# FINANCIAL TIMES

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**The bailout scandal**

Martin Wolf: banks still enjoy state support, Page 7

**How can I appear less arrogant in interviews?**

Dear Lucy, Page 8


World Business Newspaper


● Biggest shake-up for over 20 years ● Bid to end era of taxpayer bailouts

# Four-year reform drive ends as EU adopts key bank rules

By Alex Barker in Brussels and Martin Arnold in London

Europe's biggest financial rule-making spree since the creation of its single market more than 20 years ago reached its finale yesterday with the adoption of a slew of landmark reforms designed to make banks safer and financial markets more transparent.

It marks the climax of a fraught four-year drive to end the era of taxpayer bailouts and fuse together control of eurozone lenders under a banking union. The votes in the European parliament cap the bloc's lawmaking response to a crisis that spread from the financial turmoil of 2008 to leave at one stage the very existence of the euro in doubt.

Michel Barnier, the EU commissioner responsible for the reforms, sounded a note of caution. "We may have managed to avoid the worst – a complete collapse of our financial system, even the eurozone – but Europe continues to pay the economic and social price for this crisis."

The centrepiece of the reforms was an EU-wide rule book to ensure shareholders and bondholders and not taxpayers are first in line to pay for bank rescues. Within the banking union a common resolution system will enforce those rules – forcing eurozone states to release their grip over domestic champions.

It comes alongside a complex overhaul of Europe's capital markets, forcing this bank-dominated terrain to become more transparent and imposing the world's toughest curbs on high-frequency traders.

"This is not the same magnitude as the 1930s – we are mainly changing rules that already exist. They started from scratch. But it is distinguished by the sheer volume and scope of regulation," said André Sapir, a senior fellow at the Bruegel think-tank. "Europe had done a lot to integrate its markets but its rules were poor. They have done a lot on financial stability and laid the foundations to a banking union."

The European parliament passed the welter of legislation in a final rush to clear the decks before the May election. "This is Europe's equivalent of Super Tuesday," said Simon Lewis, chief executive of the Association for Financial Markets in Europe in a reference to what is often the decisive day of voting in the US presidential primary calendar.

Almost 30 legislative files relating to financial services were passed during the parliament's four-year term, driven initially by international G20 commitments and lately by the drive to shore up the eurozone.

> 'We may have managed to avoid the worst but Europe continues to pay the price for this crisis'

Regulators are now faced with the big challenge of putting the complex legal texts into practice. It will take almost 400 separate technical standards, mainly crafted by three EU financial watchdogs created just three years ago.

"An awful lot is resting on the shoulders of the likes of the European Banking Authority and the European Securities and Markets Authority – but do they have the resources necessary?" asked Mr Lewis.

Some unfinished business also remains for the next European Commission and the newly elected parliament, not least reform of financial benchmarks and Mr Barnier's proposal to force big banks to hive off trading arms.

Many political battles also remain unsettled for the UK, which took its complaints over some rules – including a proposed financial transaction tax and banker bonus cap – to court.

Regulation reform Q&A, Page 2
www.ft.com/eu

**Bank to bank: Landmark for safer lenders**

**Single resolution mechanism**
Common system for handling bank failures which completes the eurozone banking union

**Bank resolution and recovery directive**
A single EU rulebook to wind up banks without requiring taxpayer bailouts

**Markets in financial instruments II**
Setting the rules for when, where and how all financial instruments are traded

**Packaged retail investment products**
Basic investment information for retail investors

**Deposit guarantee schemes**
Better financing of the national guarantees given to depositors

**UCITS V**
Tougher standards for Europe's €6.4 trillion retail investment product industry

**Payment accounts**
Giving citizens the right to a basic bank account

## Beijing steps up crackdown on credit

By James Kynge in London

Chinese financial institutions slashed the supply of credit by $90bn in the first quarter, underlining the scale of Beijing's crackdown on its vast shadow finance system and fuelling fears of a "hard landing" for the world's second-largest economy.

The scale of the monetary unwinding could pose a bigger threat to emerging market liquidity than the US Federal Reserve's programme of reducing or "tapering" its asset purchases.

