

Systemic Economic Crisis: The Sequence of Global Insolvency Begins

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In 2007, LEAP/E2020 announced that US banks and consumers were both insolvent. More than a year ago, our team estimated that USD 10,000-billion worth in « ghost-assets » would vanish in the crisis. Both announcements came in complete opposition with the common opinion of that time; however they proved perfectly justified in the months after. In the same line, LEAP/E2020 today estimates that a new sequence of the fourth phase (so-called « decanting phase ») of the unfolding global systemic crisis has begun: the sequence of global insolvency.

The heavy consequences conveyed by the global insolvency are anticipated in this GEAB N°31, of which this announcement presents an excerpt meant to put clearly what is at stake in this new sequence of the crisis. GEAB N°31 also details the 20 “ups and downs” of the year 2009 according to the LEAP/E2020 team : fifteen upward trends and fourteen downward trends, as many decision- and analysis-support instruments for all those worried or intrigued by the coming year.

Contrary to what political leaders and their central bankers seem to believe worldwide, the problem of liquidity that they are striving to solve by means of historic interest rate drops and unlimited money creation, is not a cause but a consequence of the current crisis. It is in fact a problem of solvency which is digging « black holes » where liquidities disappear, whether we call these holes bank balance sheets (1), household debt (2), corporate bankruptcies or public deficits. In consideration of the fact that a conservative estimation of these “ghost-assets” reaches already USD 30,000-billion (3), our team considers that the world is now facing a situation of general insolvency affecting in the first place the most indebted countries and organizations (public or private) and/or those depending most on financial services.



Market capitalisation of stock markets worldwide (in trillions of US Dollars) – Source: Thomson financial Datastream, 01/2009

How to make the difference between a crisis of solvency and a crisis of liquidity?

The difference between a crisis of liquidity and a crisis of solvency can appear rather technical and in the end not very decisive concerning the evolution of the current crisis. However it is not a simple academic dispute; indeed, according to the answer to that question, the actions taken by governments and central banks will either be useful or utterly useless, if not dangerous.

A simple example can help to understand what is at stake. If you meet a temporary problem of cash, and if your bank or your family agrees to lend you the money you need to cross over that difficult path, their effort is mutually beneficial. Indeed, you can resume your activity, you can pay your employees and yourself, your bank or your family get their money back (with an interest in the case of the bank), and the economy in general benefited from a positive contribution. But if your problem is not due to a question of cash-flow but to the fact that your activity has ceased to be profitable and will never be again because of new economic conditions, then the effort made by your bank or family becomes all the more dangerous that it was substantial. Indeed, in all likelihood, your first call for funds will soon be followed by more calls, always matched with promises (honest ones we suppose) that difficult times are about to be over. The more your bank or your family has lent you (and therefore the more it would lose if your activity is stopped) the more willing they will be to continue helping you. However if the situation worsens, and it will if it comes from a problem of profitability, there is a moment when the limits are reached: on the one hand, your bank will decide that there is more to lose in keeping supporting you than in letting you down; on the other hand, your family ends up with no money left because you have siphoned its entire savings. Then it appears clearly to everyone not only that you are insolvent or bankrupt, but that you dragged down with you your family or your bank (4). You have thus dealt a severe blow on the economy around you, including on your close relatives (5). It is important to highlight the fact that all this could take place in all sincerity because you were not aware of the impact on your activity of a sudden change in the economic context disrupting the conditions of your profitability.



