EIR Economics

April global financial shock begins with Japan

by William Engdahl

Since late 1997, with the collapse of Japan's fourth-largest securities house, Yamaichi, and a series of bank and company failures, the government of Prime Minister Ryutaro Hashimoto has passed a dazzling array of emergency measures designed to prop up Japan's rotted banking system as well as to try to jump-start its depressed economy. The March 31 end of Japan's fiscal year was a deadline-point in these attempts to achieve an aura of solvency. In fact, it augurs new financial shocks ahead.

The various Japanese government measures to date, along with the lack of the right kind of emergency international efforts, has only made matters worse. Japan is at the brink of a full-blown systemic crisis, with Weimar-style hyperinflation of money supply, and a simultaneous depression collapse of the real economy. Such a process threatens not only the outbreak of a new Asia crisis, but of a global monetary and economic breakdown, in the absence of any effective governmental collaboration to create a new Bretton Woods orderly reorganization of the global system.

The message that Japan, Inc. is on the verge of collapse was delivered loud and clear on April 2. First, the Bank of Japan released its quarterly economic survey of 700 leading industrial firms, the *tankan* survey, which forecast a dismal collapse in production. The release of the report accelerated the fall of the Nikkei stock market index and the yen.

Later the same day, Sony Corp. Chairman Norio Ohga proclaimed at a press conference, "The Japanese economy is on the verge of collapsing." He chastised the Hashimoto government for fixating on budget deficit-slashing, while the economy was facing a deflationary collapse. He described Hashimoto as "worse than Herbert Hoover."

While the spotlight is on Japan, April also sees new waves of crises throughout East Asia, in Brazil, Russia, and elsewhere. In South Korea, during 1998's second quarter, more than $20 billion in corporate debt to foreigners comes due, plus there are due dates for large amounts of domestic-held debt before June 30. This portends chain-reaction defaults. Physical-economic activity is contracting by the hour. On March 26, the South Korean Labor Ministry announced that 500,000 workers were laid off during January and February alone, bringing the total number of officially unemployed to 1.24 million, or 6% of the labor force. By May, there may be 2 million workers—or 10%—officially jobless, according to Chang Sang-soo, economist at Samsung Economic Research Institute.

In Indonesia, production and trade are at a standstill, and vital import supplies, including food and medicines, are being handled on ad hoc financing terms, on "humanitarian grounds." On April 1, even the World Bank met on this subject in Washington, D.C. Indonesia has over $74 billion in private-sector debt obligations, which since January have been in de facto debt moratorium. The rough breakdown is: $13.66 billion from state-sector firms (power, transport, cement, minerals); $9.41 billion from private banks; and $58.91 billion from non-bank enterprises, including foreign investment companies. Not reflected in these figures are another $20 billion of foreign exchange-related derivatives contracts—a ticking time-bomb, ready to blow.

Though these dire events are occurring in Asia, the fact that the crisis is *global*, not Asian, is dramatically reflected, among other ways, in the recent move to sell off Asian-held U.S. Treasury securities (see box). Over the fourth quarter of 1997, Japan and other Asian nations cut *net* holdings of U.S. Treasury securities by over $17 billion. In the last quarter of 1997 alone, Japan sold a net $8.48 billion of U.S. Treasury securities.

Japan: 'a bailout too far'

The government-announced "rescue" packages for Japan have so far flopped, in parallel to the failure of the bailouts by the International Monetary Fund (IMF) for South Korea, Indonesia, Thailand, and others.

On Dec. 25, 1997, the Tokyo government announced plans to create a 30 trillion yen ($240 billion) bank rescue fund for the Deposit Insurance Corporation to prevent a meltdown of the world's second largest banking system. Of this, some 13 trillion yen would go to permit government buying of special preferred stock shares in troubled banks, to give the banks a capital injection.