Data released yesterday showed total social financing, the widest official measure, fell by Rmb560bn ($90bn) or 9 per cent year-on-year to Rmb5.6tn in the first quarter. Although not directly comparable, the US Fed has been unwinding its monetary stimulus by $10bn a month since the start of the year.

Economists saw the contraction as another bearish signal for China, which announces first-quarter GDP figures today amid concerns it is on course for its lowest growth reading since 1990, when the economy was hampered by sanctions in response to the Tiananmen Square massacre.

"We maintain our view that GDP slowed to 7.3 per cent year on year in the first quarter and will slow further to 7.1 per cent in the second quarter, partly due to weak momentum in the property sector," said Zhang Zhiwei, an economist at Nomura in Hong Kong.

A "hard landing" is generally regarded as a growth rate below 7 per cent this year.

A particularly weak segment of the economy this year has been property, with sales falling particularly in second and third-tier cities. Yesterday's credit data also revealed a big reduction in a form of shadow finance that borrowers have relied upon. New trust loans in March were down 78 per cent year on year to Rmb95bn.

Henny Sender, Page 20

## News Briefing

**Ukraine oligarchs hit by double-dealing jibe**
Pro-European activists in Kiev have descended on the Systems Capital Management building that is the HQ of the country's richest man, Rinat Akhmetov, and spray-painted slogans across its façade, accusing him of inaction – or even complicity – in the face of the separatist threat. It is feared other oligarchs may be using the threat of separatism as a negotiating chip.
Page 13; Comment, Page 7

**Heat on Swiss bank**
Hard drives and documents are being subpoenaed from Credit Suisse, including employment records of the former New York branch head Roger Schaerer. Page 11

**Factories' last gasp**
Imperial Tobacco, owner of the Gauloises and John Player brands, is to shut the last cigarette factory in mainland Britain and move production out of France, as part of cost cuts to save £300m. Page 11

**Italy's outlook shifts**
Matteo Renzi's clean sweep at large state-controlled companies has reinforced the change of mood in Italian capitalism. From the palaces of Rome to the trading floors of Milan, cash-strapped corporate Italy has had to open up to foreign standards of governance. Page 2;
Editorial Comment, Page 6

**Belgium packs punch**
Belgium has become the third-largest holder of US Treasury debt, largely due to collateral holdings of Brussels-based securities depository Euroclear.
Page 11

**Ex-PM's homework**
Italy's former prime minister, Silvio Berlusconi will serve his one-year sentence for tax fraud by performing community service in a home for the elderly. Page 2

**Jobs cheer in Japan**
Since Shinzo Abe returned to power in December 2012 the country's jobs market has surged and there are more vacancies than people to fill them. Permanency is in retreat as Japanese companies ramp up part-time posts. Page 4

**UK joy on inflation**
UK finance minister George Osborne welcomed news of a fall in consumer price inflation to 1.6 per cent, amid hopes that Treasury data today will show average earnings are rising more quickly than prices.
Editorial Comment, Page 6;
www.ft.com/economy

**Africa faces $2bn toll**
African nations are paying a "remittance supertax" of nearly $2bn a year due to the higher-than-average cost of sending money to the continent, according to a UK think-tank. Page 2

**Focus on Farage**
UK Independence Party leader Nigel Farage faces further questions about use of taxpayers' money, after it was revealed he may be subject to a Brussels inquiry.
www.ft.com/politics and policy

*Global Insight*
Jokowi fever a sign of the lack of leadership in Indonesia. Page 4

**LatAm at risk**


During the past decade 35m Brazilians, and 20m other Latin Americans, have moved up the social ladder, out of poverty and into the ranks of the consuming masses. The problem is that this expansion of the middle class, traditionally a cornerstone of political stability, has in Latin America fomented a rise in social protests, as riots from Brazil to Chile to Colombia show.

**The Fragile Middle, Page 4**

## Brussels bans taxi app Uber and will fine drivers €10,000 per fare

By James Fontanella-Khan in Brussels

Eurocrats hoping to hail a taxi at the touch of a smartphone by using the increasingly popular Uber app might find it harder to catch a ride.

A Brussels court has issued an order banning Uber – which links private taxi drivers with customers via its app – arguing that its fleet does not have the necessary licences to operate in the EU capital.

