

# **EABER WORKING PAPER SERIES**

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## **THE GLOBAL FINANCIAL CRISIS: LESSONS FROM JAPAN**

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EABER SECRETARIAT  
CRAWFORD SCHOOL OF ECONOMICS AND GOVERNMENT  
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# The Global Financial Crisis: Lessons from Japan

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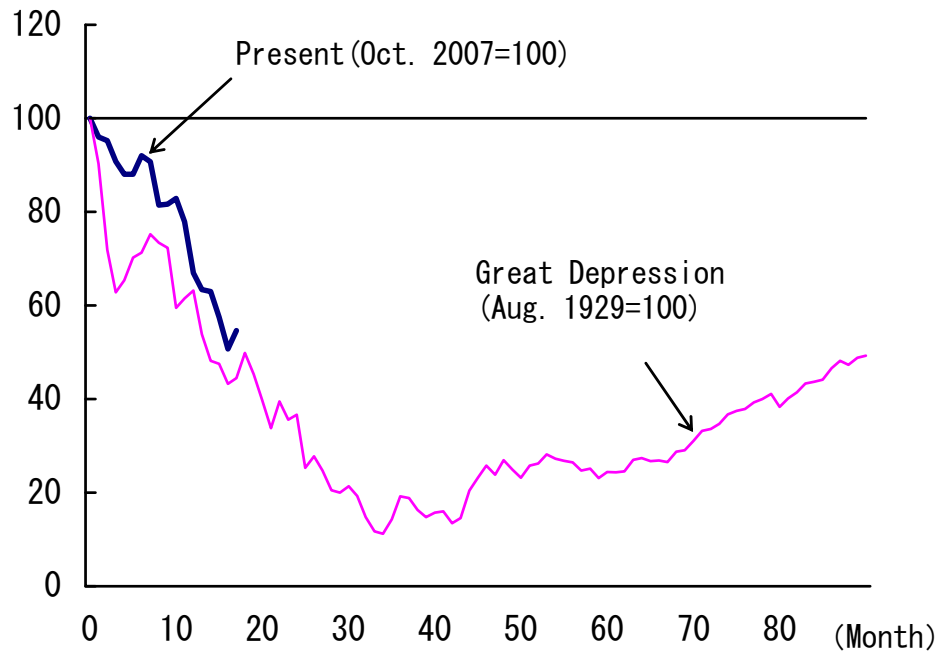
**May, 2009**

## Part I Japan's Lessons in 1990s

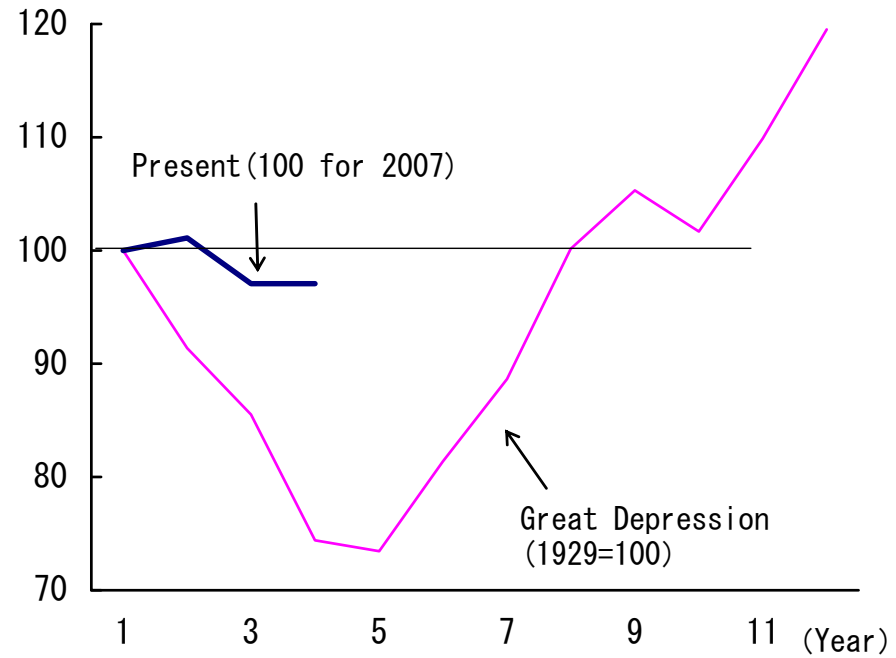
1. The Current Global Crisis
2. Origin of the Crisis: Decade of “Sequential Bubbles”
3. Causes of Sequential Bubbles
4. Measures Taken So Far
5. What Japan Did?
  - Financial Stabilization
  - Monetary Policy
  - Fiscal Policy
6. What is Needed Further?
7. How to Prevent the Emergence of Bubbles
8. Summary: Lessons from Japan

# Comparison of Financial Crisis Scales

(1) Dow Jones Industrial Average

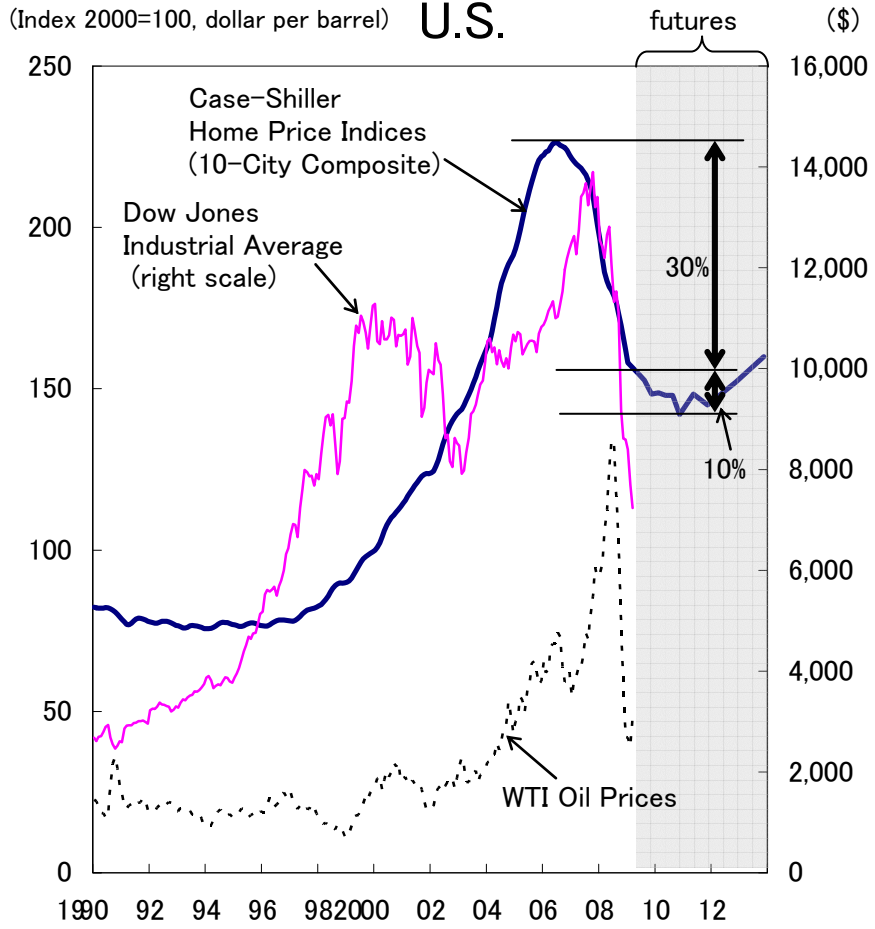
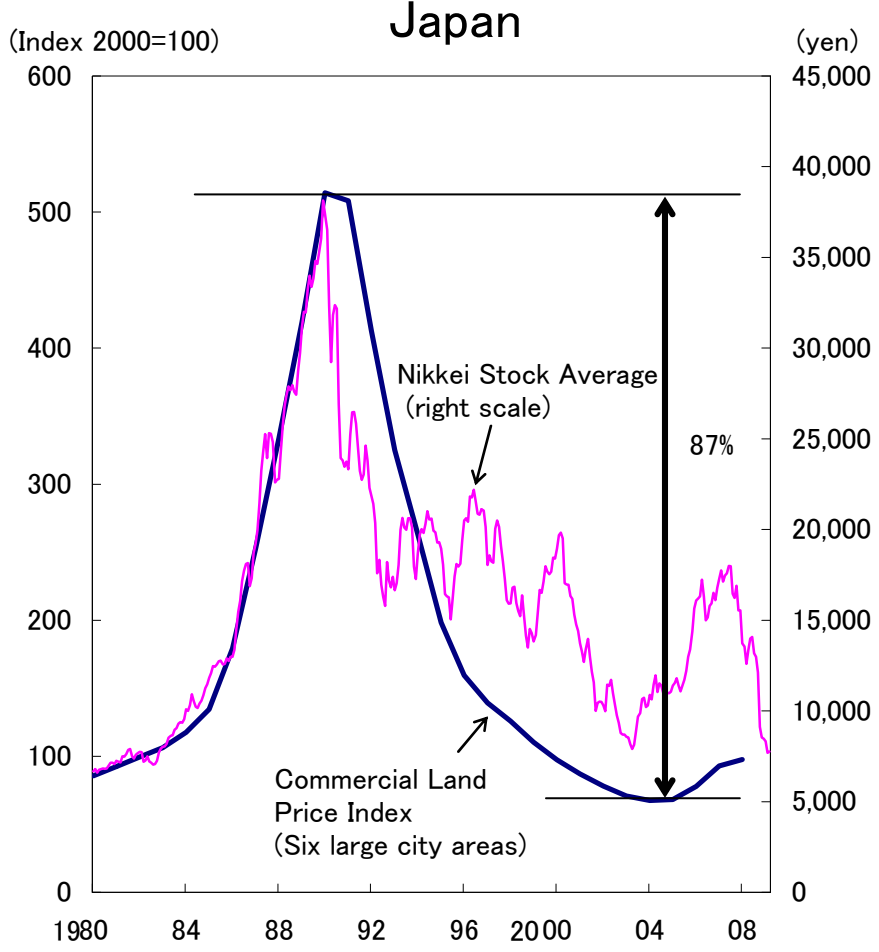


(2) Real GDP in the U.S.



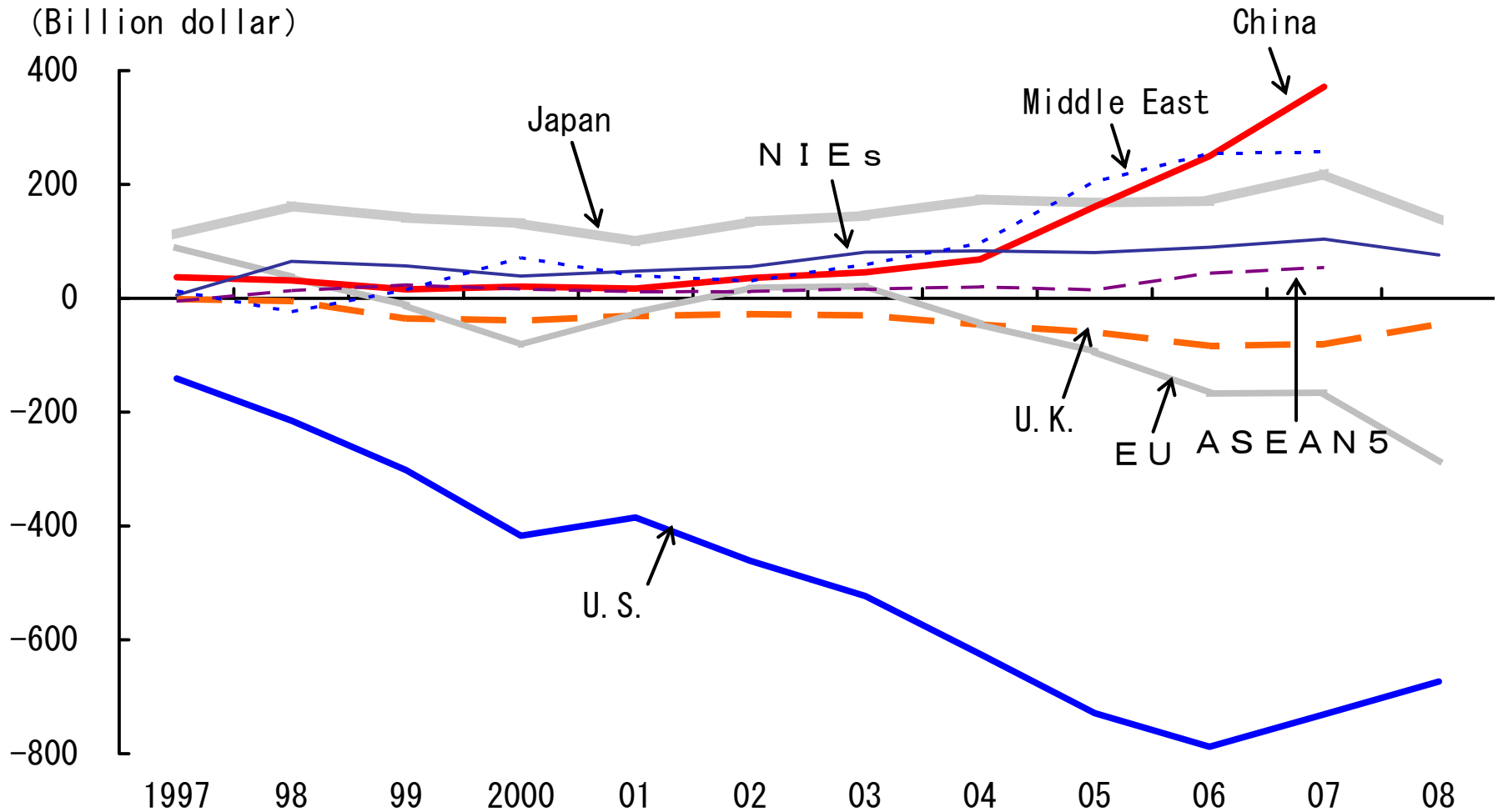
(Notes) Sources: Bloomberg, Bureau of Economic Analysis, OECD "Economic Outlook"

