ISSN 2616-7433 Vol. 1, Issue 5: 19-29, DOI: 10.25236/FSST.19010504

Analysis Of Japan'S Long Lasting Recession Since 1990s

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ABSTRACT. *In the early 1990s, the burst of 'bubble' in real estate and stock markets makes Japan suffer from a long period of sluggish economy and recession. After that, a lot of research has been done to probe into the reasons for the economic stagnation. In this paper, we mainly focus on four reasons: multiple that bank insolvency risk and the stagnant production in corporate sector, the reduction of consumption and demand, the diminishing industrial competitiveness and the failure of industrial transformation, and the impact of demographic structure. In addition to the analysis of four reasons and their impact on the Japanese economy, policy analysis is also conducted to compare different policies implemented by the Japanese government and their effectiveness in reality in this paper.*

KEYWORDS: *Japanese economy; luggish economy; Enomy recession; nomic stagnation*

1. Introduction

From 1965 to 1970, an economic boom started in Japan with 11% of the average growth rate. However, Japan's stock market and real estate burst and the economy went into a tailspin in the early 1990s, and Japan began to suffered from sluggish economic growth and recession. Actually, the main text of this paper has three part. Firstly, this paper will state the nature of this terrible recession in Japan like quickly declining price of stock market and land price in the first part[1]. Then, in the second part, this paper will discuss the main four causes of Japan's sluggish economy in details. Finally, the policies like negative interest rate policy that the government of Japan has implemented to help Japan exit from this economic disaster will be discussed in the third part.

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2. Main Text

2.1 Nature of the Problem

In the early 1990s, the surprisingly burst of ‘bubble’ in real estate and stock markets makes Japan suffer from a long period economic stagnation until now, hurting Japan’s economy in several aspects, so called, Japan’s ‘two lost decades’.

2.1.1 Directly Impact on the stock market and negative affect landprice

The direct cause of the ‘two lost decades’ is the bubble burst in stock market. The stock market collapses and it takes not so long that the bubble also burst in the real estate market which makes the price of lands declined sharply. As shown in the figures, Nikkei 225 Index and the land price suffer from a dramatically decline at the beginning of the 1990s. (Figure1 and Figure2)

The decreasing price in the real estate market results in the increasing default rate of the loans issued by Japanese banks. These bad debts result in the insolvency of Japanese banks. Until now, the percentage change of the price of lands is still at a level below zero, the real estate market is in a sustained downturn.

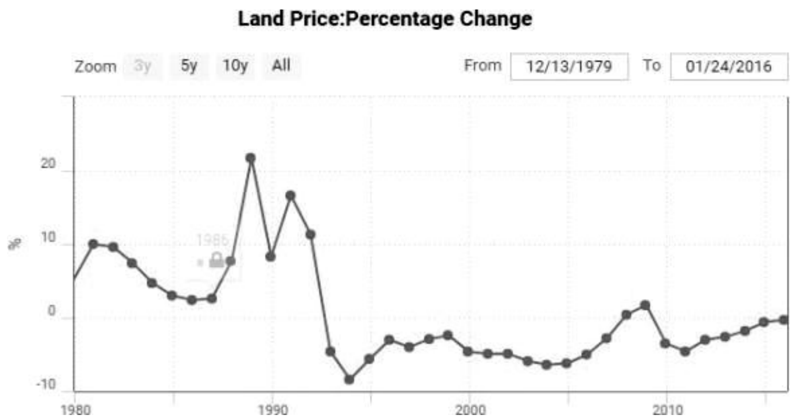

Figure. 1 Land Price: percentage Change

(Source: CEIC)

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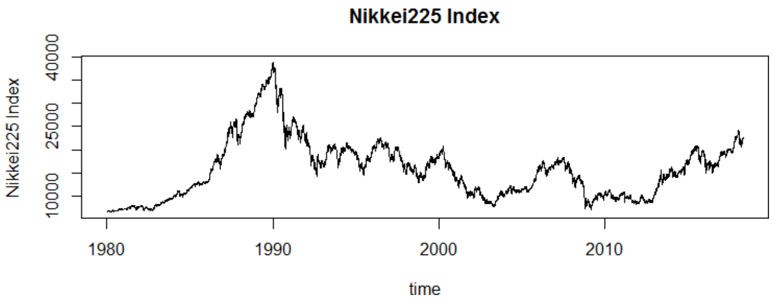

Figure.2 Nikkei225 index

(DATA Source: Wind, Source: Author's own photograph)

