1. Introduction

Financial booms and busts are complex phenomena that defy a simple explanation. The fact that such booms and busts have taken place throughout history even as financial institutions and instruments have undergone very dramatic changes over the centuries should give us pause for thought before assigning blame to any particular feature or set of economic developments in place at the time.

The global financial crisis that started with the subprime mortgage crisis in the United States in the summer of 2007 gained further momentum in 2008, engulfing not only other developed countries in Europe and elsewhere, but spreading its influence to emerging market economies also. The lessons that we are learning from the current global financial crisis provide valuable insights with which to revisit past episodes of financial booms and busts. In particular, the US mortgage crisis provides many lessons on the role of financial innovation and the importance of the increased supply of credit that results from securitization and the tapping of new sources of funding beyond the traditional deposit funding for the banking sector. Whereas retail deposits were the traditional funding source for the bank-based financial system, the shift to a market-based financial system and the securitization of financial claims enables the tapping of new sources of funding for the banking sector – both domestic and foreign.

In this paper, we offer a re-assessment of the financial boom that took place in Japan in the late 1980s in the light of the lessons learned from the subprime crisis in the United States. The empirical features of the 1980s bubble that we draw attention to have been discussed by others before us.[1] Our contribution is to gather them in a financial system perspective where the interlocking balance sheets of banks and non-financial firms are considered as a unified whole.

In the US subprime crisis, understanding the role of securitization in opening up new sources of funding is important in understanding the overall increase in mortgage funding to household borrowers. As we will see below, securitization enabled the increased funding to US households by increasing the overall leverage of the US financial system as a whole. In the case of Japan in the 1980s, our particular focus is on corporate lending following the sectoral changes that took place in Japan after the liberalization of both securities markets and the rules governing bank deposits.

Securities markets enabled the opening up of new funding sources – both domestic and foreign – away from traditional retail deposits. We highlight the role played by a subset of non-financial firms: the large manufacturing firms in Japan. As recently as the early 1980s, manufacturing firms in Japan received virtually all of their financing from the banking system, both for long-term investment as well as for short-term liquidity needs. However, with the liberalization of the securities market that began in the mid-1980s, non-financial companies were able to tap new sources of funding from outside the traditional banking sector. New stock, corporate bonds, warrants and commercial paper

[1] For example, Borio and Lowe (2002), Borio and White (2003), Okina, Shirakawa and Shiratsuka (2001), Posen (2000) among others.