Comments on "A Financial System Perspective on Japan's Experience in the Late 1980s" by M. Hattori, H. S. Shin, and W. Takahashi

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Summary of the paper

- Financial system perspective
  - Supply side story

    New securities

    →New credit from non-leveraged institutions

    →Slack on banks' balance sheets

    →Banks lending to marginal borrowers
  - The same view can explain the US and Japanese experiences

$$\sum_i y_i = \sum_i e_i(1 + z_i(\lambda_i - 1)) \Rightarrow \boxed{y/e} = (1-z) + z\boxed{\lambda} < \lambda$$

Leverage at the banking sector

Leverage at Individual bank

y_i : lending of bank i to ultimate borrowers plus holding of real assets

e_i : equity of bank i

λ_i : leverage of bank i (ratio of total assets to equity)

z_i : proportion of bank i's funding that comes from outside the banking system

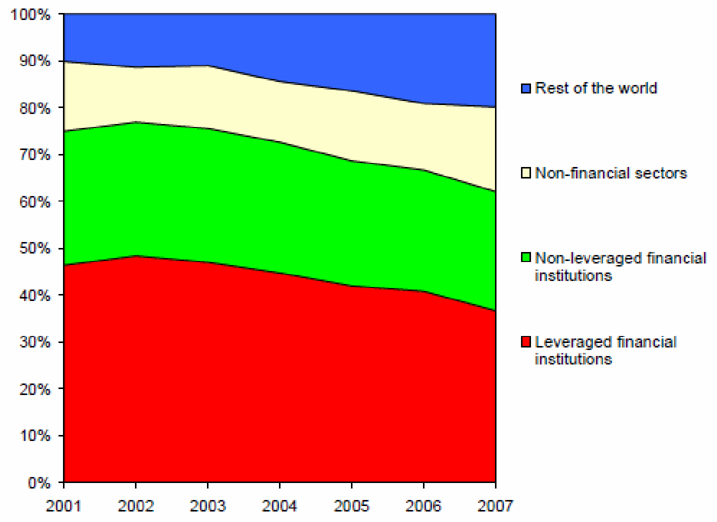
My questions about “new funding sources”

1. **Who extended new credits?**
2. **How and why did they so?**

Who extended new credits to banks by way of non-financial firms?

In both cases, non-leveraged purchasers of the new securities were important new funding sources. In the US mortgage crisis, foreigners (especially foreign central banks) bought the mortgage-backed securities (MBSs) of the US GSEs. In the 1980s bubble in Japan, non-leveraged institutions such as life insurance companies and, to some extent, foreign investors were the buyers of Japanese corporate securities.

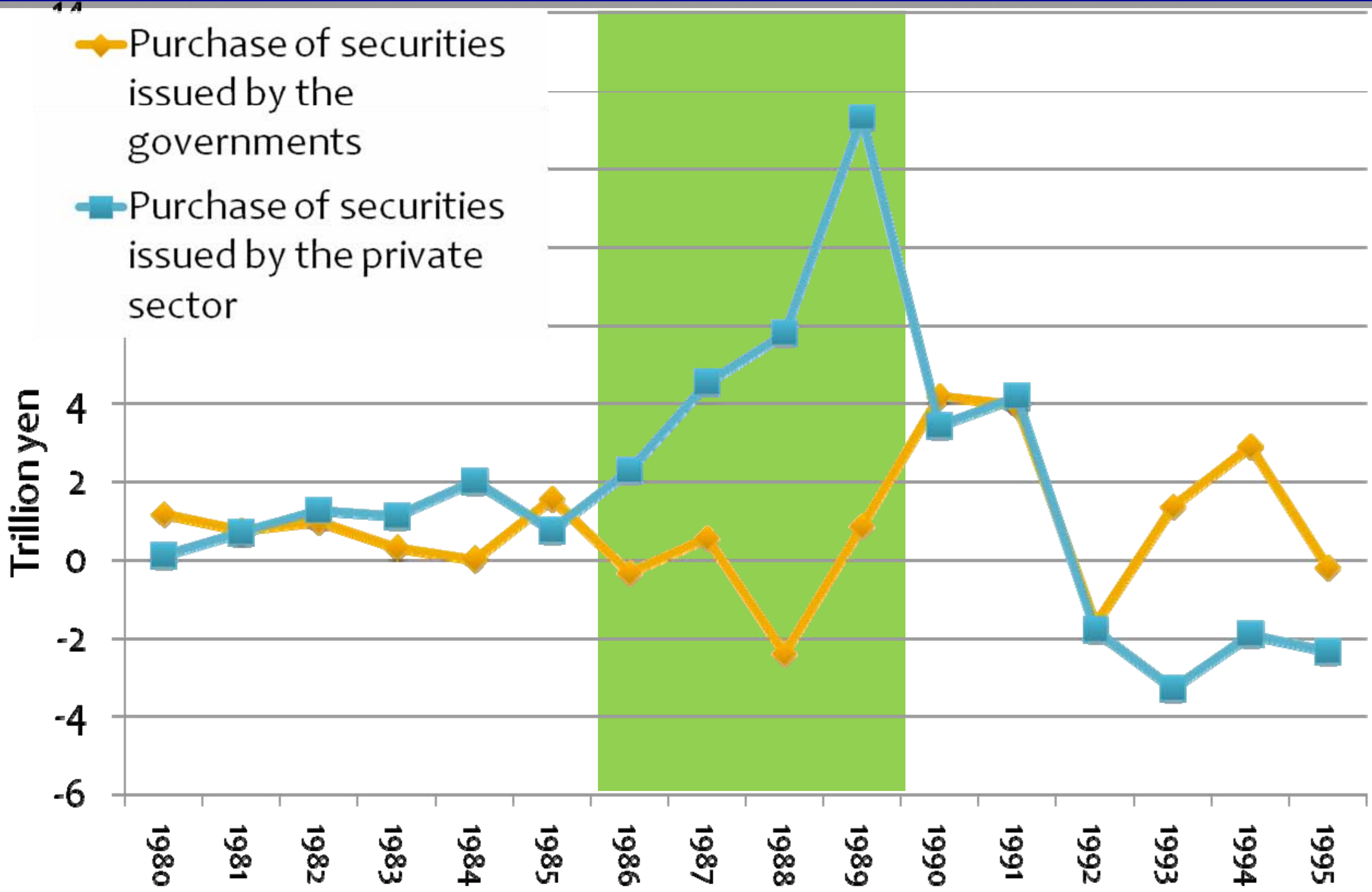
Figure 2. Holding of GSE-backed Securities (percentages)



