Japan's Banks Melt Down in 'Bush Crash'

by Kathy Wolfe

Bank of Japan Governor Masaru Hayami.

Public trust in Japan's mega-banks has been "damaged," the Bank of Japan (BOJ) said on Oct. 11, in extremely strong language for a central bank. "The strength of the banks has declined and the market's trust has been damaged," BOJ Governor Masaru Hayami told a news conference. "If there is a crisis, we will serve as lender of last resort." This was just the latest in a string of shocking statements from the highly conservative 85-year-old Hayami, after his surprise proposal on Sept. 18, that the BOJ buy up as much as $100 billion in industrial company stocks held by the major banks. In Japan, banks were originally created to fund industry, and the top eight banking groups still hold over $210 billion in industrial stocks as part of their capital.

But now, with the collapse of the Wall Street bubble and consequent crash of all global stock markets, the existence of Japan's banks is directly in question. President Bush's threats before Congress and the UN to go to war with Iraq, only magnify the crash in New York and Tokyo, Japanese analysts are warning, rather than propping the dollar as in prior Mideast wars. "People are realizing that a further rise in oil prices will worsen the U.S.'s enormous trade and budget deficits, and further deter capital flowing into the United States, and some are calling this the 'Bush Crash,' " one Japanese observer pointed out.

What is most shocking about the state of Japan's banks, is not merely the size of bad loans at the top 20 banks, estimated at $1-1.5 trillion. Certainly there are bad loans in this amount at the major U.S. banks, not to mention the $80 trillion or so in rotten derivaties at U.S. banks and other financial institutions.

But what is most dumbfounding, is the sheer size of Japan's banking system. If any one of Japan's mega-banks were to go under—and Financial Services Minister Heizo Takenaka said recently, that "No Japanese bank is too big to fail"—it could easily bring down the entire world financial system. The consolidated group assets of Japan's Big Four banking conglomerates, Mizuho Holdings ($1.3 trillion), Bank of Tokyo/Mitsubishi ($900 billion), UFJ ($700 billion), and Sumitomo/Mitsui Bank ($700 billion), come to $3.6 trillion right there. Japan's largest eight bank groups have an estimated total of $5.5 trillion in assets.

Among the Big Four banking groups alone, $500-$600 billion of their loans are estimated to be non-paying at this point—which means, that while many of these loans may be worthy credits to productive industrial borrowers, those borrowers are not paying the banks at the moment.

Background to 'Bush Crash'

How did this ever happen? Japan is facing a "Bush Crash" in not one, but multiple senses of the term. It started back in 1985, when Donald Regan—the man from Merrill Lynch, and who became Ronald Reagan's Treasury Secretary, and had the support of then-Vice President George H.W. Bush, who provided the political muscle. They forced Japan to sign the infamous Plaza Accords, which up-valued the Japanese yen by 40%. By the end of 1988, when Bush took over as President, the yen had risen by 80%. Simultaneously, the United States forced the Japanese to lower interest rates, to as low as 3% already by 1990.

Wall Street and Washington's purpose in this was rather simple: to turn the docile Japanese, captive to the U.S. "nuclear umbrella" at the height of the Cold War, into a gigantic "cash cow" to finance the collapsing U.S. economy and ballooning U.S. government deficits. Increasing the value of the yen, quite simply from the U.S. standpoint, increased the amount of dollar assets Japan could be made to buy. During this time, the Japanese purchased over $1 trillion in U.S. government debt alone—and countless trillions in relatively worthless U.S. real estate boondoggles, such as Rockefeller Center, half the golf courses in Hawaii and California, and so on.

But back home in Japan, this caused a massive real estate bubble, in which land prices in Tokyo were multiplied by six and seven times, and a gigantic stock market bubble, in which prices of everything went through the roof, creating infamous Tokyo $10 cup of coffee. During the "post-Plaza" era, Japanese banks, which had to finance all of this, grew extremely rapidly to absurd dimensions, out of all proportion to the size of Japan's domestic economy. And no wonder: Japanese banks were financing a major chunk of the U.S. and global trade deficits.

It was the equivalent of the "Roaring Twenties" in the United States—except that tiny Japan was being asked to print enough money for itself, the United States, and a chunk of the European economies, too. So, when the Great Tokyo Bubble popped in 1990 with a bang, it caused prices to crash just as precipitously. Just writing off the non-existent bubble values of the land and loans to real estate and related bubble companies, was enough to decimate the banks.