Uber drivers will be fined €10,000 if they are caught carrying private passengers, the court ruled.

The decision is the latest blow for the San Francisco start-up, backed by Google and Goldman Sachs, as it tries to expand in Europe, where it has faced intense regulatory hurdles and opposition from traditional taxi lobbies.

Neelie Kroes, EU digital commissioner, said the court's decision was "crazy" and "outrageous". She added: "This decision . . . is not about protecting or helping passengers – it's about protecting a taxi cartel."

A spokesperson for Brigitte Grouwels, transport minister for the Brussels region, defended the decision. "They do not comply with existing rules, they are not registered, their drivers don't have a regular licence and do not follow the rules that conventional taxis have to."

The court's move is unlikely to surprise Uber, which has been subject to similar actions in other European countries. "Uber has faced challenges in many places where it launched its services," said a person close to the company.

Licensed-taxi unions in France and Italy have bitterly opposed moves to open their business to more competition, and have launched a series of demonstrations to paralyse local traffic in protests.

François Hollande's administration tried to placate traditional taxi drivers by making their rivals wait for 15 minutes after an order before picking up the customer. The rule was rejected by France's highest administrative court.

Taxi unions in Milan plastered the walls of Italy's financial capital with fliers showing a picture of Uber's Italian general manager, Benedetta Arese Lucini, and a sign saying: "Damned Arese Lucini GO HOME."

Ms Kroes said the court's decision would send "a bad anti-tech message about Brussels, which is already in the 4G dark ages".



## World Markets

STOCK MARKETS

| | Apr 15 | prev | %chg |
|---|---|---|---|
| S&P 500 | 1822.3 | 1830.61 | -0.45 |
| Nasdaq Comp | 3965.93 | 4022.69 | -1.41 |
| Dow Jones Ind | 16106.45 | 16173.24 | -0.41 |
| FTSEurofirst 300 | 1306.85 | 1319.46 | -0.96 |
| Euro Stoxx 50 | 3091.52 | 3131.57 | -1.28 |
| FTSE 100 | 6541.61 | 6583.76 | -0.64 |
| FTSE All-Share UK | 3505.73 | 3528.53 | -0.65 |
| CAC 40 | 4345.35 | 4384.56 | -0.89 |
| Xetra Dax | 9173.71 | 9339.17 | -1.77 |
| Nikkei | 13996.81 | 13910.16 | +0.62 |
| Hang Seng | 22671.26 | 23038.8 | -1.60 |
| FTSE All World $ | (u) | 266.78 | - |

CURRENCIES

| | Apr 15 | prev | | Apr 15 | prev |
|---|---|---|---|---|---|
| $ per € | 1.382 | 1.382 | € per $ | 0.723 | 0.724 |
| $ per £ | 1.673 | 1.673 | £ per $ | 0.598 | 0.598 |
| £ per € | 0.826 | 0.826 | € per £ | 1.210 | 1.211 |
| ¥ per $ | 102 | 102 | ¥ per € | 140.5 | 140.7 |
| ¥ per £ | 170.1 | 170.4 | £ index | 86.1 | 86.1 |
| $ index | 86.4 | 86.4 | € index | 97.03 | 96.98 |
| SFr per € | 1.216 | 1.215 | SFr per £ | 1.471 | 1.471 |

COMMODITIES

| | Apr 15 | prev | chg |
|---|---|---|---|
| Oil WTI $ May4** | 104.05 | 104.05 | - |
| Oil Brent $ May4** | 109.07 | 109.07 | - |
| Gold $ | 1,326.40 | 1,318.47 | 7.93 |

INTEREST RATES

| | price | yield | chg |
|---|---|---|---|
| US Gov 10 yr | 101.05 | 2.63 | -0.01 |
| UK Gov 10 yr | 96.93 | 2.62 | -0.02 |
| Ger Gov 10 yr | 102.41 | 1.48 | -0.04 |
| Jpn Gov 10 yr | 99.96 | 0.60 | 0.00 |
| US Gov 30 yr | 102.88 | 3.47 | -0.01 |
| Ger Gov 2 yr | 100.22 | 0.14 | -0.03 |

| | Apr 15 | prev | chg |
|---|---|---|---|
| Fed Funds Eff | 0.09 | 0.09 | - |
| US 3m Bills | 0.04 | 0.04 | - |
| Euro Libor 3m | 0.29 | 0.29 | - |
| UK 3m | 0.51 | 0.51 | - |

