Japan's latest economic package merely a 'band-aid'

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International money markets have reacted negatively to the Japanese government's latest economic package with financial analysts declaring it will do little to address the economic restructuring they consider necessary for the world's second largest economy.

Apart from the plan itself, there is the question of who will implement it. The release of the plan on Friday coincided with the resignation of Prime Minister Yoshiro Mori, who will step down on April 24.

The core of the package is a proposal to place a two-year limit on banks to dispose of existing loans to borrowers already facing bankruptcy or at risk of failure, and a three-year limit for the write-off of new problem loans. But financial analysts have already pointed to a gaping hole in the package.

In the words of Yasunari Ueno, chief market economist at Mizuho Securities Co: “The deteriorating economic situation and the enforcement of stricter risk assessment will result in increasing volume of loans categorised as non-performing. The question is whether banks can dispose of bad loans faster than new ones arise.”

The problem facing Japanese authorities is that the bad loan problem is part of an increasingly vicious economic and financial circle. Falling prices for stocks and shares, which form the collateral for much of the bank debt, mean that more loans become non-performing. But action to remove bad debts, involving the sale of stocks and land, is likely to further depress prices, leading to the creation of more non-performing loans.

Under the government plan banks will be required to limit their share holdings to the equivalent of 100 percent of their capital, down from the current level of 135 percent. This will require a massive sell-off of shares by the banks at market prices well below those at which the shares were purchased, necessitating a further injection of public funds. It is estimated that the government plans to purchase up to 11,000 billion yen ($US88 billion) of shares owned by banks with the costs to be borne by taxpayers.

Controversy surrounded the announcement of the package after it was delayed for two days due to political infighting as to the deadline when it should be implemented.

Fearing that the proposed bank bailout would produce a voter backlash at the elections for the Upper House due to be held in July, sections of the ruling coalition called for a delay in the implementation of the package until the September sitting of the Diet. Other sections, which favour increasing the pace of economic restructuring, called for it to pass through the current sitting.

Under a compromise the two factions agreed to implement the program “as soon as possible when details are worked out.”

Criticism of the plan was spread across the financial sector. ING Baring's chief economist Richard Jerram said the package did not appear to be a sincere attempt to deal with the banks' vast shareholdings.

The credit rating agency Standard and Poor's said the plan did not go far enough because it only focused on the problems of bad loans and huge shareholdings.

“The scheme does not help the banks directly address their two other fundamental weaknesses: poor asset quality and very weak profitability. As such, Standard and Poor's does not expect that the government's scheme will have a material impact on the risk profiles of the banks.”

An article in the *Washington Post* entitled “Plan for Japan banks: A Band-Aid” summed up the concerns of the money markets.

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"The economic planning minister, Taro Aso, billed the measures as far reaching, 'painful reforms' intended to 'fundamentally resolve' the tangle of bad debt that has crippled Japanese banks and hindered growth in the second largest economy for much of the last decade.

"But the program Mr Aso outlined Friday failed to impress analysts and investors—several of whom predicted that it would mainly prove painful to Japanese taxpayers who will be forced to underwrite it. Critics charged that the proposal's key features seemed primarily designed to shield floundering construction, real estate, retailing and property concerns that are generous contributors to the governing Liberal Democratic Party."

Atsuto Sawakami, president of Sawakami Asset Management in Tokyo commented: "This is vintage Japan. Put off the problem. Avoid drastic change. If shares don't rise, make taxpayers foot the bill."

The announcement of the latest package came amid rising concerns, in particular in the United States, about the impact of continued stagnation in Japan on the global economy.

In testimony to the US Congress last week, Federal Reserve Board Chairman Alan Greenspan said the Japanese economy was "essentially stagnating" and its effects will create "a significant element of dampening in world economic activity." Greenspan said the economic crisis could not continue "without impacting the rest of us" and called on Japanese authorities to press ahead with restructuring the economy.

But that it easier said than done and the task is becoming more difficult. Economic data released in the past week have pointed to a further deterioration in the Japanese economy. One key economic indicator, the Tankan survey, which gauges business sentiment—measuring the percentage of firms that believe business prospects are favourable as against those that believe they are negative—fell dramatically for the first time since December 1998.

The index fell 15 percentage points for large manufacturers to minus 5. For small and medium size manufacturers the index went from minus 16 to minus 27. The business outlook is said to have been largely influenced by the collapse of share prices over the past few months, a slowing US economy, expected export declines and a continuing decline in consumer spending.

Another important indicator used by the Cabinet Office, formerly the Economic Planning Agency, is the index of coincident indicators, which measures the current state of the economy. According to government officials, a reading of below 50 percent is considered a sign of economic contraction and a figure above 50 percent is an indication of expansion or economic growth.

In February it registered just 14.3 percent compared with 50 percent in January.

Job losses are continuing, not only affecting workers in Japan but also at Japanese subsidiaries overseas. NEC, one of Japan's leading computer chip and electronics manufacturers, last week announced that it would cut 700 jobs in the US. Mazda, the Japanese carmaker has announced it will cut its workforce of 23,000 by 1,800 as part of its shift of production away from Japan to Europe.

The continuing economic problems are starting to be reflected in the growth of income inequality and a greater reliance on state welfare assistance. According to a recent article in the *Japan Times*: "Various data show that the income gap is widening in Japan, which has long prided itself on being a nation of equality, free of class struggle. A new wealthy class has arisen in recent years, despite the bursting in the early 1990s of the economic bubble. Members of this class include such people as dealers at foreign financial institutions and people who have made huge financial gains through such means as the public offerings of information technology businesses. Meanwhile, the unemployment rate has risen to nearly 5 percent, while more than 1 million Japanese are now receiving state welfare assistance."

Professor Toshiaki Tachibanaki, from the Kyoto University commented: "Japan's egalitarian myth has been destroyed. Disparities have been widening since the 1980s, and although the differences are not as great as in the United States, Japan has become a nation of unequal income on par with that in the major countries of Europe."

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