JAPAN’s CURRENT FINANCIAL & ECONOMIC CRISIS

A Contrarian View?
ORIGINS Current Crisis

- Successful export-led growth
- Emergence Bubble Economy
- Collapse of Bubble and extension via FDI of export-led growth to Asia
EXPORT-LED Growth Model

- Import substitution captures growth domestically and abroad

- Technology Sequencing

- Extension via FDI Using Asia as export platform & local market development
Key Characteristics Bubble

- Excess liquidity from export success

- Limited assets with restricted supply (bonds, stocks, and real estate)

- Asset inflation coupled asset based lending
Other Features Bubble

Slow domestic growth and large firms’ access global markets push lenders into middle market and real estate

Interactive compounding of lending capacity and asset inflation

Collapse of Bubble, decreased liquidity, reduced lending capacity
Recovery Strategy

Policy view was cyclical not systemic

Use fiscal and monetary stimulus

Fail appreciate mature stage economy and reduced liquidity financial sector, especially real estate market
Recovery Impacts

Blessing: source growth firms and capital exports versus hollowing out Japan

Lenders focus growing out of problem until recovery raise value stocks and real estate, so shifted to support Asian FDI
Systemic Effects Bubble Collapse

Agglomeration effects in steel, autos, electronics led exports, FDI and MNC globalization

Financial independence MNCs; Weaker financial institutions, especially banks

Illiquid real estate, growth Asian markets and FDI shift seen as mixed effects
Failed 1996-97 Recovery

Between ‘96 and ‘97 GNP grew 3.9 % compared to average 0.8% ‘93 to ‘96.

Manufacturing index (‘90 = 100) rose to 101.8 from 95.1 (‘95) and 97.7 (‘96)

Employment grew by 1 million and Nikkei rose above 20,000
Bad Timing?

Imports & exports grew, though imports faster. If ‘90= 100, then exports in ‘96 were 107 and in ‘97 were 117 but imports were 141 & 145. Export growth was mostly machinery to Asia

But ‘97, GOJ took ¥9 trillion from economy

This coincided Asian meltdown related to decline in Japan’s FDI due systemic and portfolio effects ELG policies
Policies in Disarray

Expected Recovery did not materialize despite loose monetary policy due badly applied fiscal brakes.

Economy too fragile due illiquid banking sector and huge hidden loan losses.

Interestingly corporate investment was not a contributor, rising by ¥4.3 trillion.
Result Bad Policies

‘97 GNP growth shrank 0.9 % compared 3.9% rise ‘96 due increase consumption taxes ¥3 trillion combined decrease public investment ¥5 trillion and fall housing ¥4 trillion. ‘98 expected to decline more. But, ‘96 growth rose sharply from ‘93 (0.3%), ‘94 (0.6%), and ‘95 (1.5%) despite fall net exports. Also employment rose 710,000 in ‘97 compared to 290,000 ‘96.
Fixing Short-term Financial Problem

Coupled with reversal fiscal brakes, key is to increase liquidity real estate

Currently banks cannot realize on collateral to value loans or expected losses

If they hold collateral, it is illiquid using capital and borrowing capacity
Real Estate Liquidity

Real estate supply over-hang means few buyers as prices expected to fall more.

Also, high taxes seriously dilute benefits of being right!

Government must let buyers get rich like RTC. Need tax reduction to 15 or 20% on gains.
Underwriting RE Values

But lowering taxes will increase supply. To stabilize market and encourage buyers expecting even lower prices

Tax decrease should be coupled GOJ supported land purchase company, underwriting land values at NTA prices

Funding from loans by Postal Savings
Fixing Systemic Problem

Increasing liquidity banks and real estate holders will increase demand for housing and related consumption

It will allow banks to write-off loans and resume lending by reliquifying their own and borrowers’ balance sheets

It will not solve systemic problem mature Japanese economy with most efficient sectors seeking growth abroad.
Other Systemic Issues

Under this scenario Japan is over-banked; consolidation is inevitable, though liquid real estate will help process

Further, slow growth and excess savings may continue export surplus

Japan may need Asian growth & recovery more than it will be Asian growth engine.
Limits Asian ELG

But there may be limits to Asia’s export based growth strategies due slow growth import markets and productivity

U.S. and Japan are growing slower than Asian growth targets

Asian economies may be reaching limits better resource allocation and entry to higher value added industries.
Environment Radical Reform?

To improve its and Asia’s productivity and growth, Japan should liberalize protected industries, e.g. agriculture & forestry.

But while the economy is stagnant, people are feeling limited pain. Want change but not radical reform. In ‘97, average household income was ¥7.8 MM and average cash savings ¥12.5 MM; %15-65 employed was 69% and unemployment 3.4%
Related Systemic Issues

Population aging, % over-65 rising to 27% by 2010 from 15.7% in 1997

Yet pension, social safety net under-funded with rates return to investment low, perhaps 2-3%;

Productivity growth also low with capital output ratio rising, perhaps exacerbated by FDI and shift in firm growth overseas.
Non-Beneficial Cycle

This situation may encourage excess savings leading to both export surpluses and rising government deficits.

Further promoting MNC shift overseas and lower domestic returns on investment. A non-beneficial cycle?

This directly relates to and interacts with BOJ low interest policy and failure deal effects collapse classic real estate “Bubble”