Prices are latest for edition

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# Economic slowdown puts Latin America's aspirations at risk

**THE FRAGILE MIDDLE**

## Brazil reflects how continent's middle class could fall into poverty if growth stalls, writes **John Paul Rathbone**

Shopping Recife, a shopping centre in Brazil's sweltering northeast, is one of the more obvious signs of how much Latin America has changed over the past decade – and how much it has remained the same.

With more than 450 shops, 10 cinema screens and 19 restaurants, its air-conditioned atriums were filled with shoppers on a recent weekday, some maxing out their credit cards, others resisting the multiple card offers being thrust upon them.

"It is so easy to get a credit card nowadays," exclaims Patrícia Ribeiro, a 39-year-old teacher. "But three cards are enough for me. I still need to pay my rent."

Ms Ribeiro is a typical member of Latin America's emerging middle class. Over the past decade more than 35m Brazilians, and about 20m other Latin Americans, have moved up the social ladder, out of poverty and into the ranks of the consuming masses.

The problem for the region is that this expansion of the middle class, traditionally a cornerstone of political stability, has in Latin America fomented a rise in social protests, as street riots from Brazil to Chile to Colombia show.

**55m**

**Number of Latin Americans to rise out of poverty**

"The creation of Latin America's new middle class has generated a revolution of expectations," says Santiago Levy, economist at the Inter-American Development Bank. "But countries' ability to continue delivering on these expectations may not be there. It is a whole new political game."

After two decades of macroeconomic stability, and a decade of rising employment and wage growth driven by the commodity price boom, Brazil, like much of the region, has been on a consumption binge fuelled by easy access to consumer credit.

Today, though, the model has reached a limit. Credit in Brazil has doubled over the past decade to 56 per cent of gross domestic product, an unrepeatable jump.

It is no accident that the economy began to slow in 2011 just as the average Brazilian's debt service payments peaked at 23 per cent of household income, close to where US debt service costs were before the 2008 housing market crash.

The government, for which consumer credit had been a kind of philosopher's stone, is struggling to meet expectations generated during the boom years. That is especially so as appetites for consumer goods are sated, particularly among the demographic bulge of young people who recently entered in the workforce.

"There is a problem of understanding what the young want," says Marcelo Neri, president of IPEA, a think-tank. "The young do not always know themselves well, parents less so, and governments less still."

It is a situation repeated across the continent. In Chile, traditionally Latin America's best run economy, Michelle Bachelet has been re-elected as president on a platform of free university education, paid for with higher corporate taxes, following student protests about the high debts they face on graduation. Although a socially welcome move, the tax rise has depressed investment as Chile's copper-dominated economy is slowing.

Then there were Brazil's riots last year, when 1m took to the streets in protest over corruption and shoddy public services even as the government spent lavishly on football stadiums for the World Cup.

"There is a malaise," says Lena Lavinas, economics professor at Rio de Janeiro's Federal University. "Wages and mass consumption have grown but public services – transport, health, education – remain terrible. People do not have access to what they need to participate in the new economy."

It is not only the new middle class that can feel frustrated. Increasingly, Brazil's "old" middle class, formed in the 1960s and aspiring to US standards of middle class, feels threatened by Brazil's "chav-like" new middle class, which listens to loud *funk ostentação*, or ostentatious funk, instead of the *bossa nova* favoured by their parents.

This anxiety came to a head this year in a phenomenon called *rolezinhos*: flash gatherings in shopping malls organised via social media of sometimes thousands of people, usually from the slums and often black, sporting brash gold chains and sportswear.

"The *rolezinhos* are a kind of public jamming session by the new middle class," says Mr Neri. "They are very different from the old middle class, who fear their traditional space is becoming congested."

The structural changes being wrought by this process has turned Brazil's new middle class into "a strategic political issue for governments", says Antônio Sampaio, research analyst for Latin America at London's International Institute for Strategic Studies.

