Russian crisis shakes global markets

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"There's some real full-fledged panic in the air." That was how one financial analyst described the state of international financial markets last Friday at the end of a week of extraordinary events.

The turmoil began with the announcement by the Russian government that it was devaluing the rouble, suspending trading in the short-term Treasury bill [GKO] market and imposing a 90-day moratorium on international debt repayments. It ended with the largest one-day fall on the London stock exchange since October 1987, a collapse of share prices across Latin America, a steep decline on Wall Street and a rush into US Treasury bonds, cutting their yield rate to just 5.43 percent--below the 5.5 percent rate fixed by the Federal Reserve.

And with the announcement over the weekend by President Yeltsin that he had sacked the five-month-old government of Prime Minister Sergei Kiriyenko and had called on the previous prime minister, Viktor Chernomyrdin, to form a new administration, this week is set to be even stormier. The signs are already there. The Japanese stock market fell to below the critical 15,000 mark on the Nikkei index on Monday and the Australian dollar fell to it lowest level in twelve and a half years amid predictions that it could drop still further.

The crisis in Russia has brought comments about the mental and physical incapacities of Boris Yeltsin, together with quips about shifting deck chairs on the *Titanic* and sweeping out the new to bring in the old.

But the crisis of the Russian regime and the financial market chaos is only the sharpest expression of an international tendency--the general bewilderment of the overlords of international finance in the face of the deepening global crisis of capitalism and their inability to even predict, much less control, the course of events.

Consider, for instance, the analysis provided by Deutsche Bank, one of the world's largest financial institutions and a major Russian creditor. In the wake of last month's IMF Russian bailout it assured investors that the $22.6 billion package had "gone a long way towards restoring confidence in the rouble and resolving the current crisis."

"With the additional resources available to the central bank, the pressure on the rouble has been removed and the domestic debt situation is now manageable. Although Russia will remain vulnerable to contagion from Asia, speculation about devaluation, debt restructuring and capital controls have now dissipated, and thus significantly reducing investors' nervousness about the country's risk."

Barely five weeks after these lines were written the IMF restructuring plan has all but disintegrated and the government that was supposed to carry it out has been swept out of office.

The IMF plan began to unravel from the very outset. Central Bank governor Sergei Dubunin revealed that of the $4.8 billion in the first IMF tranche handed over to Russia, some $3.8 billion had been spent in a futile defence of the rouble, while the rest was used to redeem short-term government debt.

Faced with a continuous outflow of finance, Russian authorities approached the IMF and G-7 countries for further assistance, but were turned down. With official reserves running down at the rate of $1 billion a week, they were left with little choice but to devalue the currency and impose a debt repayment freeze.

Announcing the decision, the then Prime Minister Kiriyenko pointed out that Russia was a victim of falling oil prices--they have declined from $21 per barrel to around $12 in the past year--and the Asian crisis. There was a bitter irony in the explanation.

In the late 1980s and early 1990s when the ruling bureaucratic apparatus was moving to liquidate the Soviet Union and establish capitalist market relations it held up the "Asian miracle" as the model to be followed. If only the market were introduced, it was repeatedly claimed, Russia would be able to take the Asian path. The prediction has been fulfilled, but in a perverse form.

Today, the Southeast Asian region is passing through the greatest economic downturn since the Great Depression of the 1930s--a decline matched only by the

Russian economy over the past seven years.

The events of the past week have revealed not only the extent of the financial meltdown in Russia, but also the rapidity with which a crisis in one region spreads through the whole international financial system.

Speaking in Sydney on Monday, the chief economist for the Deutsche Bank Group Asia Pacific, Dr Ken Courtis, warned that financial contagion would spread from Russia and that the unfolding crisis posed "the greatest threat to the world economy since the 1930s."

"This contagion works through capital flows, through damage to bank balance sheets, through a lowering of investors' risk tolerance, and falling demand for basic commodities," he said.

All of those factors are at work in the Russian crisis. The 30 percent devaluation of the rouble would of itself have sent a shock wave through international markets but it has been compounded by the decision to suspend repayments of GKOs and impose a 90-day moratorium in foreign debt. The virtual debt default is regarded as having even more serious consequences than devaluation because of the precedent it establishes. If Russia defaults, others could soon follow.

While Russia comprises only a small proportion of the international financial system, the amounts of money involved are not small. The total value of the Treasury bill market is estimated to be between $40 billion and $45 billion, with between $13 and $15 billion owed to foreigners. "Restructuring" has placed Russian financial authorities in a bind. If they do not ensure the repayment of foreign investors, then Russia will be frozen out of international capital markets. On the other hand, if foreign investors are repaid in anything like full measure, the Russian banking system could face collapse.

The first deputy chairman of the central bank, Sergei Alexashenko, has warned of banking failures within a few days. "It is absolutely clear that even some of the biggest Russian banks, including those in the top 20, can become bankrupt," he told Reuters Television.

Apart from the GKOs themselves there is the question of forward currency contracts. This involves more than $10 billion worth of currency agreements that foreign lenders have taken out with Russian banks in order to protect themselves against a devaluation of the rouble.

Some major international financial firms are involved in the GKO market, including Citicorp, Chase Manhattan, JP Morgan and Bankers Trust. Over the weekend rumours were circulating that Credit Suisse First Boston stood to lose between $500 million and $1.5 billion as a result of the Russian crisis.

On a long-term basis, German financial institutions are likely to be the most severely affected with $30 billion of debt outstanding in Russia. Fears of major losses were behind the 5.4 percent fall in the Dax share market index last Friday and the fall in the yield on 10-year bonds to 4.22 percent, the lowest level in the postwar period.

The collapse followed the sun around the world as Latin American markets went into a nosedive. In Venezuela, markets were gripped by fears that it could become South America's Thailand. Reports of a possible 20 percent devaluation of the currency began to circulate. The Caracas stock exchange fell 8.4 percent after dropping 9.5 percent the day before.

Trading on the Sao Paulo exchange, the largest in South America, was automatically halted for more than half an hour when the share index plunged by 10 percent. Fears of a Brazilian devaluation have sent share prices down by more than 25 percent in the last month. Market indices in Mexico, Argentina and Chile fell by between 7 and 8.5 percent during the day and the Mexican peso went to an all-time low on currency markets for the second day in a row.

Since the global financial crisis began with the collapse of the Asian markets just over a year ago, IMF bailouts have enabled the major banks to emerge relatively unscathed. But after laying out more than $40 billion since the Asian crisis began, the IMF has barely $16 billion left, sparking fears of a major default.

This is indicated both by the outflow of funds from so-called "emerging markets"--up from $38 million in the week to July 29 to $125 million in the week to August 12--and the record low yields on Treasury bonds in Europe and the United States. Capital is searching for a "safe haven".

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