

Business Briefs

Real Estate

Bernanke Sees \$100 Billion Losses in Mortgage Bubble

Federal Reserve Chairman Ben Bernanke—who was warned a month ago by *EIR* that the mortgage meltdown was “much worse than he thinks”—estimated in Congressional testimony, that there will be \$100 billion in hedge fund and bank losses in the mortgage bubble that his predecessor Alan Greenspan largely created. Bernanke testified before the Senate Banking Committee on July 19.

Bernanke’s public estimate is well down on the low end of bank and real estate analysts’ estimates of these losses, and even Standard & Poors’ forecast, in a July 14 report, that the losses will be in the \$400-500 billion range. Hedging his bets that the subprime mortgage losses might go higher, Bernanke added, “A lot of the subprime mortgage paper is not as good as was thought originally,” as he notified the Senators that he is now working with some banks to assess the value of their mortgage assets, such as collateralized debt obligations (CDOs)—pools of bonds backed by subprime home loans.

The Fed chairman was careful not to leave any room for speculation that he might cut short-term interest rates in response to the accelerating collapse of the mortgage bubble. In fact, he can’t lower them because the U.S. dollar is sinking, and the yen carry trade could be rapidly “unwound” by U.S. interest rate cuts, worsening the market crisis.

Hedge Funds

Why Locust Funds Are Leaving Germany

Both Germany and Denmark have recently passed new tax laws intended to clamp down on leveraged takeovers of companies by private equity and hedge funds. The German law is the tougher one, and reveals what was behind the fight over regulating hedge funds at the June G-8 Summit in Heiligendamm.

A German economist told *EIR* that the new law, which took effect July 1, slightly

lowers the overall corporate tax rate, but makes it apply to corporate income before deduction of debt interest expenses, with the exception of only a maximum of 30% of such expenses. And it makes a corporation report all financing it has received, including foreign financing, for tax purposes.

This is anathema to the takeover funds, or financial locusts, because they make their takeovers work by borrowing huge amounts of leveraged debt, putting that debt on the books of the target company, and then deducting the large interest charges from the new entities’ taxable income, resulting in their paying no taxes. These funds also locate parts of the target firm offshore, including the patent-holding division, to which royalty income is paid, allowing that income to escape taxation. The new law also puts an end to this practice.

The economist confirmed reports from other sources that big hedge funds were starting to flee Germany.

A Danish government tax expert described the new Danish law, which passed on April 1, but takes effect beginning Jan. 1, 2008. The Danish law mirrors that of Germany, although it is not quite as tough. It allows 45% of interest expenses of a new corporation to be deducted from taxable income, but only up to 6.5% of the total tax base of the corporation’s assets. It does not allow fees and commissions (typically to the locust funds or their banks) to be deducted, another common takeover scam. And it taxes all patent royalty income at 12.5%, no matter where it is generated or paid.

Some U.S. Congressional offices are studying these laws as potential models for dealing with the private equity and hedge funds there.

Agriculture

Biofuels Bubble Starving The Neediest Nations

Sharp increases in the prices of certain key food commodities, caused by diversion of food supplies and land to the “biofuels bubble,” are now hitting food aid to the world’s neediest nations, says the United Nations World Food Program (WFP). In an interview in the July 16 *Fi-*

nancial Times, WFP director Josette Sheeran said that food cost increases “mean we are now able to reach far less people” with a total amount of food aid which, at \$600 million annually, hasn’t changed since 2000.

WFP purchasing costs for all types of food have risen 50% in five years. Sheeran said the program will be forced to ask donor countries to provide more food and money, an appeal which may fail. Citing Uganda as one nation in which food aid programs had to be cut back because of the maize and cereal price increases, Sheeran said, “We face the tightest agriculture markets in decades, and, in some cases, the tightest ever on record.”

Global wheat stocks are at their lowest levels in 25 years, during which the world’s population has grown by 60%, according to the U.S. Department of Agriculture. In the United States, 30% of corn production is being diverted to biofuels.

Food Prices

First Tortilla Riots, And Now Pasta?

Earlier this year, riots broke out in Mexico over a surge in the price of tortilla flour. Now, the Association of Italian Pasta Producers (Unipi) has announced that, as a result of biofuel production, a package of spaghetti will cost 20% more in September. De Cecco, the number one quality producer, has already increased its prices by 10%, and Barilla, the largest pasta producer, will do the same.

Producers are adjusting prices to durum wheat, whose prices have risen 50% in six weeks on the international markets, as farmers have shifted from wheat to corn because of the higher profitability of biofuel products.

