Requiem for Market Discipline and the Specter of TBTF in Japanese Banking

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Abstract: This study examines the reaction of private market participants to the emergence of the "Too-Big-To-Fail" (TBTF) doctrine in the Japanese banking sector. The event justifying the use of the "TBTF" label occurred on May 17^{th}, 2003, when the Japanese government decided to bail out *Resona Holdings*, the 5^{th} largest financial group in the country. By using a sample of all Japanese listed banks and the standard event study methodology, we document significant and positive wealth effects in the stock market accruing to large banks and negative (though non-significant) effects accruing to smaller banks. Besides the effect on bank equity values, we also document a significant positive abnormal volume of trading on days following the bailout announcement date for the largest banks only. We extend our empirical analysis on stock prices and trading volumes by detecting an original "pure" risk effect in the Credit Default Swap (CDS) market.

Keywords: Too-Big-To-Fail; Market discipline; Credit default swap; Event study
JEL classification codes: G21; G28

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