

The end of the Great Bull Market

by Chris White

The "Great Bull Market" is over. The five-year speculative bash on Wall Street came to an abrupt end during the course of third week of October. With the end of the bull market so ends too the financial underpinnings of Ronald Reagan's "Great Recovery," now supposedly, in the 59th month of sustained economic growth, and according to some, challenging the "recovery" of 1933-38.

There's been a lot of discussion about what should be done now. Some demand that internal U.S. interest rates be increased. Others demand a further campaign to collapse the U.S. dollar on foreign exchange markets. Alan Greenspan's Federal Reserve meanwhile is playing games with the federal funds rate, the interest banks have to pay to borrow funds from the Federal Reserve System, in order to pump money into the banking system to try to keep things afloat.

Whatever the geniuses supposedly in charge decide to do, the stage has been set for the next phase of the crisis, which some are already calling the "big one." Granted, the Dow Jones Index has shed, by this writing, over 17% of the nominal value it chalked up at the market's highwater mark in August, after this publication began to warn of the disasters that lay ahead for September and October. What lies ahead, in what the more perspicacious of market analysts are already calling "uncharted territory," is much more than the awesome intellects who created the worsening crisis are equipped to deal with.

Cut off by foreign creditors

Leave aside their proposed remedies for the moment, to focus on the question of what is driving the unraveling of the stock market. On one level, the United States, dependent on a capital inflow of between \$150-180 billion per year to keep afloat, has been cut off by its foreign creditors, especially West Germany, Japan, and the oil producers of the Persian

Gulf. While foreign central banks have spent about \$90 billion so far this year, intervening against their own economies to hold the dollar relatively stable, the inflow of foreign funds has not happened. Net, the inflow of foreign funds, for the year so far, has been zero.

After all, why should Germany and Japan, and others among U.S. creditors, continue to throw good money after bad, and risk destroying their own economies, too?

The drying up of new foreign funds underlies the development of the actual crisis that is presently functioning as the driver for the more apparently sensational collapse of the stock market. That crisis is represented by the collapse of the bond markets, markets for government and other kinds of securitized debt. The collapse in that market is shown by the steady increase in interest rates on government and corporate bonds.

The conventional wisdom is that during stock market "corrections," money leaves the stock market and goes into bond markets, where returns are less glamorous but supposedly more secure. This time the collapse of the bond markets is sucking liquidity out of stocks at an accelerating rate.

The end of 'innovative' banking

Those who demand the increase of interest rates, or the further collapse of the dollar will only make things worse. But, what is it that they will make worse?

This publication, and its sister, *EIR Quarterly Economic Report*, have been almost unique over the last five years of the so-called "bull" market's existence, in warning against the proliferation of what some, like former Treasury Secretary and White House Chief of Staff Donald Regan, have been known to call "creative" or "innovative" banking practices.

Since the unleashing of the debt crisis in the fall of 1982,

the big commercial banks have moved, at an increasingly rapid rate, out of the practices traditionally associated with banking. They no longer lend to encourage a borrower's capacity to increase his potential to repay a loan. Instead, they package and pass on negotiable instruments, securities, making their money on the difference between what they pay to borrow, and what the purchaser of the negotiable notes pays them.

They have developed, on these margins, a chain-letter or Ponzi scheme bubble unparalleled in human history. The formal name for the phenomenon is the banks' "off-balance-sheet liabilities," liabilities which are not tied to banks' reserves, or to their deposit base, by any relation at all. Such off-balance-sheet liabilities, unsecured paper, amount to about \$7 trillion, growing from nothing in 1982. The liabilities that the U.S. banks keep off their balance sheets are far bigger than the total gross national product, and about half of the total debt obligations accounted for by the U.S. credit system.

The stock market is collapsing because the funds are being sucked into bond markets by liquidity-desperate banks. Meanwhile, the daily upticks in bond market interest rates are wiping out the margins on which the banks have depended since 1982 for their survival.