# Asset Price Bubbles in Japan and U.S.



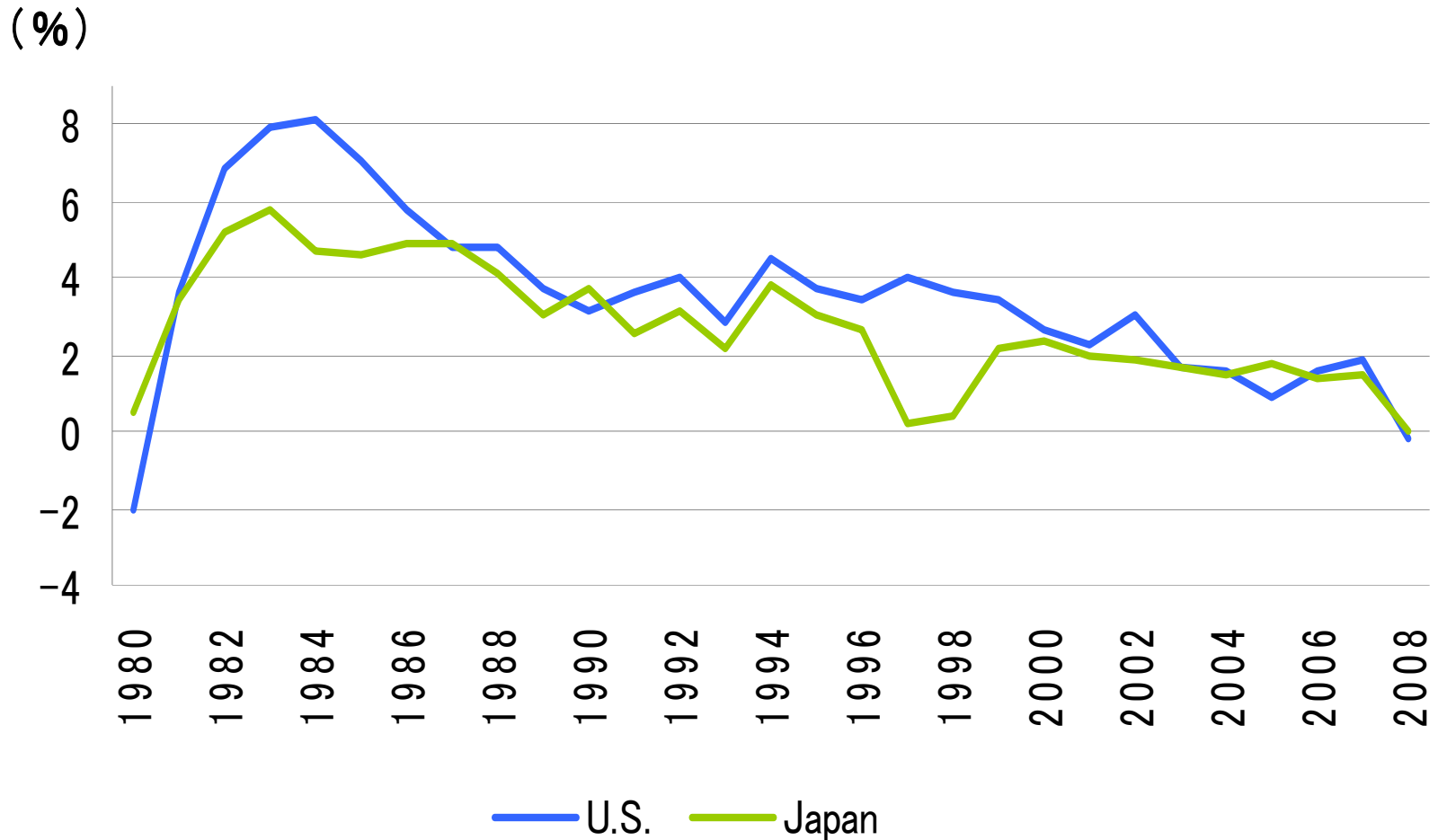
(Notes) Source: Japan Real Estate Institute, Bloomberg, S&P

# Global Imbalance of Current Account

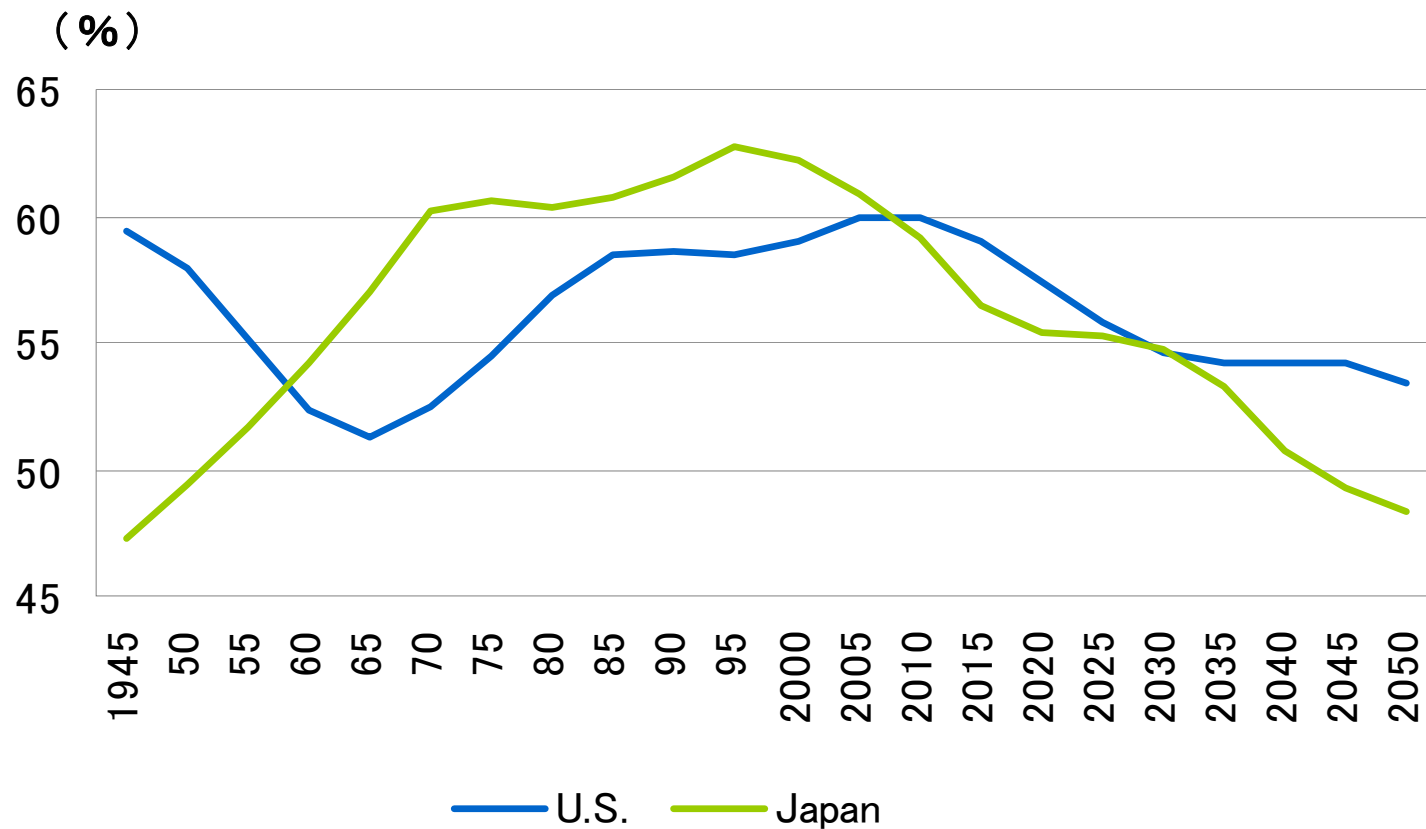


Source: National statistics and IMF, World Economic Outlook Database, October 2008.

# Long-term Real Interest Rates in U.S. and Japan

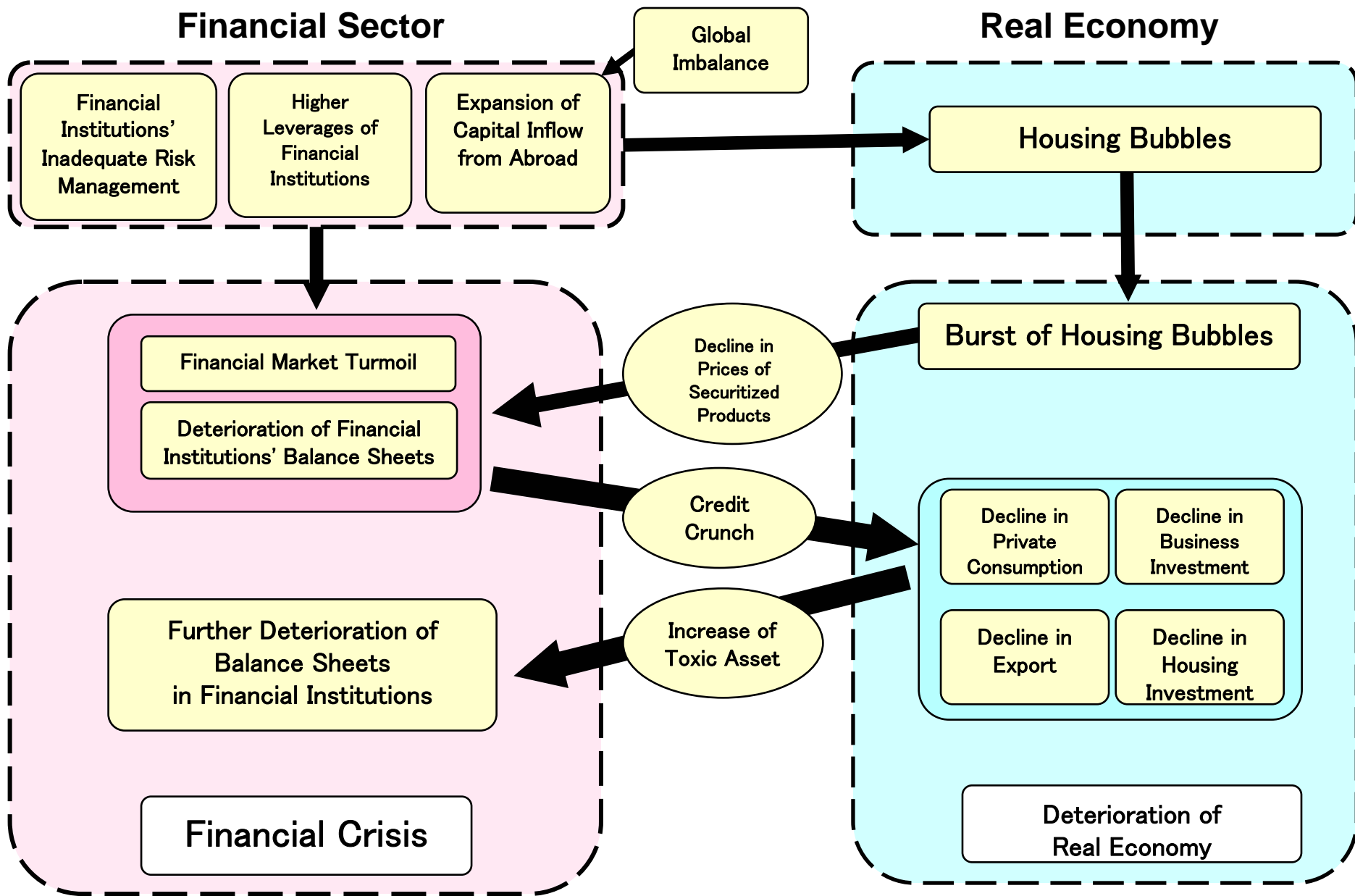


# Proportion of Working Age Population in U.S. and Japan





# “Vicious Circle” of the Financial Sector and the Real Economy in U.S. and Europe



# Size of Toxic Asset Losses in Japan and U.S.

<p><b>Japan in 1990s</b></p> <p>Non-Performing Loans(NPLs)</p>	<p><b>U.S.</b></p> <p>Toxic Asset Losses(estimates)</p>
<p><u>Total Ammount of NPLs at its peak</u> <u>(March, 2002)</u></p> <p>43.2 trillion yen(8.5% to GDP) (0.44 trillion \$)</p>	<p><u>IMF estimates(U.S.-originated)</u></p> <p>2.2 trillion \$ (IMF, January 2009)</p>
<p><u>Total Disposal of NPLs</u></p> <p>99 trillion yen (1.0 trillion \$)</p>	<p><u>BOE estimates</u></p> <p>1.6 trillion \$ (Bank of England, Financial Stability Report, October 2008)</p>



