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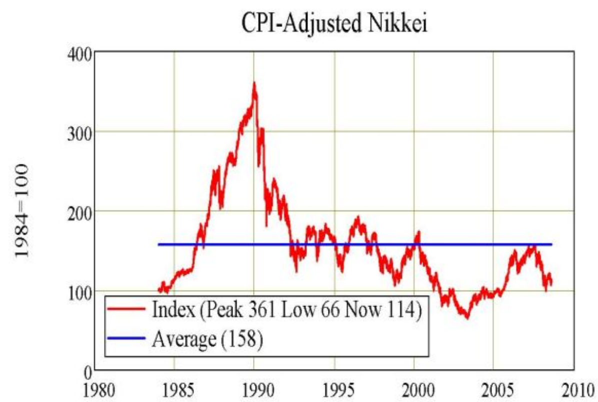
US economists have relentlessly harangued the Japanese for their supposed mismanagement of their post bubble era, which has led to nearly 20 years of low growth, borderline deflation, with a not-much-discussed, robust export sector.

Along with others, we complained in the early days of the Fed/Treasury emergency response that they were taking one of the worst elements of the Japanese playbook, namely, trying to prop up the value of dud assets, rather than figuring out how to do more price discovery and ameliorate the attendant reaction (not damage, mind you, the damage was already done when the bad loans were made). Yes, the Treasury has made some capital injections into banks, but without cleaning up the balance sheets, the benefits are limited. Even with supposedly more aggressive action on realizing losses, our banks act a lot like their Japanese pre-writedown zombie counterparts.



Japan’s stock market performance, 1980s-2008

So in yet another “putting lipstick on a pig” initiative, the authorities, having unwittingly copied the heretofore-seen-as-failed Japanese playbook, are now trying to reposition Japan as a source of valuable lessons.

Trust me, you would never have seen anything along these lines two year ago, starting with the title of the New York Times story "Japan Offers a Possible Road Map for U.S. Economy." Pretty soon, we'll have our very own Ministry of Truth (I kid you not, read the article).

From the New York Times:

> The Bank of Japan kept rates near zero for most of the last decade in an effort to end a long economic stagnation, and raised them only two years ago. Many economists say they believe that the zero interest-rate policy finally worked in Japan after regulators took aggressive steps that succeeded in restoring faith in Japan’s financial system and

Tokyo's ability to oversee it.

On Dec 18 Japan cut interest rates to 0.1%

> Now, with the Fed and President-elect Barack Obama turning to the same sorts of unconventional policy tools to battle the worst global economic crisis since the Depression, economists and bankers say they hope that Japan's lessons are not lost on Washington. They say the United States needs to take the same kinds of confidence-building steps, and much more quickly than Japan did....

Yves here. Why does this remind me of that phase of the Iraq war when the US claimed the problem was not how the war (notice how we never say occupation?) was going, but the perceptions of the war within Iraq, and launched a PR campaign? That was such an astounding success that it gets nary a mention these days.

Back to the article:

> Economists and former Bank of Japan officials say the biggest lesson they learned was that cutting rates alone has almost no effect when the financial system has fallen into a crisis as deep as the one Japan faced in the 1990s.
>
> Japanese banks simply refused to lend in an environment where borrowers could suddenly go bankrupt, saddling lenders with huge, unforeseen losses. The Bank of Japan tried even more extreme measures, like using its powers to create money to essentially stuff cash into the nation's commercial banks in hopes they would start lending again.
>
> Exasperated central bankers found that commercial banks just let the money pile up instead of lending it out.
>
> Economists say the United States faces a similar situation, after the sudden collapse in September of Lehman Brothers created fears of additional failures. Economists also fault Washington for its inconsistency in dealing with the financial crisis, leaving the impression that it does not have a clear strategy for dealing with ailing lenders.
>
> In Japan's case, economists and former bankers say, credit began to flow freely again only after 2003, when regulators adopted a tough new policy of auditing banks and forcing weaker ones to raise new capital or accept a government takeover. Economists said the

> audits finally removed paralysis in credit markets by convincing bankers and investors that sudden failures were no longer a risk, and that the true extent of problems at banks and other companies was finally being revealed.
>
> Economists say Washington needs to do something similar to make banks and financial companies more transparent, and reassure investors that there were no more collapses like that of Lehman Brothers on the horizon.

Yves here. The need for writedowns along with recapitalization was the lesson of the widely touted Swedish approach, in the wake of its early 1990s financial crisis. But Sweden went even further. It nationalized dud banks, replaced management, spun out bad assets into an independent company. That entity was deliberately overcapitalized; it was able to do triage on borrowers, liquidating ones that were goners, but more important, restructuring loans and often extending new credit to ones who looked viable.

Back to the Times, this time for comic relief:

> Economists and former central bankers said another lesson from Japan's experience was the importance of consistency. This became apparent in 2000, they said, during one of the bank's more embarrassing episodes, when it raised interest rates, and lowered them back to zero a year later when the economy faltered.

It's a little late to worry about consistency....

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For more on the sharp decline in Japanese and East Asian trade, see the December 22, 2008 Bloomberg report: Japan Exports Plunge Record 27% as Recession Deepens (Update3).

See also Kaneko Masaru and Andrew DeWit, Subprime Learning: Positive and Negative Lessons of the Japanese Bubble for Americans