2.1.2 Recession of the overall economy

During the recession, Japan experienced a sluggish economic growth period, real gross domestic production (GDP) decreases sharply since the bubble burst and then remains at a relative low level comparing with that before 1990s, with again another dramatically drop at the beginning of global financial crisis. (Figure 3)

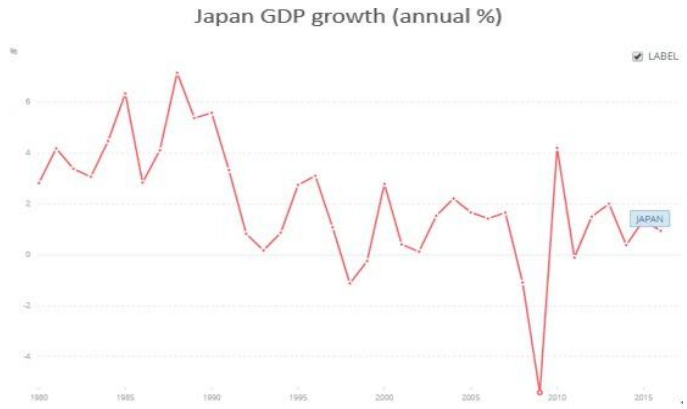

Figure.3 Japan GDP growth(annual%)

(Source:THE WORLD BANK)

2.1.3 The Decline in disposal income discourages private savings

After the supervising decline of the price of real estate market at 1991, the national disposable income of household shows a downward trend from the 1990s until now (Figure 4), which implies deteriorating private investment and lower national living standard during this economic stagnation.

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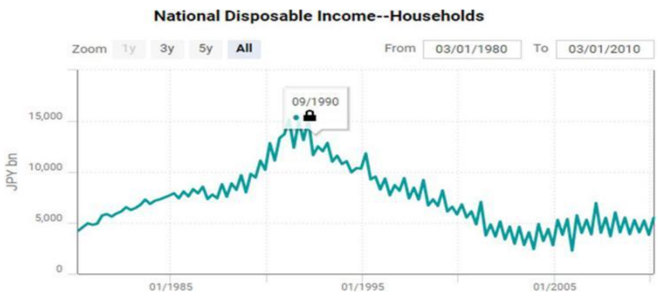

Figure.4 National Disposable income—Households

(Source: CEIC)

2.1.4 Impact on the company level

The stagnation of economy spreads rapidly within the Japan and is also manifested at the company level. Many companies especially small medium enterprises (SMEs) went bankrupt since it is more difficult for them to get loans from banks once the bubble burst. This situation continues into the second 'lost decade'. From 2001 onwards, the number of bankruptcy cases of enterprise climbed upwards, peaking at around 2009 where the global financial crises happened and hit the Japan's economy again, followed by a moderate decline until now. (Figure 5)

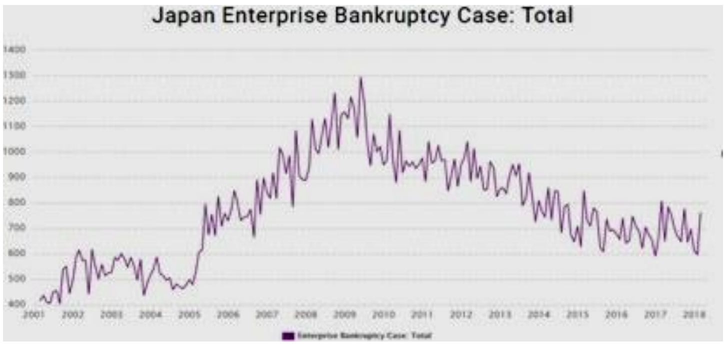

Figure.5 Japan Enterprise Bankruptcy Cose:Total

(Source: CEIC)

The high bankruptcy ratio strikes Japan's labor force market. The unemployment rate goes up after the early 1990s, and despite of some fluctuation, it remains at a relative high level. (Figure 6)

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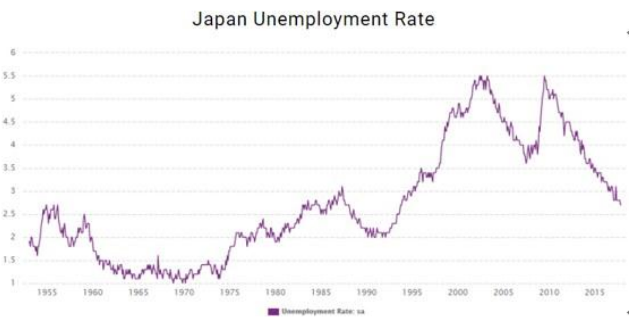

Figure. 6 Japan Unemployment Rate
(Source: CEIC)

2.2 Cause of the Problem

In 1985, Japan signed the Plaza Accord and decided an orderly downward adjustment of the exchange rate of the US dollar against the Japanese yen, leading to the sharp appreciation of the yen. Since then, the domestic stock market and real estate prices have risen sharply, and the domestic economic bubble has become severe. On October 1, 1990, called Black Monday, Nikkei stock price fell below 20,000 yen. Black Monday sounded the death knell of the Japan's bubble economy and the Japanese economy collapsed into a long period of stagnation.