# Japan's Response to Financial Crisis in 1990s

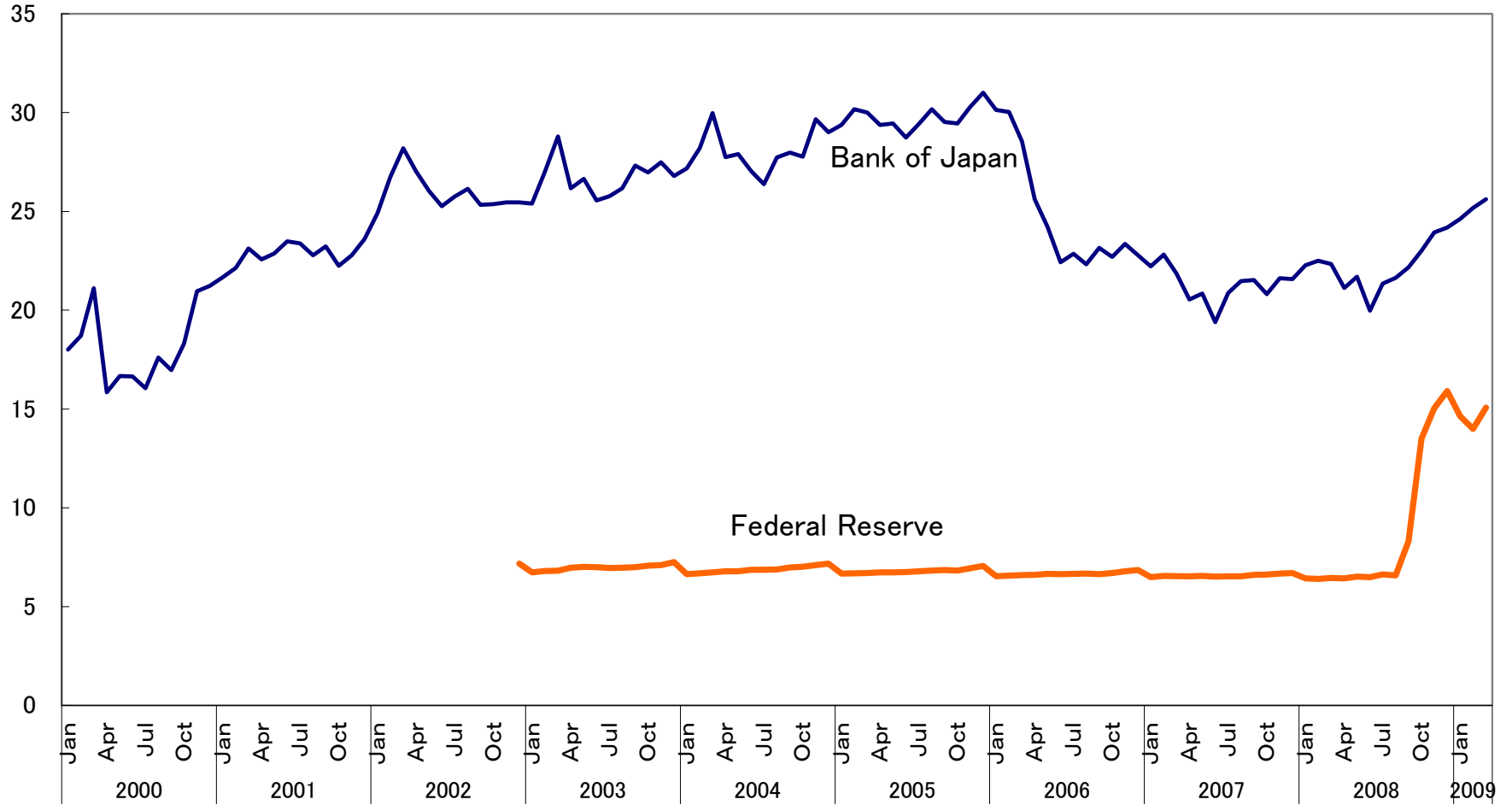
(as of Sept. 2008; Billion yen)

	Total Amount	Of which: Recovered Amount
<b>Deposit Insurance Corporation</b>	<b>47,060</b>	<b>31,818</b>
Purchase of Troubled Assets	9,776	9,596
Capital Injection	12,427	10,539
Cost related to Bank Failures (Deposit Insurance Payout etc.)	18,868	6,824
Others (Cost related to Bank Nationalization)	5,989	4,859
<b>BOJ's Purchase of Shares held by Banks</b>	<b>2,018</b>	
<b>Sub-Total</b>	<b>49,078</b>	<b>31,818</b>
<b>Government Guarantee for Credit to SMEs</b>	<b>28,944</b>	
<b>Government Guarantee for IRCJ(Industrial Revitalization Corporation of Japan)</b>	<b>10,000</b>	
<b>Total</b>	<b>88,022</b>	

Source: Council on Economic and Fiscal Policy

# BOJ and Fed: Expansion of Balance Sheets

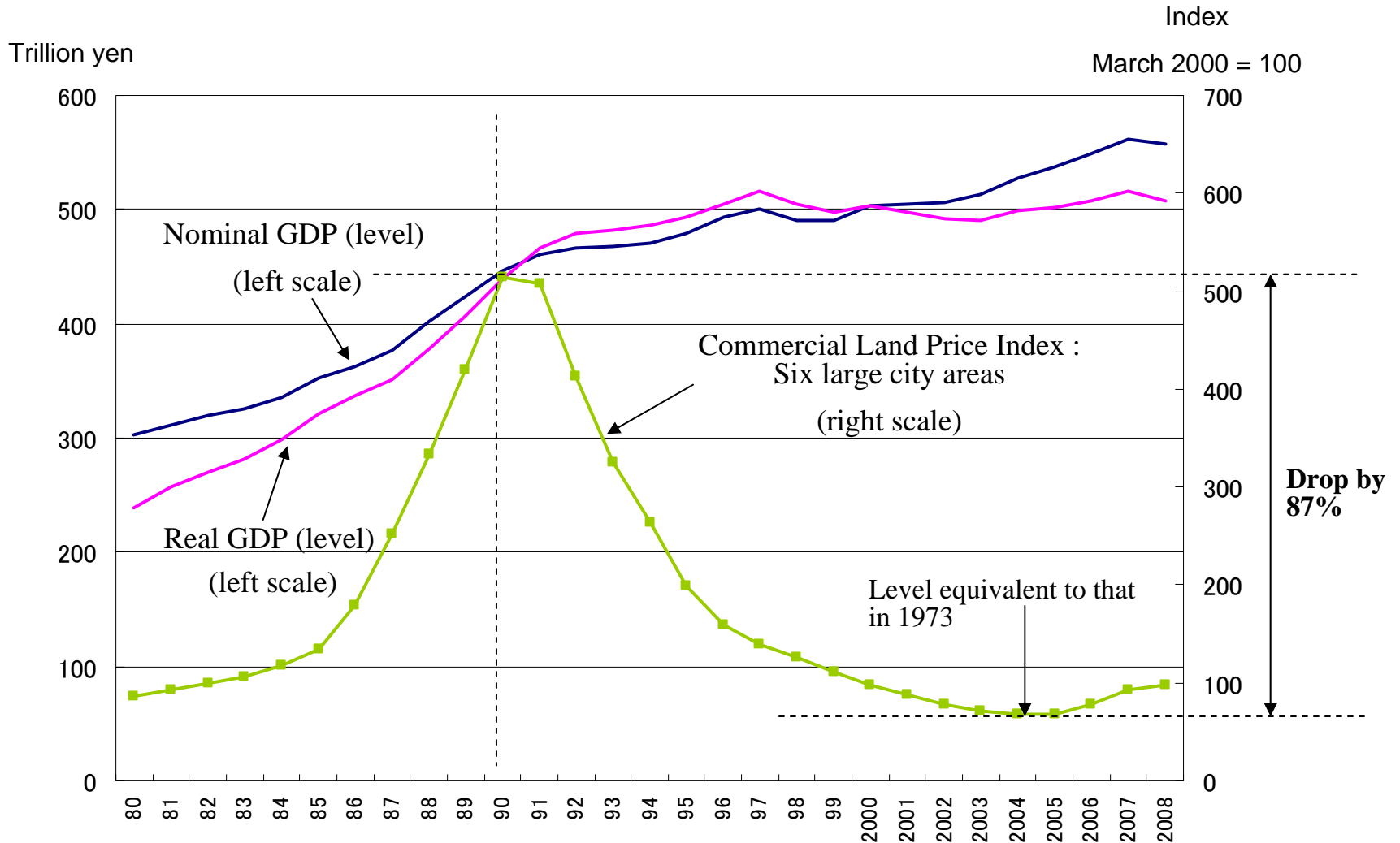
(% to nominal GDP)



Source: BOJ, Cabinet Office, FRB and Ministry of Commerce

# Japan's Growth After Bubble Burst

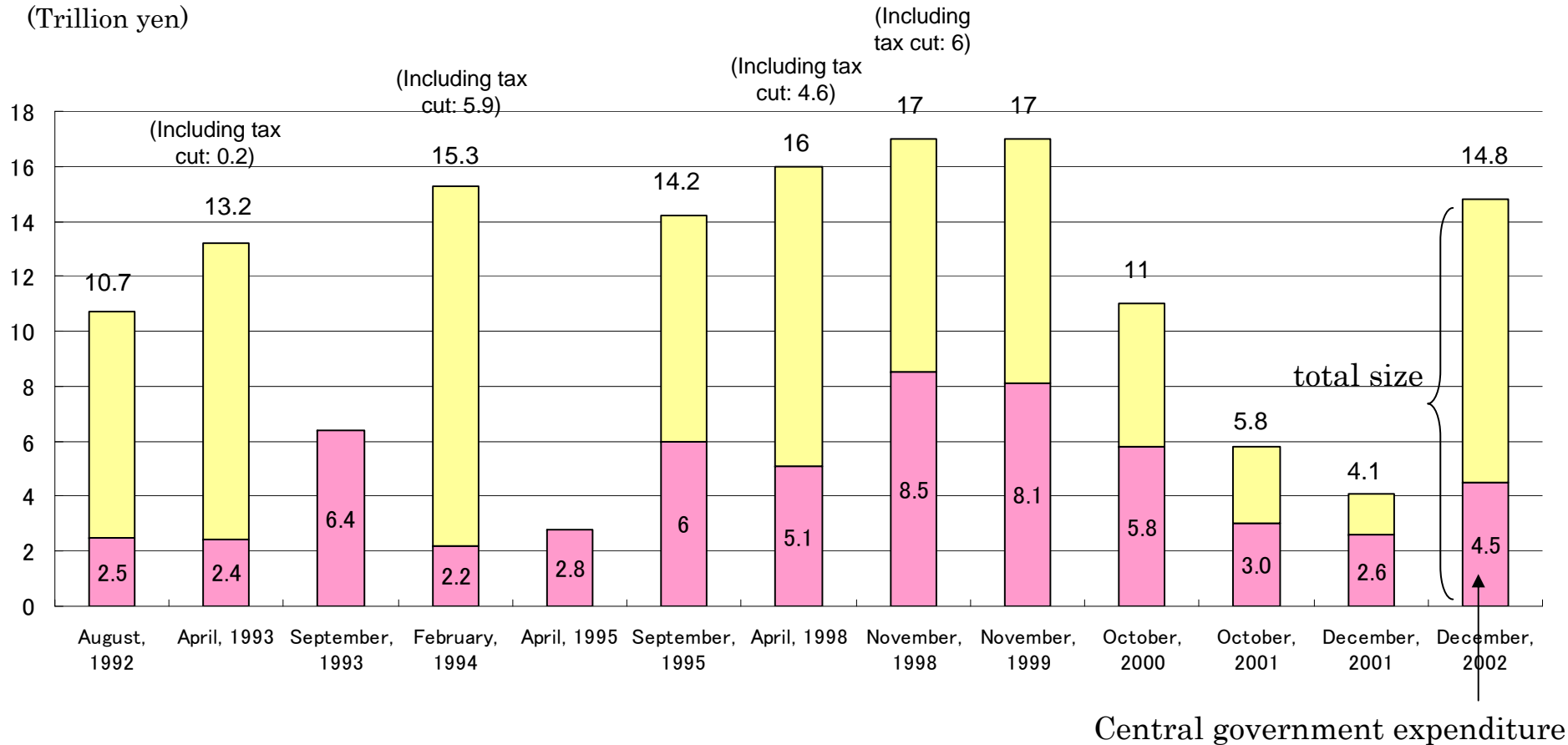
Japan's GDP continued to grow after bubble burst



