

# The real US financial crisis has yet to begin

Editorial Desk

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During his visit to London more than a week ago, Thai Prime Minister Abhisit Vejjajiva got the impression from business people and investors there that the United States did not have enough political will to take on its banking crisis once and for all. They told Abhisit that if the [US](#) had recognised the total estimated losses of the banking system and come up with the money to plug the leaking hole, it would have restored confidence and set the stage for an economic recovery. This sounds plausible, but the whole point is how much of the losses of the [US](#) banking system can really be quantified. Is it [US](#)\$30 trillion, [US](#)\$50 trillion or more?

The size of the [US](#) financial bubble that has gone bust is so large that it is impossible to quantify the losses due to the lack of transparency. The [US](#) banks, backed by the power of the Federal Reserve to issue paper currency without any limit, had over the past several decades gone global in raising money, issuing debts and all kinds of instruments in their proprietary trading and investment. They had several dozen times over-leveraged their capital. Wall Street and [US](#) banks' easy money, fuelled by a low interest-rate policy during the Greenspan era, created a bubble [economy](#).

In fact, it is not totally correct to assume that the current problem can be traced back to the Greenspan era alone. The [US](#) has walked away from manufacturing since the 1970s and shifted its policy toward consumption and financial services, backed by its superpower status to issue paper currency. The dollar has been floated around the world to become the de facto medium of international transactions without presumably any cost. The [US](#) consumers went on a consumption binge, enjoying one of the world's best living standards. Wall Street executives made filthy bonuses every year. The Wall Street model has become the fixation of American business - how to make quick money from thin air.

But we all know that there is no free lunch. The dollar paper issued to the creditor institutions, funds and sovereign governments worldwide is now starting to backfire. The global economic imbalances, characterised by overconsumption in the [US](#) and overproduction by the emerging-market economies, including Japan, are now going through a correction. [US](#) over-consumed by issuing debt to finance its consumption, while other countries re-channelled their reserves back to the [US](#) so that [US](#) consumers would continue to buy their cheap goods. Now exports to the [US](#) have collapsed. Creditors are shying away from subscribing to [US](#) debt. They are cutting losses in their [US](#) dollar asset holdings.

The [US](#) banks have made things worse by offering easy lending to the real-estate sector. Real-estate loans were bundled as mortgage-backed securities, on top of which other dubious financial products were created. This is not to mention other financial products that [US](#) banks have issued like currency only because they have their brand names attached. Currency and paper are treated without any difference. The bubble was in full swing until the sub-prime debacle hit the [US](#) in August 2007. After that the [US](#) financial system and the [US economy](#) started to go downhill.

The [US](#) banks and financial institutions have been relying on the Federal Reserve's Temporary Auction Facility to raise their liquidity. They have been facing a run, with foreign depositors and scared individuals withdrawing their money. Without the Fed's intervention with liquidity, [US](#) banks and financial institutions would have been totally broken down by now.

But the worst has yet to come. With a loss of confidence in the [US](#) financial system, creditors and investors are dumping dollar-denominated instruments. They are willing to cut losses. The [US](#) banks, who issue the instruments, have to take their debts back. Since they do not have the liquidity because the credit market has already ground to a halt, they can only rely on the Federal Reserve. As a result, the balance sheet of the Federal Reserve will continue to balloon.

[US](#) Treasuries, traditionally recognised as risk free, are now under pressure. Russia, China, India and other countries are discussing a possibility of dumping the [US](#) dollar as a reserve currency. They have proposed a return to the Special Drawing Rights issued by the International Monetary Fund.

In the meantime, the [US](#) federal government will find it tough to finance its deficit spending. Recent projects have put the deficit for 2009 at a record [US](#)\$1.8 trillion. This would complicate President Obama's efforts to pass his [US](#)\$3.55

trillion budget plan for 2010. The deficit would continue for several years to come. Where will this money come from?

The [US](#) won't be able to finance the deficit of this magnitude. The [US](#) Treasury doesn't have any money. The Americans are also losing their savings and investments in the meltdown of the stock market by at least 50 per cent last year alone. They are also saddled with consumer and mortgage debt. So the [US](#) ends up with only two options left: Borrowing from the foreign creditors or resorting to the printing press.

Under the current condition, foreign creditors will be more cautious or unwilling to subscribe to [US](#) debt. They already have toxic financial instruments in the books of their banks more than they can handle. So the [US](#) has only one option left, which is to inflate away the debt by printing money. By doing so, the [US](#) Treasury will issue bonds directly to the Federal Reserve, which will issue the money in return. The Treasury will use the money to meet its budget or other spending obligations.

This [US](#) money-printing, the Bank of England, the Swiss National Bank, the Bank of Japan, have warned is threatening hyperinflation afterward. The dollar will head for a decline. Once inflation is off and running, the printing press dollars will only have goods made in America to chase after. The real crisis has not yet begun.