Bad Loans, and Worse

Ever since that time, prices in Japan have been actually falling, in a 1930s Depression-style deflation, meaning that, no matter how many bad loans the banks write off, there will always be more businessess going under each day, and more bad loans piling up—a sort of "bankrupt's arithmetic." Japanese banks have written off some $205 billion in bad loans in the years since, but many today have worse balance sheets than before, because of the collapsing world economy, which keeps turning good loans bad at a rate faster even than the banks can write off the paper. Over the nine years through fiscal 2000, Japan's banks took over $650 billion in losses after disposing of bad loans. At major banks, such write-offs have been much higher than their profits in recent years—which is to say, that most of the banking system has been operating in the red for the past two years at least.

"Disposal of bad loans has come a long way, but there are loans that are newly becoming bad loans. That's the problem," BOJ Governor Hayami said in a press conference on Oct. 16. He said that non-performing debt is no longer the legacy of the bubble economy era, as it has often been portrayed. What has the BOJ worries about now, is the pace at which new bad debt is appearing, which is outstripping the banks' ability to roll it over.

Now, add in the crash of world stock markets, over which Japan has little or no control, and it's a like throwing a match into an oil well. Of the $210 billion in industrial stocks which Japan's largest eight banking groups hold as part of their capital, as much as $50 billion or 25% of this value evaporated between June 1 and Oct. 24, as Tokyo's Nikkei stock index suffered an almost 30% drop, from 12,000 to the 8,500 level—just following the Dow Jones and the Nasdaq on down, a phenomenon familiar to millions of unhappy American 401(k) owners. Japanese authorities are virtually powerless to stop the Nikkei from a bottomless slide for the rest of this year, since it is simply following the falling New York markets, and the U.S. physical economy, into the pit. Japan's economy is totally dependent on exports to U.S. consumers, who are buying on credit.

Nobuo Yamaguchi, head of the Japan Chamber of Commerce and Industry, warned on Sept. 6 that a further Nikkei drop would decimate shares of financial institutions ahead of the Sept. 30 closing of the books for the first-half of the fiscal year. "The stability of the financial system is the most important thing," Yamaguchi said. "The BOJ believes that the Japanese economy is trapped in a vicious cycle," *Nikkei Keizai News* wrote in its Sept. 9 editorial: "An economic downturn resulting from cuts in loans by banks is helping to push down stocks. Consequently, banks' available funds to dispose of non-performing loans are shrinking, because of eroding shareholders' equity, making them become more risk averse, and reducing loans further."

Japan now has a $150 billion fund sitting at the government Deposit Insurance Corp. to be tapped for injection into banks and other reorganization measures. But past bank bailouts, in 1998 and 1999 during the "Asia crisis," were complete failures. The government handed out more than $75 billion in public funds to ailing banks, but the cash was just used to bail out the bad debt. Under pressure from the United States, Japan abandoned its traditional practice of directing credit, and the government just handed out money, without insisting that loans to productive companies be saved, and that those to unproductive companies be ditched.

Directed Credit?

Finally during October, there was some discussion of a directed-credit bank reorganization. *Nikkei* reported on Oct. 13 that instead of letting Japan's banks just collapse, certain members of the ruling Liberal Democratic Party (LDP) are working on a plan to transfer $83 billion in bad loans held by banks to the government-backed bad-debt purchasing body, Resolution and Collection Corp. (RCC). While the RCC was set up some years back at the behest of U.S. Federal Reserve Chairman Alan Greenspan and Wall Street, most Japanese banks until now have been reluctant to sell assets to it, because the RCC was only buying loans at very deep discounts, solving nothing.

What is new about this proposal, is that it "calls for separating the recipients of the loans bought by the RCC into viable, and nonviable companies," *Nikkei* reports. "The debts against viable companies will be administered by a newly created 'corporate revival firm,' supporting the resuscitation of such companies."

EIR had previously been told by BOJ circles who follow the work of Lyndon LaRouche, that they were looking into such a new use of the RCC, after the failure of Japan's previous bank re-capitalization programs. This comes after *EIR*'s strenuous intervention into Tokyo to stress LaRouche's concept that government direction of bankruptcy operations and new credits are necessary for a banking reorganization, such that good debt tied to productive facilities is to be saved, and speculative debt is to be ditched. The LDP plan reportedly is looking at this, and aims to cushion the impact on corporate borrowers of a fast cleanup of bad bank loans, since fears of a fast write-off of bad bank loans have caused a panic that industrial corporate borrowers are about to be foreclosed upon *en masse*. Under the plan, loans judged as viable to productive companies will result in new capital to be injected into the banks which sell such loans to the RCC.

