

Lessons from Japan's Post Bubble Economy and Policy Implications

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NAKAO Takehiko

Chairman of the Institute, Mizuho Research & Technologies

1. Current Challenges to Global Economy

1. Russian invasion to Ukraine, the crisis in the Middle East, and impacts on global supply chains, and energy and food prices.
 2. Rewinding of fiscal policies which were expanded substantially due to the Covid 19.
 3. The rapid increase of interest rates by central banks to fight inflation and its impacts on emerging economies.
 4. Weaker real estate prices and debt issues, demography and stricter regulations in China. Will “Japanification” occur?
 5. Social, economic, and political divide within the US and stalemate of necessary policies.
 6. Slow recovery and some discrepancy between member countries in euro area. Impact of the BREXIT.
 7. Rapid yen depreciation and prolonged slump of the Japanese economy, and sustainability of fiscal and monetary policies.
 8. Decoupling or de-risking due to the friction between China and the West in trade, investment, technologies, and security.
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2. More Fundamental Global Issues

1. Climate change (need of mitigation and adaptation) and ocean health, increasing demand for energy and food.
2. Demographic change (declining and aging population with onus on the share of productive age and social vigor, growing population in sub-Saharan Africa).
3. Increasing divide within countries according to jobs, living places and education, on top of technologies and globalization.
4. Acceleration of digital economies and AI, protection of data, privacy, disinformation and misinformation, cyber-security, competition policies and taxation.
5. Sustainability of democracy due to social divide, effectiveness, social media, and identity politics.
6. Possible adjustments to hyper-globalization and multilateralism because of concerns about geopolitics, economic security, pandemic, and domestic issues.

3. Cause of the Bubble in Japan in the Late 1980s

- Aftermath of Plaza Accord of 1985 (expansionary fiscal & monetary policies to tackle rapid, large appreciation of Yen)
 - Very active financial activities (shift from saving shortage to saving glut, massive lending to real estate sector)
 - Increase of asset prices under the stable CPI (due to strong yen), wealth effect on consumption & investment
 - Myth for eternal land price hike, conceit on the strength of Japanese economy and high expectation of its future
 - Yen rate appreciated very rapidly from ¥244/USD in mid-September 1985 to ¥153 in August 1986
 - Nikkei stock index rose from ¥13,113 at the end of 1985 to its peak ¥38,915 at the end of 1989 (increase of total stock value as much as 150% of GDP)
 - Land prices of six urban areas rose by three times from the yearend 1985 to the yearend 1990 (increase of land value by 200% of GDP)
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4. Reasons for Japan's Long Slump since the 1990s

- Lasting impact of bubble bust - balance sheet adjustment & negative wealth effect, slow growth & deflationary pressure
 - Declining & aging population, demographic onus (decline of ratio of productive age population), burden of pension, aged care, & medical cost, loss of vigor of the society
 - More-than-expected speedy catchup by Asian emerging economies, failure of keeping pace with digitalization & new technologies, becoming much behind the US
 - Risk aversion attitude, over-reliance on government, increase of debt/GDP ratio, Ricardian effect (reducing private sector spending), inefficient resource allocation
 - Although per capita growth of productive age population is not that bad, value in terms of price especially in dollar has not increased (low deflator increase & depreciation of yen).
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5. Potentials of Japanese Companies & Economy

- Stable society with limited divide (while challenges to sustainability of extraordinary fiscal & monetary policies)
- Well-educated & diligent population (importance of directing resources to education, and R&D)
- Unique history & culture different from either China & the West (how to use its positioning)
- Many seeds to be monetized, craftsmanship for perfection, respect for trust, long tradition of market economy from Edo era (1603-1877) through Meiji modernization (1878)
- Frontrunner of aging society, building up tools to manage it (*Economist* article in December 2021)
- Closeness to fast growing Asian countries (need of friendship & deep relations of people, trade, & finance)

6. How to Revitalize the Japanese Economy

- **Diversity & flexibility** - active participation of women & foreigners, more in & out of enterprises, labor mobility, reward based on achievement, strength of individuals
- **Further integration with global economy** - expanding exchange in investment, HR, technology & knowledge, brand strategy, selling quality product/service at high price
- **Digitalization & green economy** - use of digital technology to create new service & business model beyond efficiency, aiming at zero emission with credible transition
- **Private sector vividness & role of government** - essential role of entrepreneurship, sustainability of fiscal & monetary policies, investment in education & R&D, redistribution
- **Enhancing corporate governance** - reforms not just for compliance but for promoting innovation & risk taking

7. Key To Miraculous Development of China

- Failure of central planning & import substitution
- Reform & Opening strategy since 1978
- Japan's support by consecutive, massive ODA loans after Peace & Friendship Treaty of 1978
- Foreign direct investment & technology transfer from Japan and others, Japan as export market for China
- Socialist Market Economy defined in the 1993 Constitution
- Entry to WTO in 2001, China as a center of global production network as well as huge consumers' market
- Lewisian Turning Point (end of labor mobilization from rural area) around 2001, more technology based growth

