

Business Briefs

Economic Reporting

BIS Buries the Recovery Illusion

On May 27, the Bank for International Settlements (BIS) published its latest quarterly review on "International banking and financial market developments." The accompanying BIS press release this time starts off with the headline: "Waning Confidence in Strong Recovery."

The BIS notes: "The early months of 2002 dissipated the earlier ebullient mood that had built up in financial markets during the fourth quarter. From the start of the year to the first week of May, stock prices declined and U.S. long rates edged lower with the waning of confidence in a strong economic recovery."

"In Europe, rising oil prices and new wage negotiations raised the spectre of inflation, pushing up long rates. In equity markets, investors' hopes were dashed by a lack of evidence that corporate earnings were recovering with the economy as a whole. Share prices were depressed further by continued skepticism about corporate disclosure and accounting practices, by new reports about stock analysts' biased recommendations, and by a sudden aversion to corporations that relied heavily on short-term debt."

Gold

Banks Face A Derivatives Crash

So states Switzerland's weekly *Weltwoche* in its latest edition. The article, headlined "The Fever Rises, and Rises and Rises," notes that the price of gold has always been the "fever thermometer" for financial markets. The more precarious the situation turns on financial markets, the higher rises the gold price. On top of inflation worries and the Middle East conflict, there has been a loss of confidence in the U.S. recovery and the

dollar. Aggressive gold purchases by the central banks of China, Russia, and Japan, in order to reduce the dollar dependency of their currency reserves, have also contributed to the rise.

The high gold price spells big trouble for some of the largest banks. J.P. Morgan Chase in particular, but also UBS, Deutsche Bank, and Citigroup, for years have borrowed large quantities of gold from central banks. Betting on a steadily falling gold price, they sold the gold and invested the money into high-yield securities. When the gold borrowing contract matured, the banks were able to buy the needed gold at usually a much lower price, thereby increasing the profit of the whole operation. For many years, this gold carry trade worked extremely well. Similar methods were used by the gold producers as well. Any further rise of the gold price would now hurt the mentioned banks very badly, due to their huge amount of outstanding gold borrowings. At one point, they will have to close their contracts by buying gold at a much higher price than expected. These purchases would drive the gold price still higher.

Once the gold price surpasses the \$330 level, a chain reaction will probably set in. The situation is even more precarious, "as the banks are also exposed to complex financial derivatives as part of their gold trades." The banks could therefore run into another disaster like "the collapse of the LTCM [Long Term Capital Management] hedge fund in 1998."

Auto

'Grey-Market' Cars Coming Into U.S.

DaimlerChrysler is alarmed by "grey market" sales of Canadian-built cars into the United States, reported the *Toronto Globe and Mail* on May 24. "Independent exporters buy Canadian vehicles—which can be as much as 25% cheaper than the same vehicle being sold to Americans—and ship them south of the border. The low value of the Ca-

nadian dollar against the U.S. currency helps boost the profit for exporters. U.S. dealers are charging \$41,995 (U.S.) for a fully loaded model. The suggested retail price in Canada is \$51,550 (Canadian). But if prices in the two countries were the same, Canadian dealers would be charging \$64,773, based on Friday's close of \$1.5424 (Can) for the U.S. dollar—leaving lots of profit margin for anyone able to ship Canadian-bound Ford Thunderbirds south of the border."

Over 200,000 vehicles yearly, sold originally in Canada, are being bought by brokers, who then export them to the U.S. market. DaimlerChrysler, in an attempt to stop this practice, has announced that it will not honor its warranties, as of the 2003 model year, on cars and trucks originally sold in Canada which end up in the United States.

Canada

Auto Workers' 'Future on the Line'

Buzz Hargrove, Canadian Auto Workers Union President, wrote a full-page commentary in the May 24 *Toronto Globe and Mail*, saying that after several plant closures and 15,000 auto jobs lost, auto executives, industry analysts and municipal officials are calling for a new Canadian auto strategy. In late May, Ontario Industry Ministry Jim Flaherty convened a special roundtable on the future of the auto industry, while the Canadian government will also feature such a forum in June.

In 1999, Canada assembled 3.1 million new vehicles, which ranked Canada fourth in the world in automotive output. By 2001, Canadian output shrank by 20%, says Hargrove. Canada now ranks seventh in the world, and is expected to fall to ninth place by 2005 (surpassed by Mexico and China).