Source: Cabinet Office, Japan Real Estate Institute

# Fiscal Stimulus Packages from 1990s to 2002

(Trillion yen)

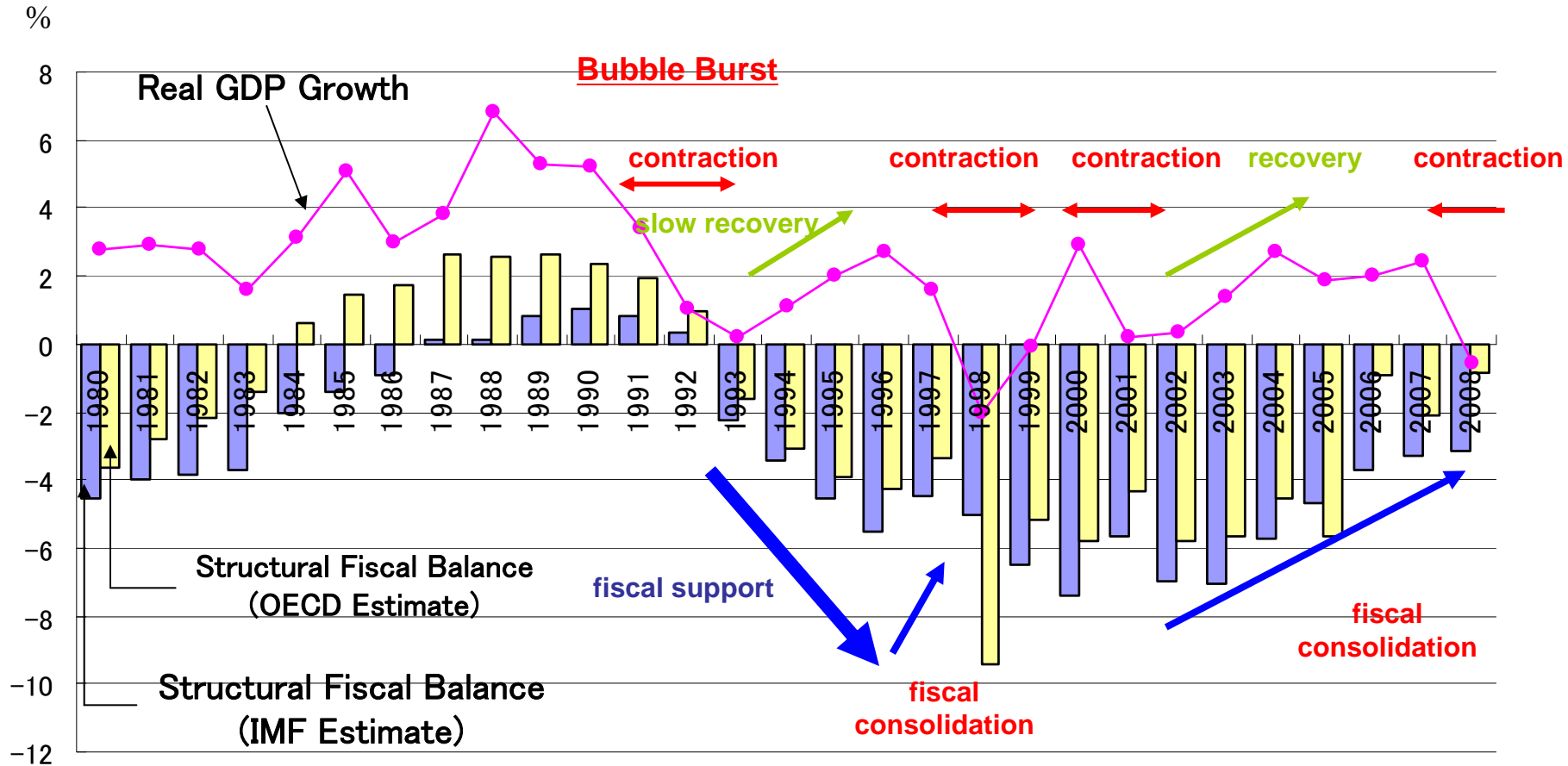


Accumulated total size of fiscal stimulus packages including public works by local governments and loans to SMEs (1992–2002) : 145.1 trillion yen

Accumulated central government expenditure (1992–2002) : 59.9 trillion yen

# What Japan Did on Fiscal Front

Fiscal measures played a role in supporting the economy



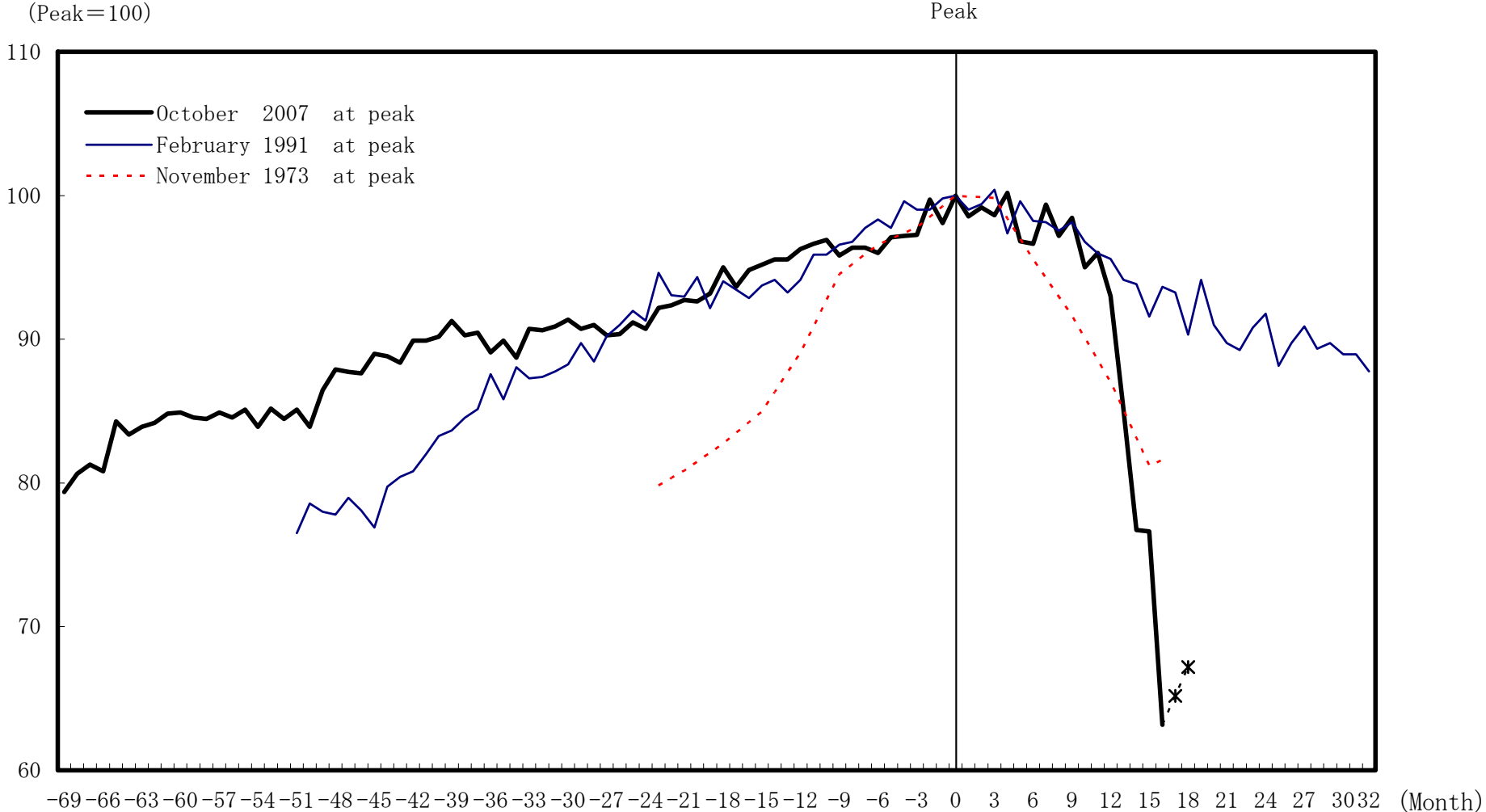
Source: Cabinet Office, OECD, IMF



## Part II Avoiding Another “Lost Decade”

1. Recession in Japan
2. Silver Lining
3. New Policy Strategy
4. Policy Package Measures
5. Fiscal Sustainability

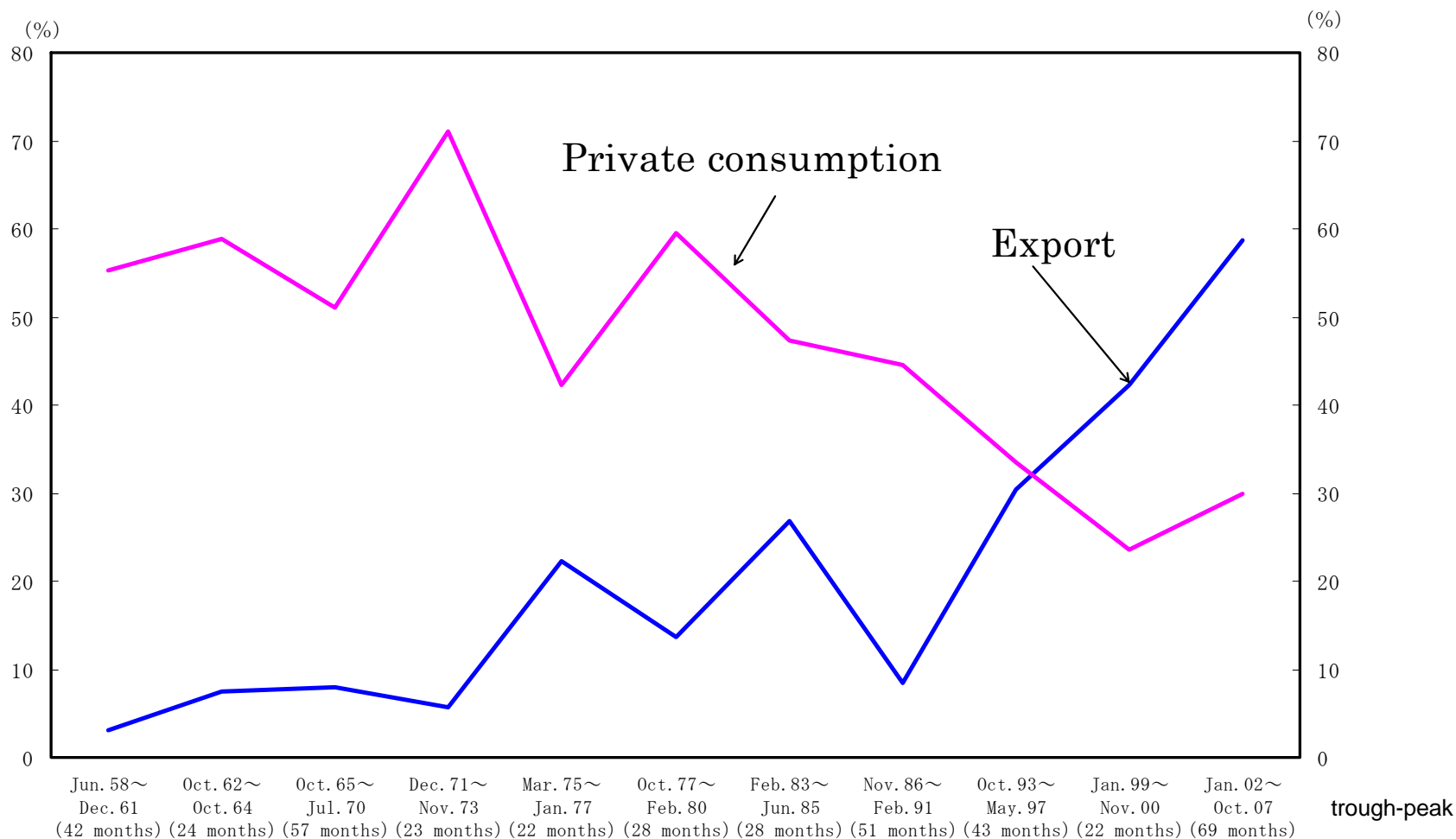
# Indices of Industrial Production in Past Economic Cycles



