



## The Coming Financial Crises? By Abbas Bakhtiar



*On Wednesday 17 May the Dow Jones plunged 214 points to 11,206 — its worst point drop since March 2003.*

The downward trend started a week ago and is a warning sign of troubles ahead. This sudden drop has come as a complete surprise to the unfortunate small investors and speculators. The so called “experts” point at the sudden threat of inflation as the main cause of the recent reversals in the markets.

What is actually surprising is the surprise of the “experts”. A cursory look at the United States’ finances will reveal the amount of pressure that its economy is under.

When Bush became president in 2001, the United States’ national debt was 5.8 trillion dollars. Today the national debt stands at 8.4 trillion dollars. Of this over \$2.2 trillion dollars are held by foreigners United States has a GDP of 12.4 trillion dollars. This gives U.S. a Debt/GDP ratio of 66%, placing it in 35th place (out of 113) on the ranking of the Debtor Nations. The current account deficit of over 7 per cent has long passed its danger levels of 4-5

per cent. In 2005 the U.S. government paid \$325 billion dollars only in interest payments alone.

Then there are the future obligations such as Medicare, Social Security and government pensions. These obligations amount to \$54 trillion dollars. This huge problem worried the former Federal Reserve Chairman Alan Greenspan. He told congress: “As a nation, we may have already made promises to coming generations of retirees that we will be unable to fulfil”.

One would think that this amount of debt would worry the president and the congress. But apparently it does not. United States’ Congress recently (March 2006) voted to increase the Federal debt limit to 9 trillion dollars. Any other nation in similar circumstances would have had to approach IMF for help. IMF would then have forced that nation to cut spending and devalue its currency. But U.S. does not need to do this. U.S. can just print some more dollars. But how long can this continue before the world loose faith in the greenback, sending it crashing to unimaginable levels.

### The Asian Lender

The Asian countries such as Japan, China and others that hold most of the U.S. debts have been happy to indulge the American deficit spending. This has been a two-way Street, America has kept its market open to their products and they have financed the Americans’ spending.

The value of U.S. dollar so far has been kept artificially high by Japan, China and oil-exporting countries. These countries by buying US debts have kept interests rates relatively low in the United States and allowed Americans to keep spending even as their debts mount.

But there is only so much risk these lenders (Asian and oil-exporting countries) are willing to take. Any serious devaluation of the Dollar will considerably reduce the value of their national reserves (mostly kept in dollars) and the value of their debt holdings (certificates, bonds, etc.). At the same time, the devaluation will affect their exports to the U.S. A weaker dollar makes their products more expensive in U.S., thereby reducing their export earnings. Most Asian countries keep up to 70 per cent of their reserves in dollars. China with the reserves of over \$800 billion dollars already begun to slowly reduce its dependency on dollars by converting part of its reserves to other currencies.

If other Asian countries —with their vast dollar holdings— follow suit, then it will be disastrous for the value of dollar. No-one is interested in holding a weakening currency.



### Petro-Dollar

Another threat against the dollar comes from countries such as Iran and Venezuela. Iran recently registered an Oil Bourse to compete with Bourses in New York and London. The threat comes from the currency in which the oil is to be sold in Euro. Iranians are going to make the Euro the standard currency for oil transactions. Some sympathetic countries such as Venezuela and others may join in.

If the Iranians succeed in this, the pressure on the dollar will be catastrophic. Nearly every country has to hold a certain amount of dollars in reserve for oil purchases. If the dollar continues to weaken in value, and there is the possibility of purchasing oil in Euro, then these countries would unload their dollars for safer currencies such as Euro. What will then happen to the value of dollar?

### Iraq and Iran

As though there is not enough pressure on the dollar, the U.S. government keeps spending money in an un-winnable war in Iraq and is considering starting another one in Iran. The total cost of Iraq war, including the future payment to the disabled soldiers, replacement of equipment, etc., is estimated be between 1 to 2 trillion dollars

Any attack on Iran will substantially increase this cost. Even if there is no attack, the tense situation in the region will keep the oil prices at uncomfortable levels, contributing to both a reduction in U.S. growth and an increase in its deficit.

