

# A Flood of Ideas for Liquefying Loans

By Sakamoto Sakae

Despite twice cutting the official discount rate and two economic stimulus packages put forward by the government in 1993, the Japanese economy remains mired in a recession. At the end of January, economists in the Bank of Japan (BOJ) stated, "The economy remains stagnant and signs for recovery have yet to appear." Some private economic institutes have even forecast zero growth in real-term GNP for 1994. To break this stranglehold, economic offices, the BOJ and political parties are studying measures to liquefy loans held by banks.

## Economists' pestilence

In early 1993, many economists forecasted an upswing in the economy by mid-year, and that then Prime Minister Miyazawa Kiichi would be able to proudly receive Western leaders at last summer's G-7 Summit held in Tokyo. However, this scenario was dashed by subsequent developments, both economic and non-economic.

Economically, the biggest blow came from the sharp rise in the yen against the dollar. This put a damper on the automobile and other export-oriented

industries in expanding overseas markets. Considering the increases in Japan's trade and current surpluses, the yen appreciation was a natural occurrence. Any oversight by the economists regarding this was of their own doing.

However, it would be cruel to blame economists for their failure to predict the unusually cold summer which depressed consumer spending. It was also beyond the economists' ken to foresee the political corruption scandals relating to the construction industry which effectively paralyzed additional public works spending, the pillar of the government economic stimulus packages.

One more factor mitigating the "sins" of the economists was the unexpected replacement of the government. The eight-party/group coalition which ended the rule of the long-standing Liberal Democratic Party last summer ushered in a change in the policy-making mechanism. Concurrently, it obscured those with actual power, making swift policy decisions impossible and resulting in a policy vacuum which has adversely affected the economy.

In short, Japan's already troubled post-bubble economy has become a depressed dirge of a stronger yen against the dollar (economic), a protracted rainy season and cold summer (weather), a corruption-ridden construction industry (social), and a change in government (politics).

## Government study groups

As one possible way to escape the grip of the lingering recession, the government and ruling coalition members have been studying

plans to liquefy bank loans and land—the latter has seen the market collapse—since November 1993. The fact that land includes collateralized real estate on bank loans reveals that the major aim of these measures is to clean up bad loans held by banks, restoring their fiscal health and allowing them to infuse badly needed capital into industry.

However, within the ruling coalition a consensus has yet to be reached on how to deal with these issues and the latest government economic policy paints the issue with only abstract expressions. A conclusion is likely to be reached sometime between April and June. Although both measures call for "stabilization of the financial system" and "overcoming asset deflation" the general public inevitably views these steps as bailing out banks. Fully aware of this, the Ministry of Finance (MOF) and the BOJ seem prepared to take their time and first focus on gaining public support.

Amidst the concentration of government offices in Kasumigaseki, there are two groups studying loan liquidization. The first is sponsored by the MOF Banking Bureau chief and includes planning staff from banks (Dai-Ichi Kangyo Bank, Sumitomo Bank Ltd. and Yasuda Trust and Banking Co., Ltd.), the insurance industry (Nippon Life Insurance Co. and Tokio Marine and Fire Insurance Co., Ltd.), and securities companies including Nomura Securities Co., Ltd. According to an inside source, the group's mandate is to "find ways to divide corporate loan assets—whether good or bad—into small lots to be traded in the market." Thus, the group is only studying methods to liquefy loans, a practice seldom seen in Japan, and one not particularly concerned with dealing with bad loans.

The other study group is headed by a Ministry of International Trade and Industry satellite organization and membered by non-banks such as Orix Corp.



The yen continued to strengthen after the Japan-U.S. summit meeting — Tokyo Forex



Following the burst of the bubble, the Japanese economy has tended to remain stagnant — Tokyo Stock Exchange

and Japan Leasing Corporation. While this one allegedly is studying the legal aspect of expected loan liquidization, it is obvious that it is seeking a way to separate bad loans currently held by financial institutions, including non-banks.

## BOJ emphasizes market mechanisms

In line with these moves, the BOJ is also appealing to the public on the issue of loan liquidization. Mieno Yasushi, BOJ governor, in a speech delivered last December explained how U.S. banks, which had been similarly troubled by bad loans, successfully terminated their "balance sheet recession." Mieno insisted that Japan should learn from the U.S. experience to find its own measures. It is unusual for a BOJ governor to refer to such a topic.

The highlights of his speech are as follows:

- The essence of the problem is how to smoothly correct bank and corporate balance sheets with particular attention paid to the bad asset problem. As in the U.S. experience, financial and capital markets may play a role in eliminating bad assets.

- [In the U.S.] ... the first move was

the banks' attempt to improve cash flow through various liquidization methods including securitization of bad loans while aggressively expanding write-offs and loss reserves for bad loans. In addition, they raised equity from the capital market through issuances of preferential shares and other various market instruments to increase fundamental strength.

- Among such measures, liquefying bad loans means a risk transfer from the seller to the buyer through discounting values, and an issuance of preferential shares means finding new risk takers in the capital market. In any case, various functions of financial and capital markets, especially risk transfer, play an important role in disposing of bad loans at financial institutions.

- The BOJ will eliminate obstacles preventing financial institutions from taking such voluntary measures, providing an environment which allows them to do their best in dealing with the problem in accordance with the principles of self-responsibility and the market.

## Calls for public funding

Politics adds some reality to such Kasumigaseki and Hongokucho (BOJ's location) arguments. One—and perhaps

the most realistic—of the political parties-initiated proposals is that of the Renewal Party, which calls for the establishment of an organization with BOJ or MOF funding to buy bad loans held by weaker minor financial institutions such as regional banks and credit associations.

Compare this to another proposal put forward by coalition members Sakigake and the Japan New Party for a new organization to buy land collateralized on bad loans held by financial institutions using money from the MOF fiscal investment loan plan and sell it to regional governments. The Social Democratic Party, also a member of the coalition government, has proposed the use of an already existing public corporation, the Housing and Urban Development Corporation, to buy land collateralized on bad loans and use the land for public facilities and residential plots.

Despite the differences in the purchasing body, and ultimate use of the purchased land, these proposals are in the same spirit as the one put forward by the Renewal Party.

The proposal of the opposition Liberal Democratic Party, on the other hand, is to inject additional funds by the BOJ or MOF into the existing Cooperative Credit Purchasing Corporation—which was established by banks with their own funds—and remove the current capital limit (i.e. all purchase funds come from the banks) to allow for increased purchases. One thing common to all these Nagatacho (Diet location) ideas is that public money be used for purchasing funds and net purchase prices and sales prices (losses for the moment) be compensated with taxes.

In the end, the proposals of the political parties ignore the utilization of financial and capital markets as emphasized by the BOJ governor. Therefore, it would be very difficult to obtain public support.

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