



Reform of Japanese Financial System

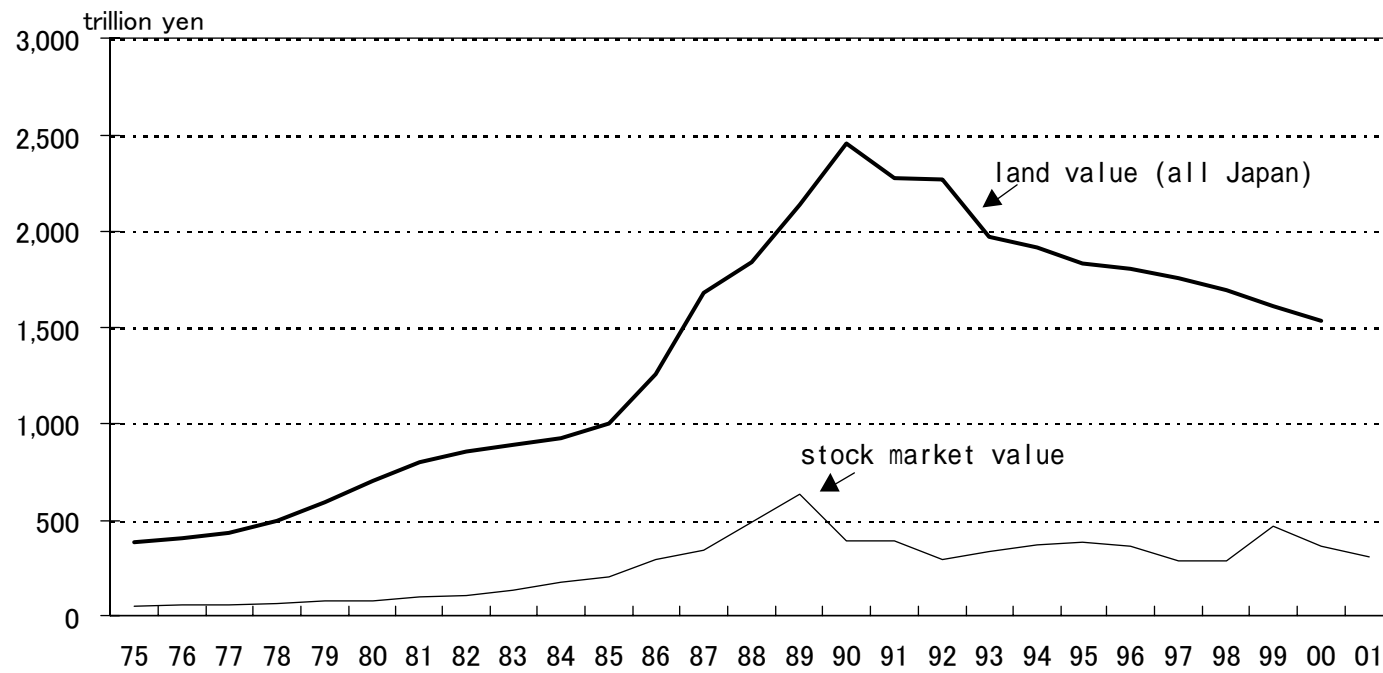
Yasuhisa Shiozaki
Member of the House of Representatives

Young Leaders Program
National Graduate Institute for Policy Studies
School of Government
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1. Nature of Japan's financial system problem

