IMF Asks Shock Therapy In Japan, Bankers Say

by Our Special Correspondent

Japan's banks and government bond markets are now in such enormous trouble that "the government has to be ready to face emergencies," International Monetary Fund (IMF) Japan chief Charles Collyns told Japanese officials in Tokyo, Agence France Presse reported on June 1. Collyns' remarks, during an IMF team's annual review of Japan's economy, were reported together with more shocking comments the same day by Kenneth Courtis, vice chairman of Goldman Sachs Asia. Courtis called Japan's banks "a threat to the global economy," according to the same wire. He said that Japan's banking system is "set to enter an unprecedented crisis, a financial implosion" which "would have vast global economic, financial, and political implications." He set "potential losses" by Japanese banks at more than $875 billion.

In a second interview with Agence France Presse on June 3 entitled "Countdown Begins to a Bond Market Crash in Japan," Courtis said that Japan's government bond market, now more than $3 trillion, according to Japanese figures, is also set for a meltdown which could destroy the world economy. "It is the biggest bubble in the world, more important than the one that exploded on the Nasdaq," he said. A Goldman Sachs study puts Japan's government debt at 146% of Gross Domestic Product, and claims that 65% of all taxes go to service the debt. In the same wire, IMF Managing Director Horst Köhler is quoted demanding a "cleanup of the budget," saying that this is Japan's "second priority," after disposal of banks' bad loans.

Asked directly, the IMF denied any connection between the Fund and Courtis or his firm, and Courtis' Tokyo office said that he was "out for the week with a terrible cold," and unavailable. "Ken Courtis has lost a lot of credibility around here," one Tokyo banker laughed. "He wrongly predicted a sharp rise of the yen just before the 1997 Asia crisis [i.e., the global financial crisis which broke out in Asia], but the yen fell. Deutsche Bank-Morgan Grenfell, his employer then, lost a lot of money, and Ken lost his job. He switched his view 180 degrees, and he has called for a collapse of the yen, and the government bond market, for three years now—wrong again."

But the situation is no laughing matter. The IMF Japan team, financial industry sources say, is demanding that Japan adopt a "shock therapy" approach to bad bank loans and mushrooming government debt—the same IMF advice which has ruined Russia and bankrupted half of South Korea, policies as bad or worse as any Goldman Sachs might propose. The Fund is, in fact, sources say, working with Goldman Sachs, sharing statistics, and making similar predictions about Japan's markets in private. Either Japan submits to IMF advice, is the implicit threat, or Tokyo markets could be "talked down" into a crash.

On the Streets

In particular, the IMF Japan team wants to stop Japan's lifetime employment system, and force a policy shift to put large numbers of Japanese out of work and "on the streets," one Wall Street source said. During its annual "Article IV consultations" on the Japanese economy in Tokyo on May 21-28, one source said, the IMF complained that Japanese banks aren't serious about writing off bad or "non-performing loans," because there is not enough pressure by Japan's government on the banks to close down large numbers of corporate borrowers. "Officials in Japan are too reluctant to see people on the streets; there's too slow a process of closing down non-viable companies and banks," is said to be the view. Apparently, the IMF is complaining that banks are funding corporate customers at too-low interest rates, continuing to roll loans over, not letting enough companies go bankrupt, while bank regulators do nothing.

Japan's bank regulators are reportedly blamed by the IMF, which wants them to get much tougher on the banks. If regulators do so, the banks will get tough on corporate borrowers, is the reasoning, which would lead to many more bankruptcies. One IMF official reportedly told a financial source that this is what Japan needs to do. For a while, he said, that means a lot of unemployed, but the IMF believes that this is necessary, despite the incredible social and culture shock to Japanese society which could ensue.

Small and medium-sized companies, known in Germany as the *Mittelstand,* are said to be a large part of Japan's problem, in the IMF's view. Japan does not allow enough competition, and needs more competition such as there is in the United States, IMF officials say, where giant, low-wage chain stores have been allowed to drive whole segments of small and medium-sized industry out of business. "Mom and pop stores," which are found on every street corner in Japan, are a major sector which is running up bad loans at the banks, according to IMF analysis. Some officials actually have said that it is the mom and pop stores that are wrecking Japan.

The IMF has even denied that the Asia crisis of 1997-98, which the IMF itself made worse, accounts for much of Japan's bad loans. Japanese officials and bankers are almost unanimous in reporting that companies all over Asia, both Japanese companies abroad and other Asian companies, all having trouble because of the IMF's rotten policies, are the borrowers most in danger of defaulting on credit extended by Japan's banks. But, IMF officials have reportedly said that loans gone bad to Asian companies account for only 5% of Japanese banks' bad loans, and that 95% of Japanese non-performing loans are domestic loans.