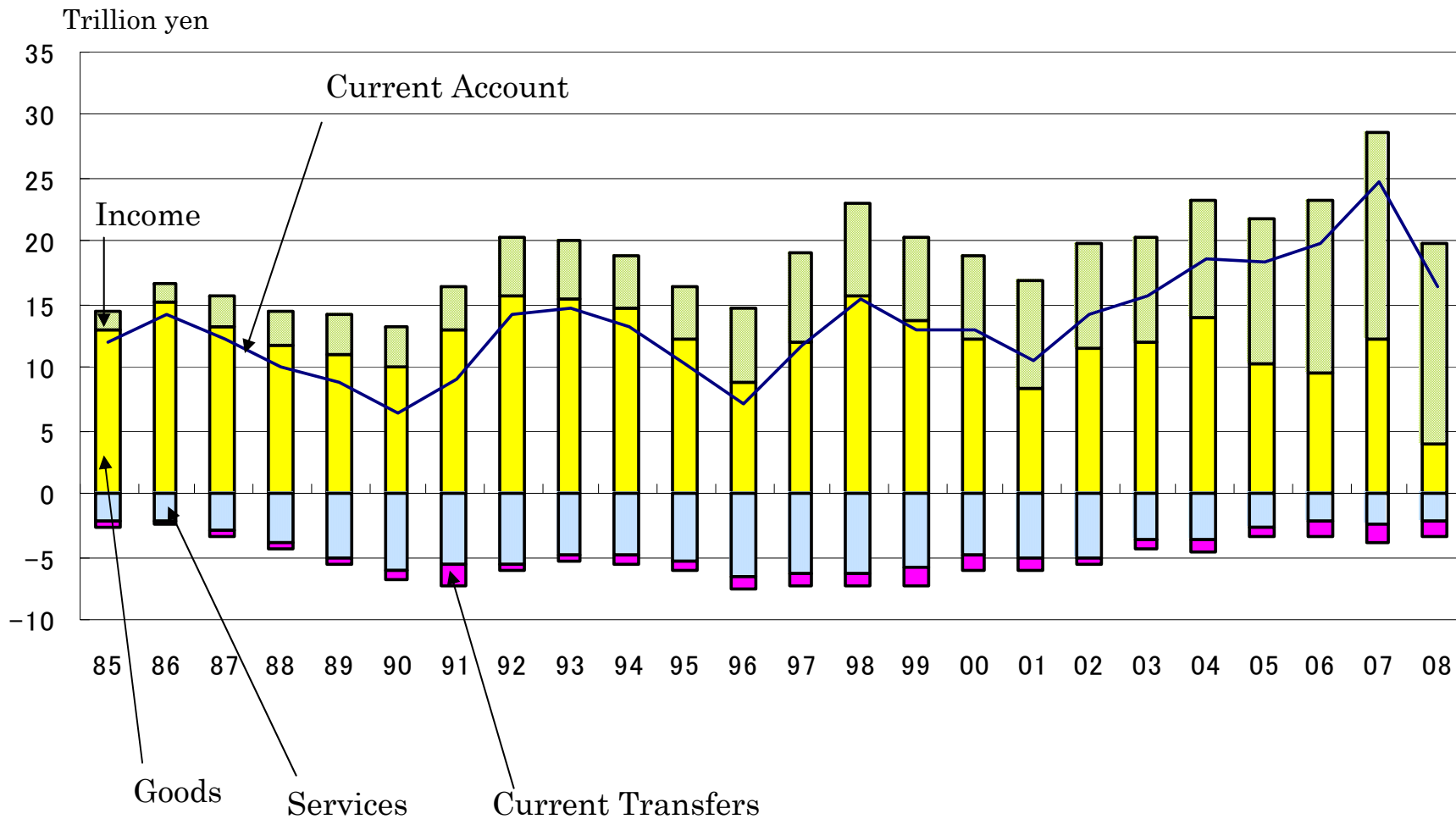
(Notes) Indices of Industrial Production, Ministry of Economy, Trade and Industry

# Contribution Rate in the Phase of Economic Expansion

The three economic expansions in the 1990s were led by external demand.



# Current Account Balance in Japan



Source: Ministry of Finance

# Major cause of negative growth: sharp decline in export

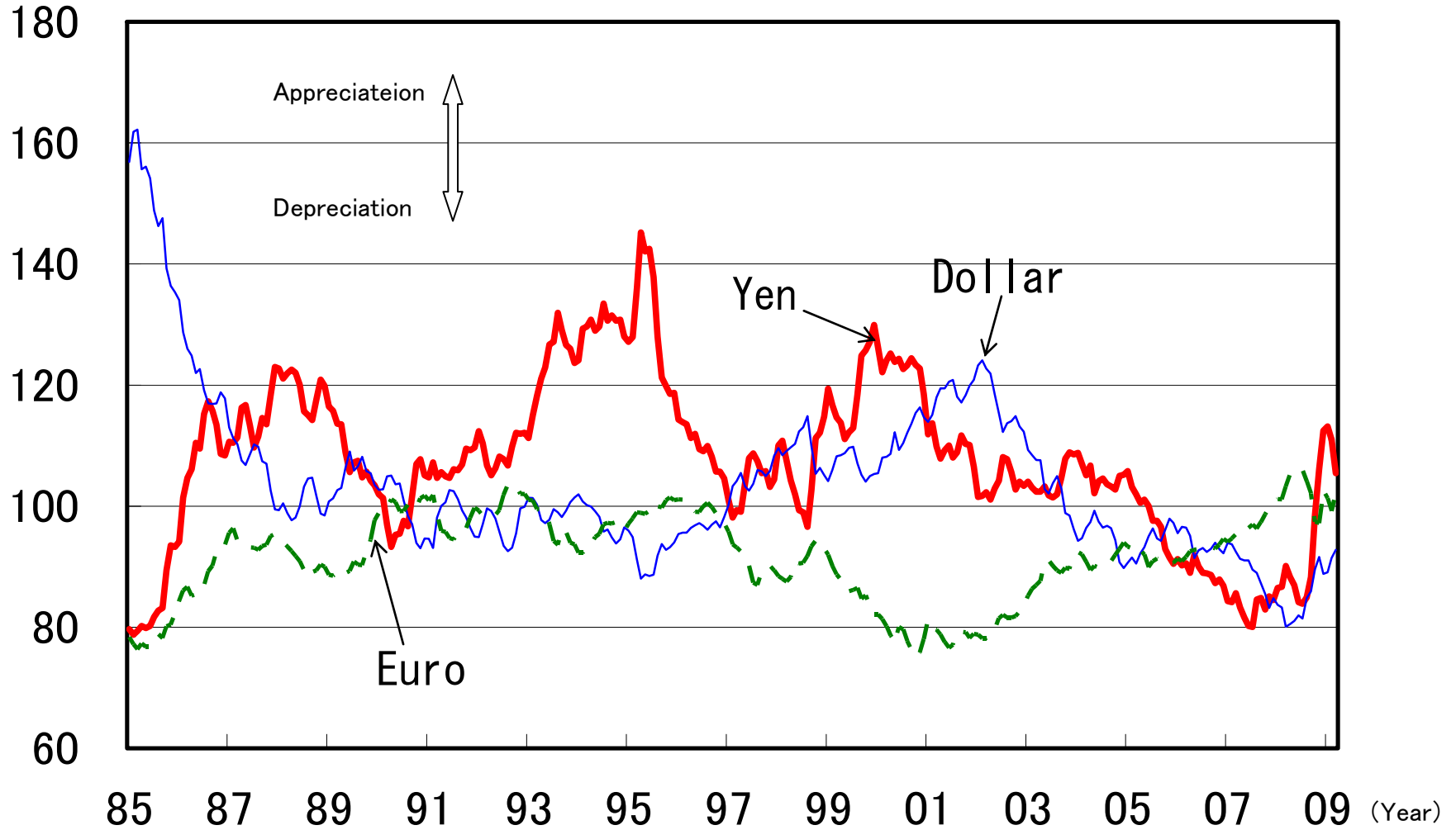
Quarter-on-quarter, seasonally adjusted annualized rate, %

	Growth Rate	Contribution of Domestic Demand	Contribution of External Demand	Export			Import		
				Contribution	GDP Ratio	Rate of increase/decrease	Contribution	GDP Ratio	Rate of increase/decrease
Japan	-12.1	(-0.5)	(-11.8)	(-10.0)	16.0	-44.9	(-1.8)	11.1	12.4
U.S.	-6.3	(-6.2)	(-0.2)	(-3.4)	12.6	-23.6	(3.3)	15.8	-19.6
Germany	-8.2	(0.3)	(-8.4)	(-14.3)	50.9	-26.2	(6.3)	44.0	-13.5
France	-4.4	(-3.1)	(-1.2)	(-4.2)	29.8	-13.3	(3.1)	33.0	-8.8
U.K.	-6.1	(-8.8)	(2.9)	(-4.3)	27.0	-14.9	(7.0)	29.5	-21.5

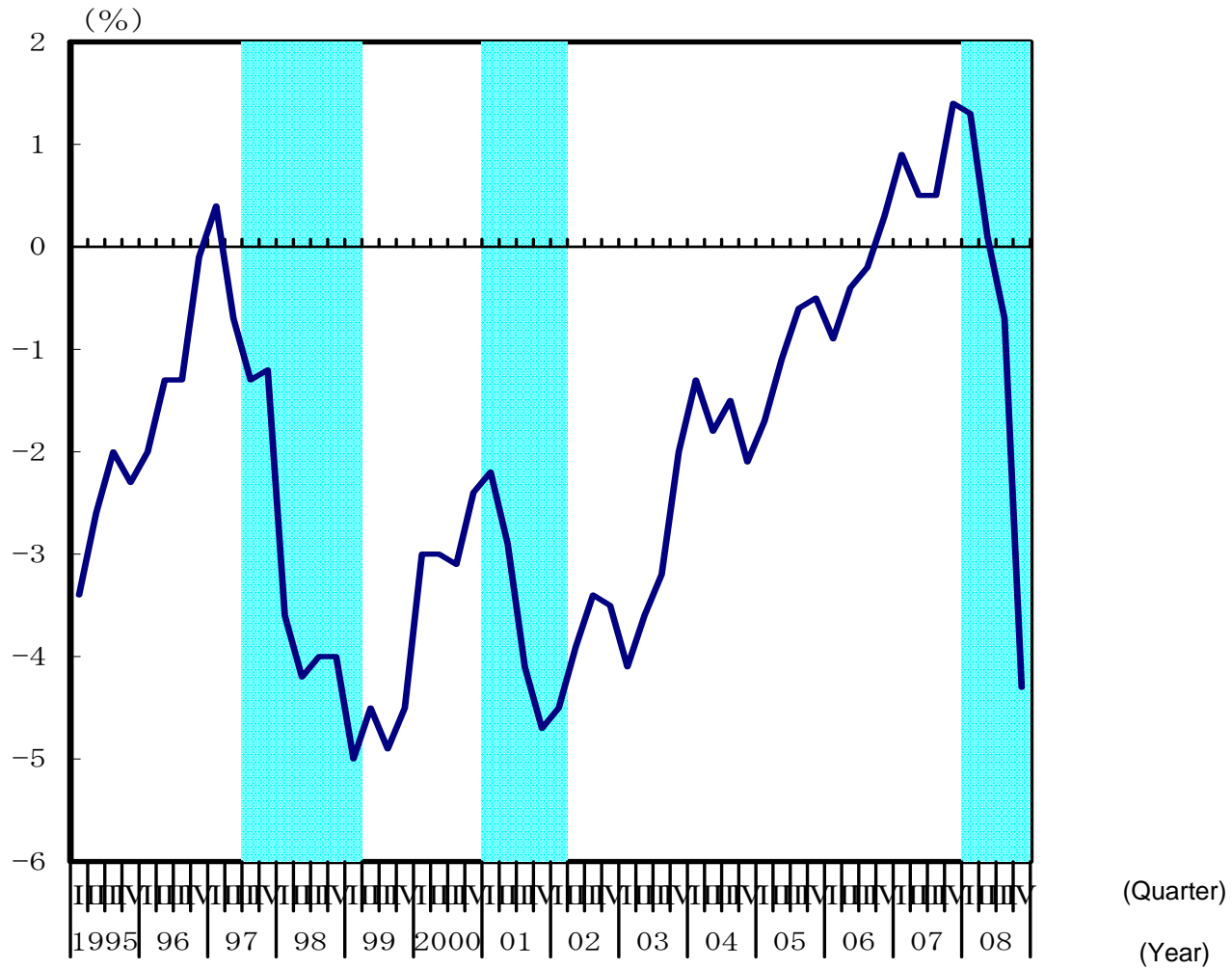
Source: Cabinet Office

# Real effective exchange rates

(Index 1990=100)