1) Asset bubble burst, largest in the world history

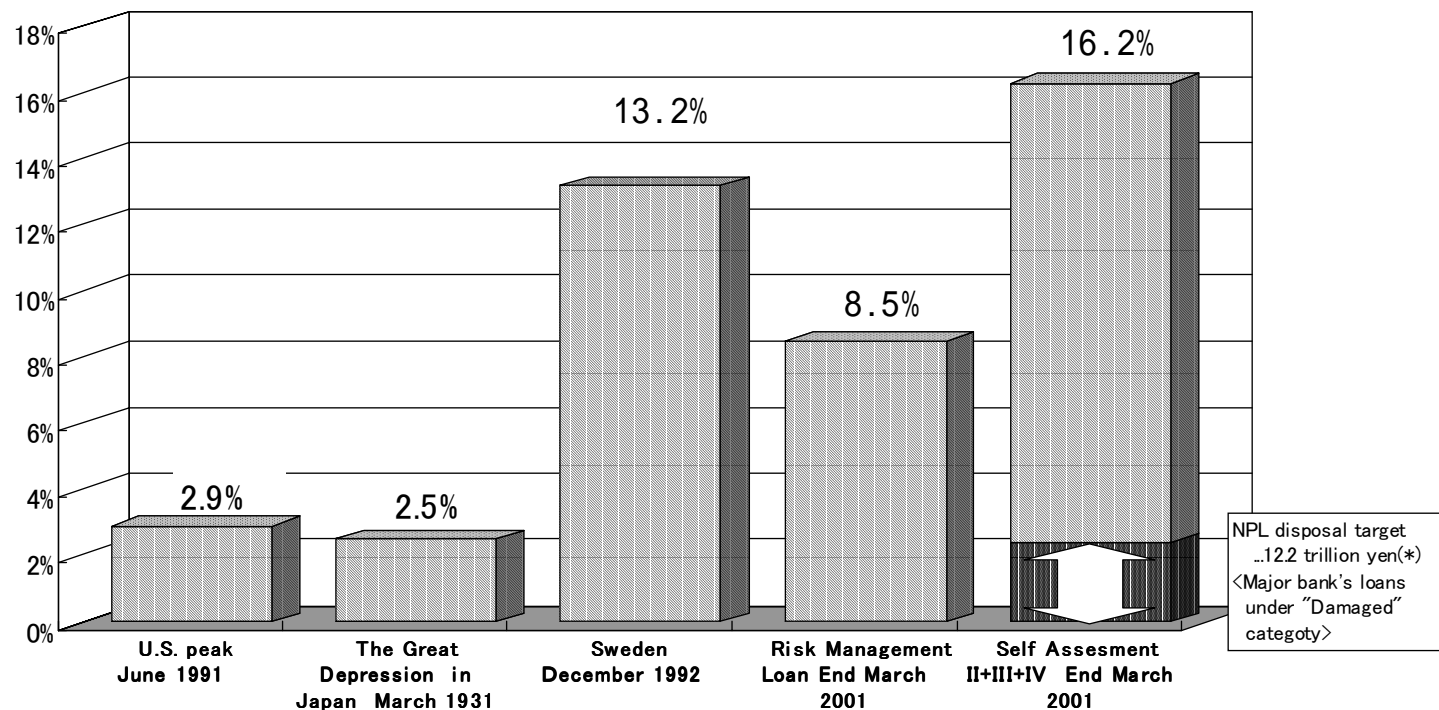
Aggregated Asset Value



2) Magnitude of NPL in Japan

Magnitude of Japanese NPL

NPL/Nominal GDP ratio



Japan's Total NPL

held by All Banks and Credit Co-ops	43 Trillion Yen	83 Trillion Yen
held by Major Banks	22 Trillion Yen(*)	42 Trillion Yen

(*) End Sep. 2001

3) Prolonged crisis, deflation and competitiveness concerns

Public Funds Utilized in Banking Crisis after 90's

		Costs	GDP Ratio
U.S.	Resolution Trust Corporation (RTC)	\$ 81.9 billion	3%
	Liquidation Costs of Federal Savings and Loan Insurance Corporation (FSLIC)	\$ 42.7 billion	
	Interest Payment Costs of Resolution Funding Corporation (RFC)	\$ 76.2 billion	
	Total	\$ 200.8 billion	
Sweden	Capital Injection and Loans	SEK 65.0 billion	4%
Norway	Capital Injection and Loans	NOK 24.9 billion	3%
Finland	Capital Injection and Loans	FIM 33.5billion	7%
Japan	Credit Lines	¥ 57 trillion	14%
	Crashable Bonds	¥ 13 trillion	
	Total	¥ 70 trillion	



2. Lost Decade

1) Chronological review

- a) Denial period 1991-1994
- b) Forbearance period 1995-1997
- c) Crisis management period 1998-2001
- d) Beyond crisis 2002-