The root causes of Japanese long-term stagnation can be explained from four aspects as follows.

2.2.1 The first reason: Bank insolvency risk and corporate sector production stagnates

This point is to start with the Japanese banking system and asset bubble. In 1980s, companies used loans from bank to purchases assets like property and create an asset bubble. When the assets price decline sharply in 1990s, the net worth of these companies declined sharply and they cannot pay for the loans from bank. Yoshino (2016) said that the default on loans caused Japanese bank facing insolvency risk. Thus, banks decrease bank loans to production companies. What makes things worse is that Japanese banking system tends to hold relatively safer long-term loans of 10 years or even of 20 years. After the assets bubble bursts, manufacturing companies are in great debt and cannot create high profits like they did in 1980s. Therefore, banks refused to provide loans to enterprises to promote production, and instead, tended to hold large numbers of Japanese domestic bonds, US Treasuries, and other fixed income securities, which were guaranteed by government credit. In the same time central bank increase supply of fiat money to stimulate economy. However, the currency created under the loose monetary policy

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of the Central Bank of Japan did not enter the production sector and enterprises, but instead returned to the accounts of the Japanese financial department because fiat money is hold by banks as government bonds. As a result, businesses do not receive financial support so that production stagnates, investment in the domestic production sector is not stimulated and the domestic economy stagnates.

2.2.2 The second reason: The reduction of consumption and demand

The second reason can be attributed to the reduction of household consumption, and the lack of demand stimulus. Chow (2010) said that in the 1980s, Japanese residents overdrawn their future wages ahead of schedule and borrowed heavily from banks to invest in the real estate market[1]. After the bubble burst, real estate prices fell rapidly, hurting the investment return of Japanese residents. Thus residents decrease their investments and consumption. At the same time, the size of domestic market is limited. Japanese manufacturers cannot find the direction of innovation to stimulate domestic demand. For the perspective of global demand, Sommer (2009) showed that the economy of Japan was particularly harmed by the decline in global demand for advanced manufactured durable goods during the economic recession period Thus, Japanese economics fell into the vicious cycle of “insufficient market demand- weakened innovation- insufficient market demand”. As a result, the economy could not find new growth points and the Japanese economy could not emerge from the predicament.

2.2.3 The third reason: The diminishing industrial competitiveness and the failure of industrial transformation

Advanced manufacturing industry as the traditional industry in Japan accounts for a large share of economic activity and production. As Akram (2014) believed, during the recession[2], the emergence of China and other Asian countries as important players in manufacturing in the international trade had diminished the competitive power of Japan. At the same time, the demand for advanced manufactured goods in the international market encountered a shrink. Affected by these two factors, many of the manufactures chose to shift the production from Japan to other surrounding countries, which caused an outflow of the manufacturing and hurt the economy in Japan further.

Another impact rises from the lack of innovation of Japanese manufacturers and the failure of the industrial transformation.

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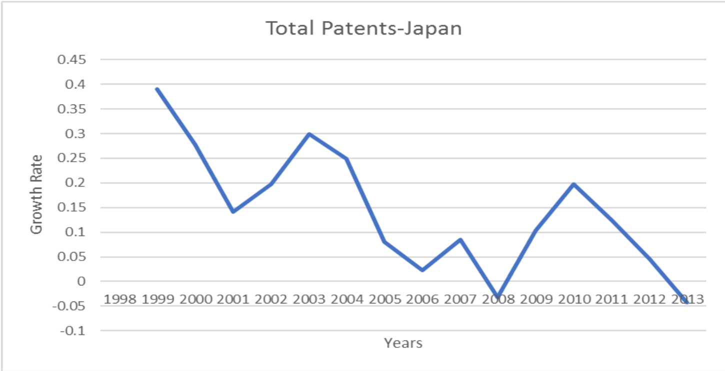

Figure.7 Total patents-Japan
(Source: OECD)

Shown by the figure7 above, the growth rate of total patents in Japan suffered a long- term decrease since 1998, which is a reflection of the relatively low level of innovation of Japanese enterprises. Typically, compared with the situation of U.S. in 1990's where new technologies such as IT and internet were prioritized and developed, Japan failed to grasp the opportunity and successfully complete its industrial transformation, which leaded to a lag of development of IT industry and the economy in Japan.