# Output gap



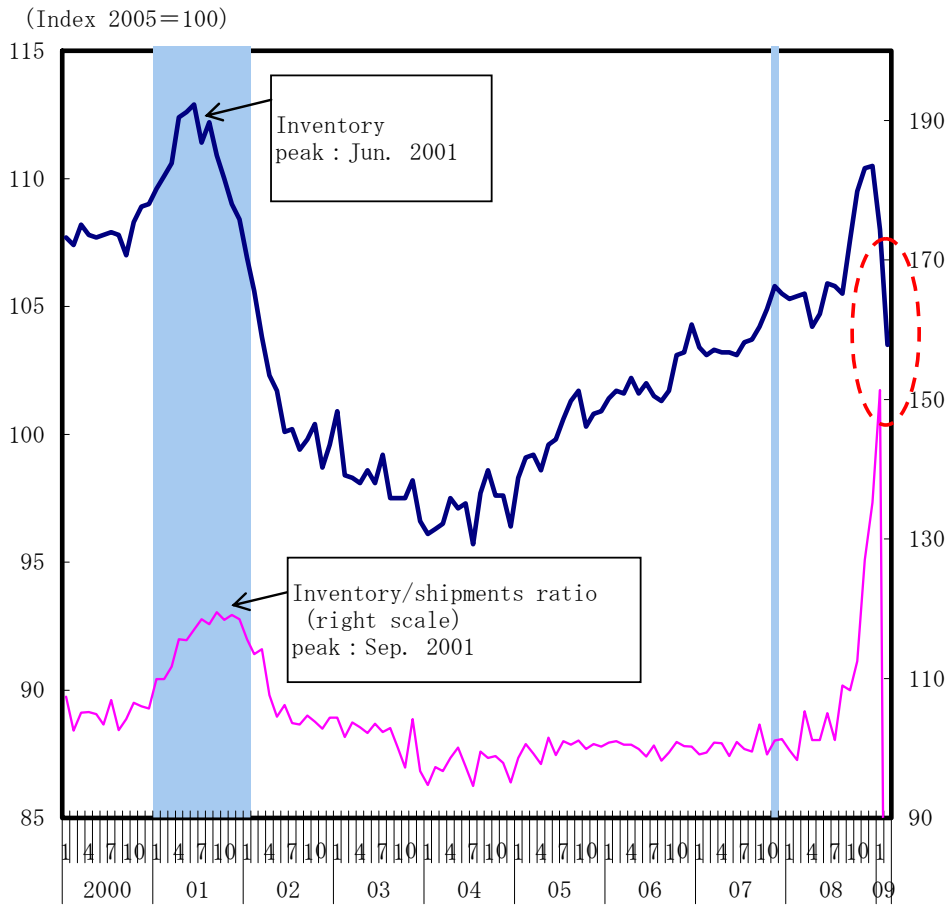
(Notes) Estimated by Cabinet Office



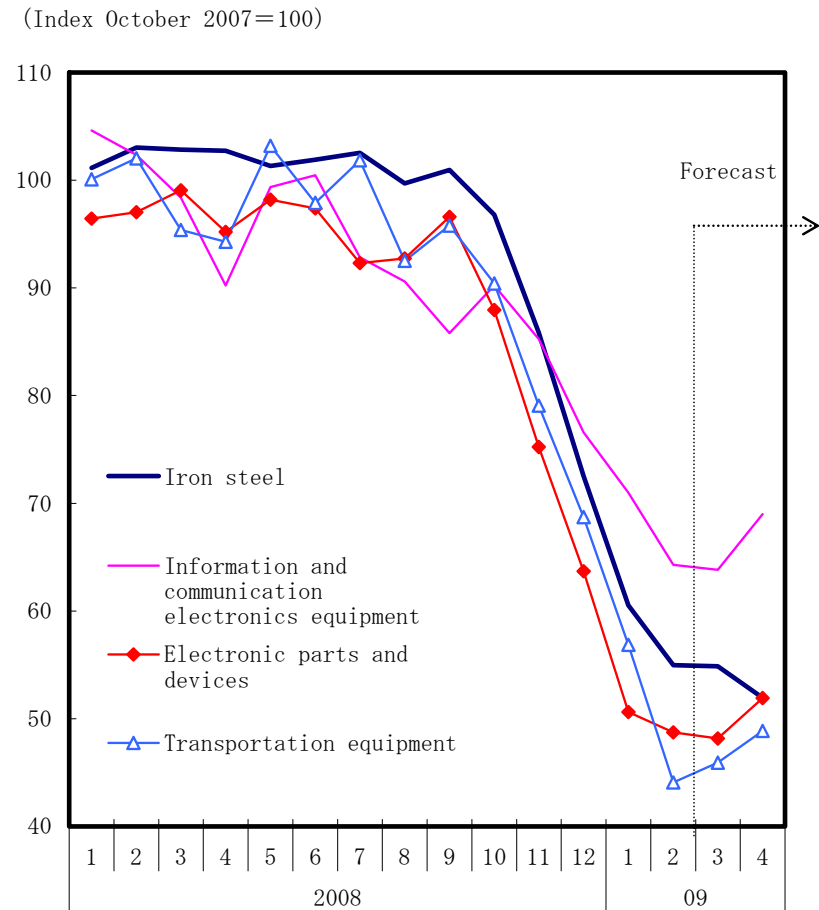


# Inventory

## Index of Inventory and Inventory Ratio



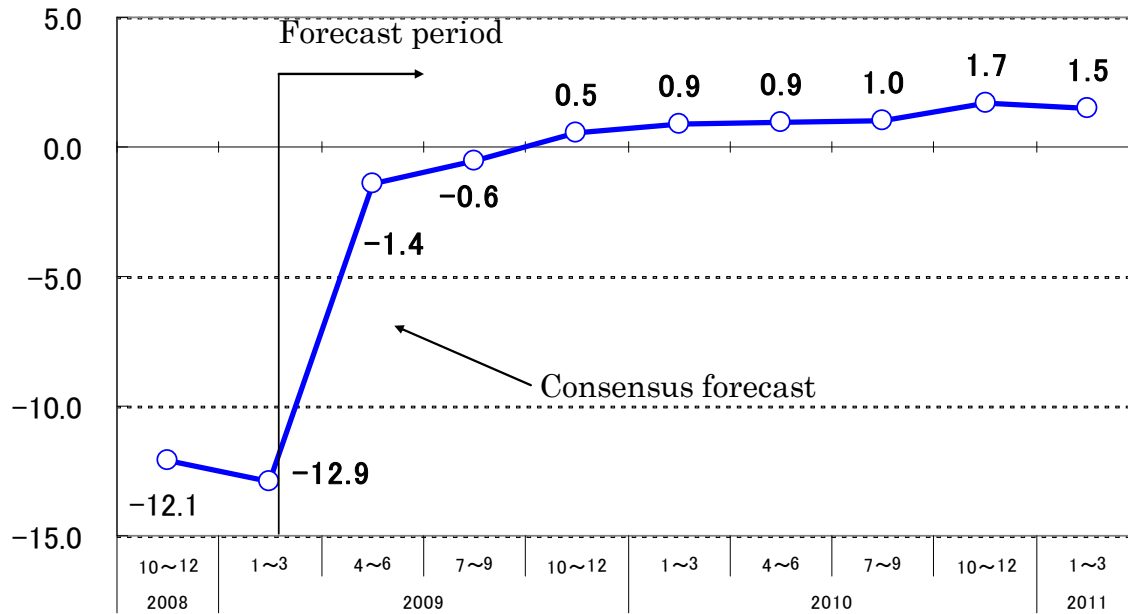
## Production Forecast



(Sources) Indices of Industrial Production, Ministry of Economy, Trade and Industry.

(quarter-to-quarter,  
seasonally adjusted at annual rate (%))

### Real GDP Growth Rate



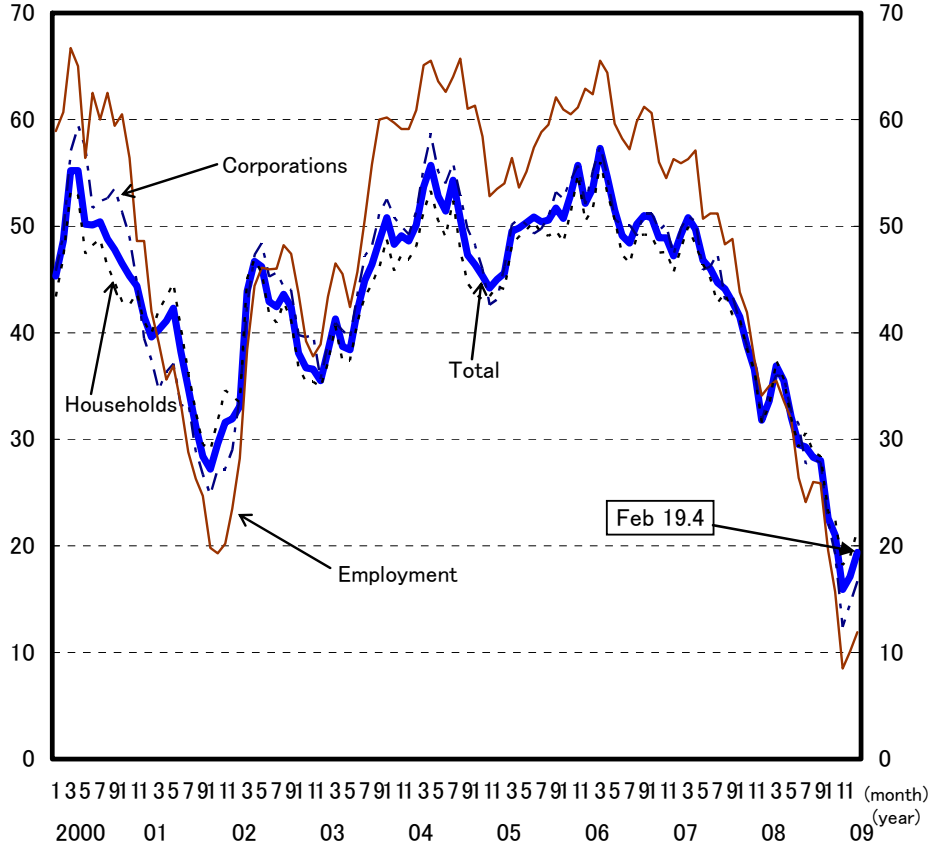
### Real GDP growth rate forecast for the first quarter in 2009

(quarter-on-quarter, seasonally-adjusted at annual rate (%))

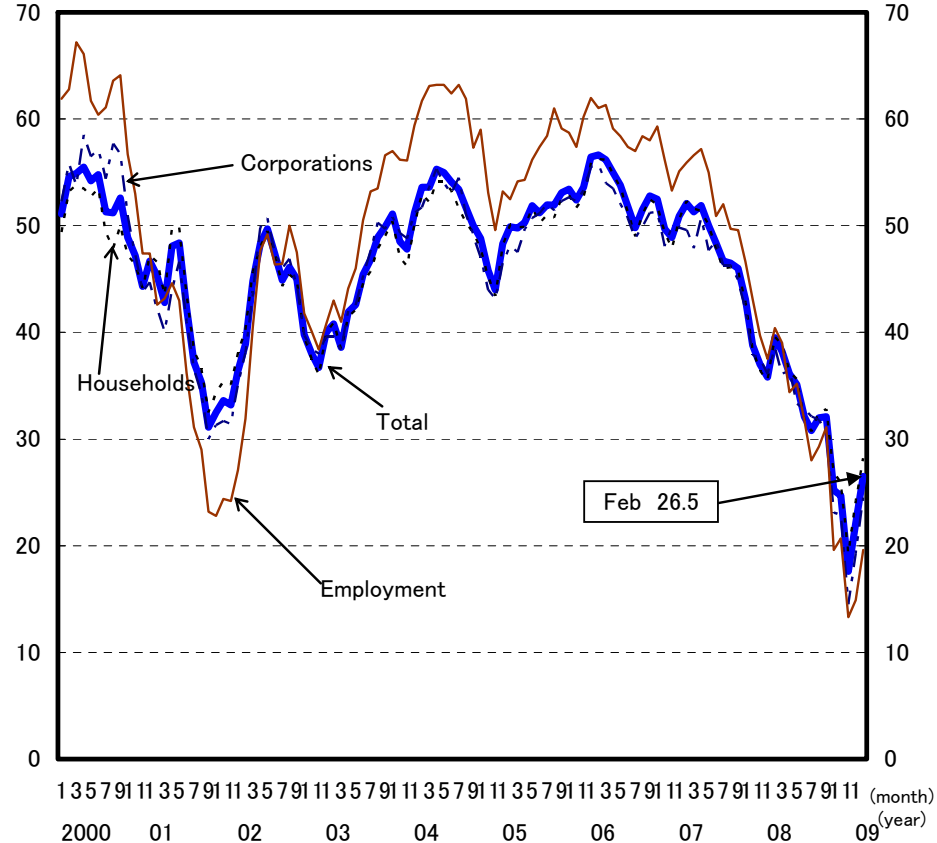
	2009
	January-March
	Forecast
After the 2nd preliminary GDP quarterly estimate (average of 18 institutions, March 23)	<b>-12.9</b>
ESP Forecast (average of 38 institutions, April 14)	<b>-12.8</b>