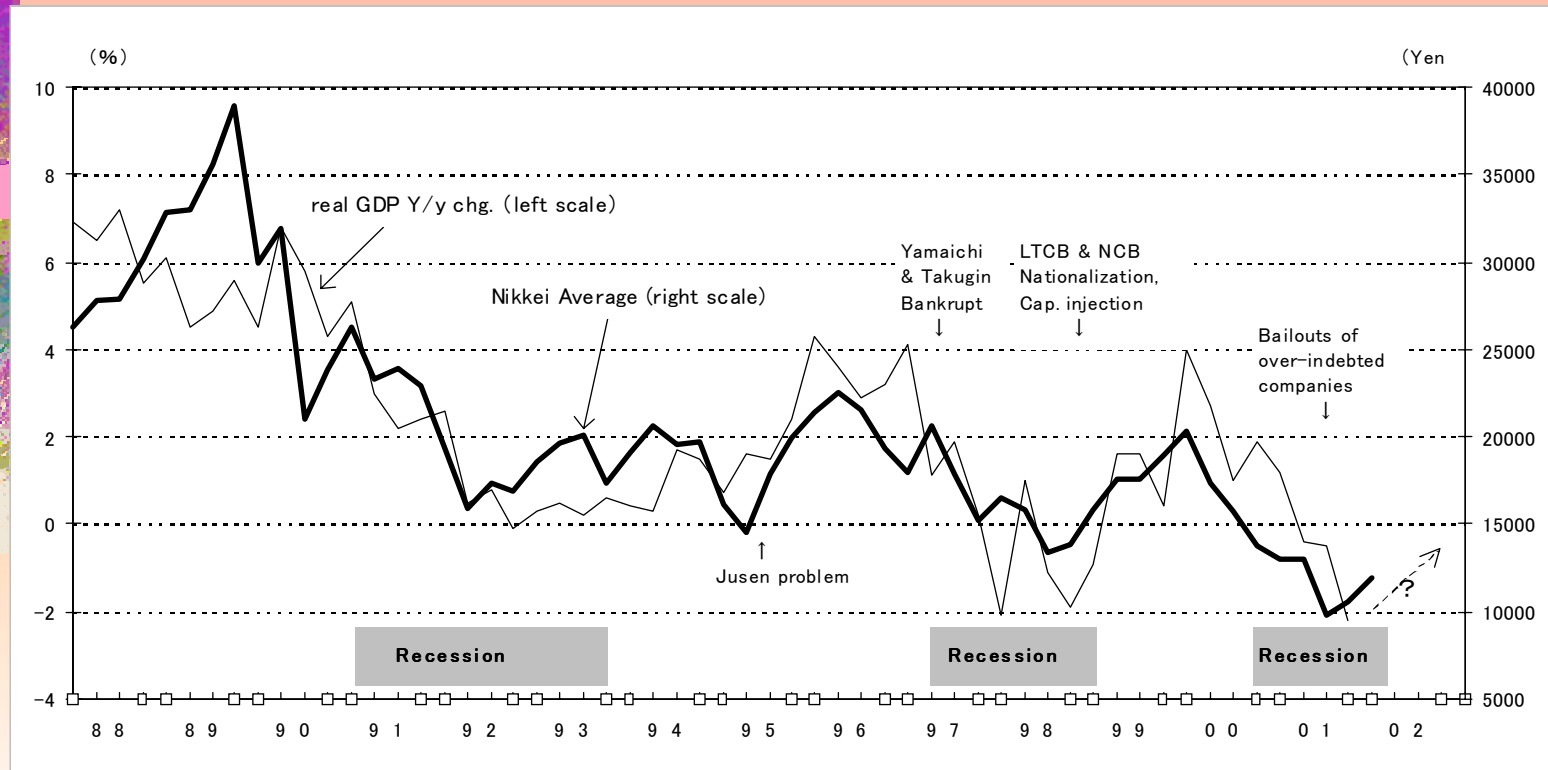
2) Macro policy response

- a) Fiscal policy
- b) Monetary policy

Structural Problem Remains, While Cyclical Recovery Started

Lead by exporters, “the third” cyclical recovery may come after the bubble burst.
Manufacturer-biased Nikkei index seems bottomed out.

	Manufacturers	Non-manufacturers
Market Cap of TSE End Feb. 2002	54.3%	45.7%
annual GDP (real) CY2000	24.9%	75.1%
Bank Lending Weight End Dec. 2001	19.3%	80.7%



Caution: Japan will NEVER get out of long term economic downturn without any fundamental reforms in non-manufacturing sector which consists three-fourth of the GDP.

