Economic Policies in Japan Since 2001:

Stocktaking of Lessons and Outstanding Issues

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Economic Policies in Japan Since 2001

• A set of unprecedented policies
• Subject to heated controversies

• 5 years of policy implementation and economic development provides an opportunity to;
  – Review controversies
  – Draw lessons
  – Identify outstanding issues for research
Economic Policies covered

- Prudential Policy
- Monetary policy
- Fiscal policy
Prudential Policy
Chronology

• 2001 Apr.  Require scheduled disposal of NPL
• 2001 Jun.  Give NPL disposal highest priority
• 2001 Oct.  Introduce ‘special inspection’
• 2002 Oct.  Aim halving of NPL ratio by March 2005
• 2003 May  Capital injection to Resona
Monetary Policy
Chronology

- 2001 Mar. Introduce new monetary policy framework
  - ZIRP with enhanced commitment
  - QEP by increase in CAB and JGB purchase
    - CAB: ¥5 trillion (01 Mar) to ¥30-35 trillion (04 Jan)
    - JGB: ¥0.4 trillion (01 Mar) to ¥1.2 trillion (02 Oct)
- 2006 Mar. Withdraw QEP
- 2006 Jul. Withdraw ZIRP
Fiscal Policy
Chronology

• 2001 Mar. Limit bond issue to ¥ 30 trillion
• 2002 Jan. Aim to achieve primary surplus by early 2010s
  – General govt. exp. to be lower than FY2001
  – Public investment to return to early-1990s
• 2004 Pension reform
• 2005 Health care reform
• 2006 Jul. Announce plans to cut govt. exp. by ¥11-14 trillion in next 5 years
Economic Development Overviewed

- Real GDP growth
- Prices
- Private sector
- Monetary situation
- Fiscal situation
Economic Development

• Recovery starts from 2002 Jan.
• Real GDP:
  – Real growth picking-up
  – Domestic demand oriented (not exports)
  – Private demand oriented (not public demand)
  – Balanced growth of corporate and household sectors
• Prices:
  – CGPI, CPI increase due to recovery and oil prices
  – GDP deflator still minus but improving
Recovery since 2002 Jan.

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<td>Recovery since 2002 Jan.</td>
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<td>0.8</td>
<td>0.5</td>
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<td>-1.8</td>
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<td>Domestic Demand Deflator</td>
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<td>-1.1</td>
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<td>Domestic Corporate Goods Price Index</td>
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<td>Consumer Price Index (CY2000=100)</td>
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<td>Consumer Price Index (CY2005=100)</td>
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<td>-0.8</td>
<td>-0.2</td>
<td>-0.1</td>
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<td>Unemployment Rate (average)</td>
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<td>4.4</td>
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<td>Wages</td>
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<td>-2.7</td>
<td>-0.9</td>
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### NPL Ratio

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<td>Mar.</td>
<td>8.4</td>
<td>8.1</td>
<td>7.2</td>
<td>6.5</td>
<td>5.2</td>
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<td>Sept.</td>
<td>4.7</td>
<td>2.9</td>
<td>2.4</td>
<td>1.8</td>
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<td>Mar.</td>
<td></td>
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### Current Profits

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<td>Mar.</td>
<td>-40.0</td>
<td>-30.0</td>
<td>-20.0</td>
<td>-10.0</td>
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<td>Sept.</td>
<td>20.0</td>
<td>30.0</td>
<td>40.0</td>
<td>50.0</td>
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<td>Mar.</td>
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Controversies Reviewed

-------------------------------------------------------------------
• Were the causes demand-side or supply-side policies?
• What was the appropriate policy toward NPL disposal?
• Did NPL disposal have a large impact on the economy?
• Was QEP effective?
• Is government debt sustainable? etc.
Were Causes Demand-Side or Supply-Side Factors?

• Demand-siders argue decline in aggregate demand were due to:
  – failures in macroeconomic polices, and
  – fall in business investment (credit crunch etc.)

→ Macroeconomic policy

• Supply-siders argue decline in potential growth rate (particularly TFP) were due to:
  – lending to troubled firms
  – labor market rigidity

→ Structural policy
Problems in both sides
Need to be addressed by structural policy
What was the Appropriate Policy toward NPL disposal?

• Aggressive NPL disposal policy dismantled ‘convoy system’ and exert pressure to dispose NPL.
  ( Chart )
• Capital injection to Resona.
• Measures to prevent moral hazard
Dismantling of the ‘convoy system’

Chart  First Principal Component of Financial Data
Did NPL Disposal have a Large Negative Impact on the Economy?

