

**BUSINESS**

IN SEARCH OF FINANCIAL STABILITY

## Realignment of local lenders said pivotal

BY KO HIRANO

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As banks have shifted their focus away from bad-loan disposal and toward revenue-boosting measures, the realignment of local financial institutions is increasingly perceived as vital to stabilizing Japan's financial system in 2004.

The government appears poised to strengthen the capital bases of regional banks; a bill expected to be sent to the ongoing Diet session would facilitate public fund injections even for financially sound banks.

The Financial Services Agency expects the new program to take effect in the summer at the earliest, with the government set to earmark 2 trillion yen for it under the state budget for fiscal 2004.

Ensuring the financial health of regional banks is a pressing task for the FSA before the envisaged scrapping in April 2005 of full-refund guarantees on demand deposits, a move many fear would prompt jittery depositors to withdraw their savings from weak banks.

In contrast to a steady decline in bad loans at major commercial banks, which is expected to help six of the nation's seven major banking groups swing back into the black in fiscal 2003, many regional lenders are still having trouble keeping their heads above water.

There are about 600 regional financial institutions in Japan. Of these, 64 are first-tier regional banks and 51 are second-tier regional banks.

Some of these are believed to be in deep trouble, with debts exceeding their assets, mirroring Ashikaga Bank in Tochigi Prefecture, which was put under state control in December.

Japan also has about 300 "shinkin" credit banks and 200 credit cooperatives, both of which are community-based. A recent Fitch Ratings survey found that nearly half of the shinkin banks are in poor financial health.

Some analysts say that Japan still has too many financial institutions and that it would be difficult for all of them to survive.

Jason Rogers, a credit analyst at Barclays Capital Japan Ltd., said the specter of a major financial realignment in 2004 will depend on how strictly the FSA inspects regional lenders.

The nation's regional banks accounted for 54 percent, or 23.8 trillion yen, of all nonperforming loans as of the end of last March, Rogers said.

“If a high degree of regulatory forbearance was to continue, we cannot expect a rapid realignment among regional lenders this year, as few lenders would dare to step forward in applying for public fund injections,” he said.

Financial Services Minister Heizo Takenaka has indicated the FSA will inspect regional lenders as strictly as major banks.

The FSA has imposed numerical targets on big banks in an effort to reduce their bad loans. It has refrained from adopting similar measures for regional lenders, given their small size, sluggish local economic conditions and persistent deflation.

Rogers said that, with the absence of a sense of crisis and a lack of resources at the FSA, “It’s unlikely that we will see the same level of regulatory scrutiny as we have seen at major banks.”

Analysts say the government must spur local economies by providing companies with tax incentives and by promoting deregulation in sectors such as agriculture, medicine and education as a way to revive regional lenders.

Yukari Sato, senior economist at J.P. Morgan Securities Asia Pte. Ltd., said the government should cut the effective corporate tax rate by 5 percentage points to 35 percent, which is the average for European countries, to avoid a further hollowing out of industry and to lure foreign direct investment into regional areas.

She called on the government to make local authorities compete with each other in attracting technology companies, especially those that produce digital home appliances using nanotechnology, in which Japan excels.

Sato also urged regional lenders to draw up fresh business models, with the FSA contemplating lifting a ban on banks conducting securities brokering as well as completely lifting a ban on banks selling insurance products.

“With weak loan demand, it will be difficult for lenders to boost earnings by relying on traditional banking business methods,” she said. “At stake is whether they can establish new business models and transform themselves into comprehensive financial services companies while taking advantage of such deregulatory moves.”

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