2.2.4 The fourth reason: the impact of demographic structure.

Japan's demographic structure faces a severe problem of increasing aged population and diminishing working population, which badly impacts the labor market and the capital market.

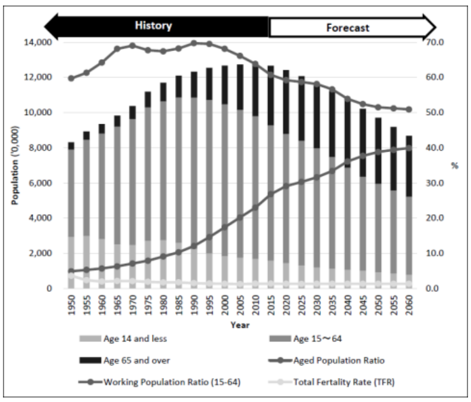

Figure.8 Population structure of Japan
(Source: Ministry of Internal Affairs and Communications, Japan.)

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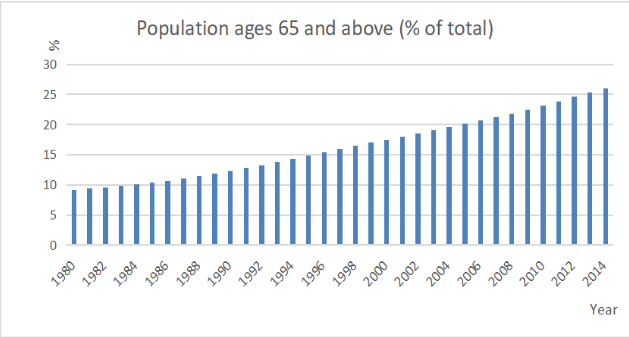

Figure.9 Population ages 65 and above(% of total)

(Source: THE WORLD BANK)

The population aging structure leads to a reduction of labor supply, which is mainly due to three reasons: Firstly, the share of population over age 65 is high in Japan compared with other countries; Secondly, the total population has declined since 2006 and its fertility rate is reported quite low as shown by Akram (2014); Thirdly, Simon and Lynch (2002) found even though the population in Japan was declining[3], Japan has not shown open to the immigration of foreign workers. These three causes leaded to a slowdown of labor force for production in Japan and poses a huge impact on Japan's economy.

Age dependency ratio in Japan (% of working-age population)

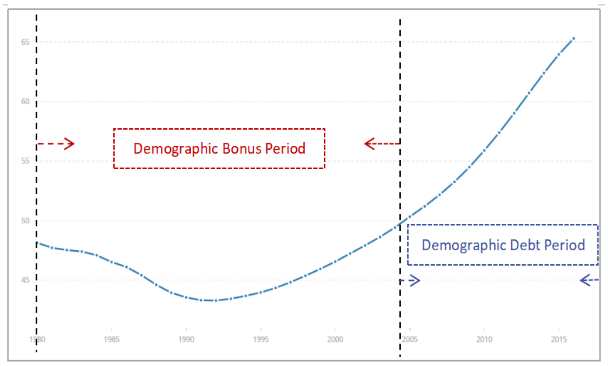

Figure. 10 Age dependency ratio in Japan (% of working-age population)

(Source: THE WORLD BANK)

From the perspective of the capital market, as shown by the figure above, Japan stepped in Demographic Debt Period in 2005. As Abel, A. (2001) believes, the population aging structure could lead to a drop of the real assets price. When the aging people get more[4], the supply of assets will increase simultaneously. However, decreasing young people will lead to a decline of the demand of assets,

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this mismatching of supply and demand has moved forward the fall of assets price in the capital market and hurt the economy. Yumi and Tsutomu (2016) also showed that increasing Age Dependency Ratio will aggravate the burden of economy and makes its growth rate slow down.

2.3 Japan's Policies to the recession and their effect

After the burst of the economic bubble in 1989 and 1990, Japanese government has adopted a series of economic policies to cope with the recession. However, most of the policies did not work as expected. Two main policies were positive fiscal policy and loose monetary policies.

