings ratio on the stock markets today have “exceeded the levels seen before the stock market break of October 1987.” The BIS report notes: “The historically high valuations of major stock markets clearly pose risks of a sharp market-wide correction. The high-technology sector would appear to be particularly vulnerable. Yet the non-technology sector also displays valuations that are high by historical standards. While for most of the first quarter of 2000 investors alternately favored one sector over the other, a shift in sentiment that favored high-technology stocks could well have repercussions for non-technology stocks as well. Such a shift in investor sentiment often requires very little to precipitate it. Large sell orders can come without warning and cause further selling as other investors infer adverse information, whether or not the initial trades were actually informative. Historically this has often led to a general loss of confidence as prices fell unexpectedly.”

And once the downward trend starts, then, thanks to the changes in the world financial system in the past decades, we have considerably worse cards than before. As the BIS emphasizes, not only is a worldwide rise in “rapid credit expansion” and a “growing willingness on the part of creditors to take risks” observable, but also the degree of concentration in the financial markets has increased. That means “not only that the global economy may have become more exposed to macroeconomic shocks, but also that the dynamic response of markets to such shocks may be harder to predict than in the more regulated past.” More pointedly put, “A combination of continuing deregulation, heightened competition, technological change and increased concern for shareholder value may have encouraged behavior and cross-sector relationships which will prove to have been imprudent only when the next downturn comes.” And if the leaders of financial institutions do not lay greater weight on limiting the risks of their trading departments, “the relentless pursuit of shareholder value, without this crucial adjustment, could prove a very dangerous strategy.”

No Solution

The Basel bankers’ sober assessments are a welcome contrast to the manic-euphoric mood spread by most of the financial media. It is remarkable that the most recent BIS warnings have been mentioned only in the European press, while so far most of the U.S. media have ignored them completely. Yet, the BIS’s analyses and warnings contain nothing which has not been addressed by Lyndon LaRouche, and covered by media sympathetic to him, in past years. More importantly, the BIS presents no solution. The BIS bankers who are gathered for the last party on board the *Titanic*, refuse to drink alcohol, and instead speak about the approaching icebergs, but they seem little worried about the fact that hardly anyone pays attention to them. The inevitable question is: Where is the captain who can swing the rudder in the other direction?

BIS Alarm Bells: Big News in Europe, Blackout in U.S.

This year’s annual report of the Bank for International Settlements was released on June 5, and its 200 pages were made available in full on the Internet. On the day of release, international wire services — Associated Press, Bloomberg, Reuters, and others — duly carried notices and accounts of the content. In Europe, the significant warnings by the BIS of prospects for a financial crash, were covered prominently and widely within 24 hours, followed in succeeding days by commentary and analysis. In the United States, next to nothing appeared.

The major U.S. press did not even send their European financial correspondents to the June 5 BIS press conference in Basel. The wire stories were killed or buried alive. This degree of coordinated suppression reveals intervention by Wall Street and the White House both. The reasons are covered in the accompanying articles.

The BIS itself confirmed that its report was blacked out in the United States. A spokesman for the Bank told *EIR* that to their knowledge, no news outlets in the United States had covered the story. Curiously, the BIS spokesman, Margaret Critchlow, noted to *EIR*, that the *international edition* of the *Wall Street Journal* covered the BIS report in two separate articles, but the *Journal* did not cover it in its U.S. edition. Also, the *International Herald Tribune*, run by the *Washington Post* and the *New York Times*, covered the story, but the *Times* and the *Post* blacked it out at home! An attendee at the BIS press conference told *EIR* that it was “surprising and puzzling” not to see the *Washington Post* reporter at the June 5 Basel press conference, given that the reporter had previously attended such releases.

Among the very few sightings of coverage in the U.S. media, was CBS Market Watch, and an item in the June 7 *Seattle Times*. The *Times* Business Section, page 1, the third topic in the “Newsletter” column covering world trade and Pacific news, ran the BIS story. The buried item gave a short, accurate rendering — imagine the impact of it as front-page news across the United States. Columnist Stephen Dunphy wrote, “The Bank for International Settlements in Manila [sic] has released its annual report on the world economy, and it is a sober one.

“The bank, the international organization of central banks, warned that a hard landing of the global economy is possible, given growth rates in the U.S. and Europe, the level of the dollar, inflation, and the high value of stock markets.

“The bank said the ‘current rate of expansion of domestic demand in the U.S. is unsustainable and potentially inflationary.’ The biggest policy challenge may be coping with a sudden reversal in the fortunes of the dollar, the bank said.”