Small to medium-sized domestic Japanese firms in retail, construction, public works, and real estate account for 50% of Japanese bank loans, in the IMF's analysis, and so they believe, for 50% of non-performing loans. Japan, they say, thus needs to have mass bankruptcies in those sectors in particular, to get rid of the problem.

Ask Goldman Sachs

Asked for more statistics on which borrowers in Japan have the bad loans at the banks, one IMF official referred a financial researcher to Goldman Sachs for the data. Overall, there seems to be an issue of improper collusion between the IMF, which is supposed to answer to member governments, and private firms—such as Goldman Sachs—with a vested interest, which are known to take speculative positions in Japan's markets.

Asked whether he agreed with Goldman Sachs' warning that the Japan Government Bond (JGB) market is about to blow sky high, one IMF official reportedly said that if, "for some reason," Japanese people decide not to hold JGBs any more, it could become worrisome. If, "for some reason," he said, sudden sales of JGBs began, Japan's government would be forced to raise interest rates to attract funds, which would raise interest rates generally. This would trigger corporate bankruptcies, causing non-performing loans to soar, a disastrous loss of bank capital, and even a bank panic, the IMF worries. Thus, in its insane logic, to protect the banks, it advises Japan to shut down the non-bank corporations first.

In addition, the IMF itself, along with the U.S. Treasury, has spent the last ten years pressuring Japan to "reflate" and borrow enormous sums for public-sector stimulus programs. The IMF freely admits this, in many published documents, but says that this year it has changed strategy. Now it is telling Japan to "taper down the stimulus packages, ramp up the structural reforms, and shut down more companies," one source said.

Certainly Japan has a huge government debt problem, as does the United States. When then-Japanese Finance Minister Kiichi Miyazawa warned on March 8 that "the nation's finances are now . . . quite close to collapse," he was referring to projections that had just been released, that the sum of gross total debt owed by Japan's central and regional governments combined, would reach $5.6 trillion by March 2003. Japan's Finance Ministry now reports this gross government debt to be $4.35 trillion, and Japanese government bonds outstanding at $3.1 trillion, compared to U.S. national debt bonds now outstanding of $5.6 trillion.

Even the U.S. Treasury Department's Japan Desk, however, noted in an interview that Goldman Sachs' figure of Japanese government debt at 146% of GDP is a tad misleading. Japan also has enormous assets, including more than $2 trillion in the postal savings fund, and other large government funds, they said, so Japan's net government debt, after subtracting assets, is much lower, $1.8 trillion, or 44% of GDP. This is at the same level claimed by the United States, which reports net debt at 43% of GDP. The Japanese also have $12 trillion in private sector savings, and many are eager to hold JGBs as a safety item. In fact, so many Japanese are eager to hold JGBs, that the government need only pay 1.8% on those bonds, and 95% of all JGBs are owned by Japanese nationals.

'For Some Reason'

One economist was so alarmed at the Goldman Sachs projections, with which the IMF agreed, that, for "some reason," Japanese investors might just suddenly decide to dump their government bonds, that he inquired further at the IMF. " 'If for some reason?' Well, for example, what reason?" he asked. Any number of reasons, came the IMF's not-so-scientific reply. Japanese are used to putting their savings in government postal savings and JGBs, but things do change and things are changing just below the surface in Japan. Many people say interest rates in Japan should be raised because retirees can't live on their savings with 1% interest rates. People are waking up and noticing that formerly conservative Japan has begun to look like profligate Italy with this huge national debt.

But, the economist pointed out, when Japan's savings system was deregulated recently, pundits predicted that everyone would pull their savings out of the low-interest postal fund, and go into foreign banks or anywhere paying higher interest. Instead, more than 95% of postal savings were rolled over and kept where they were, for the sake of safety. The lure of higher returns was not sufficient reason, and so he asked again, " 'If for some reason?' What reason?"

Very soon the Japanese people will realize that they can get a greater return for their money and we believe they will get out, the IMF official insisted. Corporate and private depositors in Japanese banks are also about to get out and go abroad to higher-rate pastures, which will force Japanese banks to sell off parts of their substantial JGB portfolios to raise cash to replace those deposits. If as a result, interest rates rise even a little, say from 1.5% to 3%, they risk a general banking panic.

The International Monetary Fund and Wall Street, it seems, have come up with a sophisticated way to scream "Fire!" in a crowded theater. Given the United States' dependence on Japan for about a quarter of the $1 billion a day which America must raise to cover its foreign deficit, flirting with a bank panic in Tokyo to gain policy ends is none too bright.