That is especially so when considering its economic sustainability as the global glut of cheap money recedes and emerging markets growth slows. Financial Times data published this week reveal the extent to which a "fragile middle" class in countries such as Brazil are at risk of slipping back into poverty in an economic slowdown.

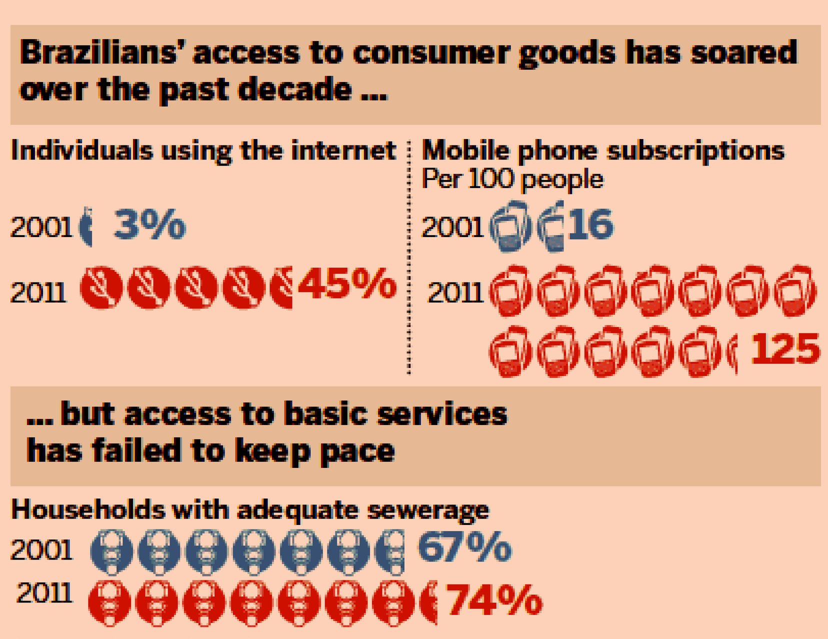
"You cannot have sustained rises in real wages without sustained increases in productivity," says Mr Levy. This is the key challenge for Brazil, where real wages have grown 30 per cent since 2003, while productivity has been stagnant.

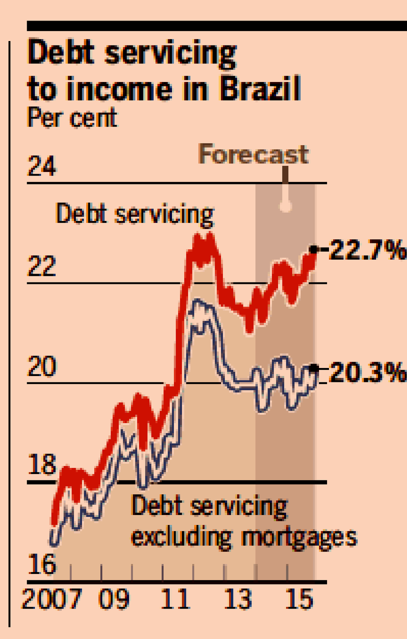
The decline in competitiveness has caused Brazil to fall from investor favour. But many Brazilians feel upbeat. Although the economy is weak, real incomes are rising and unemployment is at record lows. But how much longer can it continue?

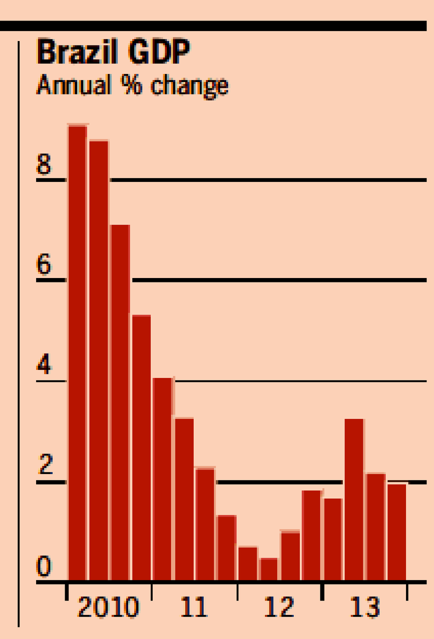
"Latin Americans tend to be optimistic," observes Mr Neri, "... but it also means high expectations, and a tendency to disappointment."

