U.S. Treasury market at risk in Japan bank crisis

by Kathy Wolfe

The Oct. 16 announcement by House Banking Committee Chairman James Leach (R-Iowa), that the U.S. Federal Reserve will provide emergency cash to Japanese banks in the United States, shows that the crisis at Japan's enormous banks is just the tip of the iceberg. The mass of bad paper held around the world now threatens to bring down the entire financial system. Leach was asked to "leak" the policy statement, because the Fed fears a crash *of U.S. debt and banking markets themselves,* a New York bank official told EIRNS on Oct. 19.

The U.S. government "is prepared to cooperate fully with Japanese authorities to facilitate, in any emergency, liquidity for Japanese banks operating in the United States," Leach told House Banking Committee hearings on "The Japanese Financial System" on Oct. 16.

Major Anglo-American investment banks in Tokyo, led by Morgan Stanley and Salomon Brothers, have reported that bad loans at Japanese banks now total 80 trillion yen ($800 billion) to 100 trillion yen ($1 trillion). Alicia Ogawa, bank analyst and research director for Salomon Brothers, Tokyo, flew to Washington to repeat this estimate before Leach's committee on Oct. 16.

Representative Leach spoke because the Federal Reserve "is very fearful of a major fall of the U.S. Treasury debt market," an alarmed New York bank economist told EIRNS. "This is an agreement to bail out the Treasury—not to bail out Japan," the banker said. "The greater problem is that . . . the U.S. has a $4 trillion national debt already. It's Japan who is the creditor, and we who are the debtor. A quarter of U.S. debt, perhaps $1 trillion, is held by foreigners, and of that, Japan has $600 billion or more." The U.S. expects foreigners to fund over $200 billion of our deficit this year, and Japan to buy $80 billion of that. Japanese banks and government agencies have bought $60-65 billion in U.S. Treasury debt during 1995 so far already, Treasury figures show.

But if the London run on Japanese banks continues, this massive flow will reverse. "Japanese banks will have to dump Treasury paper to get cash," the banker warned. "The bottom could fall out" of the U.S. banking system, "not to mention crash the dollar."

"While we can't confirm Congressman Leach's statement, it would be nothing new," a New York Fed spokesman blustered to EIRNS on Oct. 19. "If a foreign central bank ever wants us to buy back U.S. Treasury bills, we are always happy to buy back our paper for dollars, just so that foreigners don't go onto the open market and depress the price" of the Treasury debt.

Global meltdown includes U.S.

This, however, "is not a 'Japan problem' . . . we are facing a global crash," as Lyndon LaRouche emphasized in his weekly "EIR Talks" radio show on Sept. 28. Once again, LaRouche was right.

The sheer size of Japan's banks, to begin with, makes the Tokyo situation worrisome; they are the largest in the world by far. Total loans outstanding by all Japanese commercial and savings banks come to 702 trillion yen, which is $7 trillion, or twice the size of total U.S. commercial and savings bank lending at approximately $3.5 trillion.

Total Japanese bank lending is roughly equal to that of banks in Britain, France, and Germany combined.

Yet the reported $1 trillion in bad Japan bank loans pales, compared to the rotten paper in the rest of the dollar-dominated world markets. Despite the collapse of Britain's Barings from bad financial derivatives loans, somehow the media seem to have forgotten the existence of *$23 trillion* in rotten derivatives investments held by U.S. banks, and an estimated $10 trillion in derivatives held by British and Swiss Eurodollar market banks in London. Japanese banks' derivatives holdings, some $5-6 trillion, are not quite as impressive.

U.S. officials claim that U.S. banks have written off most of their bad debt from the 1980s. According to figures from the Federal Deposit Insurance Corp. (FDIC), U.S. banks have only $60 billion in loans and leases which are non-current, or 30-90 days past due.

Actual bad loans at U.S. and British banks, *EIR* estimates, however, take no back seat to those in Japan, as percentage of bank lending. Of the total $3.5 trillion in U.S. bank loans, *EIR* estimates that $500 billion to $1 trillion are rotten, and $200 billion at British banks.

Despite the FDIC, the true situation at the U.S. banks will out. It appears that federal regulators have virtually taken over New York's Bankers Trust, with its gigantic rotten derivatives holdings, just as the Fed put Citibank into receivership in 1991. In December 1994, the New York Fed and the Securities and Exchange Commission (SEC) ordered Bankers Trust to hire "independent counselors" to review its derivatives business; the bank signed an agreement to be bound by the findings.

