

Japan Central Bank Warns: Deflation, Banking Crisis, Trouble For Yen Ahead

by Kathy Wolfe

Japanese Prime Minister Junichiro Koizumi held a meeting on the danger to Japan's banking system at his residence, on Dec. 27, according to *Yomiuri News*, where it was agreed the government would "take every possible measure" in the event of financial crisis. After the meeting, which included Chief Cabinet Secretary Yasuo Fukuda and Liberal Democratic Party Secretary General Taku Yamasaki, Yamasaki told the press that Koizumi had agreed to new injections of capital into the banks if needed, using public funds, which he had previously opposed. "We will take every possible measure to prevent a run on the banks from ever happening," Yamasaki said. "We won't let the people panic, and we will take measures to prevent the economy from falling into a deflationary cycle."

Meanwhile the Japanese yen has been dropping fast, 8% since Sept. 11 and 13% during 2001, leading speculators to talk of an "Asia Crisis II."

Coming on the eve of Japan's annual six-day New Year's market closure, and days after Argentina's declaration of a debt moratorium, the Dec. 27 and related meetings spurred talk in Europe that Tokyo was using the holiday to hush over a major bank problem. "The decision to put the regional Ishikawa Bank under court bankruptcy could be the prelude to bankruptcy of other fragile financial institutions," France's *Le Monde* wrote on Dec. 29 under the headline "Fragility Of The System." Ishikawa went under on Dec. 28 with liabilities exceeding assets by over \$180 million and deposits of over \$3 billion. "Ishikawa is not important by itself," one London banker said. "The fear is . . . it might have led to a run on the banks overall, which could have produced a systemic danger."

It was indeed a bigger story. The Prime Minister's meetings focused on a private report by the Bank of Japan (BOJ), warning that continuing current policy will soon lead to the collapse of one of Japan's top four banking conglomerates, *Nikkei News* reported on Dec. 29. Without mentioning the bank's name, BOJ reported that this bank now faces a risk similar to that of the former Long-Term Credit Bank, for which internal BOJ "risk factor indicators" showed a rapid rise to 1.45% in early 1998, shortly before it went under. The BOJ indicator for the now-endangered bank is over 1.6%. This would mean the bankruptcy of one of the largest banks on earth. The top four are Mizuho Holdings, assets \$1 trillion;

and Sumitomo Mitsui Banking, Mitsubishi Tokyo Group, and UFJ Holdings, with assets of some \$500 billion apiece.

Hayami-San Speaks Out

Only *EIR*, however, had the full story and had it first, as now confirmed by the leak of the BOJ report and by an extraordinary New Year's Day interview by Bank of Japan Governor Masaru Hayami, appearing in *Nikkei* on Jan. 2.

Asked his opinion of Japan's economy and its future, Hayami flatly volunteered: "If you define a deflationary spiral as a process in which the economy worsens and prices fall at the same time, we might indeed be on the eve of one. Prospects look particularly tough for January-March." Despite decimation of the physical economy, he said, it seems the government will step up its current regulatory crack-down on banks, leading banks "to toughen lending policies toward major corporate borrowers, resulting in another series of important developments," i.e., more major bankruptcies.

Asked if the BOJ would increase money-printing in response, Hayami said that this was futile. "Financial institutions are still cautious about lending money, while fund demand from companies remains weak. Although we have substantially eased our credit reins, money is not reaching companies and the BOJ's monetary easing has yet to produce results," he said.

Hayami was then asked: "Will fears of another major banking crisis, similar to 1998, arise again?" He replied precisely: "The big difference from 1998 is that we have established a safety net for the banking system this time, namely, 15 trillion yen [\$120 billion] in emergency funds. The BOJ is also ready to offer emergency loans to financial institutions." That is, while waving the fig leaf of a large bailout, Hayami did not deny the reality of the crisis.

In this way, the Bank of Japan went public with its warning that the current Tokyo policy, of shutting down banks and corporations, while printing hyper-loose money for "the markets," is "just not working." *EIR* reported on Dec. 14 that "behind the scenes, a showdown is brewing between the IMF [International Monetary Fund] . . . and Japan's technocrats," who have begun to say that the IMF free-market model "simply is not functioning." *EIR's* can now report that its sources were high BOJ officials.

"At least the doctor is being frank about his assessment,

although he has no cure,” commented *EIR* Founding Editor Lyndon LaRouche, as the 85-year-old Hayami had offered no viable solution.

