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Financial Meltdown: Is This The Big One?

By Mike Whitney
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> "This is going to be a rough week. Fastening your seat belts may not be enough for this ride. Better superglue yourselves to the floorboards and pray for God's mercy." — James Howard Kunstler; "Fullblown Panic"

On Monday [21st of January], fears of a US recession spilled over into Asian markets sending stocks tumbling. Indexes were hammered across the board in what turned out to be the worst day of trading since 2001. In India, the Bombay Sensitive Index plunged 1,408 points, to 17,605. In China, the Shanghai Composite dropped 266 points (or 5.5%) to 23,818, while in Japan, the Nikkei fell 535 points, to 13,325 points. The bloodletting stretched across the continent and into Europe where shares nosedived by more than 4% by mid-morning "putting them on track for their biggest one-day fall in more than four and a half years."

The huge sell-off is a sign that global investors do not believe that the Fed's rate cuts or President Bush's $150 billion "stimulus package" can revive the flagging economy or breathe new life into the over-extended US consumer. After Monday's sharp downturn, the prospects for averting a deep and protracted recession are slim to none.

Economics Professor Nouriel Roubini summed it up like this nearly a month ago:

> "The United States has now effectively entered into a serious and painful recession. The debate is not anymore on whether the economy will experience a soft landing or a hard landing; it is rather on how hard the hard landing recession will be. The factors that make the recession inevitable include the nation's worst-ever housing recession, which is still getting worse; a severe liquidity and credit crunch in financial markets that is getting worse than when it started last summer; high oil and gasoline prices; falling capital spending by the corporate sector; a slackening labor market where few jobs are being created and the unemployment rate is sharply up; and shopped-out, savings-less and debt-burdened American consumers who — thanks to falling home prices — can no longer use their homes as ATM machines to allow them to spend more than their income. As private consumption in the US is over 70% of GDP the US consumer now retrenching and cutting spending ensures that a recession is now underway.
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> On top of this recession there are now serious risks of a systemic financial crisis in the US as the financial losses are spreading from subprime to near prime and prime mortgages, consumer debt (credit cards, auto loans, student loans), commercial real estate loans, leveraged loans and postponed/restructured/canceled LBO and, soon enough, sharply rising default

> rates on corporate bonds that will lead to a second round of large losses in credit default swaps. The total of all of these financial losses could be above $1 trillion thus triggering a massive credit crunch and a systemic financial sector crisis." (Nouriel Roubini Global EconoMonitor)

Decades of stagnant wages have left the American worker hamstrung and unable to continue to account for 25% of global consumption. Tightening credit and lack of personal savings have only added to his problems. The American consumer is overworked, underpaid, and tapped-out. That means that aggregate demand will fall dramatically across the world triggering increases in unemployment, decreases in capital expansion, and widespread slowdown in business activity. These are the beginnings of a deflationary spiral that will wipe out trillions of dollars of market capitalization in the real estate, equities and bond markets. Even gold and oil will retreat significantly. (as we saw in Monday's results)

The present crisis is not the result of normal market forces, but price fixing at the Federal Reserve and the financial engineering of the main investment banks. If there had been sufficient regulation of the Central Bank's activities—so that interest rates had not been kept below the rate of inflation for over 31 months straight— than the trillions of dollars in low-interest credit would not have flooded into the real estate market inflating the biggest housing bubble in US history. Despite his feeble excuses, Greenspan's role in destroying the US economy is no longer in doubt. Even the far-right Op-ed page of the Wall Street Journal conceded Greenspan's culpability in Saturday's edition. Here's what they said:

> "Amid the daily market turmoil, and to help prevent a crash, it helps to step back and remember how we got here. With the benefit of hindsight, everyone can see that the U.S. economy built up an enormous credit bubble that has now popped. Our own view — which we warned about going back to 2003 — is that this bubble was created principally by a Federal Reserve that kept real interest rates too low for too long. In doing so the Fed created a subsidy for debt and a commodity price spike."

Greenspan's low interest rates ignited a speculative frenzy that resulted in humongous equity bubbles. The Fed's "cheap money" policy created artificial demand for housing which drove prices to unsustainable levels. Now the real estate market is crashing; foreclosures are skyrocketing, inventory is at historic highs, construction-related jobs are drying up, and housing prices "across the country" are plummeting for the first time since the Great Depression. These are the real results of Greenspan's "low interest" fake prosperity.