*Additional reporting by Samantha Pearson*


Shopping in São Paulo. Brazil's consumption binge, fuelled by easy consumer credit, has reached its limit Christian Tragni




Sources: IBGE; ITU; Credit Suisse; Thomson Reuters Datastream

### 'Bolsa família' offers path out of poverty but has critics on left and right

Brazil's *bolsa família* scheme aims to help people out of poverty and into the middle class, and most of its 50m Brazilian beneficiaries regard the plan as a good thing, **writes John Paul Rathbone.**

The R$24bn ($10.8bn) *bolsa família* programme, in its 11th year, has been called a "favourite anti-poverty device" and is the world's largest conditional cash transfer scheme. CCTs are used in 30 countries, such as the US, where a scheme to improve opportunities for poor children has been set up in New York.

The reasons for their popularity are simple: CCTs apparently kill several birds with one stone. In Brazil, a mother earning less than R$140 ($63) a month is paid a benefit of R$70, on condition that her children go to school and take part in vaccination programmes.

Unlike subsidies, CCTs target under-investment in health and education and so offer a path out of poverty.

They empower the female head of the household, who is paid the benefit. Because benefits are targeted, CCTs are cheap. Yet many on the political hard left dislike CCTs because its roots lie in neoliberal theories formulated by Gary Becker, the Nobel Prize winning economist at the University of Chicago – associated with the Chilean dictator Augusto Pinochet, whose economic advisers were dubbed "The Chicago Boys".

Meanwhile, albeit with little evidence, the right tends to dislike CCTs, saying that they discourage work.

Although they have a record of reducing poverty, development agencies have also cooled on CCTs. Studies show wage and employment growth play a larger role in poverty reduction. Although CCTs increase school enrolment, there is less evidence they boost educational levels (because of poor quality schooling), so partly defeating their point.

Still, *bolsa família* has become a cornerstone of Brazil's ruling Workers' party. Now received by a quarter of its population, its popularity is such that a rumour last year that it might be suspended almost caused a bank run.

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# Jokowi fever a sign of the lack of leadership in Indonesia

GLOBAL INSIGHT

**Ben Bland**
**in Jakarta**

Indonesian voters and foreign investors alike are abuzz about the potential of presidential frontrunner Joko Widodo, known as Jokowi, to transform southeast Asia's biggest economy.

With growth slowing, inequality widening and the health, education and transport systems in disarray, the country is in dire need of fresh leadership. Yet on closer inspection, the pencil-slim governor of Jakarta's rapid rise from obscurity – and the great hopes invested in him – may say as much about the leadership vacuum in the world's third-biggest democracy as it does about his abilities.

Sixteen years after the fall of the long-ruling dictator Suharto and the start of a breakneck democratic journey, the other leading candidates are tainted by their associations with the old regime. Neither former generals Prabowo Subianto and Wiranto, who have faced allegations of human rights abuses, nor tycoon Aburizal Bakrie, whose family business has clashed bitterly with financier Nat Rothschild, have connected with the young electorate.

"Jokowi is so popular because he is standing next to recycled candidates who have run and lost many times before," says Anies Baswedan, a prominent education campaigner.

With his down-to-earth style and clean reputation Mr Widodo has inspired many. He rose from furniture factory owner to mayor in his home town of Solo, central Java, before winning the Jakarta seat in 2012.

Voters like him because he looks and sounds like an "ordinary Joe", says one rival, who calls him "Indonesia's George W Bush or Ronald Reagan". Polls predict he will win July's presidential vote with room to spare.

But after his party fared worse than expected in last week's legislative elections, the man who has cast himself as Mr Clean faces a new challenge: wading into the world of coalition-building, Indonesian-style.

The Indonesia Democratic Party-Struggle (PDI-P), of which he is the candidate, came first in last week's elections but did not do as well as predicted – thanks to an uninspiring campaign.

With less than three months to go until his own contest, the 52-year-old will have to cut deals with the motley cast of tycoons, ex-generals and would-be Islamists who make up the same elite from which he sets himself apart if he is to fulfil his ambitions. And he will have to do all that without besmirching his popular image.