# Economy Watchers Survey

DI for judgement of current conditions



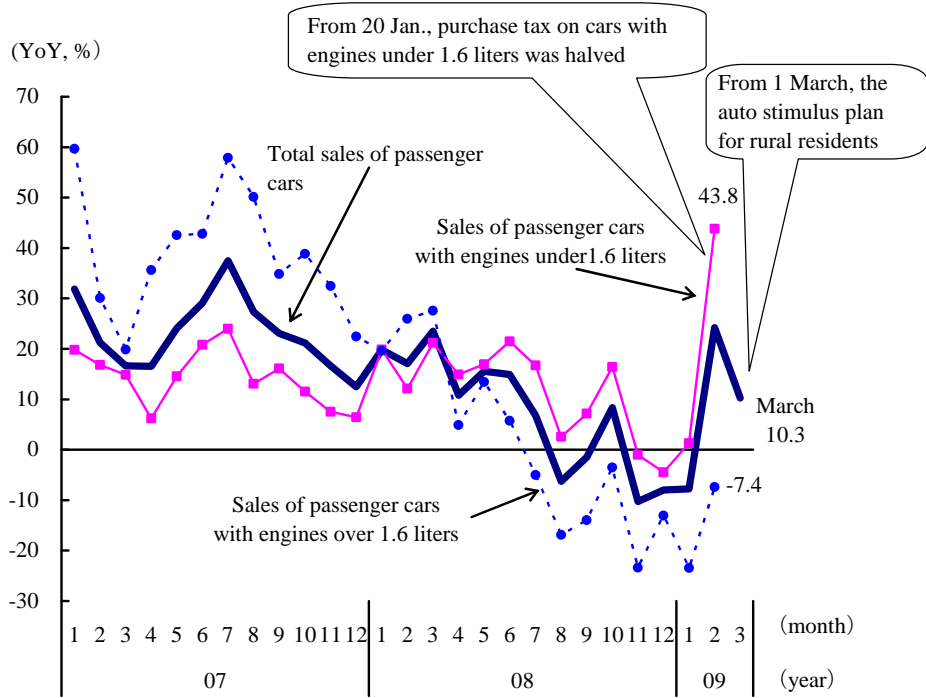
DI for judgement of future conditions



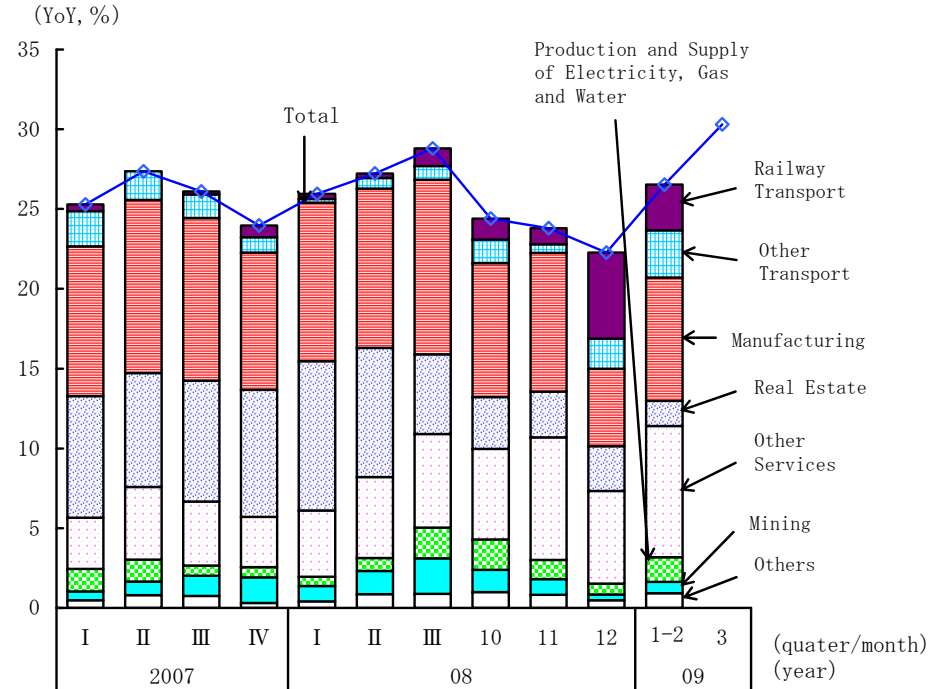
(Notes)  
Source: Cabinet Office

# Positive Signs of the Chinese Recovery

## Automobile Sales in China



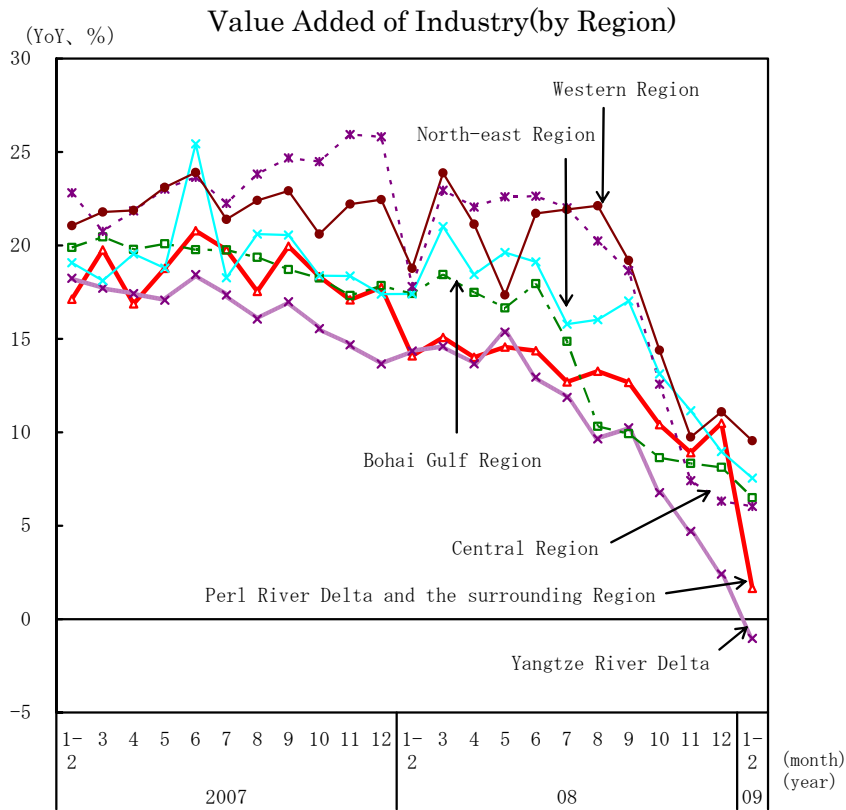
## Urban Investment in Fixed Assets (contributions by industry)



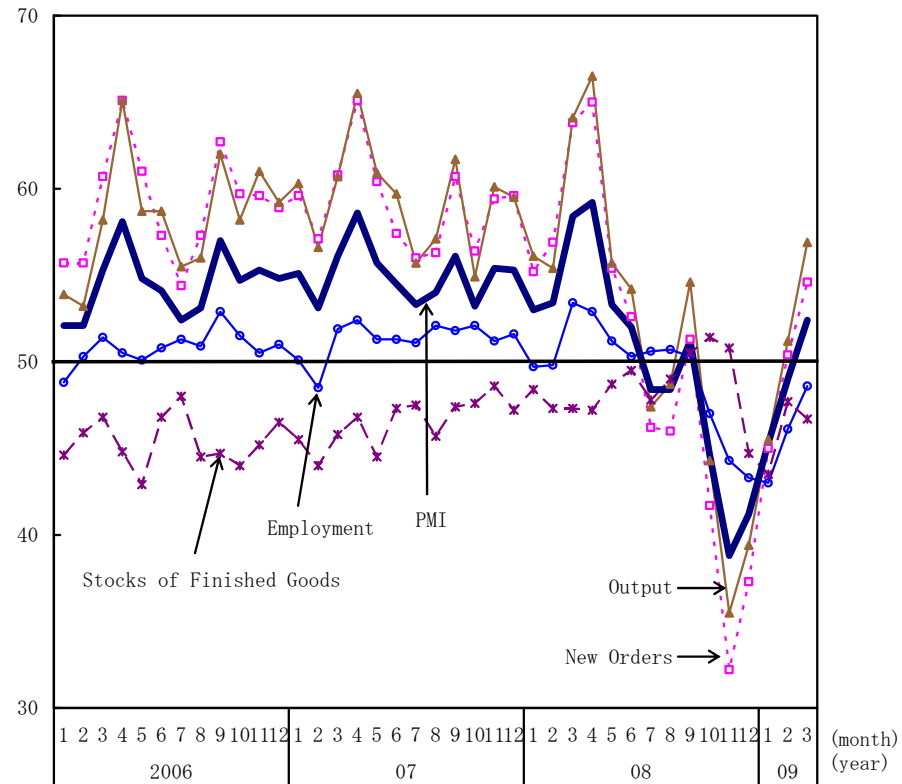
- (Notes) 1. Source: National Bureau of Statistics of China  
 2. "1-2(09)" means "from January to February in 2009".

- (Notes) 1. Source: China Association of Automobile Manufacturers  
 2. In China, the following measures are undertaken to stimulate auto sales under the package for auto industry.
- i) From 20 January to 31 December 2009, purchase tax on cars with engines under 1.6 liters was reduced from 10 percent to 5 percent.
  - ii) From 1 March to 31 December 2009, farmers who upgrade their three-wheeled vehicles and low-speed trucks to mini-trucks or purchase new mini-vans with engines under 1.3 liters are subsidized by 10% of the sales price.

# Positive Signs of the Chinese Recovery



Purchasing Manager Index (PMI) of the Manufacturing



(Notes) 1. Source: China Federation of Logistics & Purchasing

2. PMI of manufacturing is a set of comprehensive leading indices.

It reflects the cyclical situation of the economy through the changes of each index, and reflects the overall economic trend by using the comprehensive index.

Its critical point is 50. When the index is larger than 50, it indicates that the performance of manufacturing market is good or improving. When this index is lower than 50, it shows that the situation of the market is not good or worsening.

		Share of Value Added of Industry in 2007 (%)	Share of Export amount in 2007 (%)
Coastal Area	Pearl River Delta and the surrounding region (Guangdong, Fujian, etc)	15.4	34.5
	Yangtze River Delta (Jiangsu, Zhejiang, Shanghai)	22.2	39.1
	Bohai Gulf Economic Region (Shandong, Hebei, Beijing, Tianjin)	21.1	14.7
	North-east region (Liaoning, Heilongjiang, etc)	8.8	4.2
Inland China	Central region (Henan, Hubei, etc)	17.7	3.6
	Western region (Sichuan, Inner Mongolia, etc)	14.8	3.9
total		100.0	100.0

(Notes) 1. Source: National Bureau of Statistics of China

2. The growth rate is calculated based on weighted average of output of each region.

## A Path for Overcoming the Economic Crisis

### 1. Japanese economy is facing “twin crises”

- ◆ Short-term crisis – the risk of a negative spiral
- ◆ Structural crisis – responding to a “great adjustment” of the global economy

### 2. Basic principles for overcoming the economic crisis

1. Nationwide cooperative actions

2. Actions suited to various economic phases

3. Taking a comprehensive approach over a multi-year time horizon

### 3. Size and impact of the policy package

- Size:  
Central government expenditure: 15.4  
Total size: 56.8 (trillion yen)
- Impact on real GDP growth in FY2009: 2%
- Employment: 0.4 to 0.5 million jobs  
(in one year)

## Size and fiscal resources

### Size of the policy package

Central government expenditure: 15.4  
Total size: 56.8 (trillion yen)

### Fiscal resources

- Reserves in the Special Account for Fiscal Investment and Loan Program, construction bonds, special contingency budget
- Special deficit-financing bonds if those funds are insufficient

## I . Immediate measures – Avoiding a negative spiral

**<Central gov. exp. :4.9, Total size:44.4> (trillion yen)**

### 1. Measures to support employment

**<Central gov: 1.9, Total: 2.5>**

subsidies for employment adjustment, support for re-employment and development of vocational skills, creation of new jobs, protection for dispatched workers, housing and daily-life support measures, etc

### 2. Financial measures

**<Central gov: 3.0, Total: 41.8>**

SMEs, stock market, housing and land transactions, etc

### 3. Front-loading of public works projects

## II. Growth Strategy—Investing for the future

**<Central gov. expenditure: 6.2, Total: 8.8>**

### 1. The low-carbon revolution

**<Central gov: 1.6, Total: 2.2>**

- i . Solar power generation
- ii . Fuel-efficient vehicles and energy-efficient equipments
- iii . Revolution of transportation and infrastructure
- iv . Turning into a resource-rich country

### 2. Health, longevity and child-rearing

**<Central gov: 2.0, Total: 2.8>**

- i . Local health care services and new medical care technologies
- ii . Improvement of working conditions for long-term care workers and enhancement of long-term care capacity
- iii . Support for child-rearing and education

