# Biggest ever Japanese bankruptcy

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The increasingly unstable world financial system has received another body blow with the announcement in Japan of the country's biggest-ever bankruptcy. Japanese Leasing, a non-bank affiliate of the failed Long Term Credit Bank, has announced that it is filing for bankruptcy with liabilities of 2.2 trillion yen or more than $16 billion. Two other affiliates of the LTCB are expected to suffer the same fate.

The bankruptcy, which eclipses the previous record set last November with the 2 trillion yen collapse of Yamaichi Securities, was brought on by the weekend announcement of an agreement between the ruling Liberal Democratic Party and opposition parties that public funds would not be used to bail out the LTCB. The failed bank had said that if it received the funds it would forgive loans of 520 billion yen to Japan Leasing and two other affiliated companies.

After months of haggling between the government and opposition leaders, a deal seems to have been reached for the winding up of the LTCB. It will be taken over by the government, its non-performing loans separated out, and the rest of the business sold off, probably to Sumitomo Trust.

But, as the collapse of Japan Leasing already indicates, the decision not to prop up the LTCB will have far reaching consequences. Earlier this month LTCB's president pleaded for public funds for the company, warning that if it failed the 'domestic and international impacts would be beyond my imagination'.

Concerns that the Japanese banking crisis is set to rapidly escalate are not confined to that country. This week the US magazine *BusinessWeek* outlined what it called a 'nightmare scenario':

'As the fragile truce between Japan's ruling Liberal Democratic Party and the opposition unravels, all hope of a credible bank rescue disappears. The government of Keizo Obuchi falls. The Nikkei stock index falls several thousand points within weeks. One major Japanese bank after another publicly declares its insolvency. Credit evaporates, and the economy lurches from recession to depression. In a final humiliation, Japanese authorities under intense pressure from the US invite a team of experts from the Bank for International Settlements to come in and sort out the mess.'

It said the scenario was not as outlandish as it might seem, with the head of the financial firm Smith Salomon Barney warning that the situation was 'extremely dangerous'.

Analysts at the financial firm Merrill Lynch estimate there is a 40 percent chance that a Japanese banking failure could push the country into a depression within the next year, leading to a global recession.

Japanese management and financial analyst, Kenichi Ohmae, raised similar concerns in an interview with the *Australian Financial Review* published at the weekend. He warned that the problems of the Japanese banking system were now producing the gravest financial crisis the world had seen since the Great Depression.

The Japanese government has set aside $100 billion to deal with the crisis, but according to Ohmae that could be eaten up by just one failed bank.

'We are talking about a minimum of $1 trillion. If you include the untangling of the mess of derivatives, I have told [Prime Minister] Obuchi that the amount of money the government will need to get through this deep valley is about $2 trillion.'

He warned that at least three major banks could go down together.

'And that's very serious, because they have over $2 trillion in derivatives all changing hands with foreign institutions. This will cause systemic meltdown. Unless we do something now to contain this problem in Japan, it will create an enormous contraction of credit worldwide.'

Ohmae said that vulnerable banks, such as Fuji Bank and Sakura Bank, were taking the extraordinary step of asking companies in their industrial group to provide assistance. Normally money to support ailing banks would come from other financial institutions, but they do not have the resources to provide assistance. Fuji Bank is estimated to have bad loans of $17 billion; the Sakura Bank around $11 billion.

Industrial companies providing support for banks is not the only unusual measure being undertaken. According to a Japanese news agency, the government is considering lending some of its US Treasury bonds to the banks as an emergency measure to help them raise loans. The news agency, which quoted 'government sources', said that under the plan Japanese banks would borrow the US Treasury bonds and use them as collateral to obtain loans from foreign banks.

The Bank of Japan is also reported to be providing increased liquidity to the Japanese financial market and is ready to provide special loans to banks in case they run into difficulties as they rule off their books for the end of the half-financial year on Wednesday.

There are now clear signs that the Japanese economy has entered a vicious downwards spiral in which the worsening financial situation produces a further contraction in the economy, leading to the creation of more bad loans and further intensifying the financial and banking crisis.

According to the Deutsche Bank Asia chief economist Kenneth Courtis: 'The downturn is so powerful that we are now on the lip of great danger--a surge in bankruptcies, of unemployment, of new bad debt.'

The head of the Economic Planning Agency, Taichi Sakaiya, predicted that the Japanese economy 'is probably about to go through its darkest moment.' He warned that the gross domestic product would fall again in the July-September quarter, making it the fourth quarter in a row in which output has declined.

Commenting on the government's official forecast, he said: 'Some cite the government's current forecast of 1.9 percent growth and say it should be minus instead of plus (1.9 percent). I don't think it would be that bad but it could be close to that.'

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