

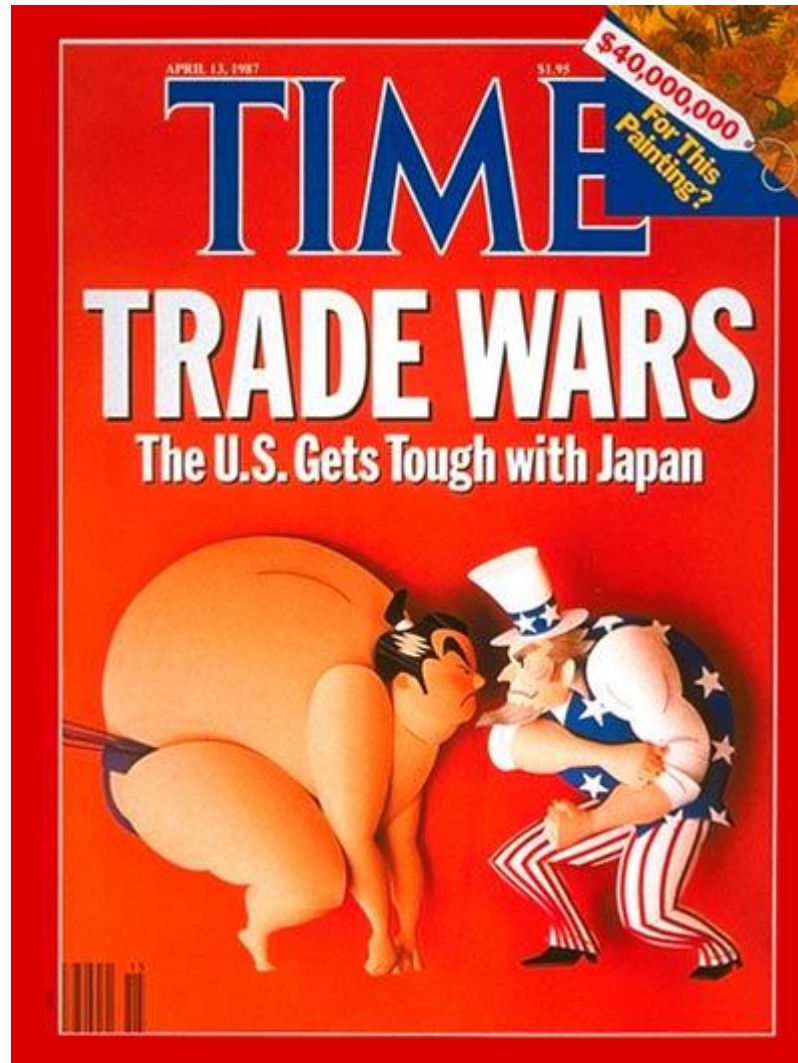
Japan's lost decade

From best


challenger

to an arthritic

Japan



13.4.1987

- Industrial policies encouraging Japanese firms to be competitive abroad
- The role of keiretsu and their formal and informal networking
- Participative model of industrial relations (lifetime employment)
- Efficient banking system
-  long-term strategies

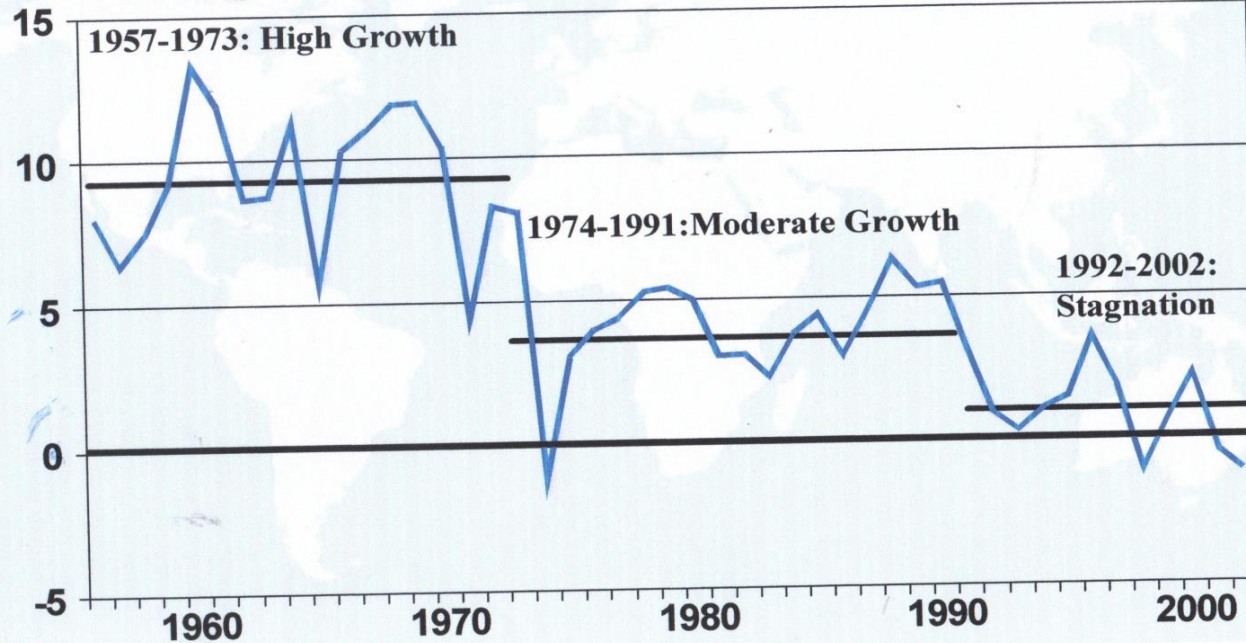
Some basic data for the early 1990's

- While together the U.S. and Japan are responsible for between 30% and 40% of world output, the overall output of the Japanese economy is only approximately 42% that of the U.S. Japanese per capita income is 83% that of the U.S.
- Greater U.S. output of goods and services per labor hour, or higher productivity is a major reason our economy is stronger than that of Japan. The American worker continues in the 1990s to be the most productive in the world, as has been true throughout this century.

Are Japan's Best Days Past?

GDP Growth

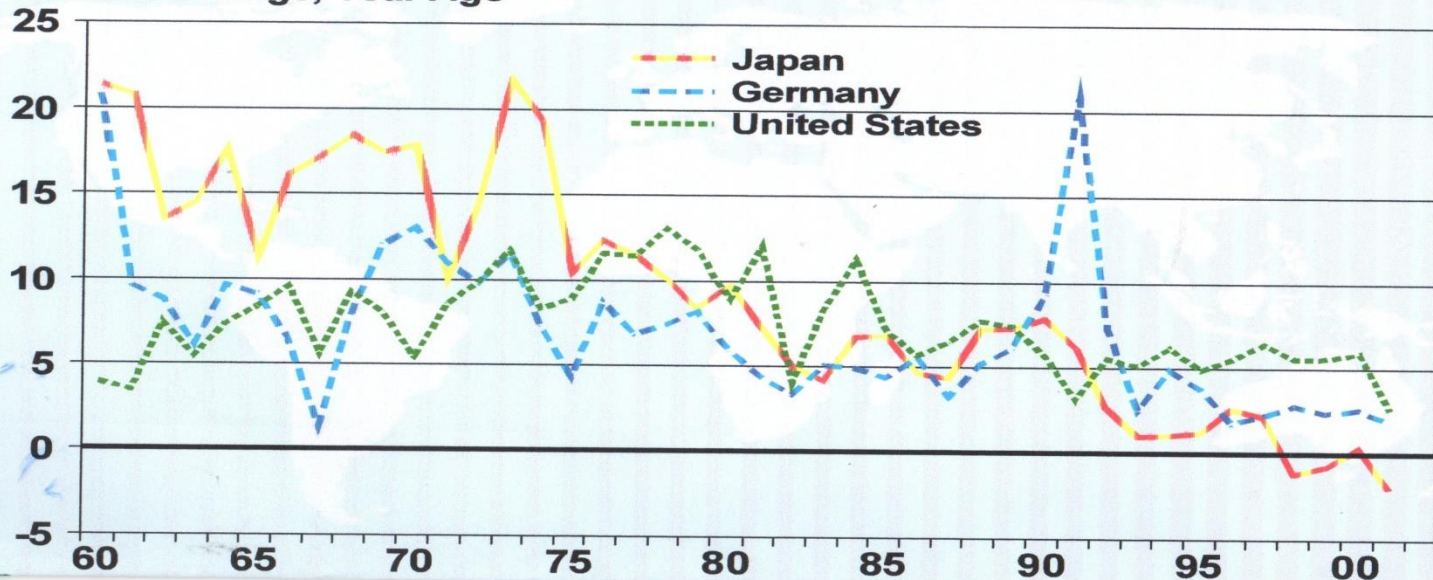
Percent Change



Gross Domestic Product Comparison

1960 - 2002

Percent Change, Year Ago



Too Much Optimism

- By the latter half of the 1980s, the strong growth and rising incomes had created a wave of optimism about the future of the Japanese economy.
- Fueled by persistently strong growth, optimism, and easy credit, asset prices in Japan soared. By the late 1980s, Japanese investors anticipated that real estate and stock prices would continue to rise (stock market tripled between end 1985 and late 1989)



- 1,4 Billion \$ in 1989-90 – lost 660 million \$ in 1995

THE AGE, Thursday 2 November 1989

Mitsubishi buys half of Rockefeller Centre

New York, Wednesday

Fifty one per cent of the Rockefeller Centre, the prince of architectural gems in Manhattan, has been sold to a Japanese corporation for \$US846 million (\$A1.09 billion), stunning many New Yorkers.

Almost daily they are reminded of their city's declining role as

John D. Rockefeller's 85 descendants, all of them beneficiaries of the oil magnate's 1934 trust, led to their selling their interests.

Mayor Edward Koch called a news conference today to calm the city: "The Japanese are coming, put up the gates, that's ridiculous," said Mr Koch, who leaves office at the end of the year.