On Feb. 20, the government announced 35 deregulation measures, including easing restrictions on pension funds' buying of stocks, and allowing banks the highly dubious option of upvaluing their real estate holdings to market value, to boost bank capital further. Banks were also given the bizarre right to decide whether to evaluate their permanent stock holdings, the core of the postwar Japanese system of corporate interlock with bank groups or Keiretsu, at either the original purchase price or the current market price, whichever is more favorable to the bank's balance sheet.

Finally, on March 26, the Liberal Democratic Party (LDP), leader of the government coalition, announced a large economic stimulus package. The package, announced with great fanfare days before the end of the March 31 Japanese fiscal year, was obviously timed to spark a wild buying rally on the Nikkei stock market, with calls for "economic measures worth more than 16 trillion yen [$124 billion], including necessary and sufficient fiscal spending centering on expanding domestic demand."

That would make it Japan's largest-ever stimulus package. However, the plan, to date lacking on details, puts priority on traditional public works stimulus, and has no provision for widely urged tax cuts to spur domestic spending. Reportedly, of the 16 trillion yen, fully 8 trillion yen will come from carryover funds from past budget allocations which the government hadn't yet spent.

What stimulus?

The ludicrous debate over domestic "stimulus" aside, the Hashimoto government, for the moment, has unfortunately staked its political life on European Maastricht-style budget austerity. This rules out any significant tax cuts for fear of revenue loss and widening budget deficits. Last November, Hashimoto got the Diet (parliament) to pass the Fiscal Structural Reform Act, which mandates cutting the annual budget deficit to no more than 3% of GDP by January 2003. Japan faces the worst demographic collapse of any major OECD country, far worse even than Germany or Italy. The prospect of an explosion of aging citizens drawing public pension support and a disappearing younger population to support those pensions, is one of the most socially controversial political issues in Japan. This makes it very difficult for Hashimoto to repeal the austerity act without losing face.

Today, Japan's budget deficit is estimated at 8-9% of GDP and rising. As a result of the November law, severe new budget austerity has begun on April 1, with the new fiscal year. This, at a time when Japan's economy is in its worst recession since 1974. The deepening government austerity in the midst of a growing economic depression, the worst unemployment in 45 years, and a growing economic depression among Ja-

Asians dump U.S. Treasury securities

Led by Japan's selling off $17 billion of its holdings of U.S. Treasury securities in the fourth quarter 1997, many Asian nations also dumped their holdings, as **Table 1** shows. The total selloff by these Asian nations was $26.2 billion in three months.

On the other hand, some nations, led by Britain, increased their holdings of U.S. Treasury securities during this period, possibly as a means to gain leverage. On Dec. 31, 1995, Britain held $123.8 billion of U.S. Treasury securities; by December 1997, Britain had more than doubled its holdings.

Overall, based on the purchases by Britain, Germany, and Netherlands Antilles, total foreign holdings of U.S. Treasury securities rose from $1,266 billion in September 1997 to $1,278.6 billion in December 1997.

—Richard Freeman

TABLE 1

Holdings of U.S. Treasury securities

(billions $)

	Sept. 31, 1997	Dec. 31, 1997	Change
Japan	317.7	300.7	–17.0
Taiwan	31.6	29.8	–1.8
Singapore	35.1	34.9	–0.2
South Korea	9.6	5.2	–4.4
Thailand	10.8	9.9	–0.9
United Kingdom	266.2	287.6	21.4
Germany	80.3	91.4	11.1
Netherlands Antilles	50.8	61.6	10.8

Source: U.S. Treasury Department, Economic Policy/International Financial Analysis Division.

pan's Asia trading partners, have prompted U.S. Treasury Secretary Robert Rubin and Ambassador Tom Foley in recent weeks to make repeated pleas to Japan to implement some effective tax stimulus to reverse the economic slide, in effect to postpone the austerity timetable.

And now, the 'Big Bang'

The present situation can euphemistically be described as a lack of consensus in leading Japanese policy circles. Some would call it chaos. The scandals, arrests, and suicides of numerous leading Ministry of Finance and Bank of Japan officials in recent weeks, have effectively destroyed the traditional agencies which have directed Japanese economic policy in the postwar period, leaving a huge policy vacuum, being filled at present by squabbles among divided political party fractions, in and outside the LDP.