On Oct. 20, Bankers Trust announced that Frank Newman, recently deputy secretary of the U.S. Treasury, has become as president of the bank, and will become chairman when Chairman Charles Sanford retires in April. Newman, who joined the bank in September, replaces President Eugene Shanks, Jr., who resigned. Shanks was Sanford's successor—before the derivatives went bad on his watch.

Desperate U.S. bank mergers also continue in an attempt to buy time to hide bad debts. On Oct. 18, Wells Fargo launched a takeover bid for First Interstate; a combined bank would have assets of $107 billion. NationsBank and BankAmerica are also talking. BankAmerica is the second-largest bank in the United States, with $227 billion in assets, and NationsBank is third, with $184 billion. The new bank would have $423 billion, more than the $257 billion Citicorp and the new $297 billion Chase Manhattan.

Bankers target France

In Europe, following the French government's massive bailout of Crédit Lyonnais, the French banks are also widely known to be rotten, with $5-10 trillion in derivatives. Just as the British media and British bankers have been hyping the Japan bank crisis, desperate to turn attention away from London and New York following the Barings bankruptcy, so London has been running deliberate operations against the French financial system.

The French franc continued to crash during early October, as those whom French Prime Minister Alain Juppé called the "gnomes of London" express their discontent at the State's economic policy. On Oct. 20, the franc fell to a new low of 3.53 francs against the deutschemark, forcing the Bank of France to raise interest rates above 7%. The CAC 40 (Paris) stock market index is also at its lowest, having lost 8.51% since the beginning of the year, which means losses of billions of francs. The top insurance company UAP lost 3 billion francs since the beginning of the year. French stocks are so low that a wave of hostile takeovers of French companies by foreigners has begun.

In Russia, which must not be ignored since its economy has been incorporated into the International Monetary Fund's "free-trade" system, 15% of all banks will close this year, Prof. Lidia N. Krassaniva of the Moscow Academy of Economic Sciences told a meeting of German and Russian financial experts on Oct. 17 in Hanover, Germany. Two hundred banks and financial institutions have lost their licenses since the beginning of this year, and another 150 are on the list of candidates for the same emergency treatment.

A run on Japan means a run on the U.S.

Representative Leach's statement on Fed policy came amidst reports of a "slow run" against major Japanese banks in the London Eurodollar market. Depositors have been pulling out, European bankers told EIRNS on Oct. 20, forcing Japanese banks to pay a "Japan premium" of up to 0.40% for deposits. Since this is higher than the 0.25% Japanese banks earn on Euromarket loans, they are losing money.

The Fed "expects a new, this time quite major Japan bank crisis to erupt, likely before the end of the year, and in order to minimize world market panic to that event, they decided to make public this agreement," one European banker told *EIR*. Fuji Bank, for example, is a target of rumors that it just lost up to $3 billion in currency speculation. Meanwhile, in Tokyo, the government has yet to announce a long-awaited package to deal with the immediately bankrupt eight Japanese housing loan companies, the Jusen, with $84-100 billion in bad loans.

"The bottom line is, the Fed wants to keep the Bank of Japan and Japanese banks from selling Treasuries on the open market at all costs," the New York banker said, speaking of Representative Leach's announcement. "The agreement means that if any Japanese bank needs some dollar cash, either they or the Bank of Japan will come to the Fed, and sell Treasury paper directly, under the table."

Leach emphasized in an Oct. 17 interview that it is the U.S. *government*, including the Clinton Treasury, that supports the plan—and also that Japan would pay its own way. "It is not intended to be a standard discount window operation," in which Japanese banks borrow at the Fed discount window, Leach said. If Japanese banks need dollar cash, they will go to the Fed, perhaps via the Bank of Japan, and sell Japanese-owned Treasury bonds for dollars. "That implies Japanese assets taking care of a Japanese problem," he said.

"The problem is not solved," however, LaRouche underlined, by this attempt "to postpone the reckoning to a slightly later time, and it's not so many months down the way. . . . If Japan goes, it will still blow out the international markets in a chain reaction. The situation in the European banking system is worse by the day. The U.S. system is ready to blow; the Federal Reserve system is . . . already as good as bankrupt."