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Friday, March 18, 1988 READING EAGLE

Japanese firm to buy Firestone in cash deal

CHICAGO (AP) — Japan's Bridgestone Corp., spurred by a rival bid, will buy Firestone Tire & Rubber Co. in an all-cash deal worth nearly \$2.6 billion, the companies announced.

Bridgestone said it would pay \$80 a share for Firestone's 32 million outstanding shares, which closed at \$62.50 Thursday on the New York Stock Exchange.

The deal was announced late

"We never considered backing away from our agreement with Firestone to become its partner in operating its worldwide tire businesses," Bridgestone President Akira Yeiri said. "The merger agreement merely represents an expansion and extension of our original agreement."

Yeiri said his company would keep the headquarters of Fire-

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rels : THE AGE, Friday 29 September 1989 vital pre-

Sony buys Columbia Pictures for \$4.4b

By PAUL RICHTER, New York, Thursday

Columbia Pictures Entertainment agreed yesterday to sell out to the Sony Corporation for \$US3.4 billion (\$A4.4 billion) cash in the biggest acquisition in the United States by a Japanese company.

Sony immediately pledged to put the 65-year-old movie and TV studio in the hands of Sony's US subsidiary and to "keep it as independent as possible as a full-fledged member of the US film industry".

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Easy Credit

- **Expansive monetary policy:** The Bank of Japan reduced its discount rate from 5 percent in January 1986 to 2.5 percent in February 1987. together with a revaluation of the yen (1985 Plaza agreements) This reduced the cost of buying and holding both real estate and business assets.
- Moreover, Japanese banks and other lenders also expected the rising prices to continue. Therefore, they were willing to extend loans to borrowers, including many who had very little equity in the purchased asset.

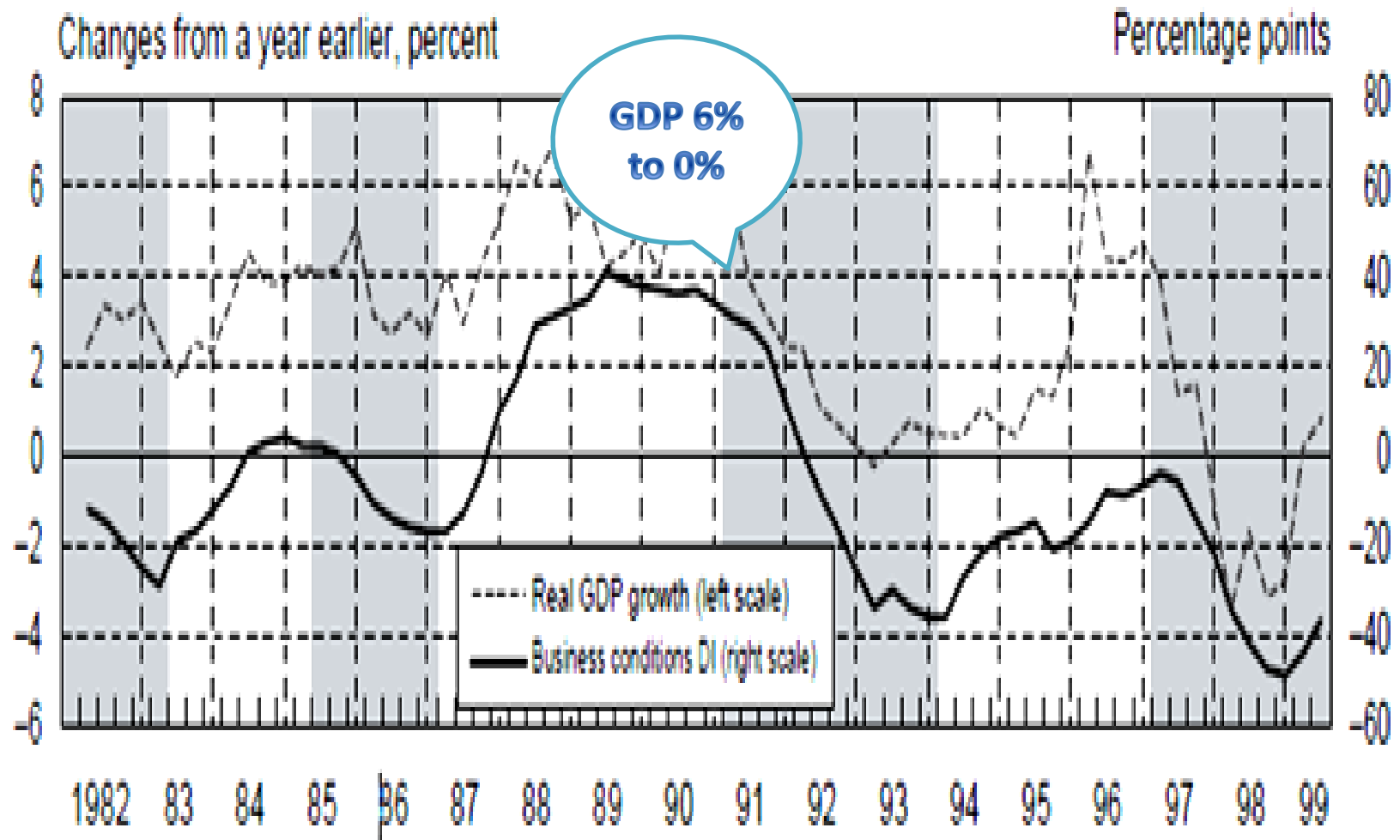
- The cozy relationship of corporations to banks and the implicit guarantee of a taxpayer bailout of bank deposits created a significant moral hazard problem, leading to an atmosphere of crony capitalism and reduced lending standards.
- "Japan's banks lent more, with less regard for quality of the borrower, than anyone else's. In so doing they helped inflate the bubble economy to grotesque proportions." (Krugman)

- Insolvent companies: Banks lent to companies and individuals that invested in real estate. When real estate values dropped, many loans went unpaid. The banks could try to collect on the collateral (land), but due to reduced real estate values, this would not pay off the loan. Banks have delayed the decision to collect on the collateral, hoping asset prices would improve. These delays were allowed by national banking regulators

Systemic reasons for deflation in Japan and real estate sinking prices

- The Bank of Japan began increasing interest rates in 1990 due in part to concerns over the bubble and in 1991 land and stock prices began a steep decline (half of the value in 12 months), within a few years reaching 60% below their peak
-  stagnation, unemployment (2 to 6%)

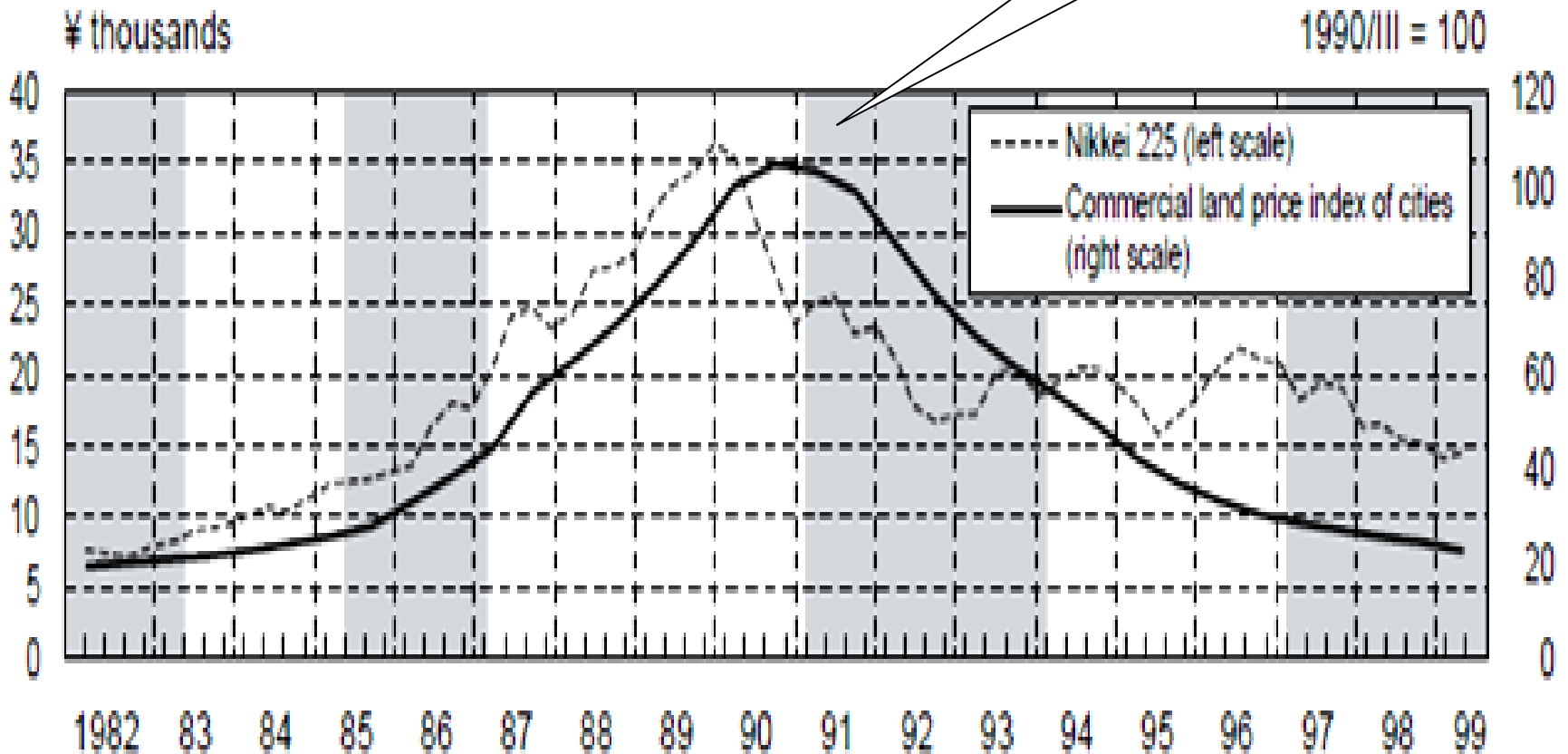
The Lost Decade or the Second Defeat




The bubble and its explosion

Nikkei 225 / Land Prices

Nikkei lost
60%, land lost
70% value



The responsibility of the banks

- Some banks make even more loans to these companies that are used to service the debt they already have. This continuing process is known as maintaining an "unrealized loss", and until the assets are completely revalued and/or sold off (and the loss realized), it will continue to be a deflationary force in the economy.
- Insolvent banks: Banks with a large percentage of their loans which are "non-performing" (loans for which payments are not being made), but have not yet written them off. These banks cannot lend more money until they increase their cash reserves to cover the bad loans. Thus the quantity of loans are reduced and less funds are available for economic growth.
- Fear of insolvent banks: Japanese people are afraid that banks will collapse so they prefer to buy gold or (United States or Japanese) Treasury bonds instead of saving their money in a bank account.
-  5 to 10 % of all loans issued during the second half of the 1980's defaulted
-

