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Move in Japan to Aid Banks Plagued by Bad Debt

By JAMES BROOKE

TOKYO, Oct. 11 — Japan's central bank moved today to force a much faster clean-up of the country's ailing banking system. It said it would spend $16 billion of its own money in a highly unorthodox plan to buy stocks from threatened banks, and it called on the government to use tax money to absorb much more of the banks' losses on bad loans.

The central bank also called for stricter review of the banks' loan portfolios, and signaled that it would offer emergency loans to banks that fall under a financial threat.

The steps were a clear signal, analysts said, that the independent central bank intends to cooperate with Heizo Takenaka, Japan's newly appointed economy chief, if he follows through on promises to bring about a sharp reduction of the mountain of nonperforming loans that is hobbling Japan's financial system.

The announcements by the Bank of Japan, which has been at loggerheads with the government for years, are a "real step forward toward coordination," Robert Feldman, chief economist at Morgan Stanley in Tokyo, said after studying the plans. "The report is saying, `We're going to do everything we can to help you.' "

The stock purchase plan, which calls for buying shares in investment-grade-rated companies held by 10 or so banks over the next 12 months and holding them for at least three years, has raised eyebrows at other major central banks, which studiously avoid involving themselves directly in equity markets. But it is seen in Japan as part of a hard-nosed campaign by the central bank to force a hesitant government to bail out the banks.

Mr. Takenaka said today that he would have a plan to clean up the banking problems and to forestall a recession ready in time for the opening of the new legislative session next Friday. He has already won agreement from his colleagues for several deregulation measures, but hopes are fading that a corporate tax cut will be included.

Mr. Takenaka, who is thought to favor a "hard landing" for failing banks and companies rather than continued financial life support, showed a softer side today in a visit to the headquarters of the ruling Liberal Democratic Party. He denied a remark attributed to him in a magazine interview that no Japanese bank was too big to be allowed to fail.

Allies of Mr. Takenaka have proposed that the government move to cut off the 30 most indebted companies from new credit and allow them to close. But some politicians and economists fear that so forceful a policy would touch off a wave of bankruptcies and plunge the nation deep into recession. Ruling-party politicians have called for stepped-up public spending to counteract that effect and keep Japan's economy, the world's second largest, from sinking.

But Yasuo Fukuda, the government's chief spokesman, said today that the government would not agree to pump more spending into the economy. He said after a cabinet meeting: "The prime minister is not thinking about an extra budget aimed at bolstering the economy. We will not cut corners."

Today, the Bank of Japan ignored pleas from politicians for a further loosening of its monetary policy, already the easiest among major countries, with short-term interest rates effectively at zero. It also rebuffed demands that it set a timetable for reversing deflation, which has plagued Japan for three years.

"It looks like they want to get out of the central bank business and into something else," Christopher Walker, senior economist in Tokyo for Credit Suisse First Boston, said today, after a two-day meeting of the bank's board ended without action on the money supply. "They seem to have given up on using monetary policy as an anti-deflation tool."

But bank officials are believed to want to tie any further steps to action by the government on the bad-loan crisis.

"The Bank of Japan has said very clearly that they will put out all the money necessary, if the government really cleans it up," Mr. Feldman said.

The commercial banks' capacity to deal with the problem loans themselves has been badly eroded in recent years by the plunging stock market, which has cut trillions of yen in value from their shareholdings. On March 31, the end of the Japanese fiscal year, the country's 11 largest banks held about 24 trillion yen ($196.9 billion) in stocks; Japanese regulations permit stockholdings to count for part of banks' capital requirements. The Nikkei index has fallen 29 percent since then.

Referring to the bad loans, the Bank of Japan said today: "During the past 10 years, Japanese banks have made progress in addressing the problem by disposing of more than 90 trillion yen in nonperforming loans. Nevertheless, they now face a more severe challenge than ever, given the decline in their financial strength and earning power."

The central bank suggested that its policy makers work with Prime Minister Junichiro Koizumi to "pre-emptively seek to prevent a financial crisis from arising." Conservative official estimates put the total face value of nonperforming bank loans at $423 billion; many economists and analysts put the true figure at more than $1 trillion.

A government-sponsored agency, the Resolution and Collection Corporation, has been operating for seven years, buying some $70 billion in bad loans from the banks. But because it is barred by law from reselling the loans at a loss, it has become more of a warehouse than a clearinghouse for the loans.

Ernst & Young estimates that private investors have paid about $30 billion since 1997 for troubled bank loans with a face value of $300 billion. Most of the deals came in the late 1990's, when market prices plunged so low — as little as 6 cents on the dollar — that the banks became reluctant to sell.

Today's developments came against a backdrop of economic unraveling. The Finance Ministry reported that new lending by Japanese banks was down yet again in September, by 4.8 percent, making 57 consecutive months of decline. Foreign investors were net sellers of Japanese stocks in September for the third consecutive month, Finance Ministry figures showed, draining a net $10 billion from Japan's equity markets.

Stocks rose in Tokyo today, with the Nikkei index up 1 percent at 8,529.61, largely because of the rally in New York on Thursday. The index had been riding a roller coaster mostly downward over the two weeks since Mr. Takenaka was given wide economic policy powers in a cabinet reshuffle.

As a reflection of Japan's toughening times, a debt-laden construction company, Kumagai Gumi, said today that it had sold America's Tower, a 47-story office building near Rockefeller Center in Manhattan, for $405 million to an American buyer, a unit of the Paramount Group.

Japanese officials emphasized this week that the Nikkei's slump was part of a global downward trend. "Stock prices in Japan are being influenced by the U.S. stock market as well as by the world economic uncertainty and Japan's economic stagnation," Mr. Koizumi told reporters.

Masaru Hayami, governor of the Bank of Japan, warned reporters today that further falls in share prices "could destabilize the nation's financial system."

Elections to fill seven vacant seats in Parliament, set for Oct. 27, will put Mr. Koizumi's economic policy to the political test. Five of the seats were last held by members of his party. "We will aim at winning all the elections," Mr. Koizumi told reporters.