

Lessons from Japan's Ceiling on Real Estate Lending and the Implications

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Amid the abrupt surge in real estate prices and related lending in the late 1980s, the Japanese government tried to curb lending with a ceiling on real estate lending. Although the lending ceiling did effectively curb the abruptly rising real estate lending, its belated timing, the lack of communication and consensus between the government and the central bank, and regulatory loopholes resulted in the bursting of the bubble and the long-term recession in Japan. For Korea to control the steeply rising household debt and to keep the economy more sustainable, it should learn lessons from Japan's lending ceiling case and carefully monitor real estate prices and the pace of increase in household debt when shaping its real estate and household debt policies using an optimal mix of monetary policy and prudential measures such as the LTV, DTI, and DSR. Going forward, Korea needs real estate and household debt policies that help secure stable housing and curb housing speculation for addressing the deepening inequality of wealth distribution.

Household debt has been cited as the single largest risk factor to the Korean economy. The abrupt surge in household debt directly stems from the increase in mortgage loans and "jeonse" loans. In response, the government toughened mortgage regulations and expressed its firm determination not to tolerate speculation in the housing market. However, as long as there are expectations for home price increases, there will be more home purchases, which will likely push up home prices further. It is hard to curb household debt amid such expectations.

* All opinions expressed in this paper represent the author's personal views and thus should not be interpreted as Korea Capital Market Institute's official position.

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The problem about Korea's current household debt lies in the sheer amount of debt as well as the rapid pace of increases, both of which are allegedly dragging down consumption and growth of the Korean economy. Cecchetti et al (2011) analyze that when the debt-to-GDP ratio exceeds the 85% threshold, it begins to have a negative impact on economic growth. Korea's debt-to-GDP ratio as of 2016 stood at 92.8%, well above the threshold.¹⁾ Kim et al (2017)'s analysis adopting the same methodology also shows that Korea's current level of household indebtedness has adverse effects on household consumption.²⁾

Acknowledging the seriousness of the household debt problem, the government is preparing for a tougher real estate policy and a household debt policy. Although the real estate measures on August 2 have curbed the rising trend of mortgage lending, credit lending with higher interest rates has increased, causing concerns about the worsening quality of household debt. Japan experienced a similar situation as well. After the Plaza Accord of 1985, the provision of abundant liquidity to boost the economy pushed up real estate prices and abruptly increased real estate lending in Japan. The Japanese government unveiled a series of lending regulations that ended in failure. This led to the adoption of the ceiling on real estate lending ("lending ceiling", hereinafter).

Hence, keeping household debt at a manageable level requires simultaneous consideration of both real estate as well as household debt issues that are like two sides of the same coin. From that perspective, it is worth exploring the case of Japan that experienced a real estate bubble and a lending ceiling ahead of Korea. By looking at the background, effect, and problems of the lending ceiling the Japanese government adopted as part of diverse efforts in stabilizing soaring real estate prices, I try to derive the implications for Korea's household indebtedness.

Japan's ceiling on real estate lending

After the Plaza Accord of 1985, Japan tried to keep its interest rates at low levels in its attempt to boost the sluggish economy amid the high Japanese yen. However, the resultant excess in liquidity inflated the real estate market. To cool down the heated real estate market and keep the rising real estate lending at bay, the Japanese government took various actions

1) Cecchetti, Stephen G. and Mohanty, Madhusudan S. and Zampolli, Fabrizio. 2011, The Real Effects of Debt, BIS Working Paper. For reference, the World Economic Forum and Bank for International Settlements set the threshold at 75% and 85%, respectively.

2) Jaechil Kim, Hyunjoo Kang, Inseok Baek, 2017, Policy Challenges for Soft Landing of Korea's Household Debt, Korea Capital Market Institute (in Korean).

and measures. More specifically, it notified financial institutions of its policy to curb real estate lending in July and August in 1985. The notified financial institutions included commercial and regional banks, life and non-life insurers, trusts, and mutual savings banks. This was followed by various qualitative regulations such as circulars to bank officials and hearings by the Ministry of the Treasury (now Ministry of Finance); self-regulation imposed by financial institutions; and window guidance by the Bank of Japan.

Despite government actions to curb financial institutions' speculation on land, the high demand for land pushed up real estate prices further. To curb the constantly rising real estate lending, the Ministry of the Treasury (now Ministry of Finance) on March 27, 1990 unveiled a ceiling on real estate lending. Although the Ministry of the Treasury took a reserved stance on quantitative regulation on real estate lending at the time, it implied that the lending ceiling was inevitable to rein in the soaring real estate prices.³⁾ The gist of the regulation consisted of two parts; to keep real estate lending (except for lending to public land development agencies) within the increase rate of total lending; and to mandate the reporting of lending activity related to the real estate, construction, and non-bank sectors.

