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Collapse of US Financial System: The Setting up of a "New Dollar"?

By Global Europe Anticipation Bulletin
Global Research, October 26, 2008
GEAB N°28 26 October 2008

Region: Europe, USA
Theme: Global Economy

In this 28th edition of the GEAB, LEAP/E2020 has decided to launch a new global systemic crisis alert. Indeed our researchers anticipate that, before next summer 2009, the US government will default and be prevented to pay back its creditors (holders of US Treasury Bonds, of Fanny May and Freddy Mac shares, etc.).

Of course such a bankruptcy will provoke some very negative outcome for all USD-denominated asset holders. According to our team, the period that will then begin should be conducive to the setting up of a « new Dollar » to remedy the problem of default and of induced massive capital drain from the US. The process will result from the following five factors studied in detail further in this GEAB:

• The recent upward trend of the US Dollar is a direct and temporary consequence of the collapse of stock markets

• Thanks to its recent "political baptism", the Euro becomes a credible "safe haven" value and therefore provides a "crisis" alternative to the US dollar

• The US public debt is now swelling uncontrollably

• The ongoing collapse of US real economy prevents from finding an alternative solution to the country's defaulting

• "Strong inflation or hyper-inflation in the US in 2009?", that is the only question.

Studying the case of Iceland can give an idea of the upcoming stages of the crisis. That is what our team has been doing ever since the beginning of 2006. This country indeed provides a good illustration of what the US and the UK should be expecting. It can be considered – and that is what most Icelandic people do today – that the collapse of Iceland's financial system came from the fact that it was disproportionate to the size of the country's economy.

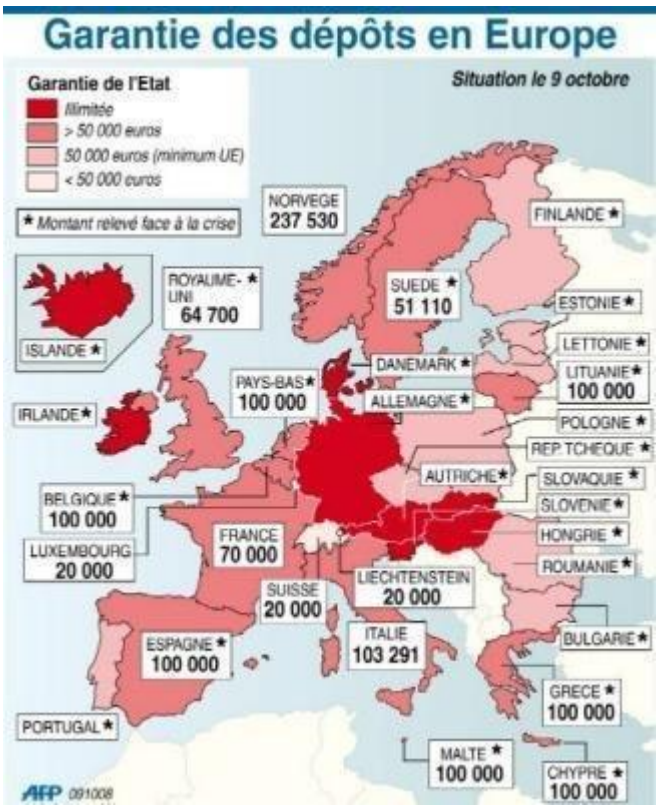
Inflation in Iceland – 2003-2008 – Source Central Bank of Iceland

Financially speaking, Iceland thought of itself as UK (1), in the same way as, financially speaking, UK thought of itself as the US and the US thought of themselves as the entire world. It is therefore quite useful to study the case of Iceland (2) in order to understand the course of events that London and Washington will follow in the next 12 months (3).

What we see today is a double historical phenomenon:

. on the one hand, since September 2008 (as anticipated in the February 2008 edition of the GEAB – N°22), the whole planet has become aware that a global systemic crisis is unfolding, characterised by the collapse of the US financial system and its contagion to the rest of the world.

. on the other hand, a growing number of global players are beginning to act on their own, in reaction to the ineffectiveness of the measures advocated or implemented by the US though they are the centre of this global financial system. What happened with this first Euroland (or Eurozone summit which took place on Sunday, October 12, 2008, and whose decisions, by their scope (close to 1,700-billion EUR) and their nature (4), resulted in a regain of confidence on financial markets from all over the world, is typical of the « post-September 2008 world ».