IT'S A



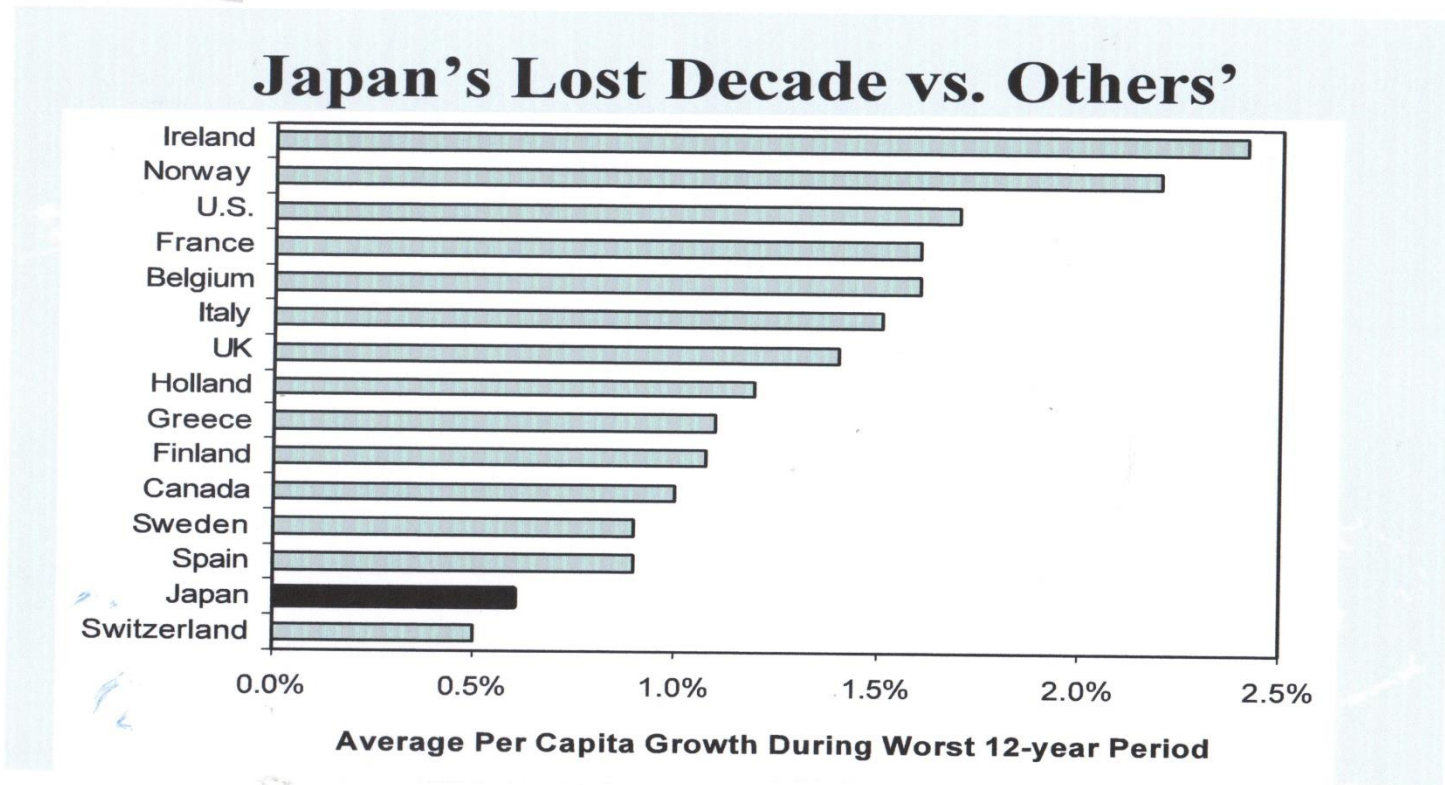
liquidity

TRAP!

The liquidity trap? (P.Krugman)

- In the late 1980s, real estate and stock prices in Japan soared. situation where consumers and firms saved too much overall, thereby causing the economy to slow. The asset bubble was massive in Japan by 1990, with a tripling of land and stock market prices during the prosperous 1980s.
- Japan's **high personal savings rates**, driven in part by the demographics of an aging population, enabled Japanese firms to rely heavily on traditional bank loans from supporting banking networks, as opposed to issuing stock or bonds via the capital markets to acquire funds.
- Japan's **stock and real estate price boom was followed by a bust** in the early 1990s. This price collapse led to a surge in **loan defaults, troubles in the banking sector**, and a **sharp slowdown** in the growth of the Japanese economy in the early 1990s. The sluggishness persisted, and the 1990s are now known as Japan's "**lost decade.**"

The lost decade: and the others?



The stimulus programmes

- Japan responded to the economic downturn with several “stimulus programs” that substantially increased spending on roads, bridges, and other infrastructure. Government spending rose from a little more than 30 percent of GDP in the early 1990s to nearly 40 percent of GDP in the latter part of the decade. This increased spending was financed through large budget deficits. Even though fiscal policy was highly expansionary, the Japanese economy continued to stagnate.

Fiscal Policy

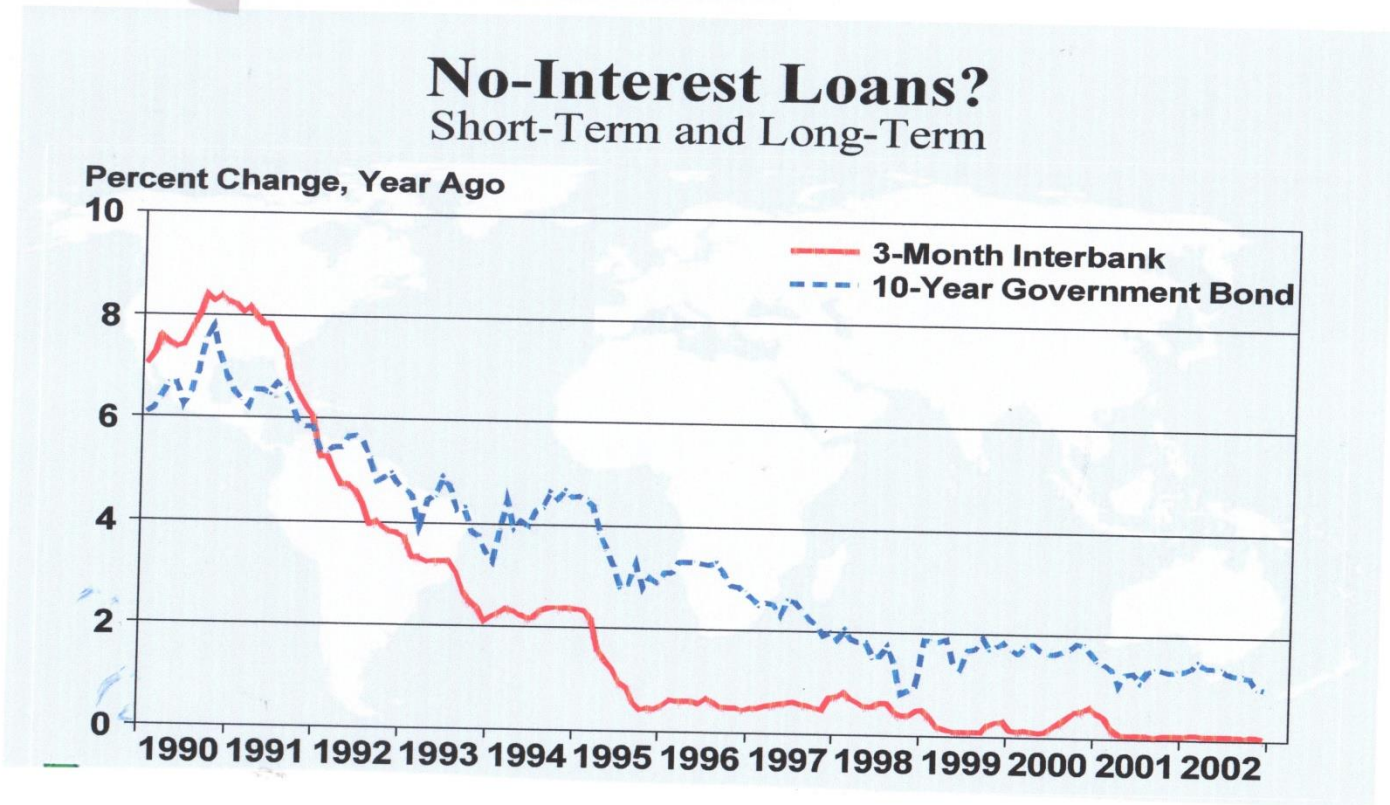
- During the 1990s, Japan adopted at least seven different stimulus packages designed and enhance economic growth. Government spending on infrastructure—roads, bridges, and airports—was increased substantially. Taxes were cut in both 1994 and 1998, but both of these tax cuts were temporary, weakening their impact on aggregate demand. These fiscal policy changes were financed with budget deficits and increased borrowing.