As hedge funds speculate on maize, driving up prices, all consumer sectors will be affected. Gian Domenico Auricchio, chairman of the Association of Italian Food Producers, reported increases in production costs of 20% for eggs, 50% for butter, and 20-40% for meat. Reporting on the situation, the Italian daily *La Repubblica*, noted a U.S. study that calculated that biofuel production will cause the doubling of starvation figures in the world.

Briefly

BUBBLES in Paris: American tourists in Europe are being surprised by higher costs due to the decline of the dollar against the euro, reported the *New York Times* July 18. Among the vignettes related, was that of a couple in Paris, who paid 9.5 euros for a can of Coca Cola, and found that their hotel was selling a single glass of Coke for 4 euros, which translates to about \$5.52, at current exchange rates.

SOUTH KOREA has a 30-year plan to become a global leader in nuclear fusion power, Yonhap news service reported July 18, in coverage of the Ministry of Science and Technology's announcement of a three-stage funding plan for nuclear fusion energy.

JAPAN is "very interested" in a project to construct a high-speed rail line from Boryspil airport to Kiev, Ukrainian Transport and Communications Minister Mykolya Rudkovsky said. Rudkovsky was in Japan July 8-13, and met with officials of the Foreign Ministry there.

A BRIDGE connecting Yemen, on the southern tip of the Arab peninsula, with Djibouti on the African mainland, is proceeding with design and construction, according to EngineeringNewsRecord.com. The Middle East Development LLC is overseeing the project, which will be carried out by the newly formed Noor City Development Corp. of California. The bridge will cross the Gulf of Aden at the southern end of the Red Sea, and is being promoted as the longest bridge in the world, at 18 miles.

SIEMENS and Russian Railways held a ceremony in Krefeld, Germany July 19, to mark the production of a new generation of high-speed trains called "Velaro Rus," which are specially designed for the technological and natural conditions in Russia, including Russian wide-gauge track, Interfax reported. These are the first high-speed rail lines in Russia, and will begin operating this year.

European Finance

Italian Ministers Support France on Maastricht Veto

Two former Italian economic ministers have supported the French government's right to override the restrictions on national spending, which were imposed by the European Union Treaty signed at Maastricht in 1992, and in subsequent amendments.

Giulio Tremonti, former Finance Minister with the Berlusconi government and Paolo Savona, former Industry Minister with the first Prodi government, independently announced support for the French government's right to override the European Currency Board and European Union Commission on matters of currency and budget.

The two interventions do not address the austerity measures promoted by the French government of Nicolas Sarkozy, but limit themselves to asserting national sovereignty. In this limited sense, they are correct and are an expression of the unavoidable crisis affecting the supranational European Union bankers' government.

Manufacturing

Russian Production Rising Rapidly

Industrial production is rising rapidly in Russia this year, according to figures published in by the Russian governmental statistics agency, Rosstat. Russia's manufacturing index was 7.7% higher in the first half of 2007 as compared with 2006, a rate of growth which Russia has not achieved since Rosstat began recording economic developments. *Kommersant* newspaper reported July 19. Growth rates from 2005 to 2006 were half the current rate.

Most important is the fast growth in manufacturing industry, which rose a record 15.6% in June alone, and 12.2% in the first half of 2007. Construction materials are a key part of this.

Kommersant reported from discussions with energy sector experts, that the highest

growth rates were in energy produced by steam and hydraulic turbines. These experts were quoted as saying that the increase is directly linked to "the beginning of the realization of a large-scale investment program in electrical energy."

Nuclear Power

Japan's Reactor Withstands Earthquake

The seven-unit Kashiwazaki nuclear plant, the world's largest in output, withstood the 6.8 magnitude earthquake July 16, while the surrounding area was severely damaged, and ten people killed.

The Kashiwazaki units shut down automatically, as part of their anti-quake safety routine. There was a small fire at an electrical transformer at one of the units, which was extinguished. A leak of water from a tank at one unit produced screaming press headlines about a "radioactive leak," but the water is radioactive at 1 billionth of the allowable level. Some drums containing low-level waste products were overturned in the quake, but TEPCO (Tokyo Electric Power Company) reported no radioactivity leak to the environment.

Nuclear power provides 30% of Japan's electricity, and there are plans to increase this percentage and pursue fast breeder reactors as the standard next-generation plant. Its nuclear program has long been the target of anti-nuclear groups, which have used every possible occasion to sow fear, this earthquake being no exception.

Japan's 55 nuclear plants are earthquake-hardened because the country sits in an quake zone. The government is now reviewing the earthquake standards of its non-nuclear equipment, such as electrical transformers, to bring them up to the quake-resistance of the reactor cores.

Kashiwazaki is 160 miles northwest of Tokyo, and is operated by TEPCO. Five of the nuclear plants are conventional boiling water reactors, and the two most recent units, built by General Electric, are advanced boiling water designs, at 1,350 megawatts each.