Financial markets criticise Japanese bank plan

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The Japanese government's latest plan to resolve the country's banking crisis has generally been given the thumbs down by financial market analysts and commentators, who describe it as too weak and not specific enough.

The stated aim of the plan, which was unveiled by Economy and Financial Services Minister Heizo Takenaka last week amid opposition from within the ruling Liberal Democratic Party (LDP) and from the banking sector, is to halve the bad loans held by major banks by 2005.

Included in the package are proposals to introduce stricter accounting rules for the banks and to tighten the measures for assessing bad loans. One of the measures that drew the strongest opposition was the proposed introduction of restrictions on the ability of banks to count tax refunds due to bad debts as part of their core capital.

These funds constitute as much as 40 percent of the core capital of major banks. Takenaka had proposed that from April 2003 the figures on tax write-offs had to be reduced to 10 percent of core capital. In effect, this would have meant that most of the major banks would have had their bank reserve ratios reduced below the international minimum standard of 8 percent, preventing them from operating internationally and making them prime targets for nationalisation in publicly funded bailouts.

The government would have effectively taken over the management of the banks, with many large corporations, classified as problem borrowers, being sent to the wall.

But the opposition from bank executives and factions within the LDP representing some of Japan's largest construction and retail companies saw the plan watered down, with no deadlines set for its implementation. Takenaka and Prime Minister Junichiro Koizumi have said they will concretise the proposals by the end of November. But with opposition certain to be raised in the Japanese parliament, the government appears to have pulled away from making decisive steps in reducing the mountain of bad loans, estimated to be at least $420 billion, or 10 percent of Japan's gross domestic product (GDP).

That, at least, is how the financial markets are interpreting events. Investment houses and credit rating agencies that only a month ago were hailing the appointment of the economics professor, Takenaka, have reacted critically to what they see as a backdown.

Richard Jerram, an analyst with ING Barings Tokyo, commented: "We are now looking at a continuation of the procrastination of the past decade." According to Koyo Ozeki of Merrill Lynch in Tokyo, the plan had been "emasculated." "It's very unfortunate. The whole deal underscores the fact how strong anti-reform forces are," he said.

Takenaka has been under constant attack from sections of the ruling LDP since his appointment when, in an attempt to establish his credentials in financial markets, he commented that no bank or company was too big to fail. He was later forced to withdraw the remark in an apology delivered in parliament.

The international credit rating agencies made it clear they regard the latest plan as insufficient. Fitch said it was a "damp squib" that will make no difference to the bad ratings it has assigned to Japan's banking sector. Standard and Poors said it was a "step back" from initial expectations and there could be further retreats. According to the agency, questions have to be raised about "whether the government has the political will to fully implement even those measures retained in the watered-down package in the face of hostility from within the Diet (Japanese parliament) and in the financial sector".

In a bid to cushion the effect of its measures, the Koizumi government intends to create a new state body that will extend loans to small and midsize companies that are deemed viable through restructuring but which are unable to obtain lending as the banks dispose of their bad loans.

Estimates on the extent of bad loans range from $420 billion to as high as $1 trillion, with the problem getting worse. Deflationary conditions in Japan are resulting in cuts in production and profits, making it more difficult for companies to repay their debts.

In an attempt to stimulate the economy, the latest package includes $8 billion in tax cuts for businesses. But here again, no concrete details or deadlines have been released. If such tax cuts are introduced they will exacerbate the government’s revenue-raising problems and make more difficult the servicing of the public debt, now the highest in the industrialised world at over 140 percent of GDP.

Finance Ministry figures show that tax revenues from firms and individuals were down 17.3 percent from a year earlier. Corporate tax revenues in the first six months of the 2002 fiscal year were down 45.4 percent on the previous year.

The conflict over the bank restructuring plan within ruling circles is not simply over what economic measures need to be introduced. There is a political dimension as well. Some factions within the LDP voice fears that, with the bankrupting of large corporations and banks, the Japanese economy is being opened up to foreign capital, in particular from the United States.

One leading LDP figure, Shizuka Kamei, last week described Takenaka as “nothing better than an agent of vultures”. According to the president of the Petroleum Association of Japan, Keiichiro Okabe: “The direction in which Takenaka has oriented himself is highly rated overseas, but we may need to pay attention to possible attempts by foreign companies to take over Japanese firms. There naturally have been demands for Japan’s national interest to be protected.”

LDP political heavyweight, Mikio Aoki was quoted in the *Asahi Shimbun* denouncing Koizumi for bringing in private sector experts who have “no business in deciding the nation’s economic policy”. “They have not been chosen in elections. It is a problem if people who are not in a position to take responsibility provide opinions that influence grave national policies and the people’s future.”

The *New York Times* reported that one Japanese tabloid headline described Takenaka as an “agent of the Americans”. Conspiracy talk in Japan described Takenaka as doing the bidding of American “vulture funds” as he moved to knock over shaky banks and force companies into bankruptcy.

Alongside the mounting political conflicts, social tensions will also increase as economic conditions worsen. According to a report in the British *Guardian* newspaper, even the watered-down measures announced last week will push bankruptcies beyond the rate of 50 corporate failures a day and raise unemployment well beyond the present almost record level of 5.4 percent.

The credit research agency Teikoku Databank reported that corporate bankruptcies for the first half of the fiscal year—March to September—totalled 9,642. While this was a drop of 0.2 percent from a year earlier, it still represented the fourth highest level in the post-war period. Corporate liabilities were the fifth highest since the war.

Two major collapses in October were the building materials supplier, Kotobuki Industry and Nisseki House Industry, an affiliated construction company. Both were publicly listed companies and went under with debts of $293 million. Their collapse pushed to 27 the number of publicly-traded Japanese companies that have gone bust this year, almost doubling the 14 recorded for all of the last fiscal year.

The number of factory closures, mainly in the manufacturing of industrial materials, has surged by more than 50 percent from the same period last year. In the nine months to the end of September, 105 companies closed a total of 187 factories.

Correspondingly, the unemployment rate among men reached a record level of 5.8 percent in September with the Public Management Ministry describing the current employment situation as “severe”.

Most workers lost their jobs through corporate downsizing and bankruptcies. The total number of unemployed climbed 80,000 from a year earlier to 3.65 million, up for the 18th straight month.

In a sign of what is to come in the banking sector, Mizuho Financial Group announced plans to axe 8,000 jobs and cut wages for the remaining workforce by 10 percent. The planned job cuts due by 2005 as part of a restructuring process, with 5,000 jobs to go by the end of fiscal 2003.

As the world economy slows, in particular the US economy, Japan’s exports have been hit severely. Many large exporters such as Toyota, Honda, Fuji, and Sony have revised income and profit forecasts and moved to scale back production. Industrial production fell for the first time in three months in September by 0.3 percent and exports declined 2.3 percent.