US daily bankruptcy filings (01/2006 – 11/2008) – Source: CreditSlips, 01/2009

According to LEAP/E2020, this simple example illustrates perfectly the situation prevailing today throughout the entire global financial system, a large part of the world economy and all the economic players (including States) who based their growth on debt in the past years. The crisis translates and magnifies a problem of global insolvency. The world is becoming aware of the fact that it is a lot poorer than it used to believe in the last decade. And 2009 is the year when all the economic players must try to assess their real level of solvency, knowing that many assets are still losing value. Moreover a growing number of investors no longer trust the traditional instruments and indicators of measurement. Quoting agencies have lost all credibility. The US Dollar is just a fiction of international monetary unit and many countries are striving to get away from it as quickly as possible (6). Thus, quite rightly, the entire financial sphere is suspected of being a giant black hole. Concerning companies, no one can tell if their order books are reliable (7) because in every sector customers cancel their orders (8) or just stop buying, even when prices are discounted, as indicated by dropping retail sales in the past few weeks (9). Concerning States (and municipalities), slumping fiscal revenues are likely to result in even higher deficits and then bankruptcies. As a matter of fact, Russian billionaires (10), Gulf oil-monarchies, Chinese commercial Eldorados (11), all the « golden-egg geese » of companies and financial institutions of the planet (namely European, Japanese and North-American ones (12)) turn out to be insolvent or hardly solvent. The question of the solvency of the US federal State and federated states (13) (as well as of Russia or the United-Kingdom) is beginning to be asked by some big international media; as well as the question of the solvency of large capital-based pension funds, major players in this past twenty years' globalised economy.

According to LEAP/E2020, the trend is clear: the sequence that has begun this year is a sequence of global insolvency.

Notes

(1) On this subject, here is a very useful list of US banks on the verge of bankruptcy, presented on [LewRockwell](#) and elaborated on the basis of Texas Ratio – measuring risk exposure.

(2) This dynamic map of credit card and mortgage delinquencies in the US (2nd quarter), elaborated by the Federal bank of New-York, enables to realize the scope of the crisis affecting household revenues and the size of their debt. Source: [NewYorkFed](#), 12/2008

(3) The evolution of stock markets capitalization worldwide is a good indicator of « ghost-assets » disappearance; even if real estate and other categories of assets capitalization losses should also be accounted for in the estimation, as well as small increases (swept away by the current storm but to be restored once the peak of the crisis is behind us) should be deducted.

(4) Not to speak about employees, suppliers, costumers, ...

(5) This kind of situation, repeated at the scale of a whole country, results in social chaos. As a matter of fact, the US army itself is beginning to envisage that social unrest caused by the crisis requires military action. Source : [ElPasoTimes](#), 29/12/2008

(6) On this subject, LEAP/E2020 wishes to made a recommendation for the intention of international financial institutions, and in particular of their statistical services: it is urgent to set up an alternative international accounting system, based on a basket of currencies (for instance: 25% USD, 25% Euro, 25% Yen and 25% Yuan, until political leaders make a formal decision about a global basket) because when the US defaults on their debt and the global monetary system breaks down as we anticipated should happen next summer 2009, there will be immediate disastrous effects on the accounting of international financial assets and flows. Therefore it is urgent, even if it results from non-official discussions and “black” accounting, to backup the current statistics (calculated in US Dollars mostly) with another version, based on a basket of currencies, in order to secure the continuity of statistics while the global monetary system is being rebuilt.

(7) A series of articles in [Der Spiegel](#) (12/18/2008), entitled « The calm before the storm: Bracing for the global downturn », gives a good idea of the crisis as seen from Germany. And the downturn of goods transport market in the Eurozone illustrates further this fact. Source: [Libération](#), 01/12/2009

(8) One advanced indicator of the global economy is provided by the market of core machines. Indeed core-machines make it possible to anticipate 6 months to 1 year in advance the state of the global manufacturing industry. The world’s two largest constructors and exporters of core-machines are Germany and Japan. The evolution of their production and export in this sector is a reliable indicator of the future global manufacturing industry. In this case, perspectives for 2009 are rather grim since, like Germany, Japan’s machinery orders registered a staggering 16.2 percent slump between October and November 2008,

i.e. the worst fall since 1987, when this kind of statistics began to be published. Source: [MarketWatch](#), 01/15/2009

(9) In the US, 2009 could see a quarter of the retailers go bankrupt. Source: [ClusterStockAlleyInsider](#), 12/27/2008

(10) « Russian billionaires » are reduced to beg money from the Kremlin, whose financial reserves are themselves melting away. Source: [Spiegel](#), 01/08/2009

(11) A « Chinese Eldorado » turning in 2009 into a socio-economic quagmire. Sources: [Janelanaweb](#), 12/25/2008 ; [Yahoo/Reuters](#), 01/07/2009 ; [Guardian](#), 01/13/2009

(12) The recent bankruptcy of Nortel, North-America's leading telecommunication industry, is a striking example.

(13) Sources: [USAToday](#), 12/28/2008 ; [Reuters](#), 01/02/2009

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