### Conclusion

The current American deficit and its long-term financial obligations, if goes un-answered, will sooner or later lead to either a marked increase in interest rate or a substantial devaluation of dollar. On one hand, a substantial increase in interest rates will lead to a major recession in USA which will be felt immediately around the world. On the other hand, a substantial devaluation will cause financial chaos in the world. What is needed is to seriously reconsider the international role of the dollar as the world currency. In other words we need a new Bretton Woods Agreement.

in Bretton Woods, New Hampshire to address the problems of reconstruction, monetary stability and exchange rates.

The delegates agreed to establish an international monetary system of convertible currencies, fixed exchange rates and free trade. To facilitate these objectives the delegates agreed to create two international institutes: the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (the World Bank). An initial loan of \$250 million to France in 1947 was the World Bank’s first act.

Since then there has already been considerable criticism of the roles of IMF and the World Bank. The above mentioned problems and the ongoing trade imbalance in the world have to be addressed by a similar gathering. Sooner or later, both the United States and the rest of the world have to address the existing problems. This problem is not United States alone. We can not ignore the largest economy on earth. It is said that if United States sneezes, the world catches cold. We have to either make sure that United States doesn’t catch cold or vaccinate ourselves against it.

At the end of the WWII 45 nations gathered at a United Nations Monetary and Financial Conference

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# Dollars on Sale 30 Percent Off



The dollar was once the almighty dollar.

It became the world reserve currency. Every investor and government wanted dollars over all other currencies. Those were the glory days for the economy but now it appears the United States has been running a trade deficit for so long that is so large, those glory days are nearing an end. It may be time to sell your dollars before the upcoming 30 percent off sale.

When the Federal Reserve cut short-term interest rates to one percent, the dollar versus the euro adjusted down from 85 to 125. In retrospect, the decline in the dollar should have lowered the trade deficit – as foreign goods became more expensive in America, and American goods became cheaper abroad – but that didn't happen. Instead, we took advantage of lower interest rates to borrow against our houses and spend more, so the trade deficit has just kept on growing! Americans now spend approximately \$800 billion more than they make each year; a mind-numbing amount of money! To paraphrase an election slogan we remember hearing from former President Clinton, "It's about the trade deficit, stupid".

Currencies in every country need to adjust from time to time to close trade deficits. Trade deficits reflect more purchases (than sales) of goods and services abroad, and are financed by the flow of financial capital. Since Americans don't save, capital, as well as goods, must flow into our country to pay for the trade deficit. (Indeed, the trade deficit creates a financial deficit.)

The fact that our federal government spends more than it taxes, adds to the problem. This basically means that our government is borrowing \$400 billion at the same time it needs to find lenders willing to cover the \$800 billion needed to finance the trade deficit. Congress has let spending run out of control, pushing up the Treasury's need to borrow.

It also doesn't help that we have a war President who has not used the spending veto - and is not likely to in an election year - and only wants to spend more on his war.

You may wonder where all the money comes from to pay for all those extra goods and services bought abroad by spendthrift Americans who don't save a penny, especially when this spending is not matched by earnings from selling America's goods and services abroad.

To finance our trade deficit of seven to eight percent of GDP and encourage the buying of dollars worldwide, a form of "financial bribery" through interest rate differentials has been used. Up until now, it has worked like a charm with investors, speculators and hedge funds to place hundreds of billions of dollar assets. For instance, as the Fed raised interest rates well above those paid on euro and yen accounts, a lot of money was made by borrowing low-cost euros and yen, and then investing them in higher-yield dollar assets.

Remember, it has taken a widening interest rate differential just to keep the dollar stable. A falling interest rate differential between what investors can earn in dollars, euros and yen, etc., will be the death of the dollar as hedge funds (loaded up with dollar assets) begin to unload them.

