

## Japan's crisis threatens global financial crash

by William Engdahl

The worsening of the global financial crisis in Japan and South Korea in recent days, has brought the world payments system to the brink of a systemic crisis like nothing ever seen before. Over the weekend of Nov. 16, feverish behind-the-scenes negotiations were ongoing between Washington and Tokyo, in an attempt to prevent a meltdown of the Japanese stock market and, with it, the collapse of the Japanese banking system. Bankers from London to Zurich to New York, and points in between, held their collective breath in nervous anticipation, as trading on the Tokyo Nikkei stock market opened on Monday, Nov. 17.

On Friday, Nov. 14, the Nikkei stock market, the second-largest in the world after New York, had fallen to 15,082. It had plunged some 2,000 points in as many weeks. What only last July had been a stock market, on paper, worth more than \$3 trillion, had lost more than \$800 billion in a matter of weeks. More alarming, much of that \$800 billion consisted of the capital base of the entire Japanese banking system. According to calculations by IBCA Ltd., the international bank-rating agency, were the Nikkei to fall much below 15,000, the entire "hidden reserves" of 18 of the 20 largest banks, among them six of the world's largest, would turn "negative."

### A financial 'Pearl Harbor'?

In what now is widely recognized as a perverse arrangement, Japanese authorities "won" a major concession from fellow central bankers of the G-10 large industrial nations a decade ago. At that time, the leading central bankers of the Basel-based Bank for International Settlements debated new uniform rules which would require member country banks wanting to do business internationally, to maintain \$8 of re-

serves against each \$100 in outstanding loans. This 8% Bank Capital Adequacy rule, agreed on in 1988 to become effective in 1992, was intended to regulate the most extreme excesses of speculative bank lending and guard against bank failures.

The Bank of Japan successfully argued at Basel for an "exception." That exception today has returned to haunt BIS central bankers, as the Achilles' heel of the entire world banking system.

Because the postwar "Japan, Inc." economic miracle had been built on a unique structure of intimate permanent links, through mutual stock share ownership, between the large Japanese banks and the industrial companies tied to them—the so-called *Keiretsu* system—Japan won the right to count those stock shares its banks held, in an amount up to 45% of their required 8% capital, or almost half the total needed.

The stock holdings constitute the so-called "hidden reserves" of the banks in Japan. Hidden, because much of the shares had been bought as far back as 25-30 years ago, when Nikkei shares were a fraction of even today's low value. Every March 31, the close of Japan's accounting year, the current market value of the banks' stock portfolio must be declared according to the closing price on the Nikkei Tokyo Stock Exchange on that day.

Different banks, according to IBCA estimates, have significantly different stock values. But a Nikkei level of 15,000, were that to hold into next March, would wipe out the entire value of most large banks' equity capital. The fear is that, as March nears, in a desperate bid to raise cash to cover the losses on their stocks, the banks would be forced to do what bankers internationally regard as the "ultimate horror scenario": emergency liquidation of their billions in U.S. Treasury securities.

That scenario, which one market source refers to as “the financial equivalent of a new Pearl Harbor,” would likely bring down the entire U.S. bond market, and, with it, the global financial system.

According to official U.S. Federal Reserve data, foreign holdings of all U.S. Treasury securities (bills, notes, and bonds) currently exceed \$1,240 billion. Of that sum, an estimated \$370 billion, almost 30%, is in Japanese hands, including the approximately \$170 billion held by the Bank of Japan, and more than \$200 billion held mainly by Japanese banks and insurance companies.

With the Nikkei in near free-fall in recent weeks, rumors began to circulate that Japan’s banks had begun to sell U.S. Treasuries. ING Barings Bank, the Anglo-Dutch bank which, according to informed reports, had been one of the most aggressive speculators against Asian currencies and markets in recent months, also came out with alarming statements of Japanese bank insolvencies and capital problems. The cost for Japanese banks to borrow on interbank markets had risen sharply for the first time since the crisis of September 1995. Japanese banks faced paying huge costs to borrow, or else had to liquidate assets in order to continue operating as of the Nov. 16 weekend.

### A surprise visit from Washington

Not surprising given what is at stake for the United States, in the midst of the crisis and evident Japanese domestic political paralysis, U.S. Treasury Secretary Robert Rubin dispatched his deputy secretary, Lawrence Summers, to make an unplanned stop in Tokyo on Monday morning, en route to a meeting in Manila. Little was said publicly following Summers’s talks with Japanese Finance Minister Hiroshi Mitsuzuka and other Tokyo officials.

According to reliable Tokyo financial circles, Summers pressed his Japanese counterparts for assurance that, “regardless what solution they finally agree on, there would be no liquidation of U.S. Treasuries by the banks. If Japan agreed to this, Washington gave its assurance of U.S. support, should Japan need it in the difficult coming period.”

As the Summers-Mitsuzuka talks were ongoing, a buying pandemonium had broken out on the Tokyo Stock Exchange. Paradoxically, it had been triggered by an official statement from the Ministry of Finance and the Bank of Japan. They announced that Japan’s 10th-largest bank, Hokkaido Toku-shoku Bank, was being closed down, and its problem loans transferred to the government’s Deposit Insurance Corp., while its customers would have deposits guaranteed by and transferred to another regional bank. For the first time, Japan had let one of the 20 big banks, earlier deemed “too big to fail,” close its doors.

