

Financial System Crisis Unfolding: Telecoms, Nasdaq Lead the Way

by William Engdahl

What began in September as a “mild correction” to the hyper-inflated U.S. technology and telecom stocks, on the over-the-counter Nasdaq market, by Oct. 12 had become the most severe financial eruption since the August 1998 Russian government bond default brought the world financial system to within a hair’s breadth of total meltdown.

However, today, unlike in 1998, multiple crises are intersecting. From stocks, to currency speculation, to debt pyramids of all kinds, the bubbles are at the bursting point, after decades of build-up. Referring to the stock markets, the German daily *Die Welt*’s Oct. 10 headline used the phrase, “October Horror Month.” Even these expressions leave out the biggest source of hyper-instability—the trillions of dollars of derivatives bets and obligations, ready to blow the financial system to smithereens.

All this takes place amidst the worst oil price shock in 25 years, combined with a political vacuum in the leading nation, the United States. With U.S. elections roughly two weeks away, prospects are remote that the kind of resolute action needed on a government-to-government level, of the type needed to avert what Lyndon LaRouche has repeatedly warned could turn into the worst debacle in at least the past two centuries, is in the offing.

During the first two weeks in October, day after day, the major stock exchanges of the Organization for Economic Cooperation and Development and emerging markets saw values plunge by at least 2-3%. Still more notable, is the fact that deliberate interventions to calm the major markets over that same time period utterly failed. On Sept. 22, President Clinton announced release of 30 million barrels of crude oil from the Strategic Petroleum Reserve, to “provide heating oil” to Americans this Winter. After a brief price fall below \$30 per barrel, oil futures jumped back up the week of Oct. 9, to over \$34 per barrel, blamed at the time on the increasing likelihood of war in the Middle East and a severe cold weather front proceeding across the United States.

As of Oct. 12, with the Israeli acts of war against the Palestinians, and the air attacks on Yasser Arafat’s headquarters, the Mideast events triggered an explosive rise in oil prices to well over \$36.50 per barrel. Heating oil futures topped the level hit during the 1990 Gulf War. Speculators were set for mega-profits off selling U.S. Reserve oil to Eu-

rope (see p. 9).

On the U.S. financial markets, the Dow Jones Industrial Average fell 379 points on Oct. 12, the Nasdaq Composite plunged 120 points, and a rally ensued in the perceived safe-haven of U.S. Treasury bonds.

Not just a stock market “episode,” the singularity of the October financial horrors was indicated by the decline in the *value of the dollar* taking place, as the Nasdaq fell. European bank sources stressed that this marked “a process of Europe disengaging from the U.S. market.”

Lyndon LaRouche, commenting on this European “reflex reaction” a week earlier, stressed that key institutions in the euro zone have known that the bursting of the Wall Street speculative bubble is imminent—followed by a combined dollar and euro crisis. Publicly, the 11 euro-zone governments may continue to proclaim their “rock-solid commitment” to the euro single currency, and salute the dollar, but quietly they are “thinking the unthinkable.” They are making contingency plans for a return to national currencies, probably in a European Monetary System setting, under conditions of a global monetary-financial and economic emergency.

Following an unprecedented, coordinated Group of Seven intervention to prop up the euro just before the Danish euro referendum of Sept. 28, and a surprise interest rate hike by the European Central Bank the first week in October, the euro has continued to drop.

From Intel to Junk Bonds

While the explosion of war in the Middle East, with attendant fears of an Arab oil embargo, has brought events in global financial markets to the brink, the stage was set weeks ago. After a relative recovery of the U.S. stock levels from their lows of last April, the Nasdaq began its latest slide downward on Sept. 22, when Intel, the world’s largest maker of semiconductor chips, lost \$100 billion of its paper stock value in 24 hours. Since then, the Nasdaq has dropped 18%, and paper values of near \$500 billion have evaporated into cyberspace or beyond.

On Oct. 9, what had been a collapse of the high-tech stocks on Nasdaq became a full-blown crisis in the corporate bond markets, when reports surfaced that Morgan Stanley Dean Witter had losses of some \$1 billion on their business in under-

writing corporate high-yield or so-called “junk bonds.” On Oct. 12, the company issued a press statement denying the rumors of mega-losses.

According to reports in the *Frankfurter Allgemeine Zeitung*, the losses were triggered when a mid-sized U.S. telecom company, ICG Communications of Englewood, Colorado, with \$1.9 billion in junk bonds outstanding, was rumored insolvent. While Morgan Stanley lost “only” \$200 million on ICG bonds, the collapse of ICG signalled the collapse of the entire high-risk corporate bond market, a market which had been the prime source of capital for information technology and telecom companies.

