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Credit crisis turns into global meltdown

By Paul Woodward

"The European Central Bank has dramatically changed its tune over the last twenty-four hours as the credit freeze worsens, acknowledging for the first time that the world faces the gravest crisis since the Great Depression," *The Daily Telegraph* reported.

"A string of governors from across the eurozone have today issued grim warnings in what seemed a coordinated move to prepare the markets for interest rate cuts, perhaps within days. "Guy Quaden, Belgium's ECB member, said the violent storm ravaging Europe's banking system was far from over. 'This is the worst financial crisis since the Thirties,' he told the Belgian parliament.

"Miguel Angel Ordonez, Spain's ECB governor, echoed the warnings in testimony to the Spanish Cortes, acknowledging that the world now faces a crisis of 'enormous proportions.'

"In a clear rejection of the ECB's controversial 'go-it-alone' policy on monetary policy, he called for joint action with the US FederalReserve to nurse the credit markets back to life. " 'We've got to get together on both sides of the Atlantic. It is absolutely essential to co-ordinate everything, including monetary policy,' he said."

The Times said: "Ben Bernanke, Chairman of the Federal Reserve, paved the way last night for an imminent cut in US interest rates as he sounded a warning that world financial turmoil will inflict a deeper and longer downturn on America.

"Mr Bernanke's boost to hopes for a Fed rate cut to attempt to head off a painful US and world recession, came as he acknowledged the threat from a financial crisis of 'historic dimension'."

Gerard Baker wrote: "serious economists now argue that the Fed should not cut borrowing costs but in effect eliminate them, by slashing the funds rate to zero and massively increasing the amount of money it makes available to financial markets. "But there's a growing consensus in markets that this needs to be a global response. Action by the Fed would be greatly amplified if the European Central Bank (ECB) and the Bank of England - and, to a lesser extent, because its problems are different, the Bank of Japan - were to join it. Co-ordinated action would also protect against the risk of serious currency dislocations. Money is sloshing around the global economy at unfathomable speed, further threatening the stability of any number of countries' financial systems, an aggressive Fed rate cut might produce a terrifying flight from the dollar.

"But, curiously, the Europeans still seem slow to grasp this. At a time when its financial system is close to shutting down, the ECB holds its main market interest rate at 4.25 per cent; the Bank of England's is even higher."

In *The New York Times*, Joe Nocera said: "The Federal Reserve announced yet another enormous injection of liquidity into the system Monday morning, saying it would make as much as $900 billion available.

'What the Fed said was that it wasn't just opening the window,' said Daniel Alpert, managing partner at Westwood Capital. 'It is taking out the window sill and chipping out the bricks around it.'
"The Fed's move was barely noticed. Now there's talk of another intervention by the Federal Reserve to help thaw the frozen credit markets by buying up short-term commercial debt.

" 'What I am worried about with all these bailouts ' said the great Wall Street historian Ron Chernow 'is whether they are going to eventually tax the resources of the federal government. The numbers are already getting very, very large. What is especially scary and unsettling is that even actions of this magnitude have not seemed to restore confidence. Each time, you thought that would be the one to stop the contagion. It hasn't happened.'

"This panic is taking place in such a compressed time frame that it is just astonishing. Mr Chernow pointed out that while the stock market crash of 1929 took place over three brutal trading days in October 1929, it took nearly three years to reach bottom. By then, stocks had lost a shocking 89 per cent of their value.

"This crisis, by contrast, seems to be moving at hyper-speed - one day it is Lehman Brothers, the next AIG, the day after that Washington Mutual. This crisis doesn't wear you down over time. It hits you over the head with a two-by-four. On a daily basis."

In *The Washington Post*, Steven Pearlstein wrote: "Up to now, it's been a financial crisis. This is a meltdown - an uncontrolled and largely uncontrollable financial chain reaction that threatens serious harm to the broader economy. "The immediate problem is that the institutions that have most of the world's free cash - banks, money-market funds, hedge funds, pension funds and major corporations - are hoarding it and won't do the normal thing of lending to one another.

"One reason is that many have taken on too much debt, lost too much money and are under pressure to use any spare cash to pay down debt and rebuild their reserves.

"The other reason is that they feel unsure about what they know about the financial health of other institutions and are afraid that some of them will fail.

"So what we've got is a liquidity crisis that is bigger than anyone has ever seen, on top of an insolvency crisis that is bigger than anyone has ever seen. And thanks to the explosion of cross-border trade and investment, the crisis has not only gone global but now threatens to take most of the global economy into recession."

In the *Los Angeles Times*, Steve Fraser said: "During the last few weeks, we've all grown reluctantly accustomed to comparing the current financial meltdown to 1929. Forebodings that this financial crisis may soon enough descend into a more widespread economic disaster are everywhere. Yet almost nobody is willing to use the word 'depression.'

We talk instead of a 'slowdown' or 'recession,' words that somehow fail to do justice to the specter that haunts the nation.

"This taboo persists in the face of ominous signs to the contrary: an ever-accelerating rate of unemployment and home foreclosures, a credit freeze that touches everyone from major manufacturers to ordinary consumers, the accordion-like contraction of businesses from automobile plants in Detroit to software makers in Silicon Valley, the rapid erosion of the dollar's value in world money markets, and so on. All of this resembles, at least in broad outline, the liquidity crisis that was prelude to the Great Depression. Still we avoid that word, and for reasons that are all too understandable."

In the *Financial Times*, Gideon Rachman wrote: "What we are experiencing now is the bust that has followed the 30-year bull run in conservative ideas that began with the Thatcher-Reagan revolution of 1979-80.