Map of deposit insurances in the EU – Source AFP – 10/09/2008

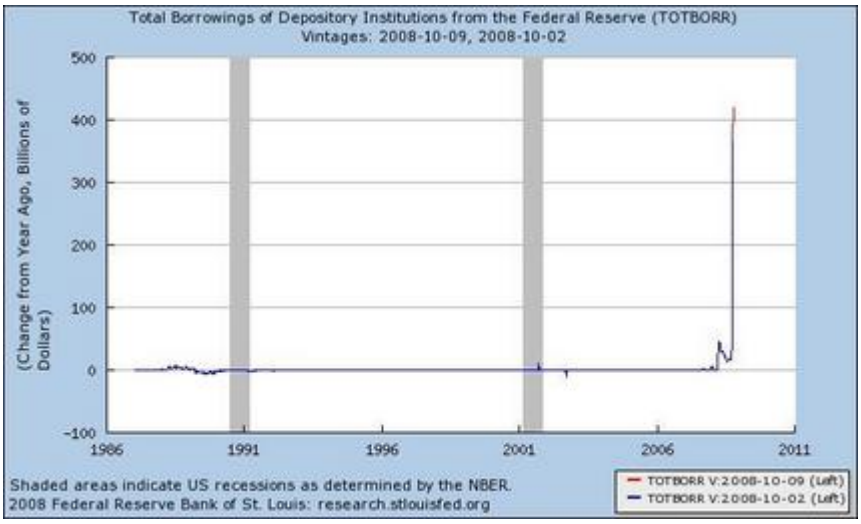
Indeed there is such a thing as a « post-September 2008 world ». According to our team, it is now clear that this past month will remain in the history books of the whole planet as the month when the global systemic crisis started; even if what is really at play is its decanting phase, the last of a series of four phases of the crisis described by LEAP/E2020 as early as June 2006 (5). As always when it comes to large human groups, the perception of change among the general public only occurs when change is already far on its way.

As a matter of fact, September 2008 is the month when the « financial detonator » of the global systemic crisis exploded. According to LEAP/E2020 indeed, this second semester 2008 is the time when « the world dives into the heart of the impact phase of the global systemic crisis » (6); which means for our researchers that, at the end of this semester, the world enters the « decanting phase » of the crisis, i.e. a phase when the outcome of the shock settles down. This phase is the longest (from 3 to 10 years, according to the country) and the one affecting the largest number of people and countries. It is also the phase when the components of new global equilibriums will start to appear, two of them being already described by LEAP/E2020 in this 28th edition of the GEAB in the graphic illustrations below (7).

Therefore, as we repeated it on and on since 2006, this crisis is far more important, in terms of impact and outcome, than the 1929 crisis. Historically, we are the very first players, witnesses and/or victims of a crisis affecting the whole planet, in a situation of unprecedented interdependence of countries (resulting from twenty years of globalisation) and people (the level of urbanization – and related dependence for all the basic needs – water, food, energy… – is also unprecedented). However, the 1929 experience and all its dreadful outcome, is still vivid enough in our collective memories to hope, if citizens are vigilant and leaders clear-sighted, that we will be spared from a « remake » leading to major

conflagration(s).

Europe, Russia, China, Japan,… are certainly the collective players who can make sure that the unfolding implosion of today's world power, i.e. the United States, does not drive the planet into a disaster. Indeed, except for Gorbachev's USSR, empires have a tendency to strive in vain to reverse the course of History when they realize their might is escaping them. It then belongs to partner-powers to channel the process peacefully, as well as it belongs to the citizens and rulers of the concerned country to be clear-sighted and face the difficult times they are about to cross.



Total borrowings of US Depository Institutions from the US Federal Reserve (01/08/1986 – 10/09/2008) – Source Federal Reserve Bank of St Louis

The « emergency repair » of international financial channels, achieved by the countries of the Eurozone at the beginning of this month of October 2008 (8), should not hide three fundamental facts:

• The "repair" was necessary to curb the panic that threatened to squander the entire global financial system in just a few weeks, but what it heals temporarily is merely a symptom. It has just bought a bit of time, two to three months maximum, as the global recession and the collapse of the US economy (the table above shows the staggering increase of US banks' borrowings from the Fed) will speed up and create new tensions in the economic, social and political fields, that must be anticipated and coped with as soon as next month (as soon as the "financial packages" have been implemented)

• The huge financial means allocated worldwide for « emergency rescues » of the global financial system, though they were necessary to put back in order the system of credit, are lost for the real economy when it is on the verge of facing a global recession

• The « emergency repair » results in further marginalization, and therefore weakening, for the United States, because it sets up processes that are contrary to those advocated by Washington for the allocation of the Hank Paulson's and Ben Bernanke's 700-billion USD TARP: bank recapitalisation by governments (a decision Hank Paulson has now come to follow) and interbank loan guarantees (in fact Euroland governments substitute to credit insurers, a mostly American industry at the centre of global finance since decades). These

trends turn more and more decision-making relays and financial flows away from the United-States when because of the explosion of their public (9) and private debt they need them more than ever; not to mention pensions going up in smoke (10).