Behind the adoption of the lending ceiling were two reasons. First, the surge in real estate prices went beyond the metropolitan areas such as Tokyo, Osaka, and Nagoya, to the whole country. Second, a series of government measures failed to curb real estate lending. Hence, the government tried to take a bolder step. Table 1 shows the changes in Japan's land prices during the period. Between 1986 and 1988, land prices surged abruptly in the Tokyo area before stabilizing in 1989. But in 1990, it began showing signs of another rise. Commercial land prices rose by only 1.8 percentage points from 3.0% in 1989 to 4.8 % in 1991, whereas residential land surged by 6.2 percentage points from 0.4% to 6.6% during the same period. From 1987, the price increase rate climbed abruptly in the Osaka and Nagoya areas. The figures in this table confirm that the hike in land prices spread from commercial to residential land, and from the Tokyo area to the Osaka and Nagoya areas.

3) At that time, the official in charge mentioned the lending ceiling regulation being "for a while", suggesting that the regulation was a stopgap rather than a fundamental tool.

Table 1. Japan's land price changes (YoY increase, %)

		1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
Commercial	Tokyo Area	5.7	4.2	5.5	7.2	12.5	48.2	61.1	3.0	4.8	4.1	-6.9
	Osaka Area	7.1	4.1	3.9	5.0	7.0	13.2	37.2	35.6	46.3	8.1	-19.5
	Nagoya Area	5.4	3.5	2.7	2.7	3.3	6.4	16.8	21.0	22.4	19.1	-7.6
	Three-city Average	6.0	4.0	4.5	5.8	9.2	30.1	46.6	14.1	18.6	8.1	-10.3
	Regional Average	5.7	4.0	2.8	2.6	2.5	2.9	5.4	7.6	15.4	16.3	0.4
	National Average	5.8	4.0	3.5	3.8	5.1	13.4	21.9	10.3	16.7	12.9	-4.0
Residential	Tokyo Area	7.4	4.1	2.2	1.7	3.0	21.5	68.6	0.4	6.6	6.6	-9.1
	Osaka Area	9.3	5.3	3.6	3.0	2.6	3.4	18.6	32.7	56.1	6.5	-22.9
	Nagoya Area	7.9	4.5	2.4	1.6	1.4	1.6	7.3	16.4	20.2	18.8	-5.2
	Three-city Average	8.0	4.5	2.6	2.0	2.7	13.7	46.6	11.0	22.0	8.0	-12.5
	Regional Average	8.5	5.6	3.5	2.4	1.7	1.2	1.9	4.4	11.4	13.6	2.3
	National Average	8.3	5.1	3.0	2.2	2.2	7.6	25.0	7.9	17.0	10.7	-5.6

Note: Land prices on January 1 of each year

Source: Japan's Ministry of Land, Infrastructure, Transport, and Tourism

Effects and problems of the lending ceiling

The lending ceiling came from a policy judgement to keep the increase in real estate prices at bay amid economic and political conditions and public consensus at that time. Under the regulation, real estate lending was restricted. As illustrated in Table 2, the increase rate of real estate lending had exceeded that of total lending before the lending ceiling. However, during the lending ceiling period, it was kept within the increase rate of total lending.

Table 2. Outstanding loans in Japan's national banks

(Unit: JPY 100 million, YoY growth in %)

	Real estate lending	Total lending
End of March, 1983	151,803 (14.4)	2,173,263 (9.9)
End of March, 1984	174,926 (15.2)	2,396,598 (10.3)
End of March, 1985	200,917 (14.9)	2,678,546 (11.8)
End of March, 1986	253,026 (25.9)	2,964,838 (10.7)
End of March, 1987	335,650 (32.7)	3,304,775 (11.5)
End of March, 1988	373,680 (11.3)	3,685,104 (11.5)
End of March, 1989	423,242 (13.3)	4,064,098 (10.3)
End of December, 1989	469,019 (14.1)	4,400,807 (10.9)
End of March, 1990	487,887 (15.3)	4,544,795 (11.8)
End of June, 1990	480,084 (10.0)	4,564,731 (11.4)
End of September, 1990	481,730 (6.9)	4,660,195 (9.2)
End of December, 1990	484,833 (3.4)	4,739,543 (7.7)
End of March, 1991	489,280 (0.3)	4,801,349 (5.6)
End of June, 1991	493,604 (2.8)	4,832,572 (5.9)
End of September, 1991	495,409 (2.8)	4,876,318 (4.6)
End of December, 1991	506,250 (4.4)	4,958,476 (4.6)
End of March, 1992	510,779 (4.4)	4,963,224 (3.4)
End of March, 1993	586,016 (6.0)	5,081,606 (2.4)
End of March, 1994	604,147 (2.9)	5,079,275 (0.0)

Note: The shaded area indicates the duration of the lending ceiling.

