

Asia crisis threatens global 'discontinuity'

by William Engdahl

Far from calming down after the dramatic \$40 billion International Monetary Fund-led emergency rescue package of Nov. 4 for Indonesia, the second in only four months for an Asian country, the Asian financial crisis has taken on an alarming new dimension. In early November, shock waves sweeping the former high-growth countries of East Asia, have exploded with a qualitative new force in South Korea and Japan, the two largest industrial economies of Asia. As well, fears are growing that the largest Ibero-American economy, Brazil, is threatened with major capital flight, despite a savage government austerity package designed to "reassure" foreign investors that Brazil's currency, the real, and with it the dollar value of their Brazilian stock and bond market investments, would hold firm.

Senior City of London financial strategist S.J. Lewis describes the events in Asia as "approaching a systemic discontinuity in several Asian economies, a discontinuity which could rapidly become a global one." Lewis dismisses the common argument among complacent fund managers, that the 30-40% devaluations of Asian currencies will be good for Asian export profits. "This is foolish. How can an industry produce, if the country has no liquidity to keep the factories running? In some of these countries, it's dangerously close to that kind of meltdown situation."

His analysis is a far cry from the prevailing mood in Wall Street firms or European banks, summed up by one European banker as "complacency. The large U.S. fund managers I deal with all tell me, 'Asia is too small a part of the world economy to have any large negative impact on us.' Needless to say, I think they're dangerously wrong, especially after what is developing in Korea and Japan in recent days."

Crisis in Korea, Inc.

The most alarming immediate problem is in Korea, the 11th-largest industrial economy in the world, and the newest member of the "club of industrialized nations," the Paris-

based OECD. "The problem in South Korea," one Korea fund manager at a major bank commented, "is far different from that in, say, Thailand or Indonesia, where we may see one or several banks go under. In this case, it is a crisis of Korea, Inc., the entire complex of banks and their related *chaebol*, or industrial groups."

Complicating the Korean crisis, where the central bank has depleted its dollar reserves in a vain effort to keep the national currency, the won, stable against the dollar, are the Korean Presidential elections on Dec. 18. "The elections mean no government action, rather, complete paralysis until after that date," the Korea fund manager said. "That is only worsening the pressures on the won."

"Korea is right now in an impossible situation," Lewis added. "I see no way out at this point, but for the government to put the entire Korean economy and banking system through some form of 'national Chapter 11' bankruptcy reorganization."

The dilemma is that Korean companies have borrowed a huge sum from foreign banks in the past two years, some \$30 billion from Japanese banks alone, to keep going. Today, Korea has a total foreign debt, public and private, of more than \$120 billion. Of that debt, \$80 billion or so comes due in less than 12 months. For the past two years, with the won rising along with the U.S. dollar, against the falling Japanese yen, Korean exports went into a sharp decline. Korea competes directly with Japan in all major export markets. That export slump has led to a wave of the worst bankruptcies since the beginning of Korea's industrialization, following the Korean War in 1953. Large companies, like Kia Motors and Hanbo Steel, have had to be rescued or closed in the past six months. Their bad debts are now on the books of the large Korean creditor banks.

To ease the problem for Korean banks, now privately owned but still government "guided," in terms of setting interest rates on loans or deciding who gets credits, the govern-

ment, in the week of Nov. 10, announced that it was creating the Korea Asset Management Corp., with an initial fund of \$3.5 billion, to buy bad bank loans. However, this is a drop on a hot stone. Official domestic bad debts are at least \$60 billion, and actual numbers are believed to be far higher. Government officials have reportedly told the banks to conceal more bad news until after the elections.

To make matters worse, not only their loans to *chaebol* industrial firms have increasingly gone sour, but, at the encouragement of the government, the banks went heavily into the Seoul stock market in 1994. "The government saw it as a sign of its own success, if the stock market rose like elsewhere in Asia," the Korea fund manager said. "The problem is, the stock boom turned negative at the end of 1994, and since has fallen precipitously."

Korean officials are caught in a nasty double-bind. To defend the won, deemed urgent to convince foreign bank creditors to roll over the \$80 billion coming due in the next few months, the Bank of Korea has drained liquidity from the banking system, forcing domestic interest rates sharply higher. That, in turn, has helped collapse the Seoul stock market and the value of bank investments, as banks are forced to call in broker loans. Seoul stocks have fallen 23% since September. Were the government now to let the won go, and try to save the stock market, a full-blown Ibero-America-style debt crisis would detonate.