Liberalization ? No, thanks, we're Japanese

- Japanese consumer groups have strongly opposed agricultural liberalization, one policy change which could substantially improve their economic welfare. In 1987, for example, the Consumers Federation of Japan (*Shodanren*), a liaison organization for fourteen of the biggest consumer groups, organized a full-fledged national campaign to oppose liberalization.
- It is tempting to conclude that the consumer groups must have been misrepresenting consumers at large, yet public opinion polls throughout the 1980s and 1990s show that consumers support this position.

- Japan's postwar economic system has fundamentally favored producers over consumers.
- The financial system shifted resources from consumers to producers by maintaining deposit interest rates below market levels. Trade barriers allowed domestic producers to maintain higher prices, and prevented consumers from purchasing cheaper and/ or better products from abroad.
- Weak enforcement of and bountiful exemptions to antitrust laws permitted price cartels and other forms of collusion between producers. And a wide range of economic regulations impeded competition, bolstered corporate profits, and increased price levels in sectors as diverse as retail and construction

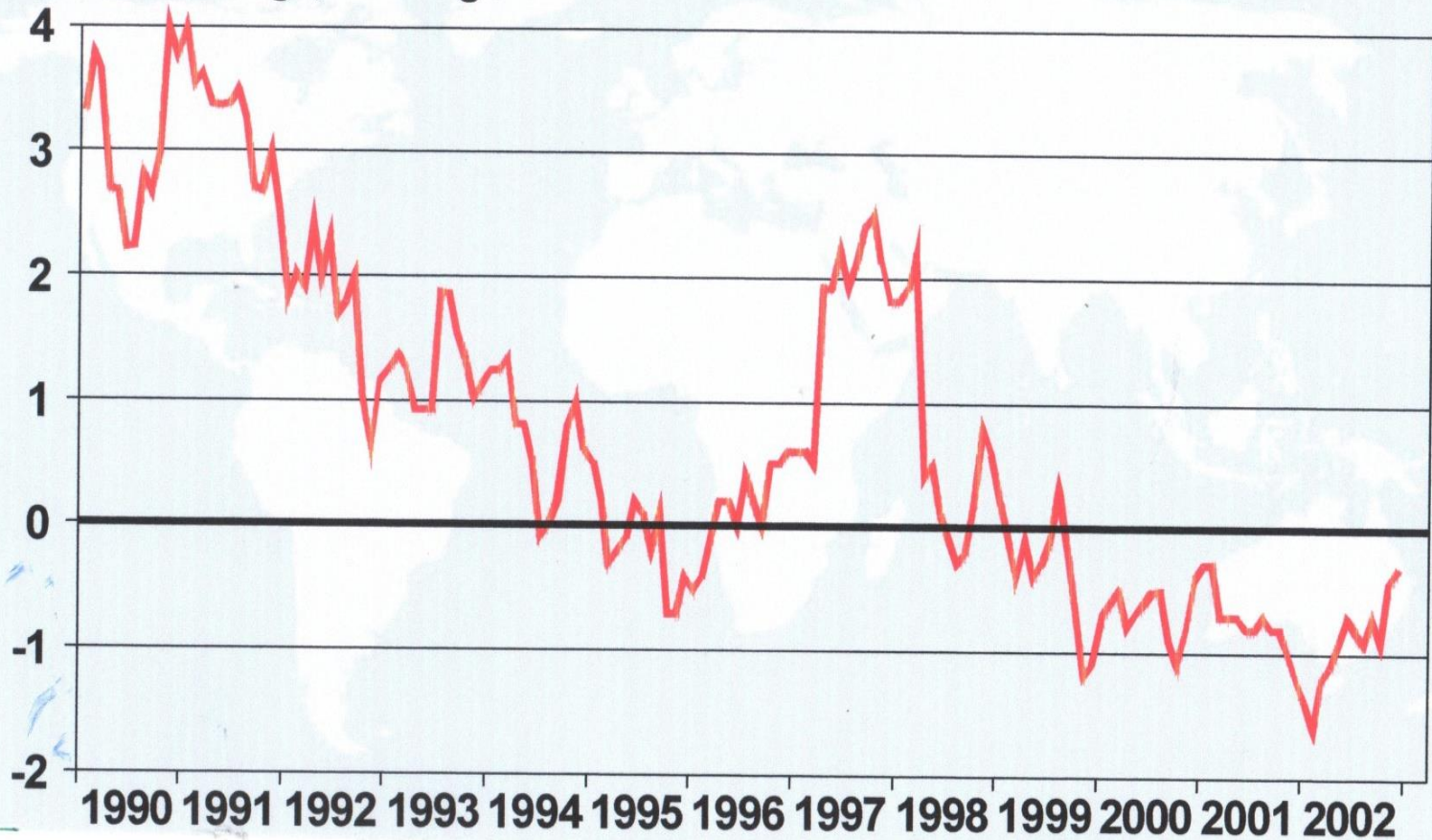
Interest rates close to zero



Japan's Inflation Rate

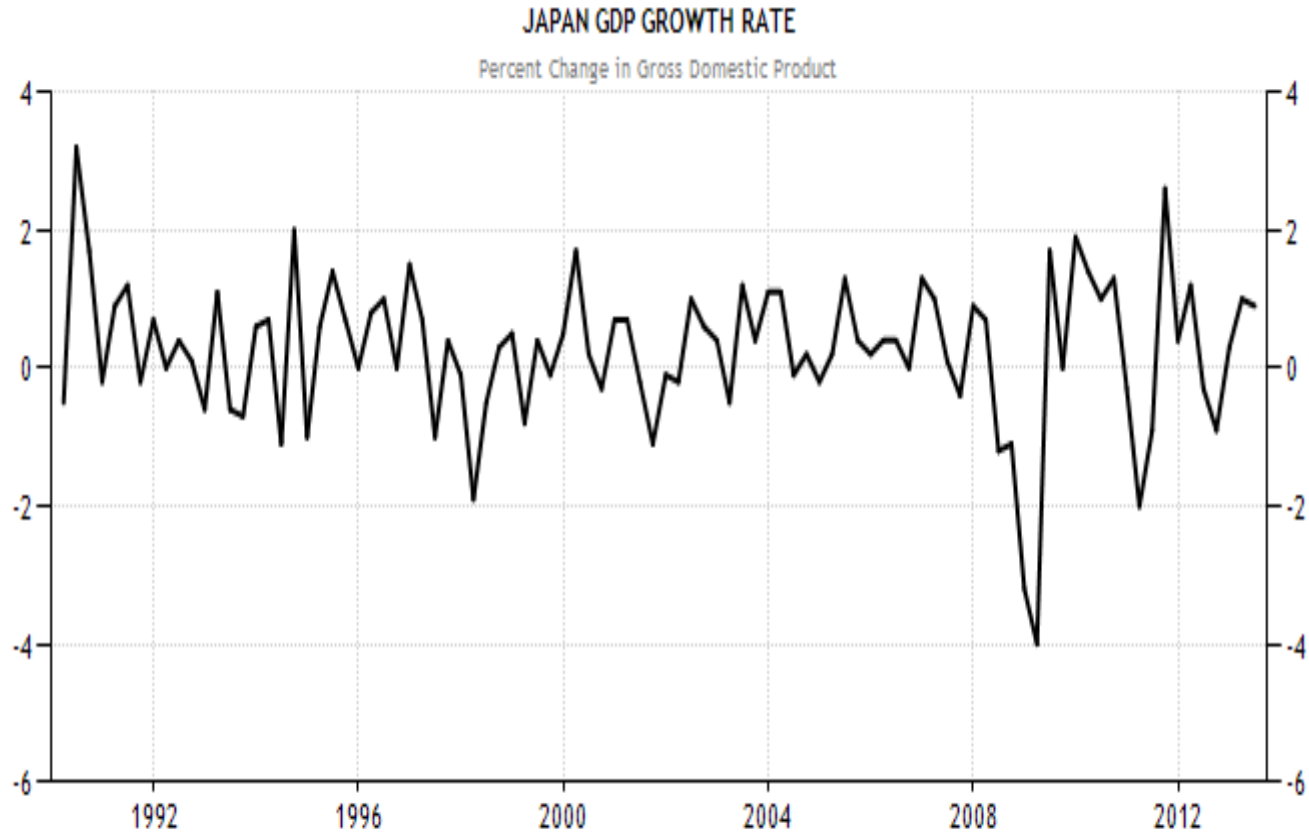
Consumer Price index

Percent Change, Year Ago



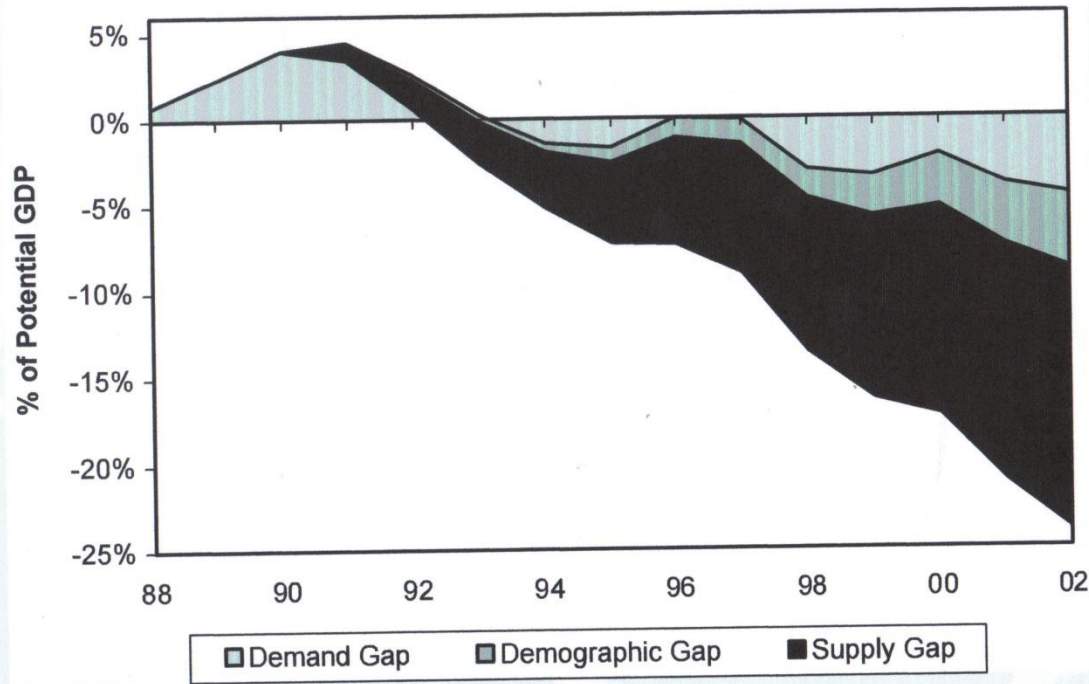
- **The**
consequences
- **of the lost decade**