3. Reality of Japan's Banking problem

- 1) Capital shortage, deferred tax, public capital
- 2) Weak earnings, lack of risk based pricing, low ROE
- 3) Governance problem, Mizuho case
- 4) Cross share-holding, Bank's Shareholdings Purchase Co.

Banking Sector Return on Equity
U.S. vs Japan

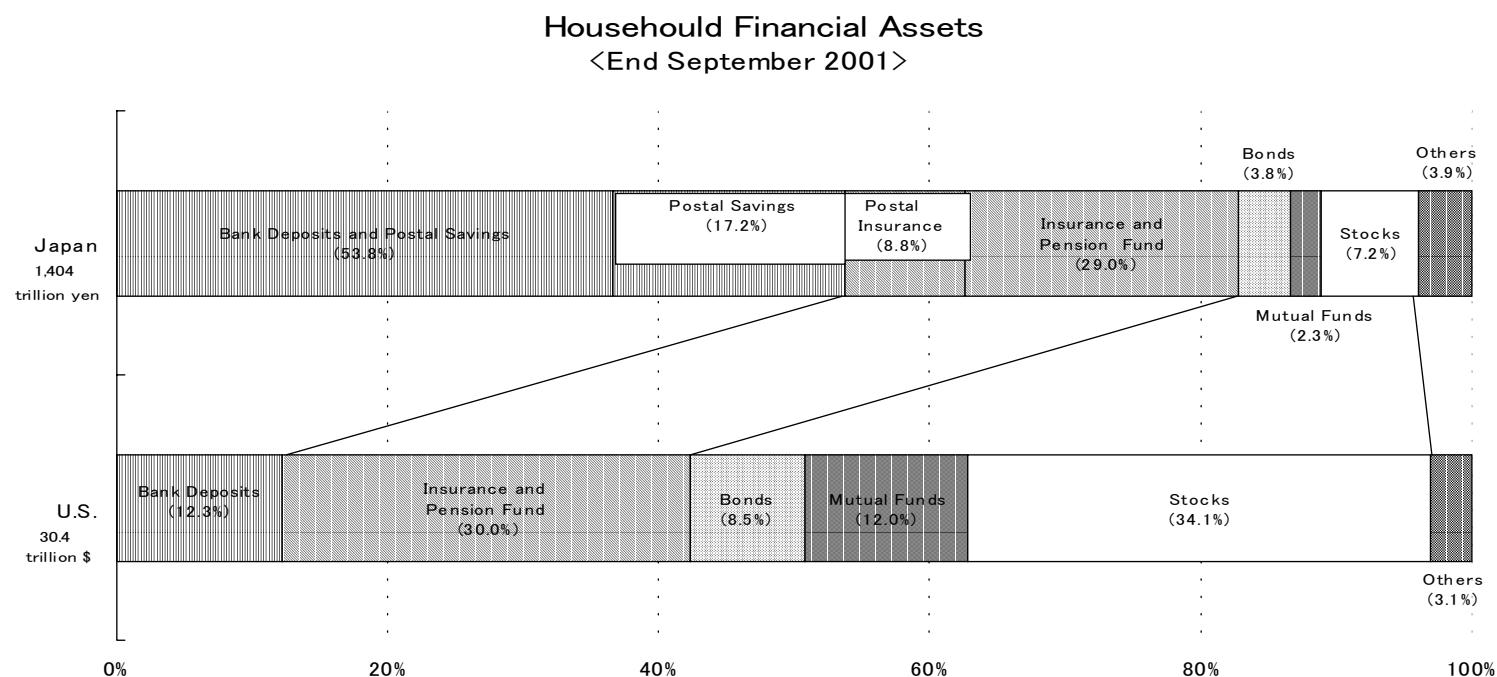


Notes 1. All Japanese Banks, All banks covered by Federal Deposit Insurance
2. Return on Equity = (Pre-tax net operating income + Provision for Loan & Lease Losses) / Total Capital

Source FDIC "Quarterly Banking Profits" Bank of Japan "Financial Report of All Banks"

4. Way Out

- 1) Common experience, i.e. U.S., Sweden, and Korea
- 2) Everything is politics
- 3) Weak capital market function



Note: 1. Percentage of total financial assets (%)
2. <> shows ratio against nominal GDP.



5. Future Scenario

- 1) “Compulsory and Aggressive” approach
- 2) “Muddle Through” approach
- 3) “Preemptive” approach