In addition, virtually every central bank in the world has been buying U.S. financial assets. Without this continued magnitude of buying, the dollar will fall. Why is there such enormous buying of dollars from world central banks? To start with, the Japanese, Chinese and Asian central banks have found it in their commercial interests to buy dollars to prevent their own currencies from appreciating. (China and Japan now hold about a trillion dollars each.) In addition, the United States government uses political blackmail and the arm-twisting of our allies and their foreign central banks, to buy dollars. Two clear examples are the Gulf Arab States stashing their earnings on oil, and the United Kingdom helping to fund the "oil" war in Iraq.



We may see a slight shift in global trends in the form of a sell-off of the dollar as central banks worldwide seek a buffer from the burgeoning U.S. trade and budget deficits.

Developing countries have for years been told that building up U.S. dollar currency reserves was the best way to maintain financial stability in their countries.

Now that the Fed has slowed raising interest rates in our country, interest rates are creeping up in Europe, Japan, China and the rest of Asia, making these currencies more attractive. However, the Fed realizes there could be a significant economic slowing and the winding down of the housing market (with declines in home sales, new home construction and housing prices) will surely guarantee the interest rate differential will shrink.

More importantly, the G7 and the IMF have gone on record to say that currencies need an adjustment; a very big adjustment! This implies that Asian currencies must go up and the dollar must go down. Also, it will be virtually impossible to prevent the euro (as well as the currencies from countries that sell oil and other resources) from going up against the dollar.

In order to fully understand what is really happening on the central bank front, Larry Summers is worth listening to, now that he is free of all the politics at Harvard. Mr. Summers who served in a series of senior policy positions – most notably as the secretary of the treasury of the United States – specialized in the currency markets. Indeed, he was "the man" who successfully engineered foreign central bank gold sales to help hold the price of gold down and make the dollar look strong!

Mr. Summers is now urging the poorer, smaller countries with excess dollar reserves, "to do something with them". Perhaps his advice is to sanction foreign aid, but I suspect he may be encouraging these smaller central banks to swap out of dollars early before the big banks do. This would preserve the real value of their foreign exchange reserves, and save the IMF a lot of money down the road for not having to bail them out.

Just remember, when someone yells fire in the movie theatre, you want to be sitting in the back row near the exit door, so you can get out before it's too late. Larry Summers has just yelled "fire".

The dollar is in grave danger because there are hundreds of billions of dollar assets funded by hedge funds that will be sold. Worldwide, central banks are beginning to buy fewer dollars at a time when the U.S. needs new buyers of dollar assets to fund our escalating trade deficit.

If America, as a matter of policy, is going to let the dollar go, there are many investments you must not own as an investor or saver: One investment is dollar-denominated bonds. A falling dollar is very inflationary. As inflation rises, it forces interest rates up so you'll lose on the currency devaluation, as well. U.S. Stocks will fight the headwinds of inflation and may go up in dollar terms, but they will most likely not keep pace with inflation.

When the dollar is declining, if you own paper-assets denominated in dollars (cash, stocks or bonds) sell them and wait for the dollar to crash before going back to owning dollar assets. The dollar could fall 20 to 30 percent before there is a material improvement in the trade deficit. You should, instead, consider owning real assets: Gold, silver, other precious metals and commodities, come to mind. For investors who prefer being in cash, it's not easy but it is possible to open up a foreign currency account. Everbank even offers foreign currency CDs insured by the FDIC, and there is a new, short-dollar currency fund offered by RYDEX Funds that offers a two-percent increase in value for every one-percent the dollar goes down.

So, if you truly value a good night's sleep, and the thrills and terror of the stock market have you spinning, put your money in cash, just not dollar cash!