So far, the going has not been easy. After last week's result he tried to regain the initiative over the weekend, embarking on what media termed a "political safari", visiting the heads of rival parties to seek their support.

He managed to secure the backing of Surya Paloh, a media mogul whose new National Democrat party won 7 per cent last week and whose newspapers and TV station have much influence. But, haltingly and unconvincingly, Mr Widodo said he had no interest in "transactional negotiations" or "dividing up seats" in any cabinet.

Many investors see Mr Widodo in the same light as prime ministerial favourite Narendra Modi in India: a no-nonsense outsider who can shake up a lacklustre centre and kick-start stalled reform of subsidies and red tape.

The presidential frontrunner seems to have frozen in the glare of public expectations

Yet whereas Mr Modi is a bombastic speaker and astute operator who is rising to the challenge of national electioneering, the more reserved Mr Widodo seems to have frozen in the glare of public expectations since he was named as the PDI-P candidate last month.

The reason for his popularity – his distance from the tired, aloof elite – could not be sustained when his nomination was reliant on the whim of a party chief, former president Megawati Sukarnoputri, who is the epitome of that grouping. And it was always going to be that much harder once Mr Widodo was forced to stoop to the pork-barrel politics of Indonesia's legislature.

Even as he gets his hands dirty, many voters still believe Mr Widodo is by far the "best of the worst" options available. "He has gone from god to human," says one friend of the Jakarta governor. "But that may not be a bad thing if he can better learn how to negotiate Indonesia's elite politics."

### China growth expected to slow

China will today reveal how quickly its economy expanded in the first quarter, **writes Jamil Anderlini in Wenxi County.**

The figures are almost certain to show the world's second-largest economy slowed sharply from 7.7 per cent growth in the fourth quarter of last year.

Analyst estimates for the first quarter range from a 7.2 per cent to 7.5 per cent gross domestic product expansion compared with the same period a year earlier. Here are four factors to watch:

**Fixed asset investment**
China's economy is extraordinarily reliant on investment, particularly investment in real estate and infrastructure such as roads, railways and airports.

In the wake of the global financial crisis the government launched a massive credit-fuelled stimulus programme that effectively replaced China's over-reliance on collapsing trade with an over-reliance on investment.

**Real estate**
Official figures showing monthly price changes and sales volume for Chinese real estate in March will be published on Friday and are expected to add to growing evidence of a slowdown in the sector. While prices are still rising in some top-tier cities, many smaller cities are suffering falls.

**Consumption**
China's monthly retail sales for March will also be released today in Beijing and will be watched closely for signs the Chinese economy is becoming less reliant on credit-fuelled infrastructure investment.

**Government response**
Recently the government unveiled some limited measures to stimulate growth and reassure investors it will not let the economy tip into freefall.

Premier Li Keqiang has accelerated existing plans to build more roads, railways, government-subsidised housing and airports, but has also pledged not to respond to "short-term fluctuations in growth".

**Full story at www.ft.com/china**

# Companies ramp up part-timers as Abenomics stirs recovery

**Japan employment**

## Job vacancies now outnumber seekers, but permanency is in retreat, say **Ben McLannahan** and **Jonathan Soble**

All Koichi Kobari wanted was a pair of hands to wash dishes in his buckwheat-noodle restaurant, a short walk from the busiest crossroads in Roppongi.

Yet after taking out a newspaper advertisement offering an hourly rate of Y1,150 ($11.31) – above the minimum wage of Y869 – the 54-year-old manager received no replies.

"I was paying Y45,000 a week for the ad, and I didn't get a single call. I was shocked," he says.

Abenomics has been good for Japan's job market. Since Shinzo Abe returned to power in December 2012, vowing to overturn deflation through all manner of stimulus, unemployment has dropped from 4.3 per cent to 3.6 per cent, matching the lowest rate in 17 years. Across the country, the job vacancy-to-applicants ratio has been above one for the past three months, meaning that there are more jobs than people looking to fill them.

But companies have mostly responded to the upturn not by increasing permanent staff, but by ramping up part-timers.

