

**BANKING CRISIS IN JAPAN
PREDICTION OF NON-PERFORMING LOANS**

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Abstract

Japan is currently suffering its third economic downturn of the past decade. While Japan suffers from a variety of structural problems, the most acute is the crushing burden carried by the banks. They still suffer under the weight of thousands of billions of yen of bad loans resulting from the collapse in asset prices a decade ago. Japan's still unsolved banking crisis constitutes a threat to a large component of the global financial system.

Some economists believe that these events were avoidable. Better underwriting by Japanese banks and more prudent monetary policies by the Central Bank of Japan could have prevented the subsequent downturn and losses. It may be impossible to prove that sound policies could have avoided the persistent crisis altogether, but it seems unarguable that better professional underwriting by Japanese banks and more prudent monetary policies by the Central Bank could have mitigated the severity of the economic downturns and reduced huge losses.

The model I have constructed analyzes whether the events leading Japan into financial crisis could have been anticipated. The model is a simple multivariate econometric equation estimated monthly data between 1980 and 1990. This model appears to explain much of the variation in non-performing loans during this period. The model simulated during the period 1990 to 2001 indicates that the non-performing loans could have been anticipated.

This model or one like it could have given bank regulators basic tools to anticipate the incidence of non-performing loans during the 1990s. Had regulators done so, it might have been possible for them to take those remedial actions that would have limited the subsequent numbers of poorly underwritten loans during the 1990s.

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