• NPL disposal was expected to exert a large negative impact on the economy.
• Forecast for FY2002,
  – NPL disposal of ¥10.1 trillion
  – 420 thousand to leave jobs
  – 140 thousand to remain unemployed.
• Outcome for FY2002
  – NPL disposal of ¥11.7 trillion
  – 100-150 thousand left jobs
  – 50-70 thousand remained unemployed.
Emphasis was on reconstruction rather than liquidation

### Table  Breakdown of NPL Disposal by Reasons

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<th>FY2001</th>
<th></th>
<th>FY2002</th>
<th></th>
<th>FY2003</th>
<th></th>
<th>FY2004</th>
<th></th>
<th>Total</th>
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<tr>
<td>Newly Emerged NPL</td>
<td>3.0</td>
<td>6.9</td>
<td>2.0</td>
<td>3.0</td>
<td>3.0</td>
<td>2.8</td>
<td>5.4</td>
<td>1.9</td>
<td>28.1</td>
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<tr>
<td>(Off-balancing)</td>
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<td></td>
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<tr>
<td>Liquidation of borrower</td>
<td>-0.3</td>
<td>-0.4</td>
<td>-0.3</td>
<td>-0.8</td>
<td>-0.2</td>
<td>-0.4</td>
<td>-0.2</td>
<td>-0.3</td>
<td>-2.9</td>
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<td>Reconstruction of borrower etc.</td>
<td>-0.6</td>
<td>-0.2</td>
<td>-1.8</td>
<td>-1.5</td>
<td>-0.6</td>
<td>-0.9</td>
<td>-0.4</td>
<td>-2.3</td>
<td>-8.2</td>
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<td>Sales of loans</td>
<td>-0.9</td>
<td>-1.3</td>
<td>-1.0</td>
<td>-3.5</td>
<td>-0.8</td>
<td>-2.1</td>
<td>-1.1</td>
<td>-1.6</td>
<td>-12.2</td>
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<td>Collection and Repayment</td>
<td>-1.1</td>
<td>-1.4</td>
<td>-1.3</td>
<td>-1.6</td>
<td>-1.2</td>
<td>-1.7</td>
<td>-1.2</td>
<td>-2.0</td>
<td>-11.5</td>
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<td>Improvement in business</td>
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<td>-0.4</td>
<td>-1.0</td>
<td>-0.8</td>
<td>-0.5</td>
<td>-0.6</td>
<td>-0.7</td>
<td>-0.6</td>
<td>-5.0</td>
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<tr>
<td>Total off-balancing</td>
<td>-3.2</td>
<td>-3.8</td>
<td>-5.4</td>
<td>-8.3</td>
<td>-3.1</td>
<td>-5.7</td>
<td>-3.5</td>
<td>-6.7</td>
<td>-39.7</td>
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<td>Net Change in NPL</td>
<td>1.1</td>
<td>2.7</td>
<td>-3.1</td>
<td>-3.6</td>
<td>-0.4</td>
<td>-1.7</td>
<td>2.0</td>
<td>-4.0</td>
<td>-7.0</td>
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Was QEP Effective?

- Empirical study confirms positive effects of ZIRP and liquidity effect of QEP, but not stimulating effect of QEP.
- Suggested area for further research:
  - Explicit analysis of B/Ss of banks
  - Analysis of motivation to hold CAB
    - Not only major banks, but also local and foreign banks held CAB. Tanshi companies held also.
    (Chart )
    - Difference in motivation should be taken into account.
  - Consideration of negative impact of NPLs
Major banks were not the only ones that held CAB

Chart  Breakdown of Excess CAB at the BOJ by Types of Financial Institutions
Is Government Debt Sustainable?

- Majority saw the current situation as being unsustainable.
- Recent reduction in primary deficit is consistent with revert to sustainability.
  (Chart)
- After achieving primary surplus in FY2011; what should be the next target to bring down debt to GDP ratio
Progress toward Sustainability

Chart: Sustainability of government debt

Gross Long-Term Government Debt vs. Primary Balance

- FY1996
- FY1997
- FY1998
- FY1999
- FY2000
- FY2001
- FY2002
- FY2003
- FY2004
- FY2005
- FY2006
End of presentation
Thank you for listening

Jun Saito
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