Source: Bank of Japan

Nevertheless, the lending ceiling triggered the bubble bursting and other side effects besides intended policy purposes. The problems in the lending ceiling are as follows.

First, Bernanke and Gertler (1999), Okina et al (2001), and Hamada et al (2011) point to the belated timing of Japan's lending ceiling. The high Japanese yen at that time required a policy tackling the economic recession, which runs counter to suppressing an asset bubble, the authors argue. Hence, they point out that the more appropriate timing for the lending ceiling is not the year of 1990, but sometime between 1987 and 1988 when the metropolitan area observed real estate prices and lending rise evidently.⁴⁾

4) ① Bernanke, B. and M. Gertler, 1999, "Monetary Policy and Asset Price Volatility", in Federal Reserve Bank of Kansas City, New Challenges for Monetary Policy.

② Okina, Shirakawa, and Shiratsuka, 2001, Asset Price Bubbles, and Monetary Policy –Japan's Experience and Lessons Learned in the Latter Half of the 1980s (in Japanese); Konishi, Shirakawa, and Okina, Bubble and Monetary Policy: Japan's Experience and Lessons Learned, Nihon Keizai Shinbun (in Japanese).

③ Hamada, K., A. Kashyap and D. Weinstein. 2011, "Introduction", in K. Hamada, A. Kashyap and D. Weinstein, eds., Japan's Bubble,

Second, the lending ceiling came together with rate hikes, which made the regulation much tougher than initially intended. Before the lending ceiling, the Bank of Japan tried to calm down the bubble by abruptly raising the interest rate first from 2.5% to 3.25% in May 1989, and five more times for one year and three months to 6% in August 1990.⁵⁾ Such off-beat policies seem to have stemmed from the lack of communication and consensus between the government and the central bank. In the late 1980s, there was no clear division of roles and responsibilities for real estate lending between the Ministry of the Treasury and the Bank of Japan.

Third, the lending ceiling did not apply to Japan's mortgage lenders (jusen) and agricultural cooperative financial institutions, and their real estate lending ballooned, which negated the policy effect.

This helped abruptly balloon real estate lending from those financial institutions left out of the regulation, which weakened the lending ceiling's effect. After the bubble burst, the abruptly risen real estate lending of jusen went sour and causes the jusen problem. For example, a total of JPY 120 trillion was originated in the real estate market in June 1991, of which JPY 59 trillion was from banks and JPY 50–55 trillion from non-banks.

Policy implications

After the Plaza Accord, Japan carried out economic stimulus and loose monetary policy aiming to weather the economic recession caused by the high Japanese yen. As Japanese companies purchased commercial land under the circumstances, the real estate prices surged and a bubble was formed. On the other hand, Korea's household debt has risen amid speculative demand expecting home prices to rise further on top of low financing costs. Although a direct comparison of two countries seems hard because Japan's course of the creation and bursting of a real estate bubble in the 1980s is somewhat different from Korea's current situation, the two countries share two common factors; the low interest rate trend, and the surge in real estate lending. Especially, Korea has observed the rising household debt to increasingly restrict economic growth and consumption. To curb the excessive growth of household debt, the Korean government unveiled a strong real estate measure on August 2, 2017. Ever since the

Deflation, and Long-term Stagnation, The MIT Press.

5) When the bubble burst, the Bank of Japan switched to monetary easing in July 1991, since which it cut interest rates six times to 2.5% for one year and seven months until February 1993.

measure, the rising trend of real estate lending has subsided. However, the measure seems to trigger a balloon effect causing real estate speculation to bulge in unregulated areas, and a rise in credit lending including jeonse loans, which raises concerns about a regulatory loophole.

In so far as real estate is viewed as a tool for household asset building and speculation instead of a place to live, and expectations exist for increases in real estate prices, it is barely impossible to curb the rise in real estate lending and the consequent increase in household debt. For economic sustainability, Korea should shape its real estate and household debt policies utilizing monetary policy and prudential measures (e.g., the LTV, DTI, DSR, etc.) based on cautious monitoring on the fluctuation in real estate prices and the rapidly increasing pace of household debt. Also, Korea should learn lessons from Japan's failure in the lending ceiling and be careful in reviewing any ceiling on household debt.⁶⁾ As described above, Japan's asset bubble burst not solely because of the lending ceiling, but also due to other factors including off-beat policies as well as the lack of communication and consensus between the government and the central bank.

Housing is a necessity good directly related to the quality of living. An increase in home prices does not necessarily lead to economic affluence. Rather, an excessive rise in home prices could destabilize the residential environment and deepen the inequality in wealth distribution between homeowners and non-homeowners. Going forward, Korea needs policies on real estate and household debt that could build a stable residential environment and effectively address the unequal wealth distribution caused by housing speculation.

6) During the last presidential election, several candidates pledged for managing the total amount of household debt.