None of this addresses the truly urgent need for Tokyo to speak up about the bankruptcy of the global system. The truth of the matter, is that nothing the Japanese do domestically, by themselves, can stop Japan's banking system from blowing out. Only the creation of an entirely New Bretton Woods monetary system can save Japan; and so, the only rational course for the Japanese, is to call for it early and often in international forums. Discussion of directed credit, however, is a baby step in LaRouche's direction.

Japan Elites Rip Harvard Boy Takenaka

by Kathy Wolfe

Japan's Financial Sercies Minister Heizo Takenaka is under fire for demanding the takedown of Japanese industry, on orders from the IMF and Washington.

Nobuo Yamaguchi, chairman of the Japan Chamber of Commerce and Industry, at a news conference on Oct. 18, kicked off what has become a flood of attacks on Harvard-trained Japanese Financial Services Minister Heizo Takenaka, for his International Monetary Fund-dictated economic policy of "surgery without anesthesia." Takenaka's new austerity plan was scheduled for release on Oct. 22, but Prime Minister Junichiro Koizumi ordered it rewritten by the end of the month.

"The United States backs Takenaka; but Japan needs to work out countermeasures on its own," Yamaguchi said, referring to statements by Glenn Hubbard, the monetarist chairman of President Bush's Council of Economic Advisers. "While scholars can rewrite dissertations, no re-do is permitted for economic phenomena," he added. (Takenaka had been an economics professor at Keio University.) The yen rose briefly on Oct. 23, when the press reported that Takenaka would be fired.

Prime Minister Koizumi was heavily attacked over the Takenaka appointment by his own Liberal Democratic Party (LDP) and the two other parties in his ruling coalition in the Diet (Parliament), on Oct. 22-23, in what Yomiuri News called "an effective vote of no confidence." "Steamrolling reforms may send the national economy into turmoil," said Mitsuo Horiuchi, chairman of the LDP General Council. Akihiro Ota, secretary general of the Komeito party, also called on the administration to expand job-relief efforts, saying, "What the people are calling for is 'reform with encouragement,' rather than 'reform with pain.' "

Mikio Aoki, secretary general of the LDP upper house, demanded that Koizumi immediately change policy. "Is Mr. Takenaka serious?" he asked, when presented with the draft of Takenaka's austerity plan. "A plan like that would certainly cause stock prices to crash."

"LDP Don Aoki Gives Koizumi Tongue-Lashing Over Policy," was the *Asahi News* headline. "Political heavyweight Mikio Aoki, a one-time defender of Junichiro Koizumi, blasted the prime minister Tuesday, saying his 'private-sector experts' have no business in deciding the nation's economic policy," *Asahi News* wrote. "They have not been chosen in elections," Aoki said of Takenaka and his Wall Street advisers. "It is a problem if people who are not in position to take responsibility provide opinions that influence grave national policies and the people's future."

Pressure From the United States

The press is openly reporting what Bank of Japan officials have told *EIR* for some weeks: that Takenaka's program will devastate Japanese industrial corporations, but produce an enormous "cheap shot" for American "vulture funds" to buy them up a quarter on the dollar, as was done in Korea in 1998-99. AT&T Corp. Chairman Michael Armstrong told the Japan-U.S. Business Council in Tokyo on Oct. 23 that Takenaka's program must be implemented with no further delay, because "Japan's structural reforms are behind schedule compared with the timetable promised in February" to President Bush. Armstrong repeated Bush and Hubbard's calls in February for Japan to let bad loan paper and industrial shares "go free into the markets," where they would collapse.

Nikkei News commented: "But some critics say that U.S. financial circles are hoping that the sale of shares would lead to more business opportunities" for American vultures. Calls by U.S. Treasury Undersecretary for International Affairs John Taylor, at a Tokyo press conference on Oct. 23, endorsing Takenaka's shock therapy plans, also didn't help much. "The United States believes it is essential for Japan to rebuild its financial system because it may need Japan to help shoulder the costs for its continuing anti-terrorism efforts," said Nikkei bitterly.