## The Rising Cost of Everything

### Folks Tighten belts, take part-time jobs, dip into 401(k)s

BY ALISON KEPNER  
THE NEWS JOURNAL

When retiree Charles Kolodjeski moved into his Little Heaven manufactured home in 1986, his monthly expenses totaled \$500. Kolodjeski estimates he now spends \$2,500 to \$3,000 a month on food, land rent, gasoline, health care, insurance, utilities and incidentals. "I stopped keeping figures because it annoyed me," he said. Expenses totaled \$500. Kolodjeski estimates he now spends \$2,500 to \$3,000 a month on food, land rent, gasoline, health care, insurance, utilities and incidentals. "I stopped keeping figures because it annoyed me," he said.

Like residents across the state, Kolodjeski, 74, is facing even greater cost-of-living increases this year. From gasoline prices and heating bills to health care and housing costs, many Delawareans are going to be shelling out hundreds of dollars more each month.

The extra cost can mean real trouble for many in a state the U.S. Census Bureau estimates had a median income of \$50,315 in 2004, with 79,682 of the state's 830,364 people living below the federal poverty line.

And other increases could be coming soon, too. Property tax hikes loom in New Castle County, and many school districts are facing shortfalls. State officials are talking about higher

tolls and fees for driver's licenses and car registrations. Come May, Delmarva Power electricity customers will begin paying nearly 60 percent more to keep the air conditioning humming. "No matter how you turn, they get you," Kolodjeski said. "My saying is this, 'When Jesse James robbed somebody, he put a gun to their face. Today, when they take it from you, you don't even know they're doing it.'" Like most, Kolodjeski's income hasn't kept pace with rising expenses.

Civilian workers' wages and bene-fits rose 3.1 percent in 2005, the smallest increase in nine years, according to the U.S. Labor Department. Meanwhile, inflation was at 3.5 percent. Adding that up has many reaching for the Maalox.

A January Bureau of Labor Statistics report shows real hourly earnings -- income adjusted for inflation -- were down 0.5 percent between December 2004 and December 2005; weekly adjusted earnings fell by 0.4 percent. The decline is due to rising inflation -- the fastest yearly price growth since 2000 -- and slower nominal wage growth, according to the Economic Policy Institute, a nonprofit, nonpartisan think tank.

Workers on the lower end of the wage scale were hit hardest. Their inflation-adjusted wages fell by 1.9 percent, the institute reported. The median worker's fell by 1.3 percent. Only those at the very top of the wage scale saw earnings growth that outpaced inflation.

"That translates to less buying power," EPI economist Sylvia Allegretto said. For the average Delaware resident, that means another year of prudence.

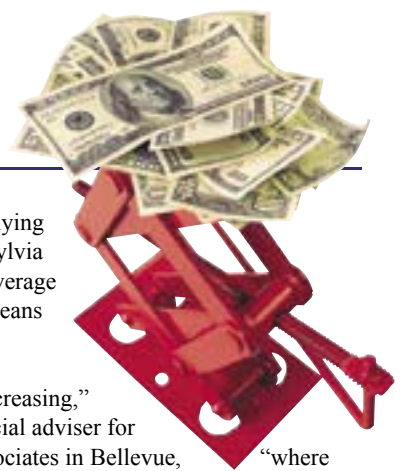
"If your wages are not increasing," said Jack Boselli, a financial adviser for Raymond James and Associates in Bellevue, "where are those funds going to come from? You've got to cut back in some manner."

#### Walking away

Patricia Parsons, 58, is one of the many not seeing income increase as expenses mount. The Long Neck retiree, who lives in the Pot-Nets Bayside manufactured home community, said her lot rent increased this year by 37 percent to \$6,200. Neighbors with waterfront lots had 70 percent hikes, she said. "A lot of people have walked away. ... They've abandoned their homes," said Parsons, who supports a bill in the General Assembly to force owners to justify increases above inflation. Parsons is tightening her budget, thinking more about nonessential spending such as dinners out or trips to the movies.

"Big jumps like heating, gasoline, your land rent ... are more than people can absorb," she said.

