Japanese bank bailout reveals deepening economic crisis

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Last week's decision by the Koizumi government to organise a 2 trillion yen ($17 billion) bailout of the ailing Resona Bank was sparked by fears that the bank's collapse could have sparked a widespread financial meltdown. The decision, taken at an emergency cabinet meeting, means that the government has effectively nationalised Resona, owning more than half of its equity.

The demise of Resona, Japan's fifth and the world's 31st largest bank, is another demonstration of the fact that, despite the continuous injection of public funds, Japan's banking crisis is steadily worsening. The Osaka-based Resona bank was created in March this year through the merger of the Asahi and Daiwa Banks, both of which are believed to have received around 1 trillion yen in previous public assistance.

Resona's problems surfaced almost immediately when it announced that its capital adequacy ratio had fallen to 2.07 percent, just half the 4 percent required for a domestically operating bank and a quarter of the 8 percent ratio required by banks operating internationally.

Only weeks before the announcement, Resona had reported a capital adequacy ratio of 6 percent. But the claimed ratio rested on shaky foundations.

In order to bolster their financial status, Japanese banks have been able to claim deferred tax assets (DTAs) as capital. DTAs are tax credits that the bank can claim on provisions for losses on bad loans.

The Resona Bank wanted to claim around 700 billion yen in DTAs. However, independent auditors, working in line with new financial regulations, allowed only 435 billion yen to be claimed, dramatically lowering the bank's capital adequacy ratio. In addition, Resona also revealed that it was expecting to post a massive loss of 838 million yen for the 2002-2003 fiscal year.

The loss figure points to the wider problems confronting all the banking and financial institutions. As the stock market falls to its lowest point in 20 years, bad loans are accumulating as fast as bad debts are being written off, giving rise to concerns that Resona may not be the last collapse. Altogether bad loans are estimated to be some 50 trillion yen.

As a recent article in the *Asahi Shimbun* put it: "Resona's predicament could be just the tip of the iceberg, with other major banks running perilously close to the minimum required capital-adequacy ratio as a percentage of overall assets, a key yardstick of financial health."

Many banks, the article noted, rely heavily on deferred tax assets or future tax credits on loan losses to prop up their reported capital figures.

"Should the so-called Resona shock spark a fall in bank shares and bring down the whole stockmarket, the shares held by the banks could also plummet in value, further eroding the banks' core capital in a vicious circle," the article stated.

The deepening problems in the banking sector are symptomatic of the malaise afflicting the entire Japanese economy which has been stagnant, in recession or on the verge of recession for the past 12 years.

Commenting on the government's decision to step in with public funds, Mitsuhiro Fukao, an economist at Keio University, pointed out that "everyone" knew this could happen to any of the other banking groups. "But the government is right; so long as it props banks up, there will be no crisis, in the sense that there will be no runs on banks."

While this might provide reassurance in the short-term, it brings long-term concerns. As Fukao pointed out: "The government's ballooning stake in the financial sector is cause for alarm. What this means is that we are edging closer and closer toward fiscal collapse and the day when we see massive capital flight. Some day depositors are going to stop blindly keeping their money in yen, and will start to worry about the state that's backing it."

According to Fukao, the nation's 10 largest life insurers hold almost 8 trillion yen in bank stock, whose value continues to plummet.

The world's largest bank in terms of assets, Japan's Mizuho Financial Group, announced a record Japanese corporate loss of 2.38 trillion yen ($19.8 billion) for the fiscal year ending March, due largely to a slump in the value of its share portfolio. The eventual loss was 22 percent worse than its original estimate of 1.95 trillion made in January.

Overall, Tokyo's Nikkei 225 index has lost almost 30 percent in value in the fiscal year ending March, with other indicators pointing to a further decline in the economy which is once again on the verge of recession after a short-lived export-led recovery.

Bank lending fell 4.6 percent in April from a year earlier, recording the 64th straight month of decline.

In the latest data released by research firm Teikoku Databank, some 18,928 companies went bankrupt in the 2002-03 business year. Although the numbers were down 5.6 percent from a year earlier, the figure was the fourth largest in the post-war period and remained above 18,000 for the third consecutive year.

A record number of 22 stock exchange listed firms went to the wall, one more than in the previous fiscal year. Notable among the bankruptcies were construction firms Dai Nippon Construction and Kokune Corp, paper producer Nippon Kakoh Seishi Co and machine-tool maker Hitachi Seiki Co.

Industrial output recorded a 0.2 percent decline in March from a month earlier, due to fall in auto exports.

Average monthly wages slumped 1.1 percent in March from a year earlier, the 23rd consecutive drop, according to the Labor Ministry. Nominal gross domestic product (GDP) declined 0.7 percent for the year, according to figures released by the Cabinet Office, recording two consecutive years of negative growth.

The outlook for GDP growth is particularly grim given the impact of the SARS virus on the Asian economy, which absorbs many of Japan's exports, and the continuing weakening of the US dollar, which is making Japanese exports less competitive and squeezing them out of global markets.

The GDP deflator, an overall price index, fell 3.5 percent from a year earlier, the sharpest ever drop, adding to the deflationary problems dominating the Japanese economy.

Unemployment levels remain at record postwar rates, with a sharp rise in youth unemployment. There are now 13.2 percent of all 15-24 year olds officially unemployed, compared to the overall figure of 5.4 percent.

The figure is worst for young males, with a record 14.6 percent of 15-24 year olds unemployed—a far cry from the boom period of the 1970s when Japan had the reputation of a country that provided "jobs for life".

In a sign of the times, an article entitled "Deflation Nation" published in the magazine *BusinessWeek*, recalled some of the consequences of a previous crisis as it set out a possible scenario for the Japanese economy and its global impact.

"Japan's deflationary spiral accelerates and never really reverses. At some point, Japan's government can no longer manage the decline. Major bankruptcies spike, investment evaporates, and ordinary folk rapidly deplete their savings. You have to go back to the Great Depression to find anything comparable. Deflation was a big factor in that crisis, too. It helped cripple industrial production around the world and drive unemployment sky-high. In the 1930s, the price of everyday goods fell by 10 percent a year in both the US and Japan, which devastated corporate earnings and undermined the financial system. The planet sank into an economic funk that it took a world war to break."