

Contemporary Monetary Policy and Financial System Issues of Japan

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ABSTRACT

It is well-known internationally that Japan has been experiencing serious economic and financial difficulties since the 1990s. This chapter aims to explain the current important issues regarding the Japanese monetary policy and financial system. Struggling with unprecedented deflation, the Bank of Japan has employed unusual policy tools, such as reducing target interest rates to zero and buying stocks. The financial system of Japan is having trouble with financial intermediation, risk sharing and liquidity services. It is notable that the Japanese financial system is quite different from that of a decade ago. In recent years, the Japanese household and business enterprise sectors as a whole are lenders, and the government and foreign sectors are borrowers. As a result, the business model of Japanese banks during the high growth period when banks collected money from households as deposits and lent it to large enterprises is no longer sustainable. In terms of households' portfolio investments, safe assets such as bank deposits and traditional insurance make up substantial shares and risky assets such as stocks are marginal. A bank-centered financial system like Japan's faces financial difficulties when the risk taking ability of financial institutions decreases, which actually occurred due to the huge non-performing loans of the 1990's. The government initiated the Japanese Big Bang to vitalize the financial market in Japan, but a satisfactory outcome has yet to be seen.