Japanese stock market tumbles after cabinet reshuffle

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12 October 2002

A reshuffle of the Japanese cabinet on September 30 has fuelled the decline of the Tokyo stock exchange to historic lows. The Nikkei 225 index—which tracks the performance of some of the world's largest banking and industrial companies—closed at just 8,543 points on October 9, a level not seen since 1983. Sellers outnumbered buyers by as much as 27 to one during the past week.

Leading the fall were the shares of Japan's major banks, which have at least 52 trillion yen ($US420 billion) of non-performing loans on their balance sheets. The world's largest bank by assets, Mizuho Holdings, had 30 percent wiped off its share value in three days and is now trading at its lowest recorded level. UFJ Holdings, considered the most vulnerable of Japan's four mega-banks, has lost 47 percent of its value since the new cabinet was announced. The stock of all of Japan's banks haemorrhaged, with the Tokyo market's index of banking shares plunging 5.9 percent on October 7.

The stock sell-off was triggered by the prospect that the Japanese government, under pressure from the other G-7 industrial nations, the Bank of Japan and the International Monetary Fund (IMF), is set to unveil a radical plan to restructure the country's banks.

Prime Minister Junichiro Koizumi sacked his Financial Services minister, Hakuo Yanagisawa, and handed the portfolio to the Economics and Fiscal Policy minister, Heizo Takenaka. Takenaka, an advocate of wholesale restructuring, hinted last weekend the government was preparing to force the takeover of weaker financial institutions by the stronger ones and push for the closure of indebted companies. This would be followed by a massive injection of state funds into the surviving banks in an effort to rehabilitate their balance sheets.

Yanagisawa was replaced due to his reluctance to call for such a state-funded rescue operation. Since 1997, the Japanese government has pumped 10 trillion yen ($US80 billion) into previous bailouts of the banking system to assist it in eliminating non-performing loans. Time, however, is running out. Over the past several years, contracting prices, squeezed profits, and the slump on world stock markets has seen bad loans accumulate faster than the banks have been writing them off. In the last six months, the level of non-performing loans grew by 17.4 percent. They now make up 8.3 percent of all bank lending. On top of the 52 trillion yen in recognised bad loans, debtors owing as much as another 100 trillion yen ($US845 billion) are considered to be in danger of default.

JP Morgan Chase's head of economic policy research, Masaaki Kanno, told the *Financial Times*: "Unfortunately, the banks will have to be nationalised." According to Kanno, the Japanese banking system needs an injection of some 50 trillion yen to stabilise, the equivalent of 10 percent of Japan's Gross Domestic Product (GDP).

The extent of the crisis was underscored by the unprecedented announcement on September 18 by the Bank of Japan that it intends to purchase shares held by Japan's major banks—a desperate means of propping up their financial position. This move is now being seen as a successful attempt to force the Koizumi government into action.

Takenaka has appointed Takeshi Kimura, head of the Japanese financial consultancy firm KPMG, to his bad loan taskforce. Kimura is considered a "hard-liner" on bad loan disposal and has advocated the liquidation of 30 large Japanese companies—labelled by Kimura the "Dirty Thirty"—which he believes are responsible for the bulk of the banking system's problems. A restructuring agenda is scheduled to be unveiled later this month.

During the past week, the shares of highly indebted corporations likely to be targeted for closure have plummeted. Retail chain Daiei, which was given a $US4 billion bailout by the major banks in February, fell 30 percent on October 7. Construction firm Kumagai, trading company Kanematsu and automaker Isuzu—all highly vulnerable companies—fell between 13 and 17 percent.

The fall has not been confined, however, to the financial sector and most indebted corporations. Investors have also dumped the shares of technology giants like Toshiba, Hitachi, Fujitsu, Canon, Sony, Kyocera and NEC. On top of concerns about the government's agenda, there is a growing fear that the US—Japan's largest export market—has entered a protracted slump and alarm over the potential global economic impact of a war on Iraq.

The largest sellers have been non-Japanese institutional investors who, along with many analysts, welcomed the move by Koizumi to elevate Takenaka but believe that far more is required in Japan than bank restructuring. Japan's economy has experienced deflationary conditions of stagnant growth, profits and prices for over a decade and the global situation is plunging it back into recession. New machinery orders plummeted by 13.6 percent in August, as manufacturing exporters scale back investment and production.

The proposed bank restructuring will dramatically worsen this economic situation. Conservative estimates are that 1.1 million jobs would be lost if the most indebted firms are liquidated. This is under conditions where the understated official unemployment figure is already 5.4 percent. Soaring joblessness would cause further falls in consumer spending, which accounts for roughly 55 percent of GDP and is already slowing due to the concerns of Japanese workers and their families over wages, jobs and retirement security.

Concerned over the possible impact, the IMF chief, Horst Koehler, has called for further action on top of an accelerated elimination of bad loans. He has declared the central bank's share purchase plan should go ahead and be accompanied by a more "comprehensive package of measures" by the government, including corporate tax cuts to stimulate investment. "I expect Prime Minister Koizumi to outline the full package in the coming weeks," he told a meeting of the IMF and World Bank in Washington last weekend.

In comments published in the *Financial Times*, Peter Tasker of Arcus Investment, a Tokyo-based hedge fund, expressed similar fears. He stated that he believed that the bad debt problems of the banks were not the prime cause of Japan's economic problems, but symptomatic of a deeper malaise.

Pointing out that American and European banks operating in Japan without extensive bad loans were also experiencing a shrinking lending base, Tasker warned: "It may be that simply dealing with the banks is not enough... I don't really accept that there are high quality options for lenders out there that are not being funded. If there was genuine demand for capital, you would have high interest rates which you simply don't have...

"To shut down the companies responsible for those bad loans would imply throwing millions of people out of work, with all the problems of social unrest—not to mention the plummeting consumer demand... The crash landing scenario is not really possible given the scale of the problem."

Whichever way it turns, the Koizumi cabinet faces an impasse. A taxpayer-funded bailout of the banks will escalate Japan's record public debt, which currently stands at over 660 trillion yen or $US5.4 trillion on the current exchange rate. In 1994, Japan's public debt, as a percentage of GDP, was lower than that of the US and Italy. Now, it has reached an unprecedented 143 per cent of GDP. Adding to the dilemma of the government, the economic conditions have caused a constant decrease in tax revenues. Figures published in the *Japan Times* indicated that for August 2002, tax revenues declined by 17.4 percent from a year earlier—the 12th consecutive month of decline. Tax revenues across the board plunged, with income tax revenue dropping 21.2 percent, corporate tax falling 17.7 percent and revenues from consumption tax declining 2.8 percent.

The only manner in which the Koizumi can both rescue the major banks and rein in the build-up of public debt is by massive cutbacks to public works spending and social services, or by increasing taxes on working people by raising the consumption tax.