"You can get a sense of how quickly the intellectual atmosphere has changed by picking up a copy of Alan Greenspan's *The Age of Turbulence*, which was published last year. Mr Greenspan, head of the Federal Reserve from 1987 until 2006, heaped praise on the magic of financial markets and decried the foolishness of those who called for more regulation: 'Why do we wish to inhibit the pollinating bees of Wall Street?' he asked rhetorically. Why indeed?

"Mr Greenspan was considered such a guru that last year Senator John McCain suggested putting him in charge of a committee on tax reform, adding: 'If he's alive or dead it doesn't matter. If he's dead, just prop him up and put some dark glasses on him.' But Mr Greenspan's reputation is now on the slide and Mr McCain has reinvented himself as a champion of regulation - and is denouncing the 'corruption and unbridled greed that has caused a crisis on Wall Street'.

"This kind of ideological whiplash is what happens when an intellectual bull market crashes. The current financial crisis can be traced to three of the central ideas of the Reagan-Thatcher era: the promotion of home ownership, financial deregulation and a fervent faith in the market. Each of these ideas did sterling service for 30 years, increasing prosperity and freedom. But pushed too far - and combined - they have created a disaster."

Time magazine reported: "In Beijing's corridors of power, economic-policy makers are said to be watching in horror as a US-led financial meltdown gathers force around the globe. According to the rapidly congealing conventional wisdom, China, ostensibly the world's economic superpower-in-waiting, is taking copious notes on how not to run a financial system.

"But that picture is only partly correct. That China is watching the meltdown with alarm is certainly true. The global economic slowdown on the tail of the financial-market blowout is already clear and present on the mainland. In what has been one of the world's prime economic engines for the past five years, growth is slowing fast. Look only at the price of steel - as useful an industrial proxy for China's economic boom as any. According to Mysteel, a Shanghai-based consulting firm, the price for products used primarily in construction have fallen to less than $590 per ton, down almost 20 per cent in just four months, forcing some companies into the red in what had been a booming industry. Baosteel, one of China's largest steelmakers, has cut prices twice since August, and its CEO is glum: The era of rapid growth for China's steel industry 'will soon be remembered as history,' says Xu Lejiang.

"But fears that the fallout from the US subprime mess might cripple reform of China's financial system - now only partly open to the world - may be overwrought. Earlier this week Beijing sent a clear signal that, notwithstanding the mess in the US and Europe, it still seeks to develop, slowly but surely, a more sophisticated capital market. China's State Council has approved a plan to allow margin trading and short-selling, giving domestic investors in China's A-share market 'new opportunities to hedge and leverage their positions,' says Jing Ulrich, head of China Equities at JPMorgan Securities in Hong Kong.

"The timing of the move was extraordinary and should be seen as a sign of relative confidence. It came, as Ulrich put it, in 'stark contrast with major offshore markets - including the US, where regulators temporarily banned short-selling in recent weeks.' "

The New York Times reported: "Emerging markets took one of their biggest collective tumbles in a decade Monday as stock markets from Mexico to Indonesia to Russia were gripped by fears of a collapse of Europe's banking system and concern that a global recession could drag down the price of commodities, forcing a steep slowdown in emerging-market growth.

"Many of the world's fastest-growing economies thought they had insulated themselves from problems in the developed world. But economists said that simultaneous turmoil in Europe and the United States was too much to bear. 'The potential of a global recession is awakening emerging markets that they will be hit stronger than we thought before,' said Alfredo CoutiÒo, a senior economist at Moody's, the credit rating agency."

The Washington Post said: "Robert B Zoellick, president of the World Bank, said the global financial system may have reached a 'tipping point' - the moment when a crisis cascades into a full-blown meltdown and becomes extremely difficult for governments to contain.

"The mushrooming problems 'will trigger business failures and possibly banking emergencies. Some countries will slip toward balance-of-payment crises,' he said yesterday, speaking at the Peterson Institute for International Economics.

"The crisis threatens to reverse years of prosperity that financed the economic growth in developed and emerging countries through a global financial system that made credit widely available. Banks and governments were able to borrow money on an unprecedented scale by selling debt in new kinds of packages, allowing even the least creditworthy consumers to borrow and spend.

"China exported goods and then loaned the money back to the United States by buying those new debt packages. The story was similar for Russia, which exported massive amounts of energy to Europe, and for Brazil, which exported commodities including orange juice and sugar. All used the massive inflows of borrowed money from the developed world to fuel economic expansions and stock market bubbles.

"Yesterday, trading on the major stock exchanges in Russia and Brazil was halted after prices crashed. China's major indexes fell about 5 per cent. The bubbles appear to be bursting in rapid succession."

McClatchy Newspapers said: "In Pakistan, already embattled on the political front, the rupee hit a new low against the dollar. With its currency having lost 21 per cent of its value already this year, Standard & Poor's warned that the country was close to bankruptcy.

"Next door, in India, stocks fell nearly 5.8 per cent, the lowest close in two years. The index has shed more than 42 per cent of its value this year, with foreign investors leading the retreat.

"In response, the capital market regulator lifted curbs Monday on overseas investors to halt record sales by offshore funds. "In the Middle East, Kuwait pumped $374.3 million into the banking systems Monday and Saudi Arabia injected more $26 million into its stock market, local newspapers reported.

"Apparently immune to all the turbulence was Iraq. The government has little if any investments in the institutions affected by the crisis and a barely functioning stock market. Most Iraqis keep their money in their homes rather than trust banks.

"'We don't believe it will affect our bank balance,' said Minister of Industry Fawzi Hariri. 'In the short term we'll be one of the least affected nations.'

"The Iraqi government has more than $25 billion in cash reserves. Even with oil prices dropping below $90 a barrel, the Iraqis forecast oil revenues to be in the neighborhood of $80 billion."