The last aspect shows how, in the coming months, solutions to the crisis and to its various sequences (financial, economic, social and political) will increasingly diverge: what is good for the rest of the world will not be good for the United States (11), and now, Euroland in the first place, the rest of the world seems determined to make its own choices.

The sudden shock that will result from the US defaulting in summer 2009 is partly due to this decoupling of decision-making processes of the world's largest economies with regard to the US. It is predictable and can be dampened if global players start to anticipate it. As a matter of fact, it is one of the topics developed in this 28th edition of the GEAB: LEAP/E2020 hopes that the September shock has "educated" the world's political, economic and financial policy-makers and made them understand that it is easier to act by anticipation than in a panic. It would be a pity if Euroland, Asia and oil-producing countries, as well as US citizens of course, discover one morning of summer 2009 that, after a long-week-end or bank-holiday in the US, their US T-Bonds and Dollars are only worth 10 percent of their value because a « new Dollar » has just been imposed (12).

Notes

(1) Iceland adopted 10 years ago all the principles of economic deregulation and « financieration » advocated and implemented in the US and UK. Reykjavik thus became some sort of a financial « Mini-Me » of London and Washington, in reference to the very Americano-British movie character Austin Powers. The three countries undertook to play the financial game of « the frog that wished to be as big as the ox », in reference to a fable by Jean de la Fontaine with a very unhappy end for the frog.

(2) Icelandic stocks collapsed 76 percent after a few days suspension designed to « avoid » a panic! Source: MarketWatch, 10/14/2008

(3) On this subject, let's spend a few lines on the amount of the "financial package" announced by London, i.e. 640-billion EUR including 64-billion EUR to recapitalize banks and a further 320-billion EUR pay back those same banks' debt (source: Financial Times, 10/09/2008). With an economy in freefall to the image of the real-estate market, with a soaring inflation, with capital-based pensions going up in smoke and a currency at the lowest,… apart from increasing the public debt and weakening even more the Sterling pound, it is difficult to imagine how the plan can « rescue » British banks. Contrary to Eurozone banks, the British financial system, exactly like its US counterpart, is at the centre of the crisis, not a collateral victim. Gordon Brown may well compare himself to Churchill and Roosevelt together (Source: Telegraph, 10/14/2008), in his ignorance of History, he seems to forget that neither Churchill nor Roosevelt had already spent 10 years in their country's governments when each of them had to cope with their « big crisis » (that goes for the US and the Bush administration – Paulson and Bernanke included – who all come from the problem and are certainly not part of the solution). Not to mention the fact that Churchill and Roosevelt organised summits such as Yalta or Tehran leaving the French and the Germans waiting at the door, while today it is him who waits at the door of the Euroland summit.

(4) Source: L'Express, 10/13/2008

(5) Source: GEAB N°5, May 15, 2006

(6) Source: GEAB N°26, June 15, 2008

(7) LEAP/E2020 made a synthesis of its anticipations on the decanting phase of the crisis by means of a world map of the impact of the crisis based on the identification of 6 large groups of countries; and of an anticipatory schedule of the 4 financial, economic, social and political sequences over 2008-2013 for each of these regions.

(8) It is indeed the Eurozone which curbed the spiral of global panic. For weeks, the US and British initiatives followed one another without any effect. The eruption of a new collective player, the « Euroland summit », and the wide-ranging decisions it made, are a new and soothing phenomenon. It is for this very reason that Washington and London have systematically prevented such a summit from taking place ever since the Euro was launched, 6 years ago. A complete set of diplomatic gesticulation was required (preliminary meeting, pre-summit group photo,...) to make the British Prime Minister believe he was not set aside the process, when in fact there is no reason why he should take part in a Euroland Summit. In this edition of the GEAB, LEAP/E202020 comes back on the phenomenon and the long-term systemic consequences of this 1st Euroland Summit.

(9) The US financial rescue plan has already increased by 17,000 USD the debt owned by each US citizen. Source: CommodityOnline, 10/06/2008

(10) It is indeed 2,000-billion USD of capital-based pensions which evaporated in the past few weeks in the US. Source: USAToday, 10/08/2008

(11) At least in the short-term. Indeed our team is convinced that it is not bad at all for the American people in the medium- and long-term if the system currently prevailing in Washington and New-York is fundamentally reappraised. This system has thrust the country into dramatic problems among which dozens of millions of US citizens now struggle, as illustrated in this article by the New York Times dated 10/11/2008.

(12) Even if it will be a minor-scale measure compared to the prospect of a US bankruptcy, those who think that it is time to invest again on financial markets may find useful to learn that the New York Stock Exchange has recently reviewed all its circuit-breaker thresholds as a result of ratings collapse. Source : NYSE/Euronext, 09/30/2008

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