JAPAN'S STAGNANT ECONOMY HURTS THE REST OF ASIA

by Sung-Soo Yang
(e-mail: yangs@hri.co.kr)

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Japan's weak economy is now having a clear impact on the rest of Asia. Exports from Asian countries other than Japan to the U.S. and Europe are increasing, but those to Japan fell 16% in the first five months of this year from the same period last year. Any further worsening of the Japanese economy would put the rest of the Southeast Asia at risk.

Whenever the yen tumbles, Japanese policy makers try to talk it up. They always say that they are doing everything to stabilize their economy and that the market should understand that. Japanese Prime Minister Ryutaro Hashimoto plans to put forth a new spending package exceeding 16 trillion yen ($115 billion), combined with plans being put in place to mop up the bad-loan problem. It could put Japan's economy back on a recovery path, but people have been disappointed for so long that it's going to take quite a bit to get them to change their mind.

Japan Banks Are Getting Weaker

Since the Asian crisis began, Japan has been criticized on many fronts. It has failed to stimulate its economy, let its currency skid and tried to export its way to recovery on the backs of giants such as Toyota, Matsushita and Sony. But Japan's struggling neighbors complain about Japanese banks, which, under the weight of bad loans, can no longer play their key role in Asia. It has been eight years since Japan's fast-growth economy ground to a halt, leaving the country's banks with a heavy burden of bad loans. Now there are new fears Japanese banks will halt lending in Asia just as their money is needed as never before.

Estimates of Japanese banks' bad loans have ballooned from $26 billion in 1992 to $550 billion this year. With these problems, banks are reluctant to lend new money, even to healthy companies. And now there are signs the credit crunch is spreading beyond Japan. According to the Bank for International Settlements, loans by Japanese banks to the rest of Asia fell 7 percent in the second half of 1997.

Japanese banks have been by far the biggest foreign lenders in Asia, accounting for 30 percent of international loans and helping fuel the region's rapid growth in the 1990s. They measure their capital in yen, while as much as one-third of their lending, including much in Asia, is denominated in dollars. That means the falling yen has eroded their capital base, sometimes to such low levels that regulators require them to withdraw from doing business overseas. Japanese banks have become very weak, and they don't have the capacity to take additional risk.

Yen's Continued Decline Sinks Other Asian Currencies

Southeast Asia will not turn the corner until Japan does—it's as simple as that. Not even the tight monetary policy stance and high interest rates being maintained by governments and central banks in the region can save their currencies from further depreciation. Nor do monetary authorities have the scope to pull down interest rates, despite political pressure to ease them.

For all practical purposes monetary policy in Southeast Asia is being dictated by the direction of the yen, and the only thing regional governments can do is try and buy the confidence of the markets by following the right policies and avoiding confusion.

The right policies at this stage, ironically, include maintaining monetary tightness. No matter how strident the domestic calls to lower interest rates and relieve the pressure on the corporate sector, governments have to keep rates high if capital flight and rapid currency depreciation are to be avoided. Even granting stability in the yen, there is little prospect of a recovery in Southeast Asian currencies. Some analysts seems to have targeted year-end rates of around 1.80 Singapore dollars, 4.5 ringgit and 45 baht to the U.S. dollar. Market participants are still trading the Singapore and the Malaysian currencies as proxies for other less liquid regional currencies, including the rupiah.

Even the extra-budgetary economic stimulus measures to be announced by the Singapore government seem unlikely to have a significant impact on the foreign exchange market. Any positive effect on the Singapore dollar will be minor compared with the influence of the market sentiment towards the yen. The one currency in the region that may succeed in delinking from the yen is the rupiah, but that is only because the severity of Indonesia's economic and political problems place its currency in a class all of its own.

Why Japan Should Boost Its Economy

The U.S. Treasury's intervention in currency markets to shore up the ailing yen may have worked in the short term, but it is up to Japan to make those repairs stick over time. The burden is on Japan to deliver in aftermath of the recent currency-support mission. The United States' move to shore up the Japanese currency may have been spurred, at least in part, by Chinese authorities, warning that inaction by the U.S. might make necessary other, more severe measures by their government. Even though the U.S. has continually emphasized that China must keep its currency value, nobody can underestimate China's ability to devalue its currency in response to a waning yen.

Actually, the worst of the Asian financial typhoon has yet to wash over American shores. If the Asian situation gets worse, however, the economic effects on America will be quite pronounced. Consequently, if Japan is not able to pull out of its nosedive, it is hard to know where things will end up.

Now, after the LDP's defeat in the upperhouse election, Japan must show the rest of Asia that Japan's new cabinet will pursue far stronger stimulus measures than ever before. Other Asian countries worry over Japan's political leadership vacuum. The LDP decided to name a successor to Mr. Hashimoto on July 21.

The Hong Kong, Singapore, Bangkok and Jakarta stock markets rapidly shrank due to worry of the Yen's sharp decline against the dollar. That means most market participants doubt if a successor to Mr. Hashimoto can satisfy the market's expectation of strong measures for boosting Japan's economy.

In order to rebuild other Asian countries' trust in Japan's key role in this region, a large-scale permanent tax cut and rapid restructuring of the financial sector are the most important things Japan has to do. As long as Japan's economy remains stagnant and Japan's financial sector continually experiences a severe credit cruch, it will take much more time for the rest of Asia to overcome the current economic and financial crisis. VIP

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