"With the announced or anticipated closure of three or more assembly plants, and a likely downturn in North American vehicle demand (once zero-percent sales incentives are lifted), things can only get worse," pre-

JAPAN'S real economy is continuing to fall. Total machine-tool orders in April fell 26% from a year before, reported the Machine Tool Association on May 25. Domestic demand and exports both fell sharply. Meanwhile, five mid-sized construction contractors posted net losses totalling \$1.3 billion for the quarter. One, Haseko Corp., is on the verge of closing down.

DEFLATION hits China. Industrial goods prices were cut by 3.1% in April, after a 4% drop in March, the National Bureau of Statistics reported in late May. One of the reasons for the price cuts, is the effect of cheaper imported goods due to China joining the World Trade Organization. The falling industrial prices have cut profits at state-owned enterprises by 20% from January-April. Consumer prices also fell by 1.3% in April, the biggest consumer price deflation in 2002.

SAVINGS in China soared to 8.67 trillion yuan (\$1.05 trillion) by the end of April. Private savings were more than 53% of all deposits at institutions. Dai Xianglong, People's Bank of China governor, called on China's banks to develop better means to use these funds.

U.S. BANKS hold huge amounts of debt of the two Federal real-estate mortgage companies, known as Fannie Mae and Freddie Mac; nearly half of all banks hold debts from these companies alone equal to one to five times their total capital. These debts are not guaranteed by the government, and are far larger than the U.S. Treasury could legally buy up, should a real-estate market crisis hit.

BANKS have rationed credit to Germany's productive *Mittelstand* industrial firms, far below the sector's requirement, squeezing these firms into a production standstill, says a study by Barclay's Capital in Frankfurt.

dicts Hargrove. The Canadian trade unionist is therefore seeking a new policy that will guarantee that the automotive industry invests in Canada. The new policy should feature, as in the recent past, both a carrot and a stick, as he explains: "Recent trends in auto investment heighten the concern. Of 16 new assembly plants built or announced in North America since 1990, Canada received one. We used to have a 'stick' to motivate auto investment here—the Auto Pact, which the World Trade Organization declared illegal, and the Liberal government dismantled. For a while, we also enjoyed a 'carrot': During the mid-1990s, we were the low-cost producer in North America, thanks to our competitive wages, our Medicare system, and the Canadian dollar."

Budgets

Illinois, Iowa in Emergency Sessions

The legislatures of Illinois and Iowa were in emergency sessions over the Memorial Day holiday weekend, as the state revenue plunge continued to worsen nationally. Refusing to admit the economic depression, many governors and state legislators are meeting in emergency sessions to argue over which limb to amputate, now, hoping to save the body for the non-existent recovery, "around the corner."

Illinois Gov. George Ryan cancelled barbeques to hold a session on Memorial Day, and make his last-ditch Fiscal Year 2003 budget proposal, which must be passed by May 31, or else a long, hot Summer session will result. Speaking for 36 minutes, he proposed 2,700 more state job cuts through layoffs, attrition, and early retirement, along with hiking taxes on cigarettes, real estate transfers, and riverboat casinos. The plan includes privatizing prison food services, closing one prison, and laying off 400 more correction officers. For the first time in 50 years, the state took in less tax revenue, year-over-year, in this fiscal year ending June 30, leav-

ing the state with a \$1.3 billion hole, and growing.

Iowa's lawmakers met in emergency session to plug this fiscal year's budget before June 30. The \$500 million shortfall has already led to extensive state job layoffs and severe cuts in human service programs. The state's revenue analyst, Michael Lipsman, told the *Des Moines Register* that, if you add together all the downward revisions of the budget this year, it is the "biggest single-year swing in state revenue since the 1930s."

Fraud

SEC Now Probes Halliburton, Others

The Securities and Exchange Commission is investigating accounting fraud at Halliburton Corp., and at Deloitte and Touche.

Halliburton, the world's second-largest provider of services to oil and natural gas companies, said the SEC has launched a preliminary investigation of its practice of counting cost overruns on disputed construction projects, as revenue, even before customers had agreed to pay for the overruns. Halliburton expects to receive a formal request for documents or a subpoena, in the next few days. The change in policy was adopted in 1998, (under CEO Dick Cheney), when the company's shares fell 43% and it posted a \$14.7 million net loss, amid falling oil and gas prices.

The SEC is also investigating Deloitte and Touche, the firm that audited Adelphia Communications' books, and appears to have been the auditor for entities controlled by the Rigas family (Rigas was the former CEO of Adelphia), which received \$2.3 billion from Adelphia. Deloitte, it seems, never informed Adelphia's audit committee that the family was using the company's credit lines to buy Adelphia stock.

Deloitte also faces a trial in Britain, brought by bondholders seeking \$300 million in penalties, for its role as auditor for Barings Bank, which collapsed in 1995.