In the past days, as he toured Asia, IMF Managing Director Michel Camdessus repeatedly offered IMF emergency help to Korea. The government refused, reportedly fearing disgrace in the elections. "The IMF would have to come up with a record-breaking package," stated Cr dit Agricole-Indoseuz economist Steven Jennions in London. "We're probably talking twice the size of the Mexican package of 1995." That, if true, would mean \$100 billion.

If Korea's stock and currency markets collapsed, this would increase the scale of the Asian economic and financial crisis twofold, by some estimates. That would then hit Japan with devastating force. According to senior advisers to Japanese Prime Minister Ryutaro Hashimoto, for such reasons, Korea is "worry number one" in Tokyo.

Japan's crisis deepens

EIR has described the seven-year-long Japanese economic decline, which inside Japan is officially given the name The Great Heisei Depression, in honor of the present Emperor. Japan, whose banks continue to choke on the legacy of an estimated \$1.1 trillion in bad debts to construction, real estate, and other companies from the "bubble economy" of the late 1980s, is in its deepest economic depression since the 1960s. Political paralysis has so far prevented a resolution of the bad debt problems. Depositors, fearing bank failures, have fled to the government Postal Savings Bank (helping make it the world's largest bank, controlled by the Ministry of Finance) or into Japanese government bonds, driving interest rates below 2%. The last time government bonds of an indus-

trial economy were that low, was U.S. Treasury bills during the Great Depression. The domestic economy is in negative growth, and only a cheap yen is driving large exports, the only bright spot to date.

Japan not only sends 43% of its exports to the Asian region; Japanese banks, in order to get high profits to offset bad domestic loans, have become the largest lenders to Asia—\$119 billion, as of December 1996, according to the Bank for International Settlements (BIS). The figure today is significantly higher. In Thailand, Japanese banks hold \$37.5 billion; and, \$30 billion in South Korea. Japanese banks are under enormous pressure to "throw good money after bad," by rolling over these loans.

This grim outlook has led to selling by investors in Tokyo of stock shares, especially those of banks and financial brokerages. The result has been an almost 20% plunge in the Nikkei Dow Tokyo stock index since September. More alarming, Japanese banks count the value of "core stock holdings," shares they hold as long-term holding in related industrial or other companies, as part of the bank's core capital reserve. As the Nikkei falls, these so-called hidden reserves fall with it.

On Nov. 11, the London bank rating agency IBCA Ltd. announced that it was reviewing 11 large Japanese banks for likely credit downgrade. If the Nikkei hits 15,000, no less than 11 of Japan's 20 largest banks would see their entire hidden reserve value disappear. That would force many banks to cut back loans to meet mandated BIS capital reserve rules, in order to continue to do business internationally. On Nov. 12, the Nikkei stood at 15,435.

"Already in the past two weeks, the dreaded Japan bank risk premia have returned," Lewis noted. "Two weeks ago it was zero over the standard London LIBOR rate for interbank credits. Today it is 0.25%. That's an ominous sign, if not yet as severe as in 1995, when the U.S. Federal Reserve and Treasury extended an emergency \$500 billion credit line to calm the crisis." Already, Korean banks have reportedly become forced sellers of large sums of Russian and Brazilian government bonds. They had bought the securities in hopes of getting far higher interest rates. Now, desperate for dollar cash, they are liquidating, sending interest rates in both countries skywards and collapsing the financial markets there.

Speculators have begun dumping dollars. "The crisis is seen as a crisis in the dollar regions of the world," Lewis said. "Europe is regarded, right or wrong, as relatively unaffected by the Asia and Brazil events. That's why the German mark has been rising, and the yen and dollar falling in recent days. If the dollar goes into free-fall, that could detonate the real systemic crisis Mr. LaRouche has long expected."

The spread of the Asia crisis to Korea and Japan has put Washington on a state of "financial red alert." If the central banks of Korea and Japan are forced to liquidate their huge holdings of U.S. Treasuries, the United States would be faced with a financial meltdown. If Japan were to sell even a fraction of its \$500 billion in private and government hands, it would detonate a dollar collapse. That point is near.