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LaRouche tells Japan: Impose capital controls, now

by Marcia Merry Baker

As of mid-September, new waves of insolvencies and payment defaults are crashing over whole countries, not just "the markets." The breakdown effects in the global physical economy are seen dramatically everywhere, from the food supply crisis in Russia (p. 38), to the new statistics showing the drastic contraction in volume of goods traded so far this year by Japan, Germany, and other world production centers. Time is running out to intervene.

At the epicenter of the world financial quakes is Japan—the second largest economy in the world—with its particular crisis element of derivatives, a detonator of world financial meltdown. As LaRouche stresses in his Sept. 1 strategic paper in this week's *Feature:* "Relative to Russia, it is the position of Japan, in relation to East and Southeast Asia, but, more significantly, the 'derivatives' bubble at the core of the ongoing collapse of the planetary financial and monetary system, which continues to be the major element of financial, monetary, and economic destabilization planet-wide."

The infamous bad debt volume in the Japanese banking sector, estimated at more than $1.4 trillions, is, in turn, interlinked with major bank exposure to derivatives. This all adds up to a potential blow-out of the world financial system, on the nuclear explosion scale. The epic challenge for Japan, is to undertake a massive, orderly write-off of unpayable debts, while deep-sixing masses of derivatives obligations, in order to preserve and expand credit connected to essential economic functioning. The guiding principle is that behind the U.S. Chapter 11 bankruptcy codes: Save the economic operations, and freeze or cancel out the unpayable debt.

An initiative in this direction was taken by Malaysia on Sept. 1, in terms of imposing controls over foreign exchange and capital flows, to penalize speculation, and otherwise act to preserve currency values and exchange rates for purposes of furthering national economic interests, not speculative ones.

Though the circumstances of Malaysia differ from Japan—which is a world linchpin economy, and also a financial bubble center—nevertheless, the principle remains that *re-regulation* of the financial sector is in the national interest, and indeed, international interest (see *EIR,* Sept. 11, "Re-Regulate, Reindustrialize: It's the American Way!").

LaRouche's urgent advisory to Japan

During the first week in September, Lyndon LaRouche issued an urgent advisory to the Japanese government to follow the example of Malaysia and impose strict foreign exchange and capital controls, internally as well as externally, to protect its economy from a chaotic implosion of the global derivatives bubble. The kind of measures he called for include a freeze on all speculative obligations within the Japanese financial system, followed up by government-directed bankruptcy procedures.

Each day since this advisory, dramatic events underscore the necessity of taking such action. The mental state of Japan's government officialdom, however, remains set on trying, "anything else, but." Especially fearful is the question of *cross-defaults* that might cascade as a result of individual defaults. Typically, what governs the betting practices of most over-the-counter (OTC) derivatives, is a master agreement formalized by the International Swaps and Derivatives Association, which has a cross-default clause, stipulating that default of any single derivatives transaction with any counterparty, would automatically enable all other derivatives transactions will all counterparties involved to be deemed in default.

If this is triggered, take cover.

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However, such a contingency only points up the rightness of LaRouche's advice for government action to impose controls quickly and decisively. The more governments take concerted action, in the footsteps of Malaysia, the closer we are to forcing the international collaboration for a New Bretton Woods effort to set up a new, nation-serving financial system, and turning away from international chaos. In recent weeks, Hong Kong (which is a Special Autonomous Republic of China) has drawn the line against speculators. Taiwan has outlawed the operations of George Soros hedge funds in their markets.

In the meantime, the derivatives fuse is burning down to the point of world explosion, as events in Japan and Russia show. Adding to the process, there are reflex-moves toward hyperinflation in Japan, the United States, and elsewhere.

Tremors at Fuji Bank

On Sept. 10, representatives of Fuji Bank, one of Japan's top institutions, held a press conference on the size of their derivatives losses. Only a few hours later, a surprise came from the Bank of Japan, which announced a liquidity push, in the form of a reduction in the interest rate on interbank overnight loans, from 0.5%, down to 0.25%.