Suddenly, not only Morgan Stanley, but other major Wall Street and European bond underwriters were found sitting on billions of dollars of bonds they could not sell, in a market where prices were plunging daily. In two days, the stock price of Morgan Stanley lost 20%, and Donaldson Lufkin Jenrette, the largest syndicator of junk bonds, was saved by a corporate takeover from the larger Crédit Suisse First Boston.

The Morgan Stanley losses triggered a panic selloff in both corporate bonds and stocks, especially of the banks which have huge exposure to telecoms. On Oct. 9, the U.S. credit rating agency, Moody’s Investors’ Services, reported that “the junk bond market is suffering from problems affecting the entire corporate bond market.”

The straw that broke the bond market’s back in past weeks, was the Universal Mobile Telecommunications Standard (UMTS) telecom license auctions in Europe. The explosive growth of debt in the giant international telecommunications sector has created what one observer has termed “an accident waiting to happen.” With the revelation of the \$1 billion Morgan Stanley losses, the corporate bond market has gone into what Steven Zamsky, bond strategist at Morgan Stanley, terms “a quasi-panic. You’ve got a crisis of confidence going on in the market right now.”

The Telecoms’ Debt Bomb

The telecom debt situation has become so alarming, that European government bank regulators have begun to investigate the degree of bank lending to the giant telecommunications groups, to determine if certain banks have taken undue risk and too great loan exposure in one area.

In mid-September, the issue of bank loans to telecoms was the focus of a special meeting of international financial regulators. Sir Howard Davies, chairman of the British Financial Services Authority, remarked that the level of lending by U.S. and European banks to the giant telecom companies was “a matter of great concern to regulators,” because of the extreme concentration of lending risks in one sector.

According to a Bank for International Settlements report, fully 30% of this year’s international syndicated loans were for telecom debt. In Europe, where mergers of giant state-owned and private telecoms have broken all records in recent months, the loans to telecoms were 40% of total loans.

The center of the debt problem is related to unprecedented cross-border mergers and, lately, the bidding of absurdly high sums in various European government auctions for new UMTS licenses, the so-called Third Generation Mobile access. But UMTS technology on a mass scale is at least several years off, and to get it will require an added telecom investment in Europe alone of some 160 billion euros (\$145 billion). At least 100 billion euros of that must come from bank loans or similar sources of credit. When all European governments have completed their UMTS license auctions, the amount to be paid out by telecom companies is estimated will exceed 160 billion euros.

According to a study by Capital Loanware, the banks with the largest loan exposure to telecoms are the New York Citigroup with \$23 billion, London’s HSBC with \$19 billion, Chase Manhattan with \$18 billion, BankAmerica with \$16 billion, London’s Barclays with \$13 billion, and Deutsche Bank with \$11 billion.

The largest telecom borrowers include the Anglo-German VodafoneAirTouch with \$46 billion of debt, the second-largest corporate debtor in the world. Vodafone took over the German Mannesmann last February in a deal worth \$161 billion, then made a large U.S. acquisition, and has just completed a \$2.5 billion investment in ChinaMobile.

Other large telecom debtors include British Telecom with \$43 billion debt, AT&T with \$39 billion, France Telecom with \$28 billion (and plans to spend another \$10 billion to buy Dutch Equant NV telecom), and the Dutch KPN with \$26 billion.

As a group, since July 1998, the largest international telecoms have borrowed \$390 billion from international banks. In the past year alone, European telecoms alone have added \$171 billion in new bank loans.

The huge debts incurred by these telecom companies, most of them still majority state-owned even if they are public stock companies (Deutsche Telekom, for example, is a private corporation, whose main shareholder is the German state, with 74%) are setting off a vicious cycle of consequences. High debt levels are leading the international credit rating agencies such as Standard & Poors and Moody’s to downgrade the formerly blue-chip credit ratings of the companies. That, in turn, makes it far more difficult and more expensive for the companies to raise needed capital for the further investment needed to make the UMTS gamble even potentially pay. The current estimate is that the companies have 6-12 months to significantly lower their debt if they are to qualify for future loans or stock issues.

The London *Financial Times*, in its editorial of Oct. 2, noted the irony of the situation. “Just imagine. Governments might be forced to use the receipts from their recent mobile phone license auctions to bail out the banks that lent to the winning telecommunications companies. It would be the ultimate irony if the only beneficiaries of third-generation auctions were the advisers in the auction process.”