GDP: around zero growth



SOURCE: WWW.TRADINGECONOMICS.COM | THE CABINET OFFICE

Lost GDP: 4/5 Supply, 1/5 Demand



The horizontal zero line shows where GDP would be if 1975-90 growth had continued. Grey area shows lost GDP due to demand shortfall. Black area shows lost GDP due to slowdown in potential growth—*not* counting slowdown in labor force growth which is shown in diagonal stripes.

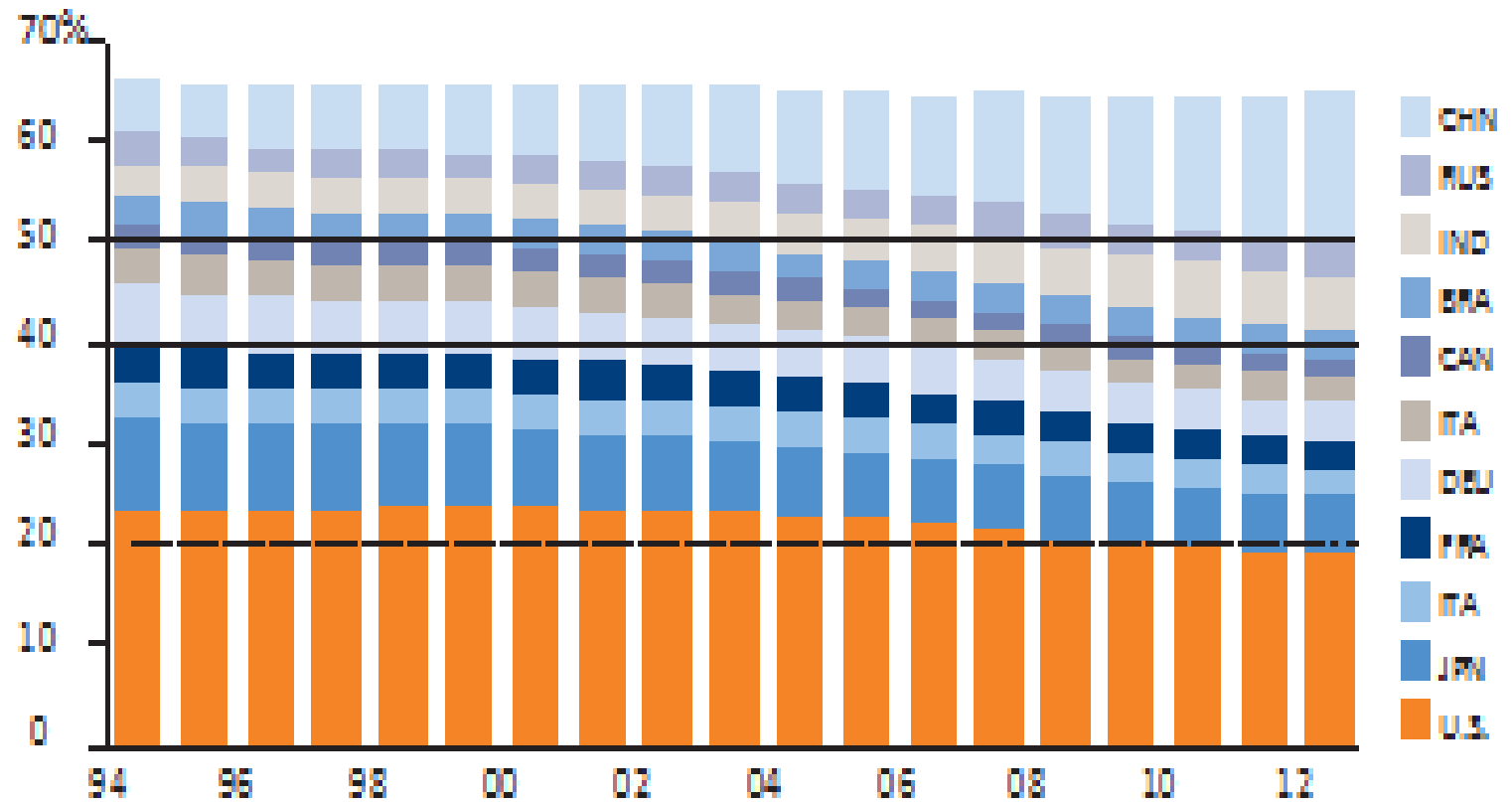
Figure 3. Japan's Growth In Real GDP per Capita Is the Lowest Among G-7 Countries

G-7 per Capita Real GDP Trend Growth Rates (In PPP-adjusted constant 2005 international dollars)				
	1980-1989	1990-1999	2000-2009	1990-2011
CAN	2.1	1.8	1.1	1.8
DEU	1.6	1.2	0.7	1.2
FRA	3.1	2.8	1.5	2.3
GBR	3.1	2.8	1.5	2.3
ITA	2.5	1.4	0.3	0.8
JPN	3.7	0.7	0.8	0.7
U.S.	2.7	2.2	0.9	1.7

Source: World Bank, Reuters EcoWin, ING Investment Management

Figure 5. Japan's Share of Global GDP Has Diminished Sharply

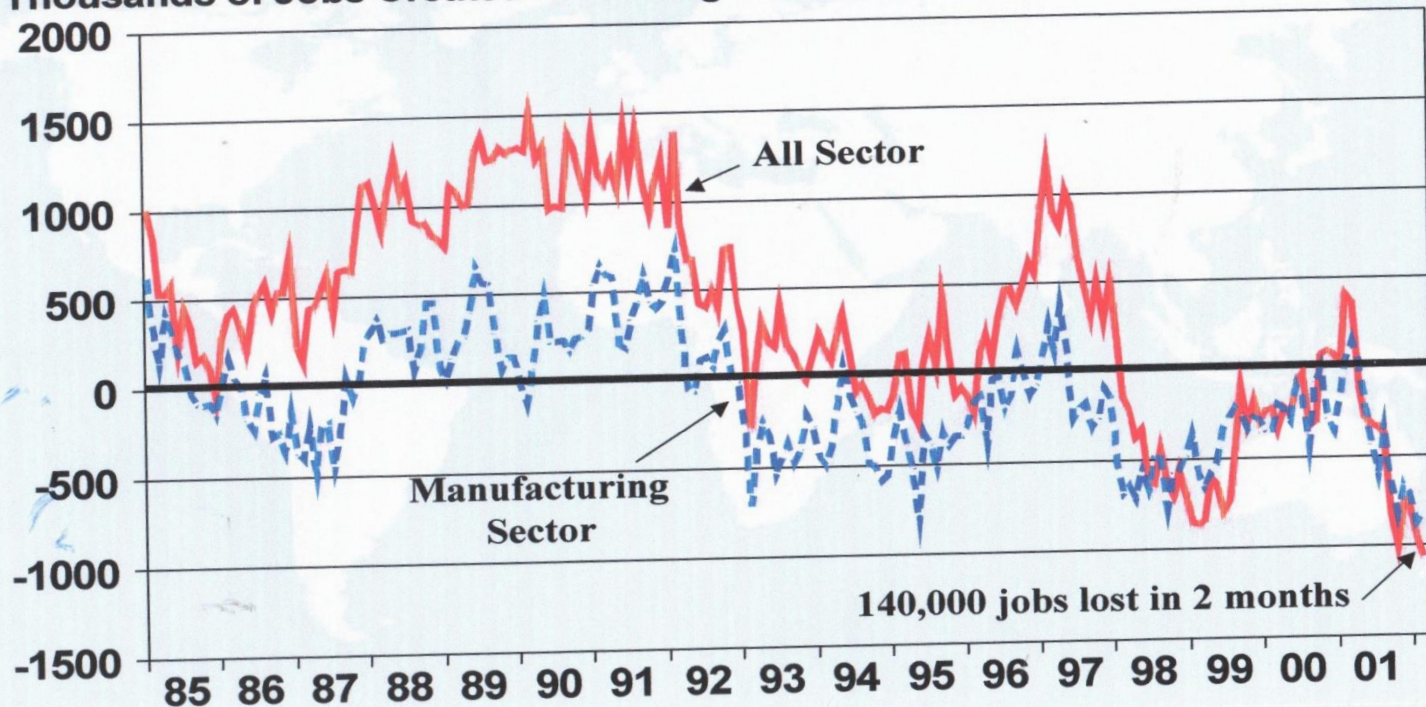
Share of Global GDP (PPP-Adjusted)



