Share market fall deepens Japan's banking crisis

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Japan's benchmark share index, the Nikkei 225, plummeted to its lowest level in 18 years earlier this month, driven down by fears over the viability of some Japanese banks.

The Nikkei slipped to 9,420.85, a loss of more than 7 percent in less than a month, with some analysts predicting it could lose as much as a further 20 percent because of the continued deterioration of the Japanese economy.

The Nikkei has lost three quarters of its value since the peak reached at the height of the bubble economy in 1989 when the index reached 38,915. At that point the Tokyo market was worth more than the rest of the world's equity markets combined.

One of the main consequences of the latest fall is to deepen the bad debt crisis of the Japanese banking and financial system. This is because many financial institutions hold shares as security for loans. Japanese banks alone are estimated to hold about 20 percent of shares.

According to a report released last week by Japan's Financial Services Agency, non-performing loans at Japan's 136 financial institutions totalled around 36.8 trillion yen at the end of September, an increase of 3.1 trillion yen from the end of March 2001.

The continuing stock market slide and the deflationary tendencies in the economy as a whole are creating conditions for a so-called "systemic financial crisis."

As a recent article in the *Financial Times* noted: "It says much about attitudes to Japanese banks these days that, when Standard & Poor's chief credit officer for Asia-Pacific recently described the system as 'technically insolvent', his comments caused barely a ripple among his audience. That is because most experts without a vested interest in saying otherwise agree that the world's second biggest banking system is essentially bust."

According to Akio Mikuni, the president of an independent credit rating agency cited in the article, problem loans far exceed the total equity of the banking system. As a result, the liquidation of these bad debts and the closing of unprofitable operations would mean that "the Japanese banking system as a whole would have to be nationalised or given more money."

The Koizumi government, which has pledged it will not allow a financial crisis to develop at the end of the financial year on March 31, last week announced it would inject another 10 trillion yen (around $75 billion) into the banks. The government has also extended to September a deadline by which time banks have to cut support to their weakest borrowers.

Initially the deadline was the end of March. The move to grant further time will lead to increased criticism from financial interests, both in Japan and internationally, demanding swifter action by the Koizumi government to "restructure" the economy and deal with the bad debt crisis.

But restructuring plans are being thrown awry by the country's continuous recession. The essential problem is that as fast as bad debts are written off new ones are created by the deflationary contraction in the economy.

There was further evidence of this process in figures released last week. They showed that Japanese household spending, now in its ninth consecutive year of decline, decreased 6 percent in December, after falling 0.2 percent in November. The December fall was the biggest in more than five years and brought the total drop in household spending for 2001 to 1.8 percent. A further sign of the deflationary spiral was the announcement that wholesale prices fell 1.4 percent in January.

The official level of unemployment, which sits at a postwar record high of 5.6 percent, is also set to dramatically increase over the next few months as firms cut back. Hitachi, Japan's third largest computer chipmaker and its largest private employer has recently announced plans to cut 11,100 jobs by March 31. Hitachi's announcement was closely followed by a report from Ube Industries, a petrochemicals and cement maker, that it would cut 900 jobs by end of March.

The worsening state of the Japanese economy is heightening international concerns about the economic and geo-political implications of a financial meltdown. Some of these fears were voiced in a recent article in the British-based *Guardian* newspaper entitled "Defenceless Japan awaits typhoon".

It explained that the recent rise in the price of gold to more than $300 per ounce was largely the result of buying from Japan.

"The buying spree for gold was concentrated in the Far East, with a rush by Japanese investors to find an asset that looks safer than shares in Japanese companies or Japanese bonds. Almost any asset looks safer at present than Japanese assets, and the flight into gold is entirely rational. Japan faces political and economic meltdown, and we are talking premier league stuff here. Argentina was only the third biggest economy in Latin America; Japan is the second biggest economy in the world."

The article noted that, while the G7 meeting "had its ritual show of concern about the need for stronger growth and structural reform," Japan had largely been written off as a basket-case.

But such an attitude would be dangerous. "The West," it warned, "cannot afford to be complacent about what is happening in Japan, unless it intends to use the country as a test case to explore whether a full-scale depression is less painful now than it was 70 years ago."

A properly functioning Japan was necessary not only for the long-term health of the world economy but for political stability as well, particularly in regard to relations with China.

"A collapse in the economy, which looks ever more likely, would have profound ramifications; some experts believe it could even unleash a wave of extreme nationalism that would push the country into conflict with its bigger (and nuclear) neighbour."