8. Is China Heading for Bubble Bust & “Japanification”?

(Common features)

- Myth for real estate & very active lending, big wealth effect
- High expectation for the future
- Starting facing aging & declining population

(Differences – disadvantages of China)

- Lower income level, weak social services & redistribution
- Divide with the US & others (though Japan also faced pressures)
- Risk of losing private vividness due to stronger government control

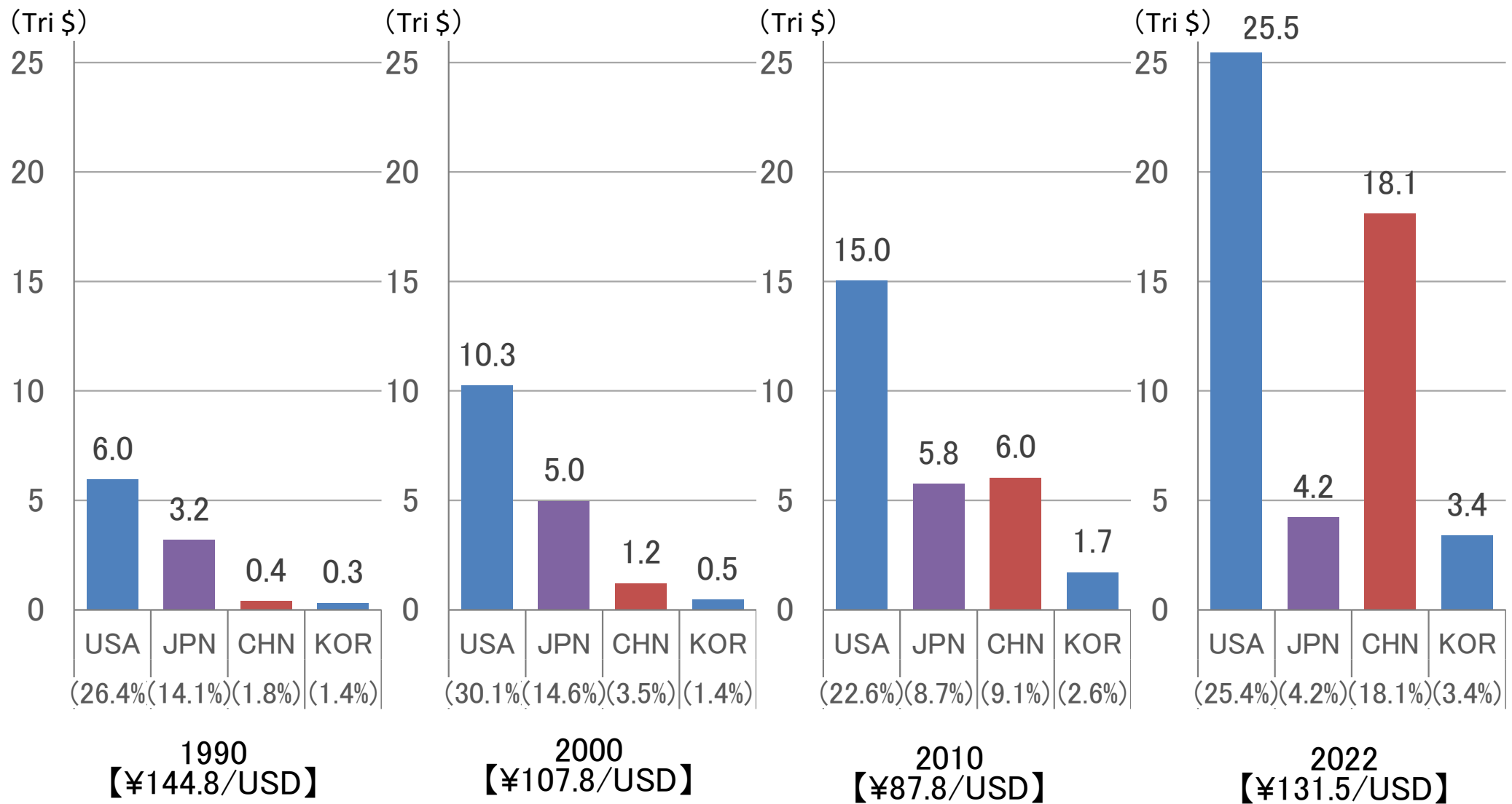
(Differences - advantages of China)

- More space for growth as it is still a developing country
- Number of researchers, active investment in R&D, use of data
- Very strong culture of entrepreneurship

