

The Whole Financial System Is Crumbling

by John Hoefle

The wild swings in the stock markets, the decline in corporate profits, the bankruptcy rumors and shotgun mergers of financial institutions once considered “too big to fail,” the rising level of defaults in the bond markets, and the panic which surfaces with increasing frequency among the gamblers in today’s “investment” casino, are not discrete elements, but are all parts of a whole: the disintegration of the global financial system. Forget the media hype about this explanation and that explanation—it’s nothing more than a soap opera to keep the suckers in the market and keep economics out of the U.S. election process. What is taking place before your very eyes, is the death throes of the current financial system. But it’s even worse than that: The entire system—political, financial, and cultural—is disintegrating. Forget the populist posturing, the single issues, the obsessions with “my money” and all the narrow little issues, and turn your attention to the question which counts: When this system collapses, what will replace it?

The only acceptable answer to that question—putting the financial system through bankruptcy proceedings, shutting down the casino, and launching a crash program of rebuilding the productive sector—leads directly to Lyndon LaRouche, the man who has devoted his entire life to saving mankind from the criminal stupidity of the elite which has led the world into the largest speculative bubble of all time, and led civilization itself to the brink of collapse.

No Stock Answers

Panic and volatility have become the name of the game in global stock markets, particularly in the so-called high-tech arena. On Oct. 12, the Davy Jones Industrial Average fell 379 points and the Nasdaq Composite fell 94 points; the next day, the Plunge Protection Team rode to the rescue, prompting a market “recovery.” But that recovery was short-lived: On the morning of Oct. 18, the Dow plunged 433 points, triggering yet another rescue effort. We’ve gone from one rescue effort every few years, to one rescue effort every few months, to, at least lately, one rescue effort a week. The Plunge group, a.k.a. the President’s Working Group on Financial Markets, is now manipulating the markets on an almost daily basis.

Many of the hot-shot Internet and computer-related high-tech stocks have already died, and the Nasdaq is headed in the same direction. It is likely that the sharp rise in the Nasdaq in late 1999 will be seen as the last gasp of the tech stocks.

FIGURE 1
Nasdaq Composite, Daily Closing,
Jan. 3, 1995–Oct. 13, 2000



Source: Nasdaq.

The value of all stocks traded on the Nasdaq doubled in 1999, and rose an astonishing 87% between Oct. 19, 1999, and March 10, 2000 (Figure 1). That sharp jump has all the markings of a manipulated event, a classic suckers’ rally which allowed the insiders to make loads of money in order to clean up their books for the end of the year, then quietly sell out to all the “little” investors who poured into the market to make a killing. That killing indeed occurred. Between March 10 and April 14, the Nasdaq plummeted 34%. As of this writing, it appears inexorably headed below 3,000, well below its peak of 5,048.

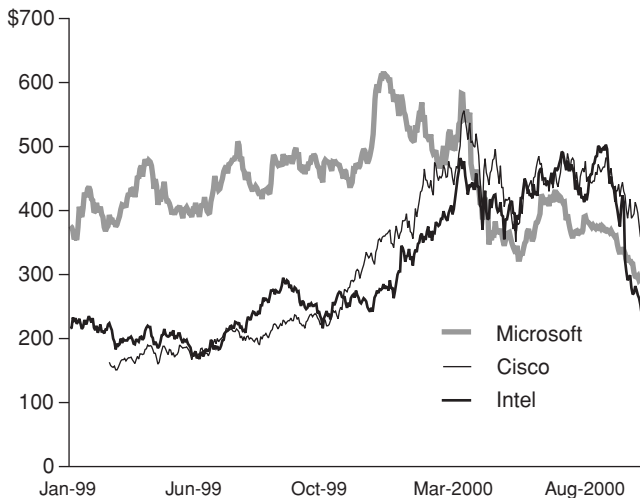
While another bump upwards is possible, the engine which had driven the Nasdaq to such absurd heights is sputtering and losing power fast. For the year to date, the Morgan Stanley Internet Index is down 49%, and at least 30 Internet companies which had market capitalizations of at least \$1 billion at the end of 1999, have lost 85% or more of their value since then.

Even more ominous are the sharp drops in the values of the Nasdaq giants. Microsoft, once the most valuable company in the world in terms of market capitalization, has seen its value more than halved since last fall (Figure 2). While part of Microsoft’s decline can be attributed to the anti-trust suit by the U.S. Department of Justice, the larger problem is the decline of the global economy. Intel and Cisco Systems, which with Microsoft were three of the four largest companies in the world by market capitalization at the end of 1999, have also fallen dramatically from their lofty heights. Intel’s stock has lost half its value since the end of August, and Cisco is down by a third since March. Other Nasdaq titans have also fallen: Amazon.com is off 81% from its peak, Yahoo! is down

FIGURE 2

Market Capitalization: Microsoft, Intel, and Cisco Systems

(Billions \$)



Source: Yahoo! Finance.

