# The effectiveness of monetary easing policy on Bank Lending in Japan during 1999-2005

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## Abstract

The aim of this paper is to find some answers to the following question *"Why the Japanese bank credits were decreasing throughout the period between FY 1999 and FY 2005 even though the Bank of Japan was conducting an unprecedented expansionary monetary policy?"*

By conducting empirical study, using a Fixed Effects Model (FEM) applied on Japanese banks' data since FY 1999 through FY 2005, we found that regulatory capital requirements and the non-performing loans burden have constrained Japanese banks to react to the Zero Interest Rate policy (ZIRP) and the Quantitative Easing policy (QEP) by increasing their lending supply.

Major banks, which represent roughly 50% of banking system total assets, were incurring more capital pressure on their risk-taking decisions than regional banks. However the latter incurred more non-performing loans pressure on their risk-taking decisions than City banks.

In this paper, the market-valued capital ratio is used in order to confirm results got from the regulatory capital ratios, extensively criticized in many academic papers for its limitations

The constraining effect of these banks' supply factors has triggered a "Credit Crunch" responsible for the delay of financial institutions responsiveness to monetary accommodations.

Although, the decrease in bank lending is explained by a decrease in the demand for external funding, this factor has played a minor role relatively to banks' supply factors.

This paper shows that, even though the effect of bank lending channel of monetary policy was limited during the period (FY 1999- FY 2005), the regulatory authority actions have succeeded in improving the banking system financial situation preparing, then, the path for the Japanese economy to get solid recovery.