9. China's Policy Options

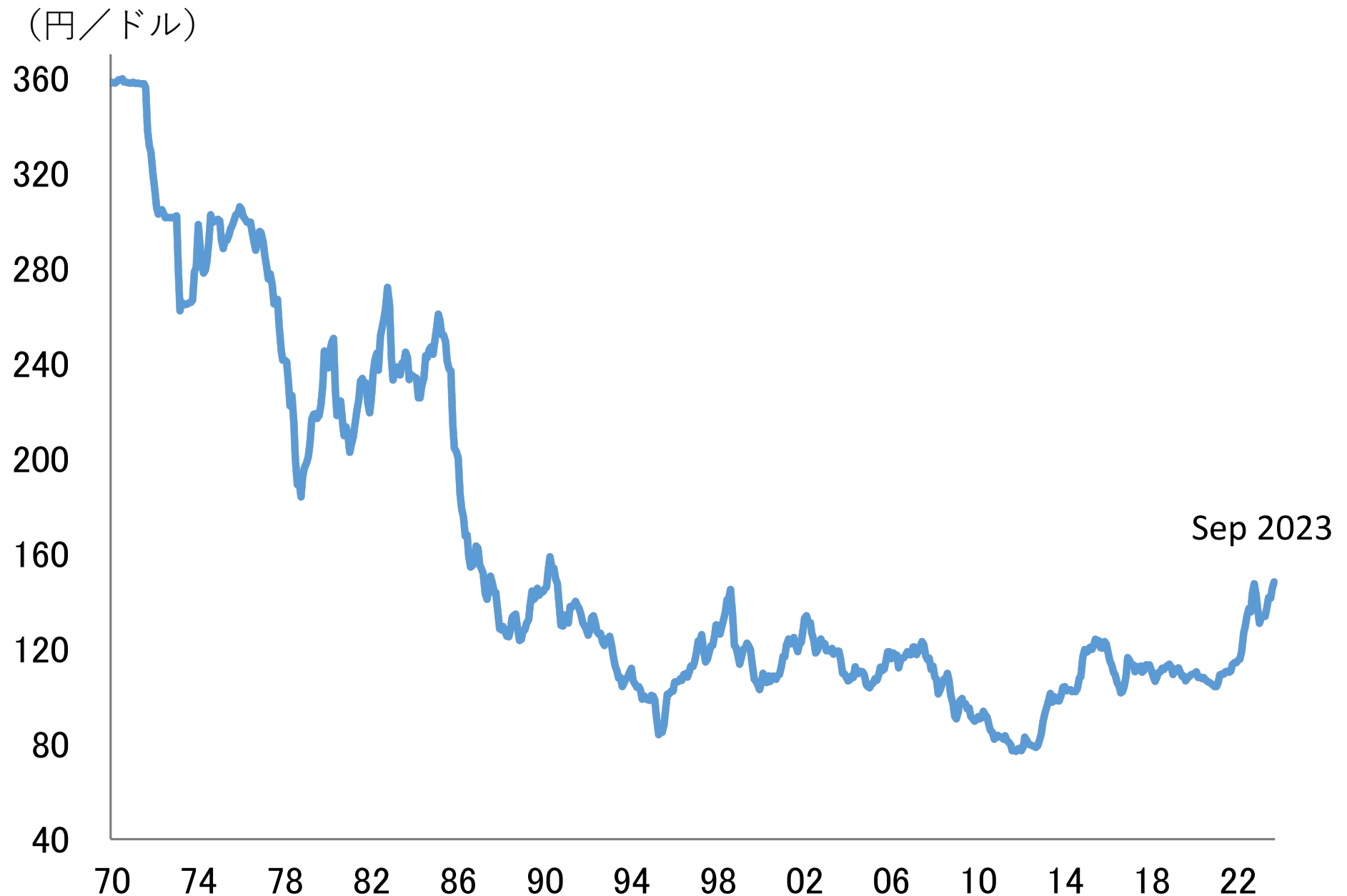
- **Will expansionary macro policies work?** – need of recognition & disposition of bad debt based on mark-to-market, risk of inefficiency by increasing public works & extended adjustment period by easy monetary policy
- **What kind of structural policies are needed?** - enhancing open trade & investment regimes, conducive & safe business environment for foreign & private companies, maintaining entrepreneur spirit, investment in technology
- **How to avoid social divide?** - reform of Huko system, strengthening public service (education, medicine & pension), redistribution by tax (inheritance, property)
- **Good foreign relations & international cooperation** - need to avoid “decoupling” by collaboration with others, enhance communication & build trust

GDP (Current prices, USD)



Note: GDP World share in (), Yen/USD rate in 【 】
Source: Made by MHRT based upon releases by IMF

Trends in the USD/JPY exchange rate since 1970 (monthly)



Source: Made by MHRT based upon releases by the Bank of Japan

Japan's Real effective exchange rate since 1970 (monthly)



Note: Benchmark year 2010, BIS methodology

Source: Made by MHRT based upon releases by the Bank of Japan