Source: Flow of Funds Accounts, Federal Reserve.

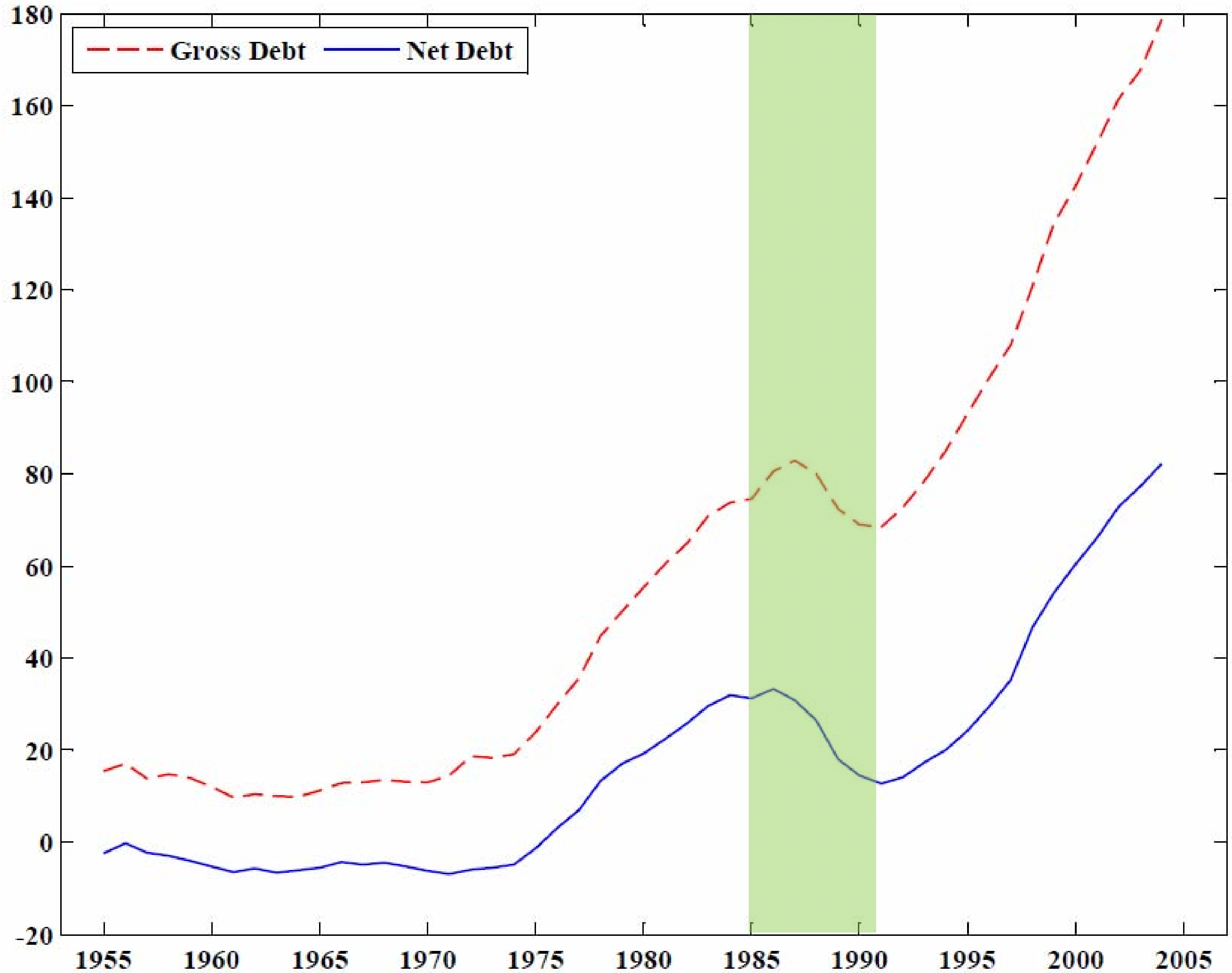
Holders of securities issued by non-financial corporations

How did "foreigners" provide funds to non-financial corporations?