Japan: Unemployment

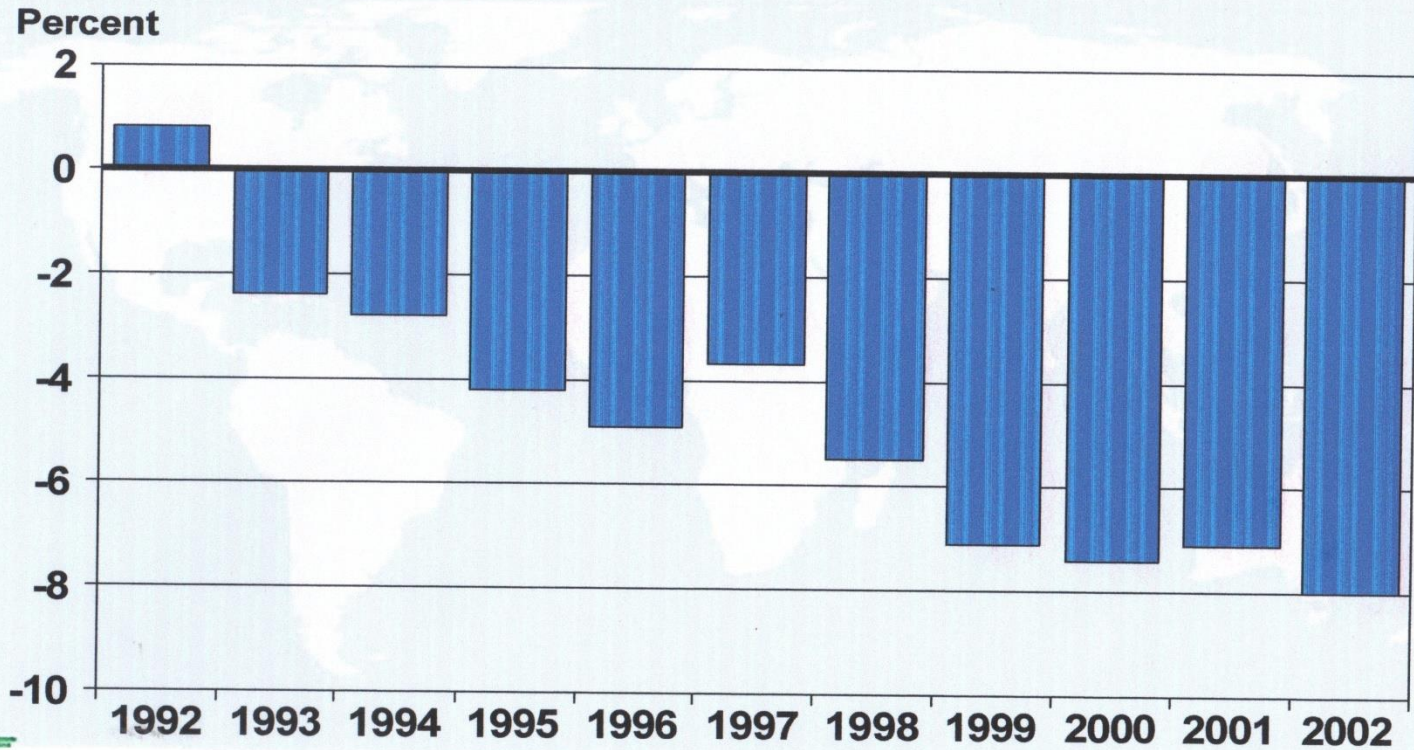
1,040,000 Jobs Lost Last Year

Thousands of Jobs Created in Trailing 12 Months



Mounting Budget Deficit

Government Surplus/Deficit as Percent of GDP



Japan's Financial Socialism

Government Debt % of GDP

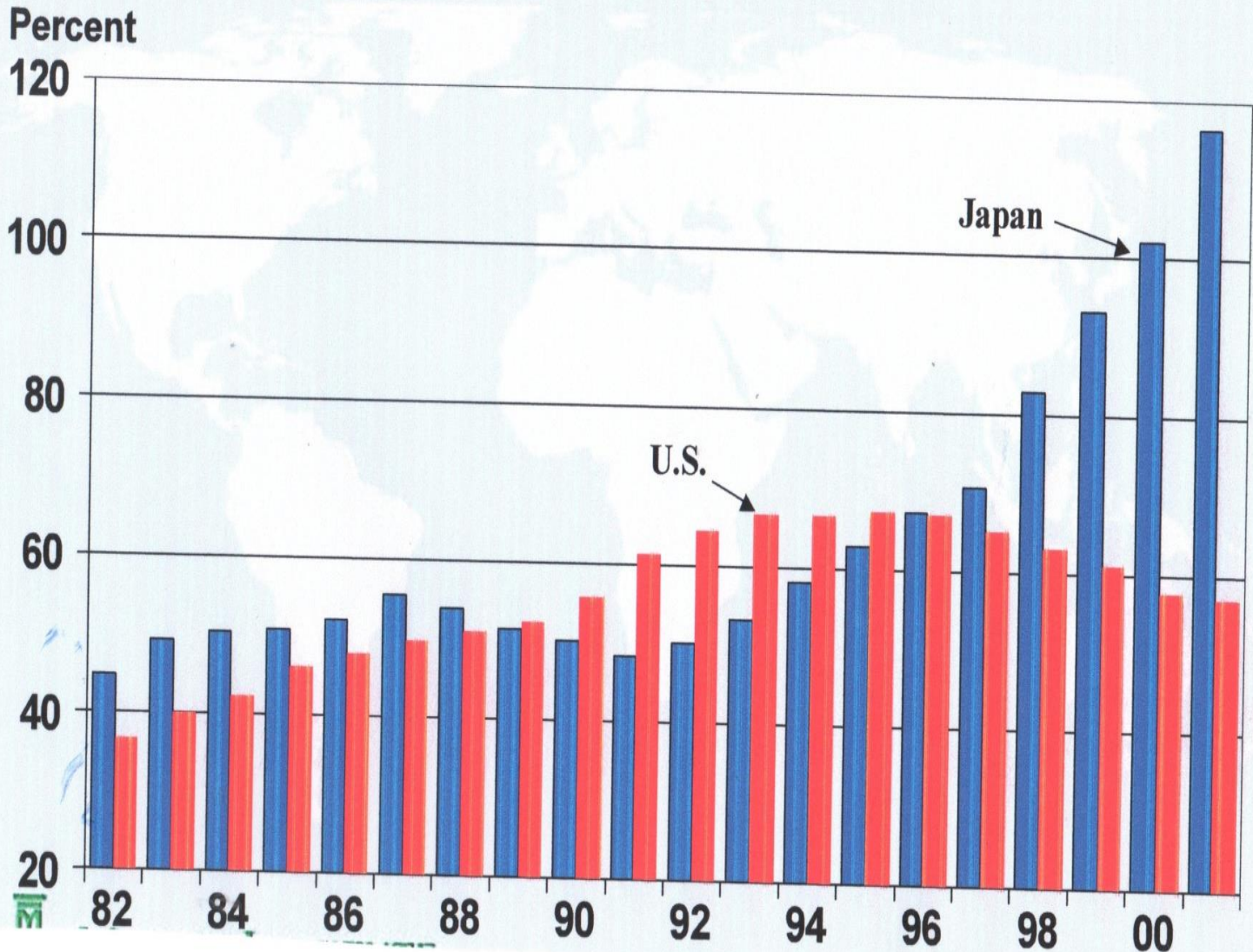
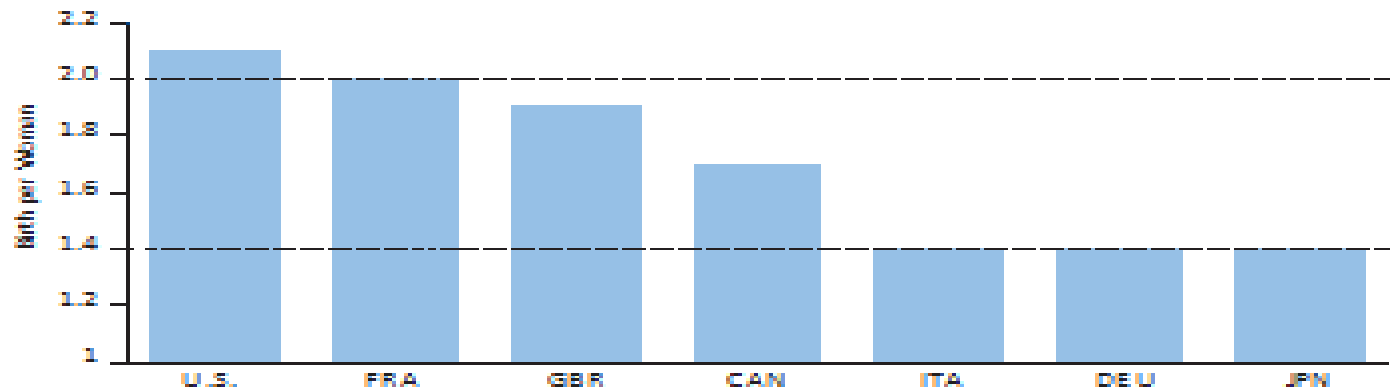
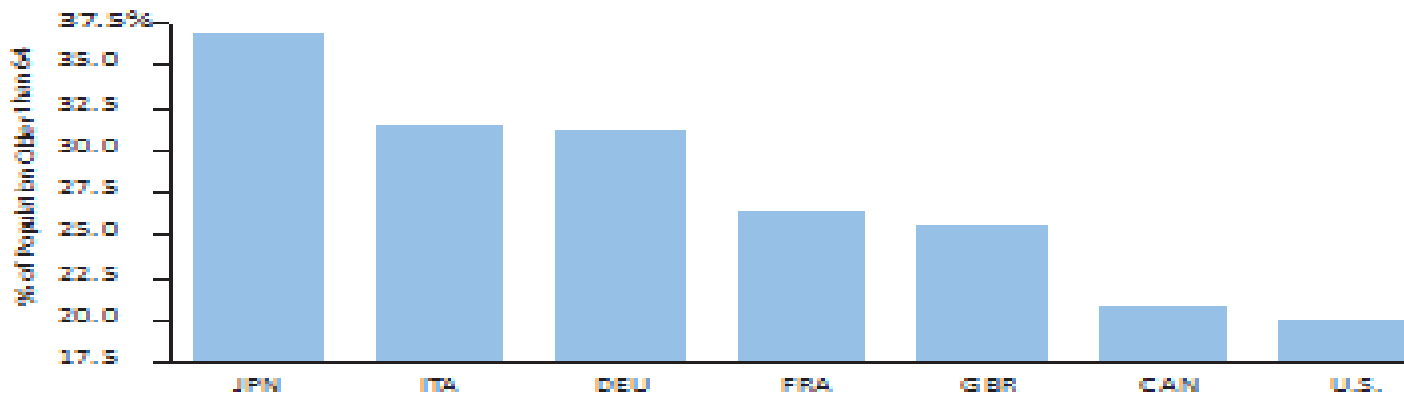