To make matters worse, the Hashimoto government has decided to go ahead with a long-debated series of financial deregulation measures, ostensibly aimed at making Japanese finance a "global player" again. The deregulation measures, called in Tokyo the "Big Bang," in reference to the deregulation of the City of London's financial rules in October 1986, will have the effect of pouring kerosene on the smouldering ashes of the Japanese banking system and the economy.

Under the Big Bang rules, which went into effect April 1, companies or individuals, for the first time, will be able to engage in foreign exchange transactions offshore, without prior permission from the Finance Ministry. Anyone can hold dollar or other foreign currency bank accounts, and buy foreign securities without restriction. The Big Bang rules all aim at liberalizing capital flows between the Japanese yen and offshore markets. This will mean a flood of money out of the yen into the dollar, or into Europe, where it can earn much more in interest than in Japan. Ten-year Japan Government Bonds today offer a miserly 1.5% return, the lowest since the 16th century. U.S. Treasury securities pay some 5%.

However, that flight out of the yen threatens to detonate another crisis. With the domestic economy already depressed, banks have been squeezing loan clients, especially smaller businesses, to repay loans, not roll them over. This, in order that banks can meet the 8% Bank for International Settlements minimum capital reserve against possible bad loan losses. This process has created a "credit crunch," which in turn is forcing record business failures, and rising unemployment, hitherto unknown to Japan.

The physical economy is reeling. On March 30, the Ministry of International Trade and Industry (MITI) announced that industrial production fell 3.3% in February alone. Official unemployment rose a record rate of 3.6%. Projections are that in March and April, industrial production will drop by at least 2.5%.

Little wonder that with capital lining up to leave Japan; with banks facing competition, under the Big Bang, from foreign banks and firms; and with the Asian crisis now entering a new, deeper economic collapse phase (some 40% of Japan's exports last year went to Asia), the Tokyo Nikkei stock market is falling sharply. On April 2, the Nikkei closed at 15,700, the largest one-day drop since January. The trigger reportedly had been a Bank of Japan *tankan* survey of business confidence, revealing a catastrophic plunge in that confidence compared with the December survey. Masatoshi Kikuchi of Daiwa Research Institute commented, "If there is no announcement of large income tax cuts soon, the Nikkei average could fall as low as 15,000."

Given present trends, that may be wildly optimistic. Market insider reports are that various speculative foreign hedge funds have taken out futures positions betting on a Nikkei of 14,000. One British financial firm, Fleming Securities, is betting the Nikkei will hit 12,000. In December 1989 it was at 39,000, before the bubble economy burst.

"Normally the Japanese government doesn't take decisive action unless things reach crisis proportions," noted Dresdner Kleinwort Benson economist Geoff Lewis. "Well, the *tankan* survey is saying, here it is, this is the crisis. This is the starkest possible warning the Japanese have to get their act together." Whether they do, and move decisively in the directon of the earlier hint by Vice Finance Minister Eisuke Sakakibara, and back a call for convening a new Bretton Woods conference, remains to be seen. What is clear is that Japanese "business as usual" is over.

Documentation

World press calls for a New Bretton Woods

Argentina

The newspaper *Clarín* on April 1 published an article by financial journalist Carlos Scavo, headlined "A Crisis and Four Lessons," with a kicker which asks: "What should a Central Bank do: Rescue the financial sector, or look after the real economy? This question poses another one: Is it not time that a 'Bretton Woods II' redefine what a Central Bank is?"

The article came out the same day that *EIR* held a conference on the New Bretton Woods in Buenos Aires.

The article reviews an analysis of the Asian crisis prepared for "Conjoncture (Paribas)," by Pierre Blanque, described as an OECD expert, which appears, from *Clarín*'s report, to warn against hyperinflationary "bubbles within mega-bubbles."

Blanque's four lessons, as conveyed by *Clarín,* are:

1. Central Banks and the IMF insist on bailouts through the financial markets, but this just adds to speculation, and