

Bank of Japan Warns Of 'Unprecedented' Bank Stock Crash

by Kathy Wolfe

Bank of Japan Governor Masaru Hayami said on Nov. 21 that an "unprecedented" plunge in bank shares has the BOJ on an alert to provide cash to the banks. "Stock prices, especially those of banks, have fallen in an unprecedented manner," he told the press. "The fall in bank shares is extremely troubling. I think it's the first time in the post-war period that we've seen such a situation. I don't recall any such rapid falls in bank share prices since I entered the BOJ in 1947—that's been 55 years." The BOJ tweaked monetary policy on Nov. 19, announcing that it would raise system funds to the top of its \$122-163 billion range.

Shares of the \$700 billion UFJ Bank have fallen 52% in November alone, and 72% since Sept. 30, amid a barrage of media reports that it will be nationalized soon; they plunged 10% the last week in November. Moody's warned that it may soon downgrade UFJ stock to "Ba1"—junk—from "Baa2." Shares of the world's largest bank, the \$1.3 trillion Mizuho Holdings, have fallen 46% in November, and 51% since Sept. 30. Since Heizo Takenaka became Japan's top financial regulator, shares of Mizuho Bank alone have lost \$12 billion in equity. The \$700 billion Sumitomo Mitsui Bank has lost 34% in November, and 51% since September; the \$900 billion Mitsubishi Tokyo Bank has dived 19% and 28% in those time frames. The Tokyo Stock Exchange's banking index has fallen 18.7% in November.

With UFJ's total capitalization now shrunk to \$4 billion, and Mizuho's to \$8 billion, these banks "are now buyout targets for cash-rich financial institutions in Europe and the U.S.," Nikkei news agency reported Nov. 19. There are no Japanese buyers.

Japanese industrial companies, which, under the traditional "cross-share" system, still hold a lot of stock in their main lender-bank partners, are desperate now to unload bank stocks before they have to declare major losses. According to an estimate from Daiwa Institute of Research, non-financial companies had unrealized portfolio losses of some \$17 billion in bank stock holdings over the last six months.

Market Forces Not Working

Japan must "take seriously" the Nov. 21 decision by London Fitch IBCA to downgrade the nation's debt rating, as

Japan's fiscal situation is under close global scrutiny, Finance Minister Masajuro Shiokawa said on Nov. 22. Fitch downgraded Japan's long-term, yen debt to AA- from AA, due to deterioration in government finances.

In fact, if Japan permits continued rule by strict "market forces," the country's finances could be destroyed. Simple nationalization of the banks raises the threat that the government would have to print massive amounts of Treasury debt—downgrading, under "market theory," the value of the debt. In a 110% "free market," there is no way out for Japan.

Despite the BOJ's massive money printing, interbank interest rates are rising sharply for the first time in years, due entirely to the rush amongst the banks themselves to hoard cash reserves, including borrowing from the Bank of Japan in an unprecedented manner. On Nov. 21-22, rates bid by banks for BOJ cash were up by 10% from the week before. The reason for the action is that "financial institutions are rushing to secure funds because we cannot shake off our broad concerns of how depositors may respond to a year-end financial crisis," an official at a major bank told Nikkei. Anything from "accelerated bad-loan cleanups, to bank stock slumps, could prompt depositors to withdraw their money from banks," he said.

In fact, without using the full range of measures proposed by Lyndon LaRouche, on the model of what Franklin D. Roosevelt did in the 1930s, starting with a "bank holiday," there is little Japan can do to stop the "market value" of these banks from falling to zero. The "market" has gone insane. The more fear of nationalization spreads, the more bank stockholders are going to dump the shares at any price they can get, as in most nationalizations, shareholders get nothing.

FDR-Style Bank Holiday

A bank holiday is the reasoned alternative to flat nationalization, and need not mean nationalization. FDR applied fair "Chapter 11" bankruptcy reorganization laws to the banks. Chapter 11 is a "standstill," which protects individuals from predatory creditors, the famous American alternative to the old European "debtors prison." But the person given Chapter 11 protection must also get his own affairs in order, and cannot continue any unsound activities. For banks, what FDR did was to freeze all activities, both irrational selling by creditors, and unsound activities by the banks, so a competent group of managers (public and private) could investigate. On average, banks were only closed 5-10 days.

With the "general welfare" of the population and physical economy first in mind, a bank holiday protects the population's savings and the operating cash of basic industry, infrastructure, and services. The freeze is then used to sort out productive assets which can be saved, from speculative and non-productive assets, and to reorganize banks accordingly. The majority of banks can be re-opened without nationalization.

The real problem has been the "Wall Street Business Model," which dictates that "no one may judge" what is a

productive loan, versus a non-productive loan! Under the "Enron Model," anything that made quick profits was king, and no businessman or government official dared call it "un-productive." That is the axiom which has to die. Both government and bank officials can and should make judgments based on sound industrial banking. All the shouting in Japan that "bank managers' heads must roll" is mis-directed. It's the "Enron Model" that has to go, and any manager who agrees honestly to keep the rules of sound industrial banking in future, can stay.

'Fiddling While Japan Sinks'

The Bank of Japan announced on Nov. 18 that it will start its highly publicized program of buying shares from commercial banks on Nov. 29. But the problem now is, that with stock prices at a 19-year low, the banks may be reluctant to sell stocks and take such gigantic losses, making the whole exercise futile.

"Fiddling While Japan Sinks" was the apt title of the *Yomiuri News* editorial on Nov. 11, a tone of outrage which is becoming widespread in Japan. "Domestic commodity prices have fallen for 54 consecutive months, while stock prices have dropped to an all-time low since the collapse of the bubble economy. How long will the government and the ruling parties continue to sit by and do little to fight the nation's worst deflationary crisis? The administration of Prime Minister Junichiro Koizumi must be sternly criticized" for focusing narrowly on the budget deficit.

"The current deflationary economy is dealing a severe blow to the financial health of the state. A decline in corporate sector's performance is seriously reducing corporate tax revenues. Gains from income tax are also shrinking, due to wage cuts at many corporations. Meanwhile, revenues from the consumption tax have fallen below an earlier estimate largely because of falling domestic prices. The government is expected to face \$20-30 billion in tax revenue shortfalls during the current fiscal year alone. . . .

"Koizumi's adherence to his 30 trillion yen limit on government bond issuance is aggravating deflation in what could amount to a crushing blow to the government's finances. All this has obviously arisen from Koizumi's misguided economic management."

In "Deepening Autumn Gives Way To Winter In Japan," Nikkei News on Nov. 21 editorialized similarly. In a trip outside of Tokyo, the editor wrote, "I encountered Fall in its splendor, but what was particularly intense was the pathos of the people, suffering under Japan's deflationary spiral. Countless people echoed the sentiments of one person who told me, 'You probably can't understand this in Tokyo, with its construction boom and all, but outside the capital, we hardly have any more tears left to cry. Almost no one walks through the shopping district anymore.'"

"I wonder whether our society has been on the right track over the past year, during which all our energies have been focused on 'reform,' " he concluded.