Moody's Attack May Be Last Straw for Japan

by Kathy Wolfe

Wall Street's Moody's Investors Service attempted to reverse the Meiji Restoration on the morning of May 31, when it made an unusual downgrade of Japanese Government Bonds (JGB) two levels at once, from AA3 to A2. This puts Japan's government credit below that of all the Group of Seven (G-7) industrial countries, including Italy, and below many Third World nations such as Botswana, down to par with Latvia and Poland.

The action unilaterally rendered Japan's sovereign paper "below investment grade," i.e., to junk level, according to the regulations of the Basel-based Bank for International Settlements (BIS), the privately owned central bank for privately owned central banks, such as the U.S. Federal Reserve and Bank of England. If one other private rating agency, such as Standard & Poors, joins Moody's in this downgrade, banks in Japan and abroad that wish to be well-rated by the BIS, may be forced to dump Japanese government debt. Any bank which does not, could see an international run on its own deposits and bonds.

This foreign intervention into Japan's credit market continued the attempt, under way since January, by the Washington-based American Enterprise Institute (AEI) and related Wall Street hedge funds, to collapse the yen. The $3.7 trillion JGB market is mostly held by Japanese, in Japan, and denominated in yen. A JGB market collapse could cause a major flight of capital from the country. That, of course, would be a most convenient boost to the sagging dollar just now.

'Financial AIDS'

In fact, the headlines for the week before Moody's partisan action, were on the free-fall of the dollar. Bank of Japan (BOJ) Governor Masaru Hayami warned on May 31, that he is concerned about a "too rapid" drop of the dollar as "it is still unclear whether the U.S. economic recovery can be sustained." Another BOJ official said, "The world economy could be thrown into confusion if investments flowing into the United States reverse course, amid growing worries about the rising U.S. current-account deficit. . . . Discussion is heating up within the BOJ about prospects for the end of the strong dollar."

The BOJ bought $8 billion over May 22-24. It turned out the dollar is so weak, that the Tokyo market's first reaction to Moody's was to dump more dollars, not yen. On May 31 Japan had to make its largest rescue operation since the post-Sept. 11 dollar crash last Fall, buying another $8 billion, then another $10 billion on June 4-5, a total of over $25 billion.

The Moody's action could be the last straw, not only for Japan but for other watchful Asian leaders. They are growing tired of "Financial AIDS"—the removal of government regulations, and the "new business models" exported by Wall Street since the 1980s, which have turned world markets over to private interests such as Moody's. The Enron scandal has now exposed this cocktail of deregulation and "creative accounting" as a recipe for bankruptcy, and much of the "privatization" as piracy.

Ministry of Finance (MOF) officials, on June 1, described Moody's action as "completely inappropriate" and "ridiculous." "Despite the rating cut, the yen has risen," Finance Minister Masajuro Shiokawa said. "We have no intention of altering our policies." Haruhiko Kuroda, vice minister for international affairs, wrote in letters to Moody's and other private raters that the downgrades "lack specific explanations" and have "no basis in fact."

Kuroda specifically pointed out that Japan is the world's biggest creditor nation (net foreign assets $1.5 trillion), with the world's biggest foreign reserves ($407 billion), and a huge foreign account surplus ($130 billion estimated for this year).

Financial Services Agency Commissioner Shoji Mori then ruled, on June 3, that "Japanese banks are properly managing the risk of JGB holdings." Mori exercised a loophole in BIS regulations which lets his agency—as chief regulator—insist for now that JGBs are still "no-risk assets," not junk.

Editorials in *Nihon Keizai News*, *Asahi News*, and other Japanese papers implied that the incident has discredited Moody's and the privateer rating system itself. "It has not been long that rating agencies began rating countries, suggesting that they may not have the necessary experience," wrote Nikkei on June 3. "It remains to be seen whether Moody's will be pilloried for its unclear criteria. . . . As many as 37 Japanese companies, including Toyota Motors . . . now have higher ratings than JGBs. It is unusual for private companies to receive a higher rating than the national government. . . . One analyst even suggested that Moody's might have kept ratings for these companies high because they pay rating fees to the agency."

Junk Bond Economics

"It is more the U.S. side which has been increasingly guilty of 'junk bond economics,' " one angry Asian official told *EIR.* Increasingly, he said, Asian analysts believe that, not just a few corporations such as Enron and Vice President Richard Cheney's former employer Halliburton Energy have a "junk financial structure," but that the "core of the Fortune 500, such as IBM, AT&T, General Electric, Xerox, J.P. Morgan Chase, and CitiGroup, have all been engaging in this kind of questionable off-balance-sheet or 'virtual' financing."