2.3.1 Positive fiscal policies

The Japanese government has introduced more than twenty fiscal stimulus packages since 1990. In 1990 Prime Minister Miyazawa implemented fiscal policy and hoped the public investment would help boost the Japanese economy. However, major highways and bridges had already been completed in Japan and new infrastructure investment has been distributed ineffectively. Yoshino (2002) said that the bulk of public investment has been increasingly concentrated in rural areas, which has a much smaller impact on rural areas than on urban areas. Such public investment did not bring about a recovery of the Japanese economy although there were some gradual and temporary recoveries. In fact, it greatly increased the fiscal deficit, leaving Japan one of the heaviest indebted countries in the world.

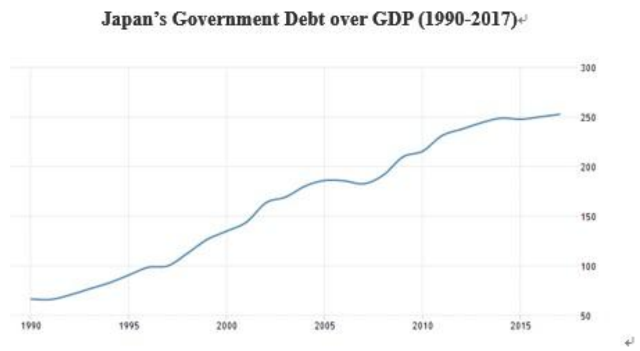

Figure.11 Japan's Government Debt over GDP(1990-2017)
Source: TRADING ECONOMICS

2.3.2 Loose monetary policies

Besides the positive fiscal policies, Bank of Japan (BOJ) also implemented a series of monetary policies. First it cut interest to low levels in the 1990s, then after 1999 BOJ implemented zero interest rate policy and quantitative easing policies (QE)

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and later implemented QQE in 2013. In January 2016 the BOJ announced negative interest rates. However, as Sean Ross (2017) said, the Japanese economy has been reeling from low growth, low interest rates, low inflation and a mountain of bad bank loans since 1990s.

Japanese Nominal Interest Rate (1987-2018)

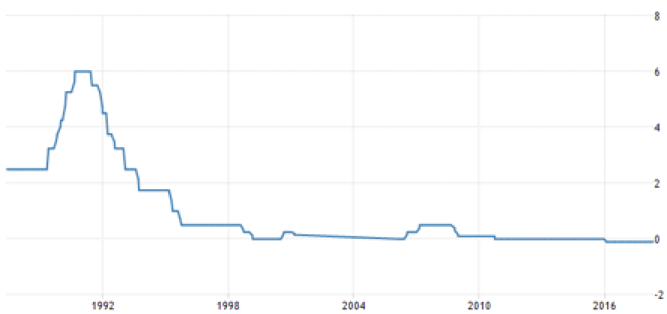

Figure. 12 Japanese Nominal Interest Rate(1987-2018)
(Source: TRADING ECONOMICS)

Economic growth seemed to return in some periods but soon vanished. Bowman (2015) said although BOJ's injections of liquidity into the interbank market boosted the flow of credit[5], the overall size of that boost was probably quite small since much of the effect was offset as banks reduced their lending to each other. The effect of liquidity on lending appears to have held only during the initial years of the QEP, when the banking system was at its weakest, and later the relationship between liquidity and lending evaporated. Drăgoi (2016) said that QE policies may offer a short term "oxygen bubble" to the economy, it may not be able to eliminate deflation. As BOJ itself stated[6], this monetary policy was not as efficient as prior expected, both because of its size and of the fact that QE failed in its fundamental goal to stimulate the demand enough to eradicate the perpetual deflation.

Although the economy growth has been in low rate, these economic policies helped Japan get through the 2008 financial crisis and finish earthquake relief work in 2011, leading to a stable economy without social chaos.

3. Conclusion

In this paper, it is clear the reasons of Japan's sluggish economy are multiple that bank insolvency risk and the stagnant production in corporate sector, the reduction of consumption and demand, the diminishing industrial competitiveness and the failure of industrial transformation, and the impact of demographic structure, all of these reasons make Japanese economy could not emerge the predicament. During the recession, Japan experienced a sluggish economic growth period, real gross domestic production (GDP) decreased sharply since the bubble burs, the suppressing

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decline of the price of stock market and land price, the decline in disposal income, and the number of bankruptcy cases of enterprise climbed upwards. Although Japanese government has adopted a series of economic policies to cope with the recession, most of them like Keynesian policies did not work as expected. However, these economic policies like negative interest rates policy and quantitative and qualitative monetary easing policy helped Japan in a sense.

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