Lessons from Japan's Banking Crisis

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Overall Comments

- Japanese experience demonstrates crisis responses are inevitably messy
- Ad hoc responses – fits and starts

Parallels between Japanese and current US approach

- Japan started with AMCs:
  - Private AMCs (1992)
  - Public/private partnerships (1995, 1996)
  - Government-owned AMC (2003)
- In 1998, Government began putting capital in banks – preferred, sub-debt and then common shares
  - Banks were "cajoled" into accepting government capital.
- Depositors and interbank loans effectively guaranteed by government
- Rigorous supervisory assessment of banks initiated in 2003, several years after start of capital support program

Lessons from Japan: Bank recapitalization

- Japan struggled to gain public support for "bailing out banks"
  - Did government ultimately gain public support?
- At the outset, Japanese banks asked to absorb part of the cost of failing banks (hogacho).
  - How well did this system work? Are there any implications for BofA/Merrill/Countrywide; Wells Fargo/Wachovia; JP Morgan/WAMU/Bear Stearns; Lloyds/HBOS
- How well did government explain its capital "support" for healthy as well as weak banks?
- Was Japanese approach ultimately successful in attracting private capital into banking system?

Lessons from Japan: Cleansing banks' balance sheets

- Japan encouraged banks to continue lending – and required semi-annual lending reports to document lending
  - Did the banks comply? Given the risk associated with such a practice, would the Japanese adopt this policy again?
- AMCs and banks were slow to address problem borrowers -- weak corporations (zombies) were kept afloat
  - Are there any lessons for how to resolve nonperforming loan problem in US?
- Did the Japanese approach, in the end, result in a stronger and more resilient banking system?