### 3. Realizing the potential power of Japanese economy and development of new infrastructure

**<Central gov: 2.6, Total: 3.8>**

- i . Realizing the potential power of the agricultural, forestry and fisheries industries
- ii . Development of cutting edge technologies, enhancing human resources and support for SMEs
- iii . Development of infrastructure for cooperation between regions and the enhancement of the competitiveness of regions
- iv . Realizing the potential power by utilizing IT
- v . “Soft power” and tourism



## III. Easing anxiety and enhancing vitality – Employing every policy tool

<Central gov: 4.3, Total: 5.0>

### 1. Revitalization of regions

<Central gov: 0.2, Total: 0.4>

- Revitalization of regional transportation
- Support for regional development and revitalization

### 2. Safety and security

<Central gov: 1.7, Total: 2.2>

- Social security
- Drastic enhancement of consumer policy
- Disaster management and safety measures
- Improvement of systems for safety and security

### 3. Support for local governments

<Central gov: 2.4, Total: 2.4>

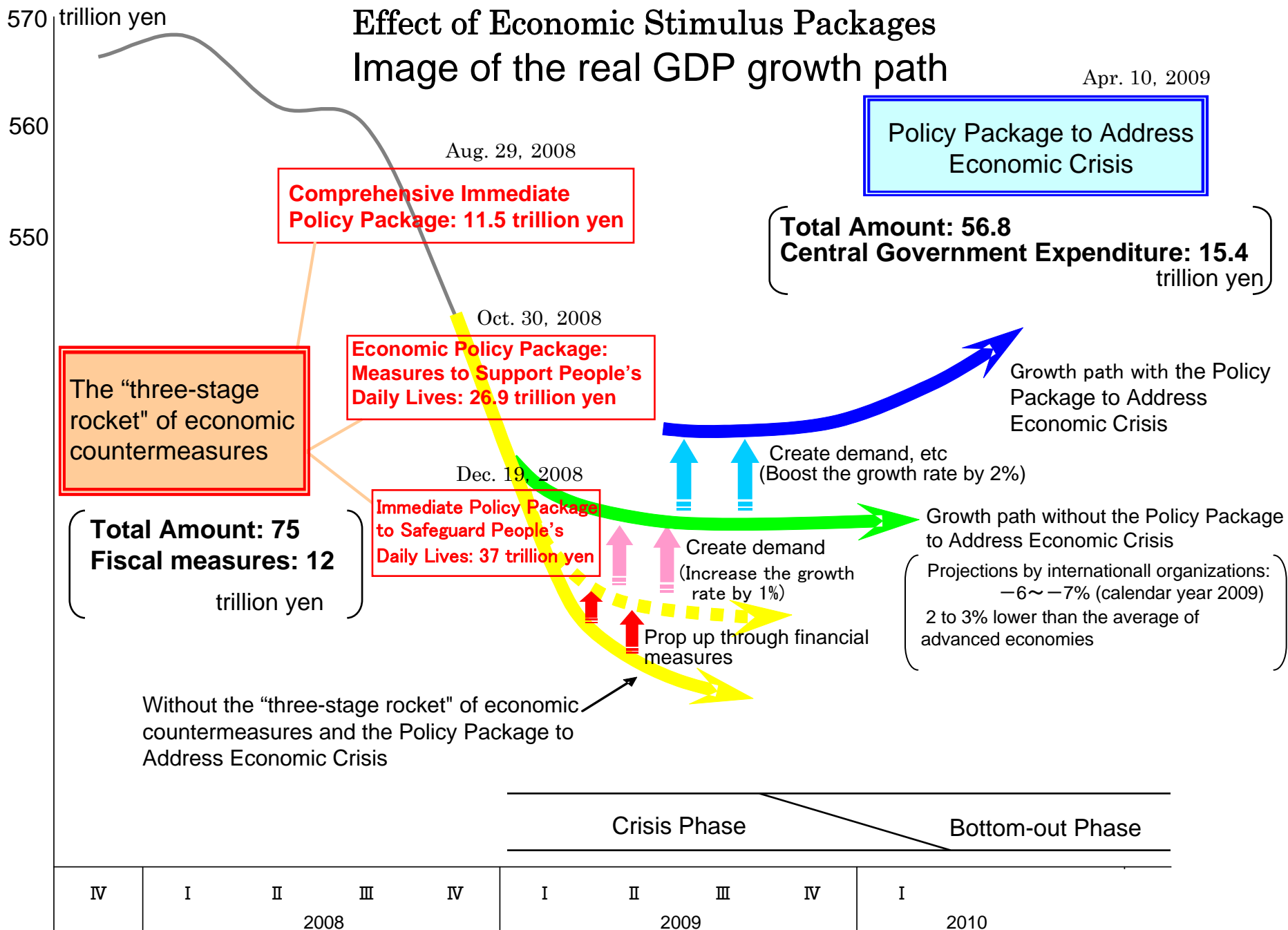
- Financial support for local governments

## IV. Tax Reform

- Reducing gift tax for purchasing houses as a temporary measure
- Reduction in tax on special expenses of SMEs <Central gov: 0.1, Total: 0.1>
- Expansion of tax incentives for R&D

# Effect of Economic Stimulus Packages Image of the real GDP growth path

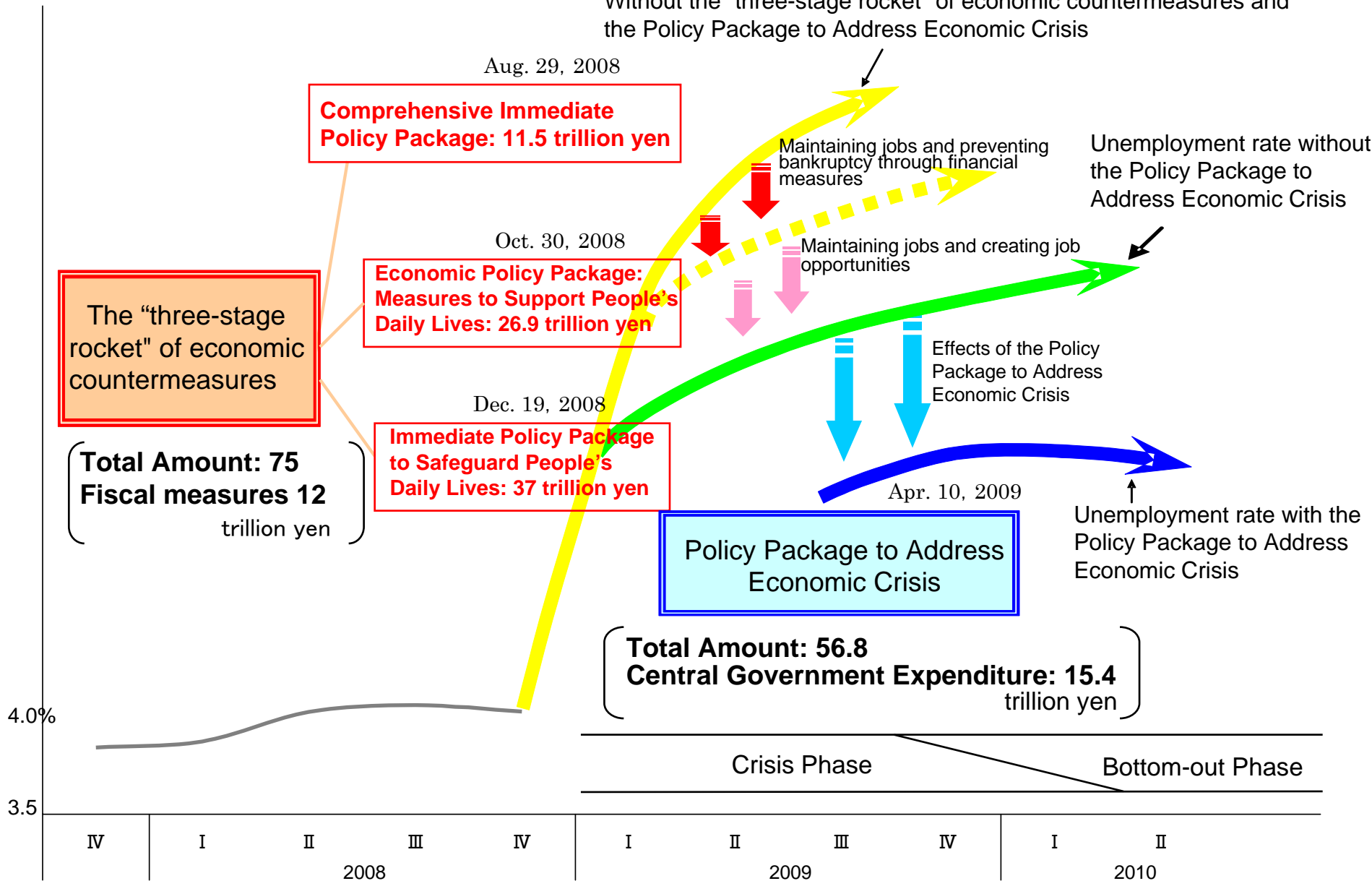
Apr. 10, 2009



# Effect of Economic Stimulus Packages

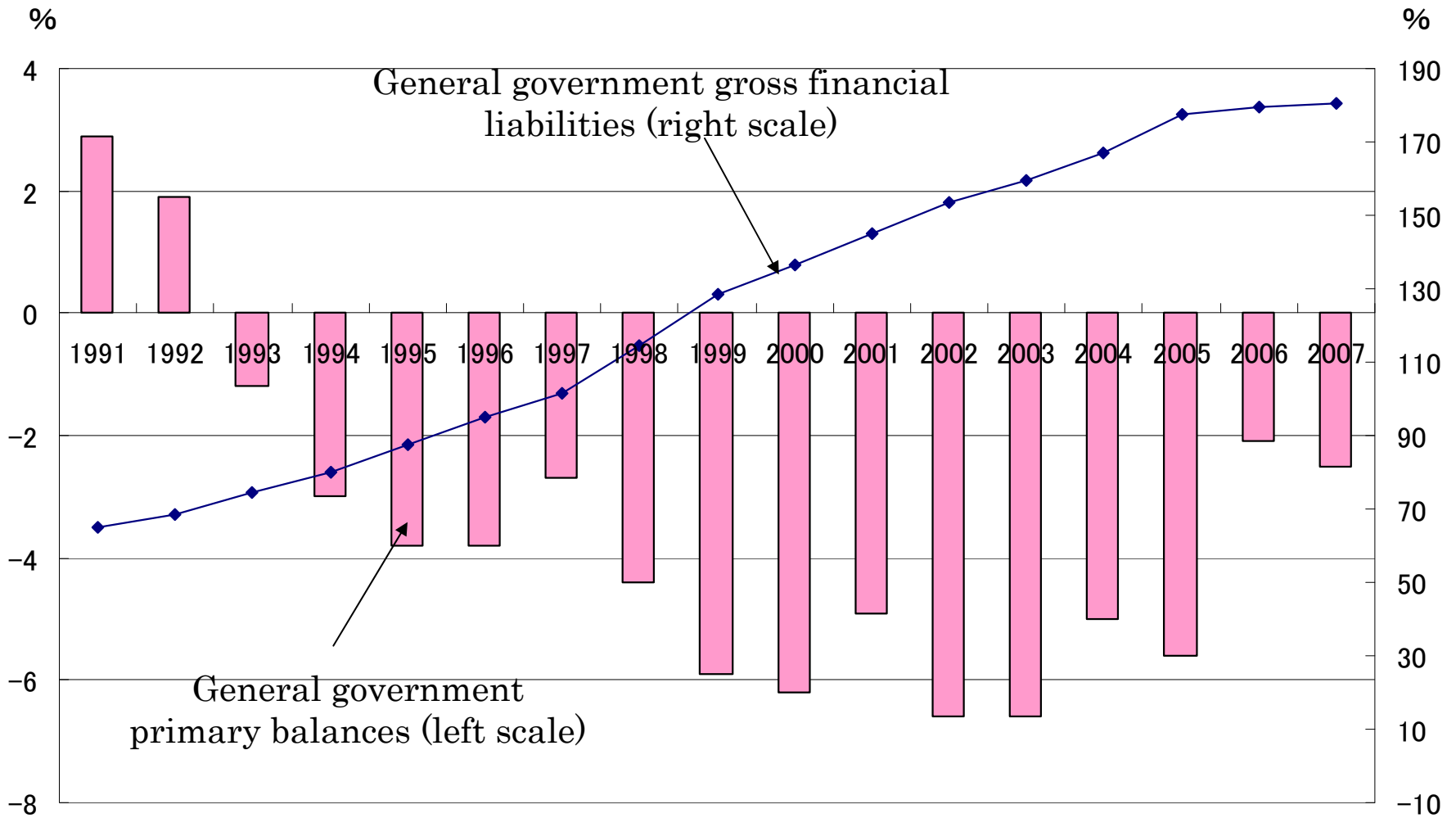
## Image of the unemployment rate development path

Without the "three-stage rocket" of economic countermeasures and the Policy Package to Address Economic Crisis





# Primary Balance and Public Debt



Source: OECD