Lowering interest rates (i.e., pumping liquidity into the imploding world monetary system) was the hint from Federal Reserve Chairman Alan Greenspan in his Sept. 4 speech in San Francisco, where he attended meetings between Treasury Secretary Robert Rubin and Japanese Finance Minister Kiichi Miyazawa.

In particular, it is the derivatives exposure of Fuji Bank that is considered the occasion for the Bank of Japan's lowering of interest rates. Early on Sept. 10, with the opening of the Tokyo stock exchange, rumors were flying that Fuji Bank had suffered losses on derivatives contracts in the range of 2-3 trillion yen, or about $20 billion. This far outstripped the ephemeral good news from Wall Street's 380-point "rally" of the day before. The Nikkei stock average index dropped 158 points on Sept. 10, and then continued to fall, ending that week below the 14,000 level.

One source of the Fuji Bank rumors was the report in the Sept. 10 daily *Kochi Shimbun,* that the top 19 banks in Japan had potential derivatives losses of 24 trillion yen ($180 billion). Fuji Bank, at a hastily called a news conference, described the rumors as "totally groundless."

Yutuka Komatsu, the derivatives products general manager at Fuji Bank, claimed that the maximum possible loss from the bank's derivatives trading would amount to a paltry 15 billion yen ($110 million), because, "our derivatives trading is controlled to have very small market risk."

He defended Fuji Bank's derivatives contracts, as mostly less risky interest-rate swaps, and said that the bank had taken appropriate measures for risk hedging. However, Fuji Bank announced at the press conference that the notional volume of its outstanding group-based derivatives contracts at the end of March 1998, amounted to 418 trillion yen—about $3 trillion! The majority of the contracts were owned by Fuji Capital Markets Corp., a swap house based in New York and fully owned by Fuji Bank.

Fuji Bank stocks went down 15%.

The notional value of the volume of derivatives contracts outstanding worldwide is in the range of $140 trillion. Despite periodic public debate about the threat of a derivatives blowout, including from the Bank for International Settlements, over the last four years, no substantial action has been taken. Derivatives exposure of the banking system internationally has grown like the cancer that it is.

Western exposure to Russian default

In late August, there were warnings that the Russian government's freeze on certain currency transactions was a threat to settlement of as much as *$100 billion* in OTC ruble "forward contracts." A Russian failure to meet these obligations threatened to trigger a chain reaction among the Western derivatives "counter-parties," the warning went. Certain major Western banks, including Deutsche Bank (Germany) and Republic Bank (U.S.A.), have reported (probably conservatively) hundreds of millions of dollars in losses in connection with their Russian exposure.

The Swiss-based Bank for International Settlements puts the Western bank exposure at around $72 billion in potential Russian losses from loans in abeyance. According to the London *Financial Times*'s Sept. 11 survey of the September plunge in share values of Western banks, the largest exposure so far reported is Crédit Suisse First Boston, with $2.2 billion. Deutsche Bank has around $750 million of loans not covered by Russian state guarantees; Germany's Dresdner Bank, around $700 million. Bank Austria, the nation's largest, announced earlier this month a huge—relative to Bank Austria's size—need to make provision for $197-380 million in relation to derivatives contracts used to hedge its holdings of Russian securities.

In the Western Hemisphere, the "exposure" question for U.S. and other banks is posed by Brazil. On Aug. 31, the global financial crash struck that nation, with worsening effects each day as markets collapse, capital flees, credit stops, and banks go under. De facto, the country owes $500 billion in foreign debt—on any terms, an unpayable amount. No government actions, whether budget cuts, interest rate hikes (up to 29.7% on Sept. 4), or the like, have mattered. During the first week of September alone, $8 billion fled Ibero-America's largest country.

On Aug. 25, Japanese Finance Minister Miyazawa spoke of the derivatives threat in remarks to the Parliament's Lower House, stating his belief regarding Japan's de facto bankrupt Long-Term Credit Bank, that "the notional amount of LTCB's derivatives trade is over 50 trillion" yen. If LTCB "should find difficulty in paying," he added, "then there is a danger of default." According to Reuters news service, he said that such a default "could lead to a Japan-triggered global financial depression."