80%, Dell and e-Bay are off 59%, America Online is off 54%, and Oracle is down 27%. Oracle (number 12), AOL (31), Dell (44), and Yahoo! (77) were all among the world's 100 largest public companies at the end of 1999, ranked by market capitalization.

Many of the Internet companies have been kept alive by venture capital, bank loans, and junk bonds, but those sources of capital have largely dried up, leaving the firms in a death spiral of no income and no cash cushion.

The turmoil has also hit the corporate bond market, where the junk bond sector is the bleeding edge. The junk bond market, with some \$690 billion of bonds outstanding, is now far bigger than it was during the heyday of now-defunct Drexel Burnham Lambert and its star bubblebuilder Michael Milken. In fact, more junk bonds were issued in 1998 alone, than in all of the 1980s (Figure 3). The 1980s boom ended with soaring default rates on junk bonds, a process which is occurring again, but on a much larger scale. Moody's Investors Services predicts that the default rate on speculative grade debt will top 8% by mid-2001.

Given the rumors flying through the markets in recent weeks, the losses in the junk bond market may already be much higher than has been admitted. Morgan Stanley Dean Witter and Deutsche Bank are each rumored to have lost a billion dollars on their junk bond dealings. Morgan Stanley took the unusual step of issuing a press release on Oct. 11, denying that it had suffered such huge losses, claiming it had lost only \$90 million.

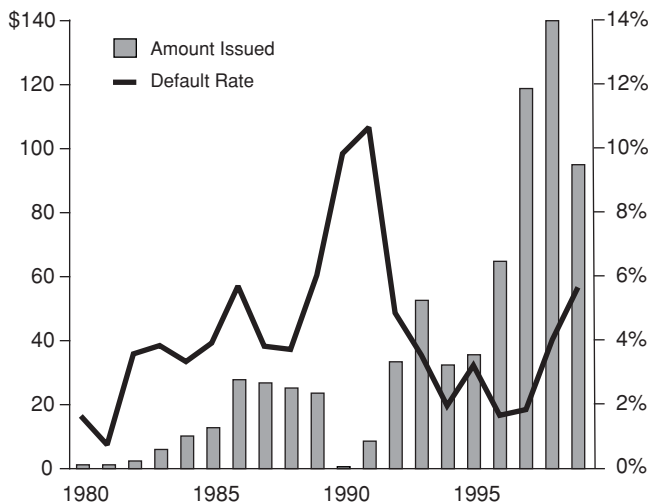
The biggest area of concern in the junk bond area is with bonds issued by telecommunications companies. The past

FIGURE 3

Junk Bonds and Defaults on the Rise

Amount Issued (Billions \$)

Default Rate



Sources: Thomson Financial Securities Data, Moody's Investors Services.

few years have seen a frenzy of activity in the telecom sector, as big companies gobble up each other and smaller companies take on huge amounts of debt in hopes of cracking into the big time. For seven of the last eight years, the telecom sector has been either first or second in dollar volume of announced mergers and acquisitions, creating a class of giant companies; a third of the 30 largest companies in the world are telecommunications manufacturers or service providers. At the same time, many companies—particularly in Europe—have gone deeply into debt to buy the rights to frequencies in the broadcast spectrum. As the economic foundation underlying the bubble crumbles, these debts threaten some of the biggest commercial and investment banks in the world.

A 500-Pound Gorilla

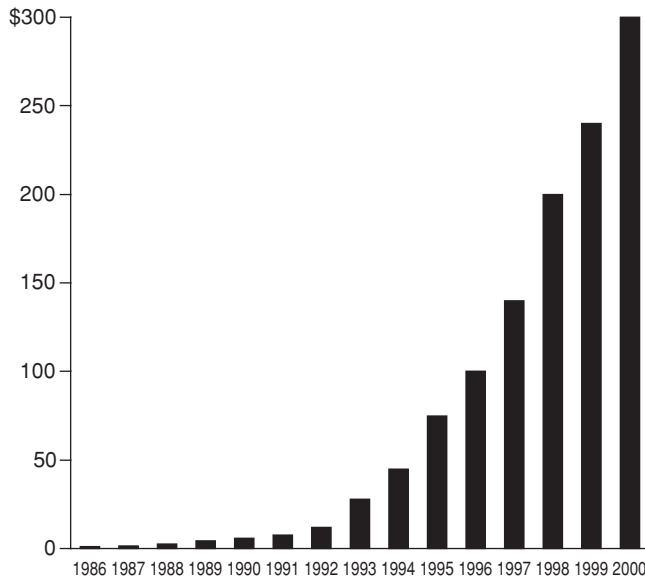
While reams of newsprint have been devoted to the state of the stock market and much has been written about bonds, references to derivatives have almost disappeared from the press. That's akin to reporting on the nervousness of a room full of people, without mentioning that there is an angry, unstable 500-pound gorilla glowering from the corner.

