Return of the Living Dead: Japanese Economy in 2009

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Outline

1. Japan back to recession
2. Government policy responses so far
3. Problems ahead
Subprime Related Products at Major Japanese Banks (Billion Yen)

<table>
<thead>
<tr>
<th></th>
<th>Subprime related products</th>
<th>Other CLO, CDO, RMBS, CMBS, Leveraged Loans</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Balance</td>
<td>Loss</td>
<td>Balance</td>
</tr>
<tr>
<td>Mar. 2008</td>
<td>933</td>
<td>775</td>
<td>17,668</td>
</tr>
<tr>
<td>Jun. 2008</td>
<td>876</td>
<td>817</td>
<td>18,533</td>
</tr>
<tr>
<td>Sept. 2008</td>
<td>719</td>
<td>867</td>
<td>17,693</td>
</tr>
</tbody>
</table>

- Tier I capital of major banks at the end of March 2008
  - 25,987 billion yen
- Low exposure compared to capital, but capital has been depleted since March 2008
# Capital Evolution for Japanese Banks
2003 to 2007 (¥ trillion)

<table>
<thead>
<tr>
<th></th>
<th>March-07</th>
<th>March-03</th>
<th>Change</th>
<th>Percent contribution to change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Official Capital</td>
<td>40.0</td>
<td>24.8</td>
<td>15.2</td>
<td>100.00%</td>
</tr>
<tr>
<td>Common stock</td>
<td>9.3</td>
<td>10.2</td>
<td>-0.9</td>
<td>-6.13%</td>
</tr>
<tr>
<td>Capital surplus</td>
<td>8.7</td>
<td>8.6</td>
<td>0.1</td>
<td>0.39%</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>13.4</td>
<td>4.4</td>
<td>9.0</td>
<td>59.07%</td>
</tr>
<tr>
<td>Net unrealized gains on stocks and others</td>
<td>8.2</td>
<td>0.1</td>
<td>8.1</td>
<td>53.25%</td>
</tr>
<tr>
<td>Revaluation reserve for land</td>
<td>1.0</td>
<td>1.5</td>
<td>-0.6</td>
<td>-3.70%</td>
</tr>
<tr>
<td>Net deferred gains on hedging instruments</td>
<td>-0.3</td>
<td>0</td>
<td>-0.3</td>
<td>-2.07%</td>
</tr>
</tbody>
</table>

Note: Some small components have been omitted and because of this and rounding columns may not sum to totals.

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Impact of Global Economic Downturn on India and Japan

Impact of Global Economic Downturn on India and Japan
GDP Growth (% from a year ago)
Industrial Production (SA, 2005=100)

Year

2003 2004 2005 2006 2007 2008

Impact of Global Economic Downturn on India and Japan

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Recovery depended on exports, but not exclusively (contributions to growth, %)
Unemployment Rate (%, SA)
Effective Job-Offers to Applicants Ratio (SA)
Policy responses so far

- Monetary policy: back to ZIRP (almost)
- Fiscal policy: expansionary (but tax hike as early as 2011), ¥2 trillion (0.4% of GDP) cash handout
- Act for Strengthening Financial Functions revived (with less stringent conditions for capital injections)
- Improved safety net for unemployed (especially non-standard employment), job creations in public sector
- Help (pressure) firms not to layoff employees, including non-regular workers
- Problems of non-standard employment attracted special attentions
Proportion of Non-standard Employment (%)
Attempts to protect employment can create zombie firms

- **Zombie firms**: unproductive firms that should exit the markets but are kept alive by the help of creditors/government

- **Zombie firms** hurt the economic growth by discouraging more productive firms from entering the market (or expanding) to create jobs (Caballero, Hoshi, and Kashyap, *AER*, 2008)

- This was indeed a mistake Japan made during the long stagnation of the 1990s
Zombies defined as firms getting subsidized credit

The sample is listed firms in manufacturing, construction, real estate, retail and wholesale (other than the nine largest general trading companies), and services.
Zombies Hurt Non-Zombies

Employment growth or Investment

$$\text{Activity}_{ijt} = \text{constant} + \alpha' \text{year}_t + \delta' \text{industry}_j$$

$$+ \beta \text{non-zombie}_{ijt} + \chi \text{industry zombie}\%_{jt}$$

$$+ \varphi \text{non-zombie}_{ijt} \times \text{industry zombie}\%_{jt} + \varepsilon_{ijt}$$
### Impact of Global Economic Downturn on India and Japan

#### Table: Dependent Variable Analysis

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Sample</td>
<td></td>
<td></td>
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<tr>
<td>Constant</td>
<td>0.239 (0.008)</td>
<td>0.014 (0.002)</td>
</tr>
<tr>
<td>Non-Zombie Dummy</td>
<td>0.026 (0.006)</td>
<td>0.0011 (0.0018)</td>
</tr>
<tr>
<td>Industry Zombie %</td>
<td>-0.137 (0.038)</td>
<td>-0.045 (0.012)</td>
</tr>
<tr>
<td>Non-Zombie * Industry Zombie%</td>
<td><strong>-0.089 (0.033)</strong></td>
<td><strong>-0.023 (0.010)</strong></td>
</tr>
<tr>
<td>( \bar{R}^2 )</td>
<td>0.054</td>
<td>0.090</td>
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</tbody>
</table>

Zombie’s Hurt Non-Zombies
Total Factor Productivity by Industry: 1980-2002
(1995=100)

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Impact of Global Economic Downturn on India and Japan
Summary

1. Japanese economy: back into recession
2. Policy response: protect employment, help (pressure) corporations/banks to keep the employees
3. Watch out for the return of zombies
THEY'RE BACK FROM THE GRAVE AND READY TO PARTY!

THE RETURN OF THE LIVING DEAD