Greenspan is not the only one responsible for the present calamity. The financial markets have been reconfigured in a way that accommodates all manner of corruption. The new model, "structured finance", allows worthless "subprime" loans to be dressed up as valuable assets—stamped with a triple A rating— and sold to unsuspecting investors. The Wall Street Journal explains how our $800 billion current account deficit created a circular loop which channeled vast amounts of borrowed money back into US markets:

> "That capital flow and debt subsidy, in turn, became fuel for smart people in mortgage companies, investment banks and elsewhere to exploit. In a sense they created a new financial system — subprime loans, SIVs, CDOs, etc. — that is enormously efficient and brought capital to new places. But thanks to low interest rates and human enthusiasm, this debt spree also got carried away. "

“Got carried away”? Now there’s an understatement. Stock markets across the world are crashing because the insatiable greed of a few market-heavyweights gunked up the whole system with worthless mortgage-backed slop.

The Wall Street Journal admits that a new “structured debt” market was created to package dubious subprime liabilities (from “no doc”, no collateral , “bad credit” loan applicants) and sell them to hedge funds, insurance companies and foreign banks as if they were precious jewels. The WSJ avers that this is the way that “smart people exploit” the opportunities from lavish “capital flows”.

But was it “smart” or criminal?

Fortunately, that question was answered this week in an extraordinary outburst on cable TV by market-insider and equities guru, Jim Cramer. In Cramer’s latest explosion, he details his own involvement in creating and selling “structured products” which had never been stress-tested in a slumping market. No one knew how badly they would perform. Cramer admits that the motivation behind peddling this junk to gullible investors was simply greed. Here’s his statement:

“ITS ALL ABOUT THE COMMISSION”

(We used to say) “The commissions on structured products are so huge let’s JAM IT.” (note “jam it” means foist it on the customer) It’s all about the ‘commish’. The commission on structured product is GIGANTIC. I could make a fortune ‘JAMMING THAT CRUMMY PAPER’ but I had a degree of conscience—what a shocker!–We used to regulate people but they decided during the Reagan revolution that that was bad. So we don’t regulate anyone anymore. But listen, the commission in structured product is so gigantic. (pause) First of all the customer has no idea what the product really is because it is invented. Second, you assume the customer is really stupid; like we used to say about the German bankers, ‘The German banks are just Bozos. Throw them anything.’ Or the Australians ‘M O R O N S’ Or the Florida Fund (ha ha) “They’re so stupid let’s give them Triple B (junk grade) Then we’d just laugh and laugh at the customers and Jam them with the commission…That’s what happened; that’s what happened….Remember, this is about commissions, about how much money you can make by jamming stupid customers. I’ve seen it all my life; you jam stupid customers.” See the whole damning confession on: http://www.cnbc.com/id/22706231 [1]

Trillions of dollars in structured investments (CDOs, MBSs, an ASCP) have now clogged up the global financial system and are dragging the world headlong into recession/depression. Cramer’s confession is a candid admission of criminal intent to defraud the public by selling products which people–within the financial industry—KNEW were falsely represented by their ratings. They sold them simply to fatten their own paychecks and because there is no longer any regulatory agency within the US government that curtails illicit activity.

BOYCOTT US FINANCIAL PRODUCTS?

As the stock market continues its inexorable downward plunge, foreign central banks and investors need to determine whether they were deliberately ripped off and aggressively pursue legal alternatives. They should initiate a boycott of all US financial products until an appropriate settlement for the hundreds of billions in losses due to the “structured finance” swindle can be negotiated. That is the best way to serve their own national interests and those of their people.

> Deregulation has destroyed the credibility of US markets. There is no oversight or policing agency. It's the Wild West. The assets are falsely represented, the ratings are meaningless, and there's a clear intention to deceive. That means that the stewardship of the global economic system is no longer in good hands. There needs to be a fundamental change. As the "nightmare scenario" of global recession continues to unfold; we need new leaders in Europe and Asia to step up and fill the void.

Articles by: Mike Whitney