Figure 11. ...As Its Fertility Rate Is Well Below Replacement Rate
Fertility Rate (2010)



Source: Reuters EcoWin

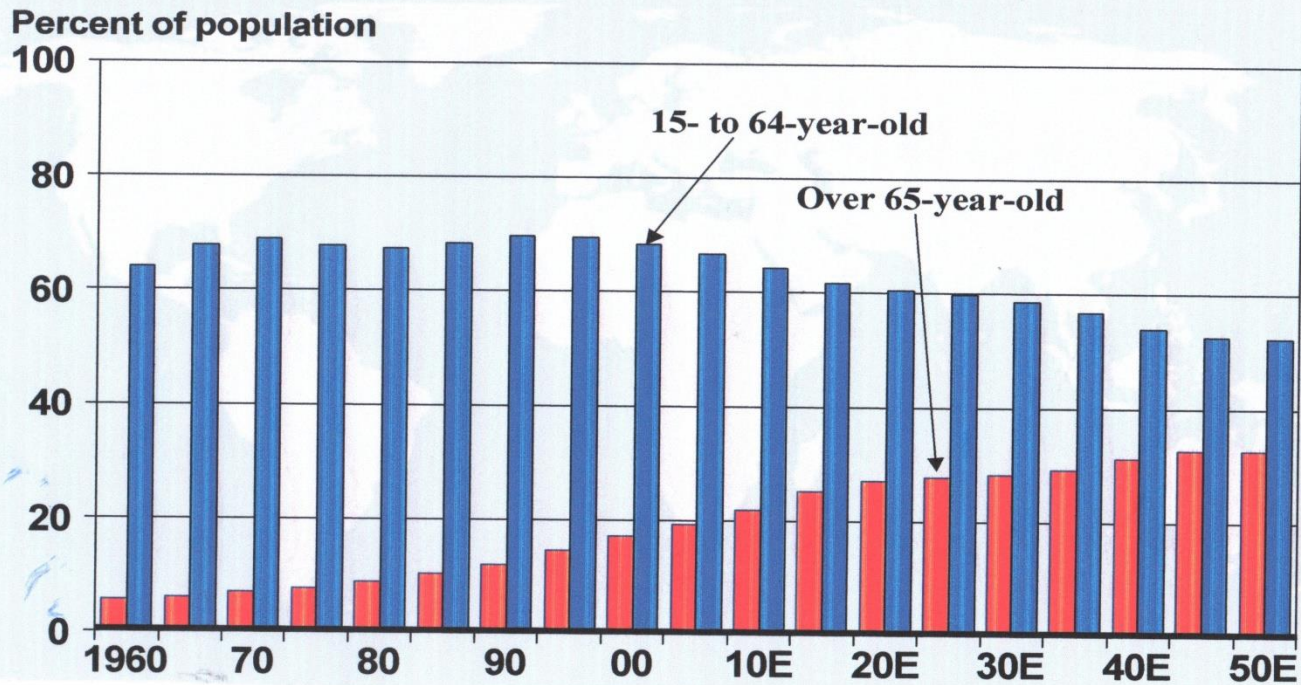
Figure 12. Japan's Population Is Aging Rapidly
Dependency Ratio (2011)



A demographic trap ?

- The share of the population age 65 and over in Japan nearly doubled during 1990–2010.
- Reduction of the productivity and higher taxes on current workers for the finance of retirement benefits and health care for the elderly.

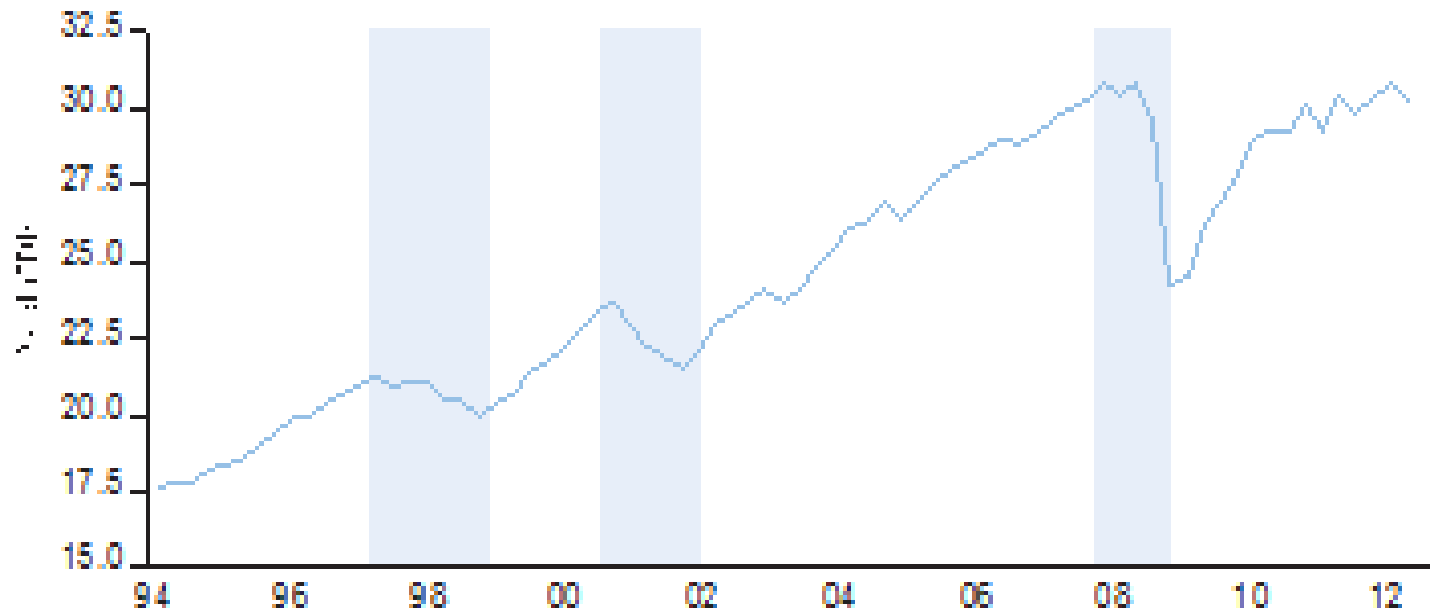
Japan: Growing Older Population, Declining Working Population



Japan & globalization

Figure 17. The Japanese Economy Has Become More Open Through Trade Linkages

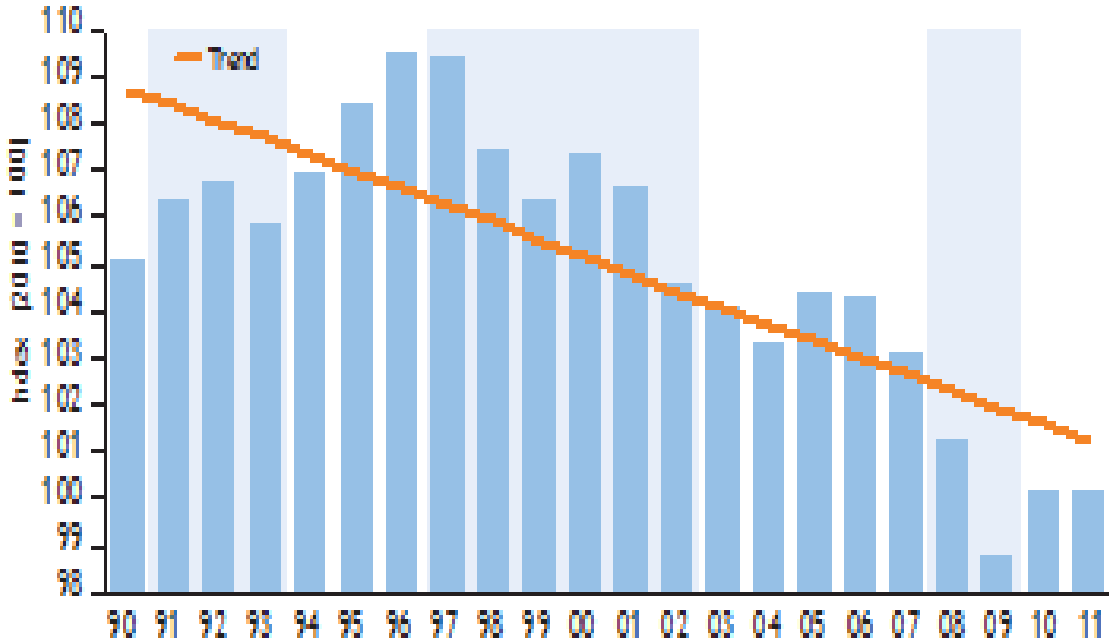
Real Trade $[(\text{Real Imports} + \text{Real Exports})/\text{Real GDP}]$



