

Will Japan's 'zaitech' bring a market crash?

by William Engdahl

The current joke circulating in international financial centers is about the number of Japanese workers needed to produce an auto today. The answer? Three. One to operate the industrial robot assembly, and two to speculate in stock futures.

The Sept. 2 announcement by a medium-sized Japanese chemical company, Tateho Chemical, that it had incurred losses in speculation in the Japanese bond market of \$141 million, some \$25 million beyond the company's entire net worth, sent a shock wave into already nervous financial markets from New York to London and back to Tokyo.

Some analysts argue that the public mauling of Tateho Chemical, as well as rumors that major Japanese institutions might be in the same kind of trouble, were encouraged by the Japanese monetary authorities, for two reasons. The first is to warn market participants to pull in their horns; the second is to make clear to the United States that Japan can no longer afford to invest \$90 billion or more per year in U.S. securities.

Senior London financial sources expect that the impact of the Tateho affair will be felt internationally in the coming weeks. "Japan won't blow in any imagined '1929' way," one leading London broker stressed to *EIR*. "Instead, the Japanese government will step in fast to bail out any crisis situation. This would, however, result in extreme caution by Japanese who would then pull back from overseas investments. That would pull the rug out from under American and European financial markets." Japan has been investing overseas at an estimated \$100 billion annual rate in the latest period. This is equivalent to the entire foreign debt of Mexico or Brazil.

The process by which industrial firms compensate for large production losses and export declines by indulging in an orgy of speculation is known in Japan as *zaitech* (literally: "financial engineering"). Since the more than 40% appreciation of the Japanese yen against the falling dollar over the past two years, Japanese companies have turned to *zaitech* to prop up their corporate profits.

As long as the Tokyo or other stock and bond markets seemed to be rising with no upper limit in sight, it was a "sure win" game. Companies in Japan are almost without formal regulation regarding financial speculation, buying stock on margin (where the buyer need put up only a tiny fraction of purchase price). Even insider trading is commonplace. When the Bank of Japan and the finance ministry took a number of recent steps to rein in the dangerous levels of market specu-

lation, rumor had it that Tateho was not the only company to take staggering losses. West European banking sources have heard reliable market reports that at least one major Japanese bank has incurred losses "in the billions" in foreign exchange and securities trading recently.

The actual extent of *zaitech* is unknown outside Japan, but one report is that the giant Toyota Motors relied on its *zaitech* speculation for fully one-third of its 1986 pre-tax profits.

More to come

A spokesman for one of the largest Japanese investment houses in London, who asked not to be named, said that the problem inside Japan of such speculative exposure is very "worrying" and that the possibility of an imminent "30-40% correction of the Nikkei" was considered great by informed Japanese financial circles. The Tokyo Nikkei, Japan's equivalent of the Dow Jones average, has risen a breathtaking 105% since January 1986, as soaring yen prices for export-dependent Japanese industries such as shipbuilding, steel, and auto collapsed.

According to estimates, industrial economic growth this year will hit a 30-year low. The combination of this enormous profit squeeze on one of the world's few remaining industrial economies, plus U.S. and London pressures on the Japanese to open up their financial markets to the speculative practices which have so endangered those markets, has created the danger of a domino-style collapse of paper. Because of the concentration of Japanese firms, and the rise in the yen, their dollar-denominated asset holdings have become staggering even by Wall Street standards.

Nomura Securities, one of the Big Four, manages some \$237 billion worth of customer assets worldwide. Nomura has replaced Toyota as the nation's most profitable company, with profits up 63% over the year before. When the Sept. 22, 1985 agreement by the finance ministers of Japan, the United States, West Germany, Britain, and France insured the plunge of the dollar from its record highs, Japanese companies began to invest in stock speculation to shore up profits, rather than in new plant and equipment. One estimate is that the greater part of some \$142 billion set aside in special corporate investment funds by Japanese industrial companies in recent months, is devoted to *zaitech*.

Wall Street has been a significant center of such speculative investment by Japanese companies. The U.S. Treasury bond holdings of the large Japanese houses have been the prop for some 40% of recent U.S. debt sales.

The danger is compounded by the unique character of Japanese bank regulation. Unlike their U.S. or European counterparts, Japanese banks are allowed to count stock market holdings as "primary capital," the capital and reserves which a bank uses to determine its legal lending exposure levels. If there is a sharp contraction in stock values, bank primary capital could be wiped out, just when it is most needed to protect against default.