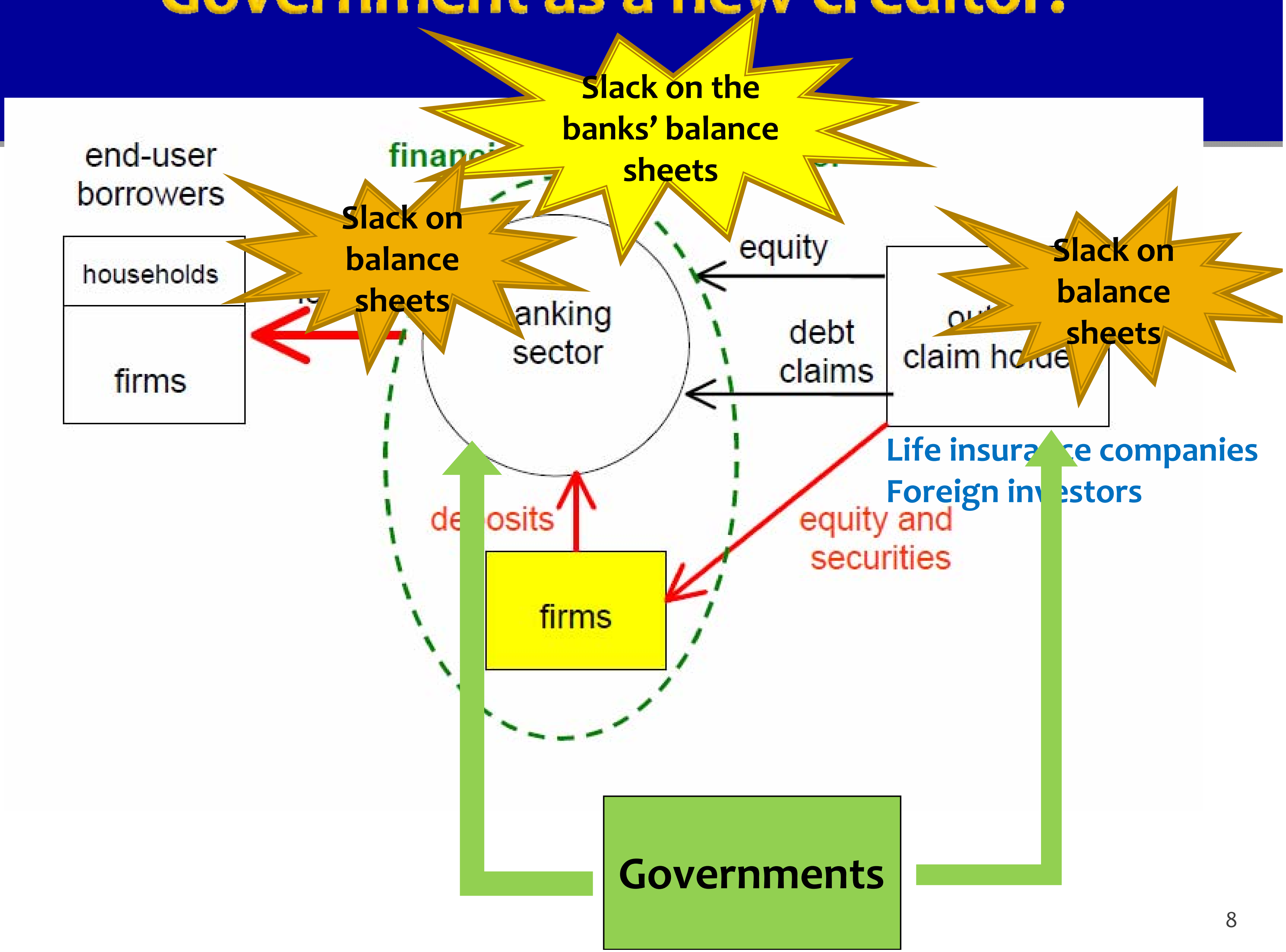
Source: Flow of Funds Accounts

Fiscal restructuring in 1985-1990



Sources: Economic Planning Agency, *Report on National Accounts*, 1955 to 1969, and Cabinet Office, *Annual Report on National Accounts*.

Government as a new creditor!



My comments

- The government as a “new creditor”
  - The government shrank its balance sheet in 1985-1990.
  - This created “slack” on the balance sheets of non-leveraged institutions (like life insurance companies) and those of banks.
  - Such “slack” forced banks to find new borrowers.
- “Supply side story” advocated by the paper still looks okay, but need some modifications.
  - Financial innovations and deregulations played a less important role in Japan. The housing bubbles in Japan and US are not the same, at least in this respect.
  - I want to see a new section about “lessons for fiscal policy ” in addition to the section about monetary policy.