In the fourth quarter of last year, Japanese companies cut 470,000 "regular" roles while adding more than 1.2m "non-regular" positions, according to government data. In February, non-regular workers – part-time, temporary and contract workers – were a record 37 per cent share of non-executive employees.

The country is in the grip of a "permanent jobless recovery", says Takeshi Yamaguchi, senior economist at Morgan Stanley MUFG Securities.

The shift away from regular workers began during Japan's economic downturn in the 1990s. Companies hung on to existing employees but stopped recruiting, creating a generation with little opportunity to enter full-time employment.

The trend has accelerated since Mr Abe took the helm. That is partly demographics, as baby-boomers retire.

It also reflects a return to the labour force for women, whose participation rate last year saw its sharpest increase since the early 1990s. But a more important factor, say economists, is Japan's rigid labour laws, which make it difficult for companies to cut more expensive full-timers.

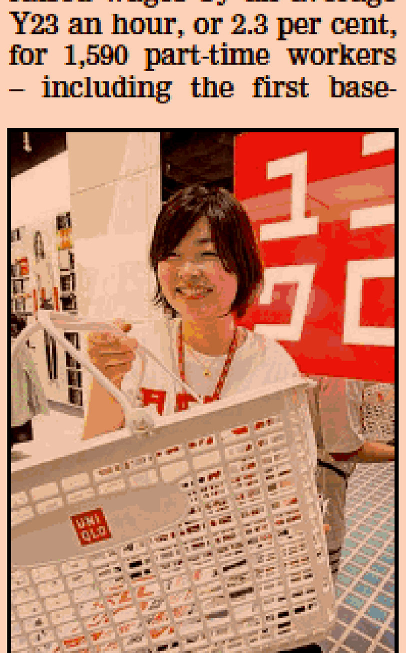
Most companies are still "cautious about the sustainability of growth" and thus reluctant to increase permanent payrolls, says Harumi Taguchi, principal economist at IHS Global Insight.

Last year companies paid Y166tn in labour costs, according to the finance ministry. That was 3 per cent less than the year before, and 7 per cent less than the peak in 2000.

That is hardly an ideal backdrop for this month's increase in consumption tax, the first in 17 years.

"Everything seems so much more expensive than before," says Fumiko Okabe, 67, a part-time worker at a housing reform organisation in Tokyo. "I'm sure higher taxes will affect my life in future."

Plenty of companies are improving terms for part-timers. K's Denki, an electronics retailer, says it has raised wages by an average Y23 an hour, or 2.3 per cent, for 1,590 part-time workers – including the first base-wage increase since 2000. Nitori, a furniture retailer where 80 per cent of staff are part-timers, says it is upgrading more of its best performers to full-timers, echoing moves at Uniqlo, Diesel and Starbucks Japan.



Retailer Uniqlo has upgraded some of its part-time staff

At BTMU, the largest unit of Japan's biggest financial group by assets, contract employees are now eligible to join the staff union, for monthly dues of Y500 – a big discount to the Y900 paid by full-timers.

But for now, the divide in the labour market looks wide. When Mr Abe announced plans last October to set up a special zone to test looser labour laws, it did not take long for some weeklies to denounce the new area as a "beheading zone", using the characters for "cut" and "neck".

If the zone succeeds in removing protections for regular workers while improving protections for the rest, it could help to correct Japan's "unbalanced" labour market, says Jun Saito, a former cabinet office economist now working at a think-tank.

Fukuoka, the largest city in the southern island of Kyushu, was a good choice for a test bed, he adds, given its fast-growing population – 1.2m to 1.5m in the past 25 years – and a culture of nurturing start-ups.

The "experiment" is "certainly worth doing," he says. "The dual labour market exists and is a structural problem."

● Japan's central bank governor sought to reassure Shinzo Abe yesterday that he would not allow the country to fall back into deflation, promising further monetary easing should year-long inflation stall.

"If there is a diversion from the path toward our 2 per cent price-stability target, I will not hesitate to adjust policy," Haruhiko Kuroda told reporters after a meeting with Mr Abe.

"I explained that we are firmly on the path, although we are still only partway there," Mr Kuroda said. "I think the prime minister understood."

*Additional reporting by Mitsuko Matsutani and Nobuko Juji*