Thumbs down on latest Japanese economic package

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Prime Minister Junichiro Koizumi's anti-deflation package released last week has not been well received in financial and political circles. It is considered to fall far short of demands for a radical "restructuring" of the economy needed to resolve the mounting bad loan crisis in the banking system.

Announcing the package, Economy Minister Heizo Takenaka said it was aimed at wiping out bad debt in the banking sector, propping up the stock market, expanding credit to small business and boosting consumer spending. The plan calls for the state-run Resolution Collection Corporation to purchase bad loans from Japanese banks. But the problem, so far as financial markets are concerned, is that no estimate is provided as to how much of the estimated $275 billion worth of non-performing loans would be purchased.

Amid calls for a massive injection of money into the banks to enable them to wipe out their bad debts, the government has said only that it will use public funds to recapitalise the banks if there are fears of a financial crisis. In other words, the financial system will continue to stagger on as before. The banks will not wipe out their bad debts by foreclosing on their corporate debtors and sending them to the wall.

The reason for the attempt to maintain the status quo was highlighted on the day the deflation package was announced. The Koizumi government gave its support to a $4.3 billion bank bailout for indebted supermarket chain Daiei Inc.

Reflecting the hostility in financial circles to the deal, Commerz Securities chief economist Ron Bevacqua commented: "By keeping Daiei afloat, that obviously keeps excess supply in the economy. There's simply too much of everything in Japan. It's definitely a non-anti-deflation kind of policy." He also pointed to the reason for the government's decision. "The trouble is, there's not just one Daiei but thousands of companies like that out there. No politician in any country is willing to close 20 percent of the nation's companies and weather 10 percent unemployment."

In other words, if the Koizumi government were to implement the type of policies being demanded by financial markets, it would create a social crisis the like of which has not been seen in the post-war period. So it tries to stagger on while introducing stopgap measures.

Koizumi's new package includes measures by the Financial Services Agency to curb the practice of "short selling"—the sale of borrowed shares in the expectation that shares can be repurchased at a cheaper price when their values drop. The Bank of Japan will also increase its purchases of long term government bonds every month by 25 percent, taking the figure to 1 trillion yen ($7.43 billion) from 800 billion yen in order to increase liquidity and provide funds for government spending and corporate lending.

The new measures were the subject of derisory comments from the representatives of financial markets. In the words of Nobuaki Murayama of Cigna International Investment Advisors: "The government must carry a gene that makes it impossible for it to address problems." Ryo Hino, from JP Morgan in Tokyo, described the plan as "window dressing". "They are just leaving options open and making no decisions until they are backed into a corner."

Even sections of Koizumi's Liberal Democratic Party (LDP) criticised the new plan as a stopgap measure. "I can understand it as 'measures for the time being', but it is clearly insufficient if you ask me whether it is a fully fledged initiative to tackle deflation," said Taro Aso, head of the LDP's Policy Research Council.

Internationally, it seems that the Bush administration is signaling its dissatisfaction as well. During his visit to Japan last month Bush was full of praise for Koizumi and his plans to tackle the country's economic crisis.

But last week one of Japan's biggest newspapers, the *Asahi Shimbun*, published details of a leaked letter in which the Bush administration expressed concerns about the state of the economy. In the letter, dated January 17, Bush urged Koizumi to "continue moving forward to tackle the problem of Japan's non-performing loans and assets." While welcoming the steps taken so far, the letter went on to say that Bush was "deeply concerned" these loans and assets were not being moved onto the market quickly enough.

Commenting on the latest plan, Koizumi tried to brush off calls for stronger action. "This is a long battle," he told reporters. "There are no silver bullets. We will absolutely prevent any financial crisis. This is not the end of our steps. We will continue to take bold and flexible steps because the economy is like a living creature."

That "living creature" is suffering serious health problems. Last week the government announced a fall of 1 percent in the January industrial output index with the slowdown being recorded mainly in the machinery and automotive industries.

Consumer prices recorded a 0.8 percent year on year fall to mark the 28th consecutive monthly decline. There was a very sharp decline in prices of portable personal computers—a fall of 34.2 percent from a year earlier—and a similar massive fall in the price of desktop computers, which dropped 30.6 percent. The continuing price falls are further undermining corporate profits and the ability of borrowers to repay bank loans; adding more non-performing loans to the existing mountain of bad debt.

Tax revenues recorded a 13 percent fall in January from a year earlier, representing the largest monthly decline since the start of fiscal year 2001. This is of particular concern for the government as it attempts to service a growing public debt now standing at more than 130 percent of gross domestic product.

Although the official unemployment rate recorded a 0.3 per cent drop from its record level of 5.6 percent, job losses in January amounted to 230,000, the biggest decline in four months. The fall in the unemployment rate has been attributed to the fact that increasing numbers of people have given up looking for work as jobs become scarcer. A Labor Ministry report indicated that the participation rate, which measures the proportion of the workforce with a job or looking for a job fell to 60.6 percent from 61.4 percent in December. It also reported that for every 100 applicants at state-run work centres in January there were only 51 jobs compared to 65 jobs a year ago.

Job losses are expected to rise sharply in the coming months as companies carry out restructuring and complete severance plans ahead of the March 31 end of the fiscal year. According to Aozora Bank senior economist Yasukazu Shimuzu: "Falling prices are eating into company earnings, especially at manufacturers, forcing them to cut costs. Joblessness will surely rise."