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## The Rising Cost of Everything *Continued from pg 3*

Bear homeowner Ken Betts, 65, is rebudgeting, too. He is bracing for May when Delmarva Power's prices will jump. He already had sticker shock when he opened his 2006 New Castle County sewer bill, up \$98, a 40 percent increase. "All of these things are adding up," he said. "People should be warned."

Bob Cronin, a Realtor with Patterson Schwartz in Newark, expects rising energy costs eventually will affect the housing market. Energy-efficient houses will be easier to sell, while buyers in the low- or moderate-housing market may be more interested in smaller homes that are more affordable to heat and cool, he said.

"When people see the prices going up and are aware of it, the smart buyers are going to be anticipating these costs," he said. Some people are looking to squeeze even small savings from their household budgets. Betts joined a wholesale club, where buying in bulk could save him on everything from toilet paper to potatoes. He shops around for the best prices and is careful not to choose convenience over cost, such as picking up bread and milk at the gas station.

Bob Schmidt, 71, of Dover bought a scooter in September to save on fuel. On nice days he uses the scooter, which gets about 90 miles a gallon, to buy stamps at the post office or drop off library books. Schmidt and his wife, Norma, also try to save on energy costs around their home. The gas fireplace in their living room is cold. They closed it off to keep warm air from rising up and out of the home. For the same reason, they closed the exhaust fans in the kitchen and bathrooms. The door to their guest bedroom is shut, too. They closed off the room for the winter. Schmidt also insulated the water pipes and garage. They try to save money on food, too. They shop the circulars, marking the best-priced items and stocking up during sales. Like many neighbors in their

Wild Meadows development, the Schmidts eat daily at the Modern Maturity Center, where lunch is \$2.50 a person.

Schmidt grows his own vegetables, too. The eggplant, zucchini, green peppers and cherry tomatoes from his garden feed the Schmidts and their neighbors, who often share dishes in turn.

Others are seeking extra income to help with rising costs. Neighbor Charles Munroe, 68, took a part-time job moving and washing vehicles for the Enterprise car-rental company. That helps cover the 10 percent increase in the retiree's lot rent and his extra health care costs. His former company stopped covering supplemental insurance for its retirees, requiring Munroe to spend about \$6,000 a year on that and Medicare costs. All that had previously cost him \$2,500, he said. "Either you have nothing or you have it all. Anybody in between, they are creaming them," he said. "It's a shame."

### No room to trim

Some don't have extra money in their budgets to trim. Single motherCarolynn Bird, 48, struggles to support daughter Allison, 11, and son Bradley, 13, with no child support. "I can't work two jobs because they would be alone," said Bird, an administrative assistant at Bank of America who earns too much to qualify for government help.

Bird, who is paid biweekly, pays the first half of the \$819 monthly rent for the family's three-bedroom, Newark-area apartment with her first check. She pays the other half -- and a 5 percent late fee -- with the second. Her car and electric bills are late most months, too, she said. Her first apartment after her divorce 10 years ago was a one-bedroom, the only place she could get on her credit. She slept on a day bed with the children's bunk beds crammed next to her. When the kids got older and began

jumping from the top bunk, she took the beds apart, and she slept on the living room sofa. It took her six years to get her own bedroom. The family then lived in a less expensive apartment complex. They moved when Bird got fed up with men urinating in the communal washing machines and loitering on the stoops until the early morning hours. She isn't greedy, she said. She just wants to live comfortably.

"There are a lot of people in my situation," Bird said. "We work hard." The rising costs affect landlords, too, said Rebecca Saxton, who rents out 27 houses in New Castle and Kent counties. Saxton, whose three- and four-bedroom homes rent for \$850 to \$1,200 a month, hasn't increased her tenants' rent in a year and a half but expects a few will go up this year. "If someone is being a good tenant, then you are not going to increase their rent because you want them to stay," she said. But at the same time, she too is dealing with higher costs, from postage to gasoline to construction materials for repairs. "A lot of people think that being a landlord either is easy or that it is a lot of money," but neither is true, she said.

