Click here for Full Issue of EIR Volume 13, Number 45, November 14, 1986

Will Japan-U.S. accord survive?

The hidden agenda of the Oct. 31 Baker-Miyazawa agreement did nothing to help the administration in the U.S. elections.

Japan apparently drove a hard bargain with the Reagan administration in return for financing a pre-election boost for the U.S. dollar and securities markets. The supposedly broad-ranging economic agreement announced Oct. 31 by Japanese Finance Minister Miyazawa and his American counterpart, Treasury Secretary James Baker III, boils down to the following:

1) Japan demonstratively cut its discount rate to a postwar low of 3% from 3.5%, a purely symbolic action which could not, by itself, have any impact on foreign exchange markets.

2) Japanese investors agreed, for the moment, to continue to throw the proceeds of the country's $50 billion trade surplus into American securities.

3) The American side agreed to sell Japan a big piece of the store, namely, the $120 billion-per-day market in U.S. Treasury securities.

For apparent political reasons, reflecting Japanese Prime Minister Yasuhiro Nakasone's concern with President Reagan's ability to maintain his strategic policy, Japan reversed its previous stated intentions, and continued to finance the American markets. Earlier, Japanese private investors had abandoned their $50 billion-plus rate of investment in U.S. markets, evident during the second quarter; during the third quarter, they appeared to prefer gold, which they bought at an annual rate of nearly $30 billion. In the interim, Japan's central bank bought dollars on the foreign exchange market in order to prevent further appreciation of the yen (and deterioration of Japanese foreign markets). These dollars, invested back into U.S. Treasury securities, financed the lion's share of America's third-quarter deficit.

That arrangement could not last long without broader support for the dollar, which Miyazawa provided on the Friday before the U.S. elections. The yen fell to about 164, and the DM to about 2.07, a swing of between 2% and 3% for both currencies, as a result.

What did the Japanese get in return? Although the principal motivation appears to have been political, they insisted on cementing the agreement through a bigger, open presence in U.S. bond markets. The purchase of New York's Aubrey Langston, one of the most prestigious of the 35 primary dealers in U.S. Treasury securities, by a Japanese bank, was announced two days before the Baker-Miyazawa agreement; in some ways, it is even more important than Sumitomo's purchase of a 12.5% stake in Goldman Sachs.

The U.S. banks and investment houses are facing enormous competitive pressure from the huge Japanese trading houses such as Nomura, Daiwa, and such in the U.S. Treasury market. In what observers characterize as "open warfare," the Japanese are believed moving to use their investments in U.S. government debt to increase their control of the U.S. financial market.

As the largest primary purchasers of U.S. Treasury securities, the Japanese have the leverage to dominate the primary dealerships as well. One wire-service account quotes an unnamed Merrill Lynch executive complaining, "We were always afraid of becoming Nomura-Merrill Lynch."

However, the effect of all this on the dollar is not likely to last long. First of all, only the Japanese, but not the West Germans, agreed to American demands for such a public-relations exercise. The West German Bundesbank continues to build support for a European bloc against the dollar, as the central bank's president, Karl-Otto Pöhl, represented to British Prime Minister Thatcher during his October visit to London.

West Germany depends much less on the American market than does Japan, but that is not sufficient to explain the divergence of policies. Rather, the Bundesbank now orients towards the Munich-Zurich-Trieste banking and insurance combination, which foresees a central European bloc moving by steps out of NATO.

To be fair to the Bundesbank, it does not have an American policy to work with. The Federal Reserve, as most Wall Street commentators noted, is merely looking for cover under which to throw huge amounts of money at the U.S. banking crisis. Any rise in U.S. interest rates would not merely hurt securities markets, but would cause huge chunks of the rotten real-estate market to fall out, compromising the entire savings and loan system, as well as large parts of the commercial banking system.

The Fed is so sensitive to this perception that it immediately announced that it had no plans to cut its own lending rate. But that is what it will have to do, and the unravelling of the banking system will continue the pressure on the dollar, whatever the Japanese do.

© 1986 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.