Lessons from the banking crisis in Japan

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Views are the speaker’s and do not necessarily reflect those of the JFSA.
5 phases in Japan’s last 25 years

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Underlying graph taken from Tang and Upper, "Debt reduction after crises" (2010)
Challenges in Phase 3 (crisis management phase)

Risk of overshooting the bottom due to negative feedback loops between:

• Banks and other banks,
• banks and market,
• financial system and real economy,
• banking system and public finance, and
• economy and politics

through:

• interbank exposures,
• fire sales and declines in asset prices and market liquidity,
• panic and runs on deposits and other claims,
• credit crunch, recession and increased credit costs, and
• economic performance, confidence in political leadership and feasibility of taking effective measures.
Lessons from Japan’s phase 3 (crisis management phase)

A non-systemic case can have a systemic signaling effect.
  Sifi-ness is state-contingent.

Sequencing is the key.
  Before holding a surgical knife, set up the operation room (for example, a safety net).

Publish bad news and remedial measures at the same time.
  Timely disclosure should be matched by timely actions.

Practical detail matters.
  How to avoid queue on the street, how to deal with the press, how to secure mental health of bank management, etc.

Be strict on management and shareholders, careful on creditors.
  We should avoid moral hazard, but we should also extinguish the fire.

Get public support for using taxpayer money.
  Some institutions may not be resolvable yet in a stressed, contagious environment, particularly in a cross-border context.
Lessons from Japan’s Phase 4

**Borrower and bank restructuring should go hand in hand.**
Bank balance sheet uncertainties will stay until borrower balance sheet repair is over.

**Valuation/provisioning comes before capital.**
Borrower restructuring will not proceed until banks make proper provisioning and valuation.

- **Borrower B/S**
  - Asset
  - Debt
  - Capital

- **Bank B/S**
  - Asset
  - Deposit
  - Capital
A lesson from Japan’s phase 5

Fundamental causes may stay even after the completion of borrower balance-sheet repair.

**Ageing Population and Property Prices: Japan**

- Relative abundance of young coincided with higher property prices
- Declining property prices aggravated B/S adjustment
- Relative abundance of old leads to lower property price

Ageing Population and Property Prices: US

In US also, increasing IDR coincided with the property bubble
Declining IDR may also coincide with decline in property prices

Ageing Population and Property Prices: Spain

Price decline has not halted yet, suggesting prolonged B/S adjustment for households and SMEs?

Inverse Dependency Ratio: Ratio of Working-Age Population to the Rest
= How many people of working age have to provide for one dependent person?

Core Europe (Germany, France, Italy) compared with Spain
Core Europe already passed the peak 10+ years ago

Inverse Dependency Ratio: Ratio of Working-Age Population to the Rest
= How many people of working age have to provide for one dependent person?

2010-2015: Sharp turning point

Japanese banking crisis in 1990s

Causes and symptoms

**Symptoms:**
- Bank B/S
- Lost confidence in the system

**Immediate causes:**
- Bank governance and risk management
- Supervisory intensity and effectiveness
- Regulatory and accounting framework

**Intermediate causes:**
- Non-financial corporate sector B/S
- Asset price

**Fundamental causes:**
- Demographic change
- Lost competitiveness vis-à-vis Asian neighbors

Remedial measures

- Emergency Support
- Capital adequacy
- Valuation Provisioning
- Borrower restructuring
Lessons from Japan’s crisis?

Many have concluded that the key lessons from the Japanese banking crisis is the importance of speed.

We need to go through the borrower balance-sheet repair phase (phase 4) at some stage. During the phase, we need to find a narrow path to attain both

a) borrower balance-sheet repair, and
b) economic growth

and to avoid

c) recurrence of banking crisis

d) rooms for further fiscal or monetary policy measures are limited,
e) use of public fund is not favored among taxpayers, and
f) public confidence in regulatory authorities and political leadership is depleted.

Is rapid adjustment always better than slow one, regardless of the aggregate size of the systemic adjustment needed?

The size of aggregate available tax revenue, bank and corporate profit, and household income to fund the adjustment is a function of time.
Lessons from Japan’s crisis

Show a short-, medium- and long-term roadmap to deal with symptoms, diseases and root causes.

- A systemic crisis does not occur with a single cause.
- Immediate remedial measures can stay credible only when accompanied by longer-term policies to address deeper causes.
- A crisis can provide a rare opportunity for painful but needed reform, and a road map allows us to make best use of it.

For further reading:
- International Monetary Fund, *Crisis management and resolution: early lessons from the financial crisis*, IMF staff discussion note, March 2011
- Ryozo Himino, “Rethinking banking Supervision”, *Risk*, March 2012