### 'Cheaper to eat unhealthy'

This year will be an especially tough time to deal with higher rent, Bird said. Like her utility bills, her medical co-payments are higher. She expects her rent to increase \$20 a month. Food is costing more, too. She remembers a few months ago when a gallon of milk cost almost \$4. "It's cheaper to eat unhealthy," she said. "You can get a big bag of cheese curls for 99 cents, and that will fill you up." Bird already cut nonessentials:



no gym membership for her, no new coat for Allison, no summer camps for either kid. Instead of going to the movies, they go camping with friends.

### But it's not enough.

Bird routinely borrows money from her 401(k) retirement plan to get caught up. "Frankly, I need it now, not later," she said. Financial advisers say that is the wrong move. "I would recommend that be the last resort," Boselli said. The minimum amount workers should save is the percentage their company will match, he said. If possible, save the maximum allowed. "Over the past several years when the market was difficult ... the one thing that saved investors was that they continued to put money into the investment on a monthly basis," he said. "They were able to buy stocks at a lower price ... when the market turned around, those people experienced a very nice profit."

As important as saving is, many Americans aren't doing it. The U.S. Commerce Department reported Monday that Americans' savings fell into the negative for the first time since the Great Depression. The savings rate only has been negative for an entire year twice before -- in 1932 and 1933, a time when many lived on savings during massive job layoffs and business failures.



## Rising Cost of Raw Materials Hits Stocks

### Oil and commodity prices and the possibility of further rate hikes prompt a major sell-off.

By Walter Hamilton, Times Staff Writer



Wall Street suffered its biggest sell-off in nearly four months Thursday as a fresh surge in oil and commodity prices stoked fears that inflation pressures are building and that the Federal Reserve might continue to push up interest rates.

Only a day before, the Dow Jones industrial average had edged to within 80 points of a record close. But rising energy costs, a lower-than-expected retail sales numbers and lingering concerns about the Fed's direction combined Thursday to send stocks broadly lower.

The Dow retreated 141.92 points, or 1.2%, to 11,500.73. The technology-laden Nasdaq plummeted 48.04 points, or 2.1%, to 2,272.70. The Standard & Poor's 500 index of blue-chip shares sank 16.93 points, or 1.3%, to 1,305.92.

Small-company stocks, which have spearheaded the market's rise in recent years, were thrashed. The Russell 2,000 index tumbled 2.4%. Even stocks of oil and gold-related companies — which generally rise in tandem with prices of these commodities — fell with the rest of the market.

"This is probably a shakeout the market needed, but it's very broad-based," said Todd Clark, director of trading at Nollenberger Capital Management in San Francisco.

Losers topped winners by nearly 4 to 1 on the New York Stock Exchange.

The sell-off appeared at least in part to be a delayed reaction to the Fed's meeting Wednesday. The central bank boosted its benchmark interest rate to 5%, as expected, but said further hikes "may yet be needed." Many investors had been looking for a sign that the Fed would take a pause after its latest increase.

These investors believe the economy will cool on its own because of a decelerating housing market and rising gas prices. Further rate hikes, they say, could choke the economy and decapitate the bull market.

"The biggest risk that faces the market is that the Federal Reserve will be seduced by worries about inflation into raising rates too high," said Hugh Johnson, chief investment officer at Johnson Illington Advisors in Albany, N.Y.

Jim Glassman, senior economist at JPMorgan Chase Securities in New York, said investors should take comfort in the fact that the Fed is being vigilant about inflation. "I don't know what problem the market thinks there is," he said.

Glassman said Wall Street's unease probably stems from the fact that new Fed Chairman Ben S. Bernanke is not telegraphing his intentions the way his predecessor, Alan Greenspan, would have done. But that's natural given that Bernanke has his own style, he said, and investors simply have to get used to it.

Johnson said that with another month of economic data still to come before its next meeting in June, the Fed is smart to keep its options open.

"But that's no good for investors," Johnson acknowledged, "because they want to know what the Fed is going to do."