**Intervention aims to avert further crisis in BCM**

Loans to people and businesses in disaster-stricken northeastern Japan are becoming delinquent, creating the potential for a banking crisis as borrowers wrestle with the loss of homes, businesses, jobs, and in some cases family members. Banks likely will support the government’s efforts to provide assistance for rebuilding, but questions linger: What will happen to the loans outstanding prior to the earthquake and tsunami? Will debt relief be offered as it was after the 1995 Kobe earthquake? Will debt forgiveness, which was not available after Kobe, be pushed forward? The answers are still unknown, but the implications may be significant for the banking sector and for taxpayers.

**Government expects banks to forgive loans to Tokyo Electric Power Co.**

As part of the Japanese government’s plan to help Tokyo Electric Power Co. (Tepco) compensate those affected by the Fukushima Daiichi nuclear power plant disaster, banks would be asked to forgive some of the loans the company received before the earthquake.

Given the scale of Tepco’s outstanding debt at the three megabanks, however, massive losses would result. (See chart.) Sumitomo Mitsui Financial Group Inc. announced it does not intend to erase these loans, but the others have not announced their intentions. Since the disaster, the three banks have provided ¥2 trillion in emergency loans to Tepco.

**Central bank eases monetary policy**

Massive loan defaults could stem from the widespread destruction as borrowers who lost businesses, property, or jobs are unable to repay debts. In addition, people left unemployed may be forced to deplete their savings, which would also strain banks’ liquidity. To guard against a banking crisis, the Bank of Japan has eased monetary policy to ensure adequate liquidity in the system.

Within days of the disaster, the central bank had injected ¥38 trillion ($475 billion) into financial markets to ensure adequate liquidity. By lowering interest rates and printing money, the central bank provided lenders access to cheap funds in the short term.

Before the earthquake, Japanese banks had been hopeful interest rate spreads were normalizing after two decades near zero. The prospects for that now — even in the next year — are dim.

**Emergency loan program announced**

The central bank also announced a ¥1 trillion ($12.5 billion) loan program aimed at diverting funds to commercial banks to help rebuilding efforts in devastated areas.

The fund will lend for a period of one year at an interest rate of 0.1%, with a maximum per institution ceiling set at ¥150 billion ($1.9 billion). It is scheduled to end in October.

In addition, the Bank of Japan eased collateral standards for financial institutions in earthquake areas borrowing to fund operations. The central bank will now accept corporate bonds issued in the area, as well as other assets with lower credit ratings, as proper collateral through October 2012.
Regional banks suffer most
Although the three megabanks have substantial exposure to Tepco — each estimating between ¥10 billion and ¥20 billion in earthquake-related credit costs — regional banks in the affected areas bore the brunt of the disaster.
The eight regional banks in the heavily damaged Iwate, Miyagi, and Fukushima prefectures expect combined losses of ¥44.6 billion, reflecting large increases in provisions for disaster-related loan losses. Before the earthquake, the banks had projected combined profits of ¥28.9 billion.
Six of the eight banks expect to report losses for FY12. The two others forecast net profit declines stemming from disaster-related expenses, credit costs, and weaker economic conditions. The government likely will seek public funds to boost capital levels at these banks.
Shinkin Bank is expected to be a key financial institution for helping companies and individuals rebuild and recover. Since the disaster, credit balance in Shinkin Bank in the Tohoku region has been increased by 5% on average and by 10%–20% in Sanriku, the most damaged area.
At the urging of the Financial Services Agency, major banks have allowed borrowers to delay loan payments. Latest figures show payments have been deferred on 12,690 loans — about half of them to individuals and half to businesses.

Rebuilding efforts affect stock market
Equities in Japan are rising more than in any other developed country. After taking the Nikkei 225 down by 18% in three days after the March 11 earthquake, investors are driving it back up on the belief that earnings will improve as Japan recovers. By mid-July, the index was within 4.7% of its pre-disaster level.
The optimism seems warranted. Having largely managed through short-term disruptions in supply chains, most Japanese companies will not be significantly affected going forward — particularly those that derive a significant portion of their revenues from international markets.

On a cautionary note, the global financial crisis prompted a decline in Japan’s historically high household savings rate. For some households, the earthquake and tsunami disaster will leave them with even less savings. As more money is directed toward reconstruction and away from the markets, interest rates, currency movement, and equity markets could be affected.

Government debt vs. household savings rate (2000–2012 est.)

Easing the dual debt problem
At present, many borrowers are required to repay loans on what they lost in addition to securing new loans to rebuild. Measures are necessary to help these companies and individuals rebuild and recover.
The government likely will allow financial institutions to write off debt-forgiveness losses against their taxable income. In addition, a special credit guarantee program will be required to mitigate risks for financial institutions that help companies that lost production capacity, business partners, customers, employees, or other components of their operating bases.

Source: IMF, OECD