MAS040101

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Responding to the BoJ Offer

On March 20th we wrote:

> "Long time observers of the Japanese monetary politics should ask themselves one question. 'What has the Bank of Japan gotten back from the Government in exchange for adopting a strong quantitative commitment to ending deflation?' We don't know the answer that the Government has given. We only know the demand that the Bank of Japan has made."
> **MAS032001 A Revolution in Japanese Monetary Policy: Where is the Quo for this Quid?**

The **BoJ** is still waiting for the Government's response, although there is now evidence of an emergency policy package that the LDP is preparing in conjunction with various Government officials. Such a package will be designed to address three major issues. **(1)** the Commercial Bank NPL problem;**(2)** Commercial Bank Equity Holdings; and **(3)**Tokyo (Metropolitan) Redevelopment. In short, the three items that weigh down the Commercial Banking system (NPL's, Equity and Real Estate) are now to be addressed in some (realistic) fashion by the Government (the '**quid**' for the **BoJ**'s '**quo**' ?). Our view on the **BoJ** policy change was the policy change was an "opening," and that the **BoJ** was waiting for a response from Government on these issues before making a major effort to increase various monetary aggregates.

We understand that the current proposals now under discussion are as follows.

NPL's: Write off and remove the NPL's now categorized as 'loss' and 'damaged' from the balance sheets of the banks. The amount at stake is thought to be approximately 13 trillion yen.

Comment: The Banks are undoubtedly hiding a lot of non-performing assets probably under the label, "substandard." The estimates are 50 trillion yen. There is a widespread feeling that insufficient due diligence has been done which accounts for the huge spread between the amount of NPL's to be written off under the proposal (13 trillion yen) and the estimated 50 trillion. Substandard non-performing assets could include large construction firms. When Sogo Department Stores failed, it was carried on the books as a "substandard" loan.

Bank Equity Holdings: The Government wants to impose a regulation to limit bank holdings of equity shares to 100% of the individual bank's own equity with a two to three year grace period to allow the banks to sell their holdings. .

Comment: The books of the commercial banks contain about 50 trillion worth of equity holdings, while the banks' own equity is some 37 trillion! This ratio far exceeds that of say Germany, where commercial bank holdings of equity amount to some 60% of total equity of the commercial banks! This suggests sales of some 13 trillion in equities to the Government. **The Government proposes to create a fund to buy the shares and essentially create a mutual fund of some sort.**

Metropolitan Tokyo Land: The Government wants to embark on a redevelopment scheme in certain areas of Tokyo in order to revive the property market. The feeling in Japan is that until the property market is revived, getting rid of the NPL's that involve land will present a huge and impassable barrier.

The entire policy package is only the beginning of a resolution of the bad asset problem in the commercial banks. It may be better than old fashioned pork barrel politics, but the LDP has lost immense credibility. It is unlikely that anything truly substantive can change until the Upper House elections July 29th. If the LDP and its allies lose sufficient seats, then a general election for the Lower House will occur in the fall.