In this case, that gorilla is the \$300 trillion global derivatives market (Figure 4). Globally, *EIR* estimates, there are some \$400 trillion in financial aggregates outstanding, of which about 75% is in derivatives, with the remaining portion in debt, stocks, and the like. This figure is two to three times higher than the so-called "official" derivatives figures (the highest official figure released to date is \$131 trillion, for some 70 selected financial institutions at the end of 1998). (That there is a concerted effort to downplay the size of the derivatives market, was made clear by the *Washington Post*

FIGURE 4

World Derivatives Totals

(Trillions \$)



Source: EIR estimate.

TABLE 1

World's Largest Derivatives Institutions, 1999

Bank	Country	Trillions \$
1. Chase Manhattan	U.S.A.	12.9
2. Deutsche Bank	Germany	11.1
3. J.P. Morgan	U.S.A.	8.9
4. BNP Paribas	France	7.4
5. Citigroup	U.S.A.	7.4
6. UBS	Switzerland	5.6
7. Société Générale	France	5.2
8. Goldman Sachs	U.S.A.	5.2
9. Bank of America	U.S.A.	5.1
10. Crédit Suisse	Switzerland	4.6
11. Fuji Bank	Japan	4.3
12. Merrill Lynch	U.S.A.	3.9
13. Tokyo-Mitsubishi	Japan	3.7
14. Morgan Stanley	U.S.A.	3.4
15. Lehman Brothers	U.S.A.	2.9

Sources: Swaps Monitor, EIR.

some months ago, in a reference to the “\$5 trillion” global derivatives market; later in the article, the *Post* admitted that the global derivatives market actually had a notional principal value of \$88 trillion, but that only \$5 trillion was at risk.)

Even using the official figures, it is clear that the banking system is hopelessly, fatally addicted to derivatives (**Table 1**). U.S. commercial bank holding companies had \$42 trillion in derivatives as of June 30, 2000, led by Chase Manhattan

with \$14.4 trillion and J.P. Morgan with \$9.6 trillion. The recently announced merger of Chase and Morgan will create a bank with \$24 trillion in derivatives. It is highly likely that the merger of these two banks was a direct result of huge derivatives at one or both of the institutions.

German-U.S. Maglev Pact Boosts Export Prospects

by Rainer Apel

In the context of the International Transportation Symposium, “Moving To the 21st Century,” in Washington, D.C. on Oct. 9-12, which was attended by delegations from 90 countries, U.S. Secretary of Transportation Rodney E. Slater and German Transportation Minister Reinhard Klimmt, signed an agreement on the exchange of technological information on magnetically levitated (maglev) rail technology. The agreement includes the establishment of a joint governmental commission, which is to prepare for the first use of the German Transrapid maglev rail system in the United States, within the next four or five years.

Potential candidates for the first such line include from Washington, D.C. to Baltimore, whose mayors are considering a maglev link that, at about 320 miles per hour, would reduce travel time between the cities to 17 minutes. The first U.S. maglev line would get Federal funding of \$950 million, which would cover about one-third of the construction costs for a 40-50 kilometer project.

There are also at least six other options that might see the start of construction work by no later than 2003, including in the Los Angeles, Pittsburgh, Atlanta, Las Vegas, and Miami areas, and one in the state of Louisiana. The commission has a three-year mandate, to select a route and prepare for the first U.S.-German maglev project.

Why Now?

The use of the German maglev system in America has been being talked about for some time, and even after the signing of the U.S. Transportation Equity Act for the 21st Century about two years ago, many experts and politicians remained skeptical that such a project would come about in the near future. What made the Slater-Klimmt agreement possible now, is, as the Germans see it, the attempt of the outgoing Clinton Administration to make sure that, first, the next administration is prevented from opting out of the project again, and second, its desire that the project finally take off.

Slater is seen as a backer of maglev technology. And, whereas frictions seem to now dominate most aspects of relations between Germany and the United States, positive mod-