First Quarter Conjuncture

While Hayami did not mention the IMF, it is an open secret that behind the current danger of banking explosions, against which the BOJ is warning, is the IMF program in Japan. The IMF is demanding shock therapy for the physical economy in which regulators force closure of banks and industrial companies. “We want the regulators to get tough on the banks. . . . That would lead to many more bankruptcies—and that’s what they need,” the IMF’s Japan Desk said in June, as *EIR* reported at the time. “That may mean a lot of unemployed forced onto the streets, but this is what is needed” (*EIR*, June 15, 2001).

The IMF is also behind the ever-escalating demands for more BOJ money-printing, as *EIR* documented on Dec. 14, and is now promoting “inflation targetting,” in which the BOJ agrees to add “whatever it takes” to the monetary base to stop prices from falling. This is what Hayami has now publicly called pointless.

Japan’s situation could indeed go sour as banks and companies begin in February to announce losses for the fiscal year ending March 31. Japan’s 135 banks announced on Dec. 29 a joint pretax loss of 1.3 trillion yen (\$10 billion) for the fiscal half ending Sept. 30, compared with a 1.13 trillion yen profit for the same period a year earlier. A 19% rise in core profits for basic banking was outweighed by huge losses from bad loan write-offs and the fall in value of the banks’ stock portfolios as the stock market plummets. Experts fear the results for March 31 could be much worse. The Nikkei bank stock index hits new lows daily.

The public is also worried about the safety of savings when the government deregulates bank deposit insurance. Starting on April 1, individual deposits will only be guaranteed up to 10 million yen (about \$80,000), an action promised to the IMF and Wall Street under former Prime Minister Ryutaro Hashimoto’s “Big Bang” deregulation craze of the mid-1990s. Keeping this foolish promise could be suicide in today’s hyper-unstable global conditions.

This Crisis Is Global

However, it is not some peculiar flaw in Japan, but the global nature of today’s crisis featuring the Enron, Argentina, Turkey, Poland, and other bankruptcies, which threatens to bring down major U.S. and European banks, as well as Japanese institutions.

This is the environment in which Japan’s yen could go into free fall. Of course, the dollar could go into free fall just as well on any Monday, due to the collapse of the U.S. economy. To avoid this, Japan, Korea, China, and other Asian nations have been furiously buying dollars to support the dollar since Sept. 11. Japan’s Finance Ministry (MOF) has proba-

bly bought almost \$100 billion U.S. dollars since Sept. 11, and China and Korea have been doing the same, all trying to cheapen their exports to compete for the evaporating U.S. market.

“The Japan crisis is actually a dollar crisis,” LaRouche commented on Dec. 30. The yen has been “the major firewall for the dollar” on the financial markets, he said, since the Japanese government must debase the yen in order to print reams of it to buy up dollars for this dollar support. “And then there is the euro crisis. All of these are part of the chain-reaction collapse of the world system,” LaRouche noted. At the moment, the yen is taking the heat. At year-end 2001, the yen fell almost to 132 per dollar, down more than 8% since Sept. 11.

So far, it has been Tokyo policy to “talk down” the yen. “I believe the yen, which has been a bit too strong for some time, is in a corrective phase that will see it better reflect the actual performance of the Japanese economy,” Haruhiko Kuroda, the Finance Ministry’s top currency diplomat, told *Nikkei* on Dec. 27. One Tokyo economist told *EIR* on Dec. 29, that the MOF and other agencies worry, that if the yen stays as high as it had been, it raises the question: “Will Japan continue to be a manufacturing nation, or will it shift, as the U.S. did during the 1980s, into a post-industrial society? Japan is now being flooded with cheap imports from China and many other Asian countries,” he said, “which is driving down prices inside Japan below the price of production for most of our manufacturers. This is a major cause of the terrible deflation here. Deflation of physical production is killing Japan.”

True; but it won’t be solved by tinkering with bits and pieces of the monetary plumbing. The same speculators who started the 1997 run on the yen and the Thai baht are now threatening a “herd” attack against the yen, which could get out of any MOF control. European and U.S. hedge funds have begun large-scale yen-selling, *Nikkei* reports, and many hedge funds are planning a new bout of yen-selling again starting in January. Deutsche Bank in London forecast on Dec. 25 that the yen will drop by 5% this year to 140/dollar, and to 205/dollar by 2005.

BOJ Governor Hayami, in his Jan. 1 interview, also warned that this yen tinkering could get out of control. While it might help exports a bit in the short term, he said, “I hope yen depreciation will not prompt active selling of Japan’s other financial instruments, including stocks and bonds. Some argue that the BOJ should purchase foreign bonds to guide the yen even lower, but no country has ever prospered by cheapening its currency.”

“Japan, however, is not exactly in the deepest trouble of all the major industrialized nations,” Hayami also warned, in an aside to those in Washington wondering how far Tokyo can be pushed. “Many analysts are of the view that the U.S. economy will hit bottom in the second half of this year.”