Chinese-American investment adviser Henry C.K. Liu wrote in the *Asia Times* issue of May 14, that it was "the emergence of junk bonds, providing risky ventures with access to institutional money, which was instrumental in bringing into existence" firms such as "MCI, Turner Broadcasting, Dell, AOL, and Microsoft, which constituted the New Economy. . . . Much of the phenomenal increase in indebtedness of U.S. corporations during past decades has been due to junk bond holdings, not bank loans, at least until creative accounting [i.e., Enron] allowed corporations new off-balance-sheet access to virtual money. . . .

"Corporate bonds outstanding in the United States have grown from $366 billion in 1980 to more than $2.5 trillion now. It is $1 trillion larger than municipal debt. It is 50% as large as the outstanding Treasury debt. Corporate bond issuance has increased more than fourfold since 1990 and, for high-yield junk bonds, more than tenfold. A total of $16.4 billion of junk bonds, or 3.1% of the $510 billion outstanding, went into default in January and February 2002 alone, . . . on the heels of $43.6 billion of defaults last year."

Making the most direct comparison of the sinking dollar to the yen, an Asian financial official asked, "What about the U.S. Treasury bonds?" He referred to recent revelations by Treasury Secretary Paul O'Neill, that the U.S. budget, which was claimed to have a surplus of $127 billion during fiscal 2001, was actually in a deficit of $514.8 billion, on an accrual accounting basis. This was learned from a document on the U.S. Treasury website, authored by O'Neill, entitled "Financial Report of the United States Government, 2001," for fiscal 2001, from Oct. 1, 2000 to Sept. 30, 2001. The document shows that, under accrual accounting, in which the government reports the actual expenses that it incurs, rather than reporting expenses only when the time comes due to pay them in cash, "the deficit was $514.8 billion in fiscal 2001."

White House Chimes In

Apparently not quite aware yet that the U.S. side looks increasingly suspect, "Washington also resumed its criticism of Japanese economic policy" the same day as Moody's action, the London *Financial Times* reported on June 2. "Glenn Hubbard, Chief White House economic adviser, also urged Tokyo May 31 to make changes in its fiscal policy. 'The outlook is that there are needed changes to be made in fiscal policy in Japan and the sustainability of the economic performance of the country,' he said." Hubbard, a disciple of free-market extremist Milton Friedman, has been increasingly vocal in demanding that Japan further deregulate, and simply cut the budget, despite the horrible deflation now gripping its economy.

The fact that the White House and Moody's are on the same policy line, demanding more deflation in Japan, has not been lost on the Japanese. "These rating services, it should be noted, are after all private firms from the United States," Yukio Yanbe, professor at Kobe University, wrote in *Asahi News* on June 2. "Credit ratings agencies are selling Japan short. As such, their ratings represent nothing more than a private investment guide."

Professor Yanbe's editorial documented that, if anything, U.S. Treasury bonds are more "junk-like" than the Japanese JGBs. "To be sure, Japan's government debt, taken as an isolated figure, is 120% of GDP, while figures for the United States and major European countries are about 60%," he wrote, putting the Japan Government Bond debt at 400 trillion yen ($3.25 trillion). "But we will miss the big picture if we focus only on the level of public debt. The Japanese government also holds more than 400 trillion yen [$3.25 trillion] in financial assets, including pension funds and foreign exchange reserves," making the central government's net debt zero—while, since the United States has no such assets, its net central government debt is at least the $5 trillion in outstanding Treasury notes. Even making Tokyo responsible for all of Japan's municipal and local government debt of another 300 trillion yen, this makes a net debt load of 51% of GDP. "That is lower than the numbers for Italy, Belgium, and Canada. It is also lower than the euro-zone average of 55%.

"From 1991 to 1998, the U.S. government's net debt load in proportion to GDP stayed at 50%-plus. In 1994, it was 60%. Yet U.S. bonds received the highest rating. If that rating was accurate, then there is no reason why Japanese bonds today should not receive the top rating," Professor Yanbe concluded.

"Second, the ability to sell bonds completely, is much greater in Japan than it was in the United States," he insists. "There is an annual fund surplus of over 10 trillion yen in Japan, despite massive bond sales. In the United States, there was an annual shortage of about $100 billion [12.5 trillion yen], so the U.S. government has had to depend on foreign investors for a considerable portion of [U.S. government bond] sales.

"Third, in terms of future bond absorbability, Japan is more stable than the United States. Japan today is the world's largest creditor nation, with over 130 trillion yen in external net assets, while the United States in the 1990s was already the world's biggest deficit country, with about $1 trillion worth of net borrowing abroad."

None of this, of course, addresses the underlying physical economic collapse in both Japan and the United States. But neither does the entirely political attack on Japan's credit launched through the American Enterprise Institute, which failed in March; nor the continuation of that attack by Moody's in May, which has so far failed to help the sliding dollar.