Current Situation of Japan's financial system and FSA's policy response

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Current situation of Japan's financial system

➢***Severely affected by deterioration of real economy, market volatility***

➢***However, relatively sound compared with US, Europe***

- Smaller losses incurred from securitized products
- Smaller exposure to toxic assets

Reasons for relative soundness

1. Japanese firms: not strongly innovation-oriented

2. Final stage of resolving NPL problems coincided with spread of “originate-to-distribute” model

3. Improvement in firms’ risk management, early implementation of Basel II

Main sources of risk for Japan's financial system

1. Rising credit costs

- Caused by weakening of real economy

2. Valuation losses/impairment on shareholdings

- Expect banks to draw lessons from bitter experience

“Once-in-a-century” or “Second-in-a-decade” ?

Comparison between now and 1990s

Positive aspects:

- **Current turmoil triggered exogenous shock**
- **Improved regulatory framework/financial safety net**

Negative aspects:

- **Global recession, collapse of external demand**

Two categories of policies

Policy response to global financial market turmoil

➢ ***Short-term crisis management***

- to stabilize financial markets
- to maintain functioning of financial intermediation

➢ ***Medium-term reforms of financial regulation***

- to “re-design” regulatory framework
- to prevent similar crises in future

Crisis management measures

US/Europe: extraordinary actions with massive public support

- Large-scale capital injection
- Temporary bank nationalization
- Credit guarantees by governments…

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Japan: more focused on maintaining financial intermediary functions

because of :

- relative soundness of financial system
- severe weakening of real economy

“Re-design” of regulatory framework

Medium-term reforms to prevent recurrence of crisis

- **Capital adequacy**
- **Addressing procyclicality in financial system**
- **Market integrity/transparency**
  Strengthened disclosure, ensuring traceability, regulation of CRAs…
- **International regulatory cooperation**
  Supervisory colleges…

Five lessons learned from Japan's experience in 1990s

1. Need for prompt, accurate recognition of losses

2. Need to take toxic assets off balance sheet

3. Need to recapitalize banks, with public funds if necessary

4. Exceptional measures as options in times of serious crises

5. Right balance between short-term measures and medium-term reforms

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