The Bank of Japan has unveiled a draft plan to provide up to Y1,000bn ($10bn) in subordinated loans to large commercial banks, in the latest radical effort by one of the world’s leading central banks to stem the global economic crisis.

The BoJ move, which it said it was exploring as an “extremely extraordinary measure”, follows the Bank of England’s decision to buy UK government debt and the Swiss National Bank’s announcement of its plan to intervene in currency markets to drive down the Swiss franc.

There is speculation that the US Federal Reserve could move towards buying US government debt at the close of its two-day policy meeting on Wednesday, though most analysts think it is more likely to expand purchases of mortgage-related securities issued by Fannie Mae and Freddie Mac instead.

In other moves on Tuesday, an International Monetary Fund official revealed that the fund has dramatically cut its estimates for global growth this year, with Japan the worst-performing big economy.

Teresa Ter-Minassian, an adviser to IMF managing director Dominique Strauss-Kahn, told reporters that the IMF now expects the world economy will shrink by 0.6 per cent this year, with a 5 per cent contraction in Japan, down from the 2.6 per cent contraction expected in the fund’s last official forecast in January.

The IMF said the figures were “unofficial and already out of date”. They were based on forecasts drawn up in late February.

The IMF is set to unveil more up-to-date predictions for global growth on Thursday, and comprehensive forecasts for international economies towards the end of April.

The BoJ also said it would only make the loans available to banks subject to international capital standards - which include the country’s mega-banks and other larger commercial lenders - thus excluding most of the sector’s weakest members.
The central bank made clear it was seeking to put in place a safeguard that could be used if conditions worsened for local lenders that have so far been much less affected by the global financial turmoil than US or European counterparts.

“If strains in financial markets at home and abroad further intensify and financial institutions become more conscious of capital constraints due to concern over a future decline in stock prices, there is a possibility that the financial intermediation function will not be carried out smoothly,” the BoJ said in a release.

Analysts said that while falling share prices initially eroded tier banks’ two capital, tier one was also affected when net unrealised gains from their shareholdings become net unrealised losses. The BoJ’s subordinated loans would only boost tier two capital.

“Japan’s toxic assets are essentially equities and any pick up in stock markets will be more significant for improving tier one capital,” said Glenn Maguire, chief Asia economist at Societe Generale.

However, the BoJ scheme shows the generally cautious central bank is willing to consider new approaches amid a domestic downturn of stunning speed and severity and could help to ease pressure from politicians and business for it to act more boldly.

While the BoJ has yet to decide crucial details of the terms under which it would make the loans available to banks, it made clear it hopes they will be able to raise the capital they need without its assistance.

Japan’s major banks have already raised preferred shares and securities to bolster core tier one capital, though the markets’ willingness to provide more funding is unclear.

The BoJ said its loans would be made available to leading banks as a backstop should they need help in shoring up capital bases eroded by losses and falls in the value of their investments.

The scheme is the latest in a series of attempts by the Japanese authorities to stabilise Japan’s financial system.

The government has also offered capital-short banks direct infusions of public funds, with the Financial Services Agency announcing on Friday that it would inject a total of Y121bn into regional lenders Sapporo Hokuyo Holdings, Minami-Nippon Bank and Fukuho Bank.
Analysts were sceptical that the new scheme would do much to address worries about Japan’s banks.

“It’s not really addressing the issue,” said Jason Rogers, an analyst at Barclays Capital. “This is about supplementary capital, not tier one capital, which is the focus of the markets at the moment.”

"This is a true global crisis, impacting all parts of the world and countries at different levels of development,” Ms Ter-Minassian said.

Japan’s economic growth was revised down sharply from a previously expected 2.6 per cent contraction, leaving it the sick man among the world’s advanced economies in spite of having avoided the extent of the banking problems experienced in countries like the US and the UK. Its export dominated economy has been hit hard by a plunge in global trade, with sales of Japanese goods abroad falling by 45.7 per cent in January. Its economy contracted by 3.3 per cent in the final quarter of last year alone.

By contrast the US will contract by 2.8 per cent this year, against an earlier expectation of a 1.6 per cent decline. The UK is set for a 3.8 per cent contraction in GDP, much worse than forecasts from the European Commission out last month, and far lower than the 2.8 per cent drop originally expected by the IMF.

The eurozone is forecast to decline by 3.2 per cent, compared to the previous forecast of 2 per cent.

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