There were reports in the Tokyo market that the move was part of a definitive effort by the Hashimoto government to finally deal with the seven-year-old worst bank crisis in



*A battle royal is raging in world financial circles, over whether or not to try to bail out the speculators and the bankrupt banking systems. Here, the Peruvian daily Sí takes a pot shot at megaspeculator George Soros, who had described himself, in a Nov. 5 U.S. television broadcast, as “a kind of gigantic digestive tract, taking money in one end and pushing it out the other.”*

Japanese history. According to reports, the government was now ready to break the political taboo and spend public funds, ultimately taxpayers’ money, to clean up what private estimates place at \$900 billion to \$1.2 trillion in bank bad debts left from the disastrous “bubble era” of real estate and stock speculation in the late 1980s. It was reported that the government planned to propose a new law allowing the world’s largest bank, the Postal Savings Bank of Japan, to, in effect, buy up the banks’ bad loans to allow the banks to reorganize.

The Postal Savings Bank, a government agency with government guarantees, has become the most sought-after refuge for Japanese savings. Today, it controls an asset base of some \$2.8 trillion, and its deposits total 45% of all Japanese bank deposits. The political problem is that, by law, the Postal Savings Bank is part of the public pension system. It is politically explosive in Japan to speak of taking such money to

clean up the banking mess.

As it turned out, the Tokyo Nikkei index climbed by over 7% on Monday, and another 3% on Tuesday, amid statements from Prime Minister Hashimoto vaguely affirming his intent to offer bank bailout legislation to the Diet on Dec. 10.

The euphoria lasted all of 48 hours. On Nov. 19, the Nikkei plunged again, following a denial by Hashimoto of plans to use public money. "The most powerful institution in Japan today is the Budget Bureau of the Ministry of Finance," London economist S.J. Lewis told *EIR*. "They are strongly opposed to any public bailout. Among other things, they fear an out-of-control public budget deficit, at a time when Japanese elderly public pension costs are about to explode."

As of this writing, the situation in the Japanese financial system hovers on the brink of disintegration. "The Nikkei euphoria is not justified by any political decisions taken so far," noted IBCA Japan bank analyst David Marshall. "If the present crisis can finally force action, I cannot say. But even if, it's a bit late to act decisively now. Had they done so five-six years ago, it would have made a difference." According to Marshall, whose group has just lowered the credit rating of several large Japanese banks, a number of regional banks are also on the brink of collapse, and the Deposit Insurance Fund will likely be drained dry by the costs of closing Hokkaido Takushoku Bank. All this doesn't even reckon the impact on Japan of a meltdown in Asia's second-largest industrial economy, South Korea.

## The 'Ginseng Crisis'

As *EIR* described last week, the crisis of the South Korean economy is even more acute than that of Japan. On Nov. 18, the South Korean government said it would no longer try to stop the fall of its currency, the won, which had been formally pegged to the U.S. dollar. The won immediately fell below the "danger" level of 1,000 won to the dollar. As of Nov. 20, it had dropped to 1,140 won, a plunge of nearly 30% since August, with no end in sight.

The crisis of the won is the crisis of "Korea, Inc.," as one Korea expert termed it, or, as some have dubbed it, the "Ginseng Crisis," referring to Korea's most popular herb. In recent years, Korean industrial companies had turned to Japanese and other foreign banks to borrow money to service old debts or to finance expansion. But a high won, the result of the sharp rise in the dollar against the Japanese yen since April 1995, had already put Korea into a deep recession, as its exports were outpriced by "cheap" Japanese and other goods. Since March, seven major industrial groups, *chaebol*, have gone under, with tens of billions in debts. The government has ordered the Korean banks to take over their bad debts, giving the banks a huge bad loan burden, officially admitted to be \$28 billion.

But the real time-bomb in Korea is the foreign debt, reliably estimated at near \$200 billion. Of that, said one Tokyo source, Japanese banks, desperate for profits abroad to make

up for problems in Japan, have lent some \$57 billion to Korean companies. In total, Japanese banks have almost \$200 billion lent across Asia, making Japan by far the worst hit by the deepening Asia crisis.

Even worse, some 75% of South Korea's foreign debt is due in 12 months or less. With the dollar 30% dearer to the won, Korean companies must come up with that margin more of dollars or yen to service the debt, or convince its creditors to roll over the loans. Foreign banks are said to be doing the opposite, i.e., cutting interbank credit lines to Korean banks, expecting the worst.

The Korean government, which had been paralyzed because of Presidential elections on Dec. 18, on Nov. 20 finally asked the International Monetary Fund for a \$70-80 billion bailout. But that begs the question, whether the IMF will be able to organize another \$70-80 billion, in the wake of the \$17 billion for Thailand and the estimated \$40 billion for Indonesia.

"This is the biggest test global monetary authorities have faced in history," Lewis stressed. "It already is larger than the 1929-31 international crisis. Central bankers still feel they somehow will be able to muddle through with the present system. However, Mr. LaRouche's New Bretton Woods monetary reorganization ideas are becoming more credible as the costs of all this climb."

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