This has shown up in the recent collapse of First Bank of Minnesota. It was the first bank to reportedly go under because of the effects of the declining spreads on the bond market. The efforts by Chemical Bank and Marine Midland in Buffalo to organize a stampede for an increase in interest rates proceed from the same causes. Chemical just announced losses of \$66 million for the recently concluded quarter, and has laid off 10% of its staff, and cut back on its real estate holdings. Marine Midland is desperately trying to induce the Hongkong and Shanghai Bank to expand its share in the bank to the whole operation.

Similarly, at the level of the investment banks themselves: There, two of the largest, Salomon Brothers, and Kidder Peabody, have announced layoffs, and the closure of whole departments, all for the same reasons.

Then, we presented the analysis some months ago that an increase in interest rates, to the level of 8½-9%, would be sufficient to push about 1,000 of the country's approximately 3,000 thrift institutions over the edge.

The collapse of the securitized "off-balance-sheet liability" shell game, threatening the banking system as a whole, is the reality behind the stock market collapse. The bankruptcy of the banking system, wrecked by so-called "innovative" banking practices, has set off what could well become a self-feeding liquidation cycle which will suck all into the abyss.

Three sets of options

What this implies is quite straightforward. Whatever Treasury Secretary Baker and Federal Reserve Chairman "Ayatollah" Greenspan decide to do over the next short period ahead, through Oct. 26, when U.S. bank regulators have

to, yet again, decide what to do about Brazil's defaulted debt, will be pretty much irrelevant. They may seek to demonstrate that someone is in control in the United States to halt the slide in the stock market, but they will not be addressing the liquidity crisis in the bankrupt banking system, which is driving the liquidity out of the stock markets.

Does this mean that the next phase of the crash is, as of now, unstoppable? Not necessarily. Baker and Greenspan, given their limitations, will play around with three sets of options. Increasing interest rates, collapsing the dollar, and opening up the printing presses and floating the U.S. banking system out into the sunset on a sea of freshly printed liquidity. Given the way these characters work, they will probably implement some combination of all three, in order to secure the broadest "support" from the banking system.

However, collapsing the dollar further, in the range of another 15-30% against the deutschemark and the yen, will force Germany and Japan to definitively choose between self-preservation and self-destruction. Increasing interest rates will accelerate the process of dissolution that now is getting off the ground, to the effect of wiping out a whole section of the commercial banking and thrift sectors. Recourse to the printing press, which the Fed employed on both the Thursday and Friday of Wall Street's disastrous week, may buy time, but at the cost of making the next eruption that much worse, while also helping to drive Germany and Japan out of U.S. markets.

And then, it's not simply a problem for the United States. "Innovative banking practices" have swept the world in the last five years. There is not one capital market, or banking sub-sector anywhere in the world, which can withstand what is now unleashed. Some may be bigger, more vulnerable bubbles than even that in the United States—and there are a few of those around the world—and some may be in relatively stronger shape. The same sickness rots out all.

What's now unleashed is the kind of crisis that only presidential candidate Lyndon LaRouche foresaw, and only LaRouche has a policy to deal with. The banking and credit system can be secured, and he is the one, with the ideas to do it. The others, the Bakers and the Greenspans, not only don't know what to do, they're part of the crowd which created the problem in the first place with the stupidity of their get-rich-quick, "grab the money while you can" types of ideas.

Left to their own devices for even a few weeks, the chances are that Baker, and the degenerates from the banking sector, will succeed in creating a problem that moves rapidly from bad to worse, jeopardizing the banking sector as a whole. The storms that hit the stock market in mid-October will then pale in comparison to the consequences of the decisions such characters are about to make.

It doesn't have to be that way. And it may be that those consequences, with help from the printing press, and further arm-twisting of allies and friends, can even be delayed into the spring. Whichever way it is, Reagan's bull market just came to its definitive end.