Some other effects of globalization

Figure 18. The Waning Trend In Japanese Real Wages

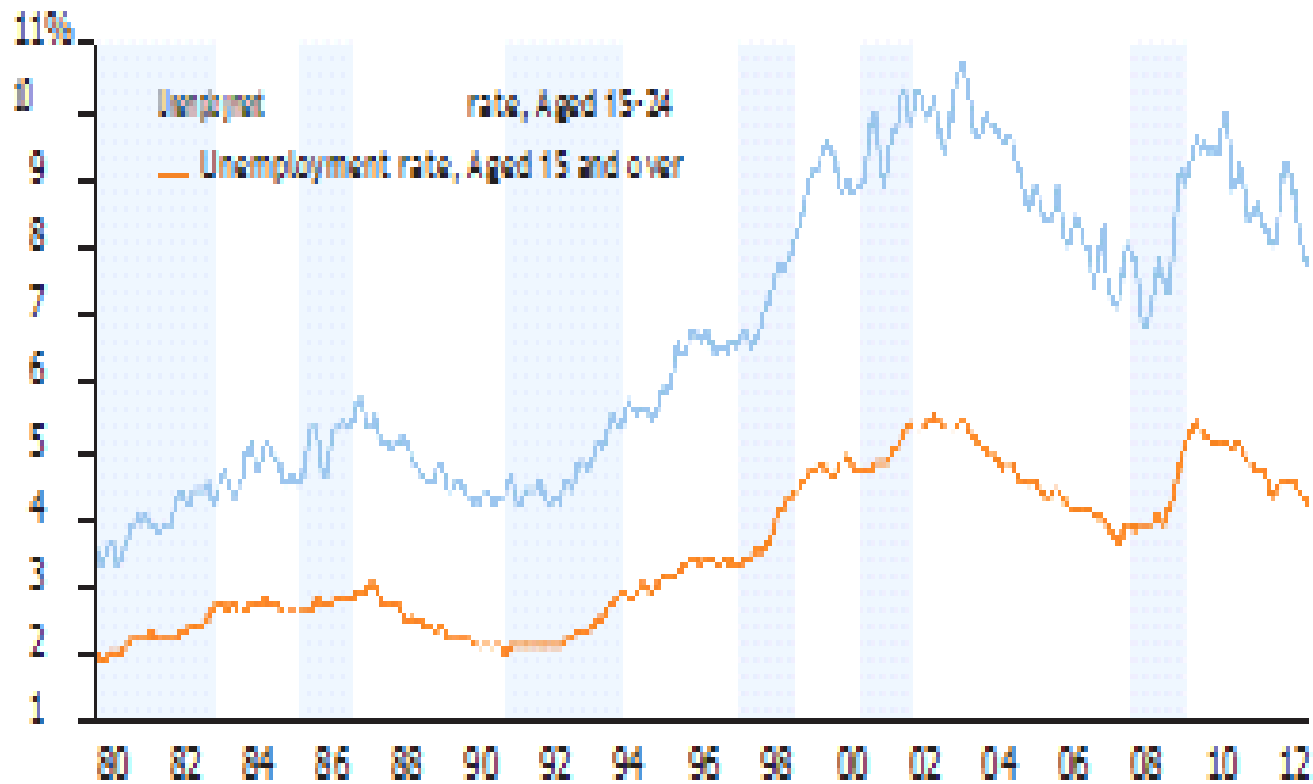
Average Monthly Real Earnings



A new unemployment

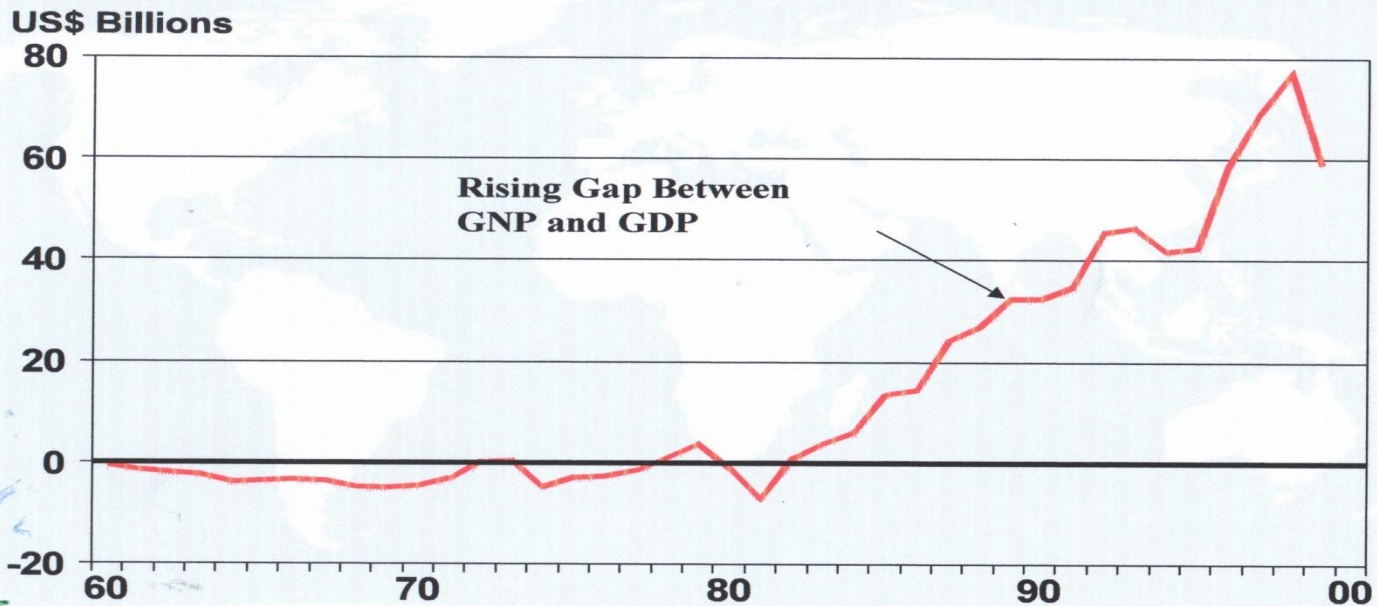
Figure 15. ...While the Unemployment Rate — Particularly Among Youth — Has Drifted Higher Since 1990

Employment Rates (Seasonally Adjusted)

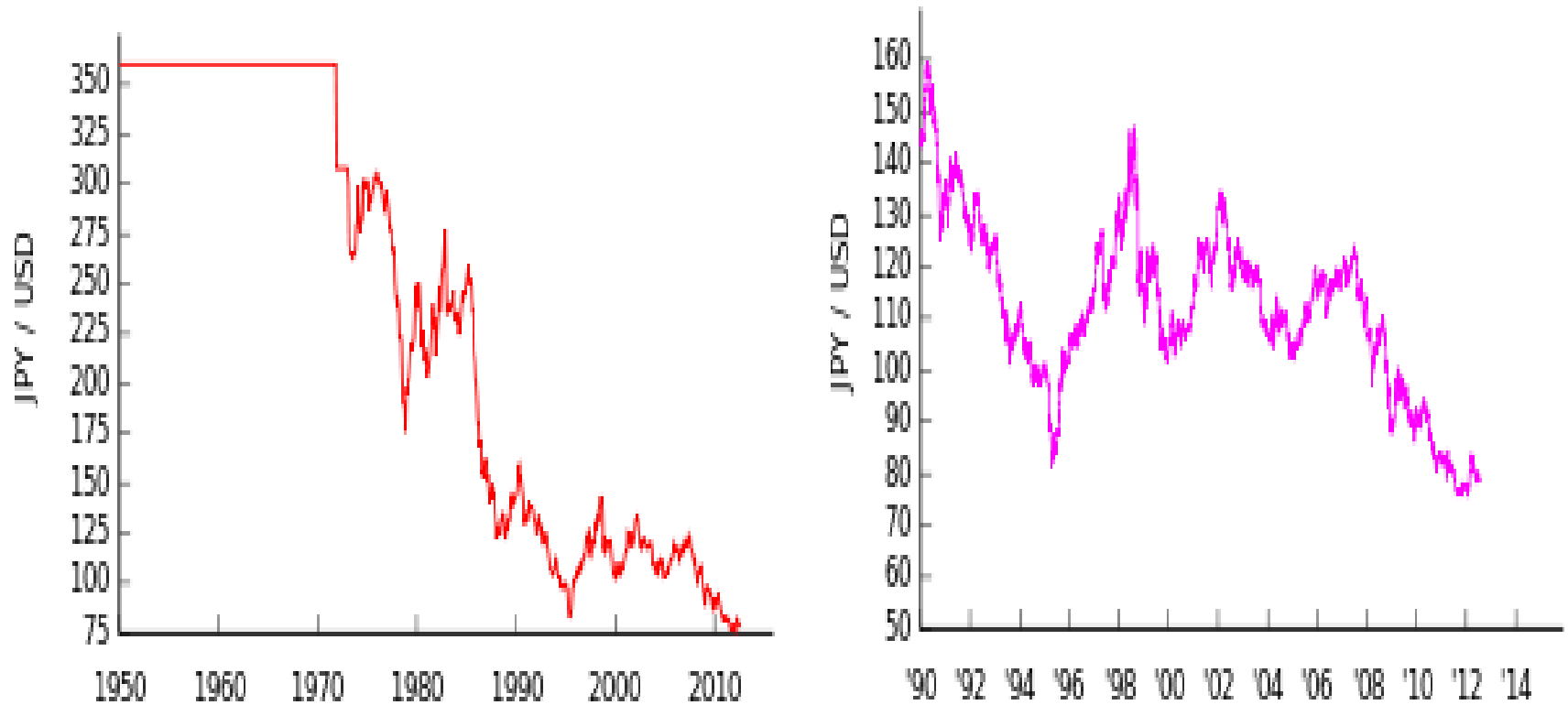


Japan's Exports

Evidence of Success for Japanese Businesses in Foreign Markets?



USD-YEN EXCHANGE RATE



The end of the story ?

An Epic Run Ends | Japan's imports and exports



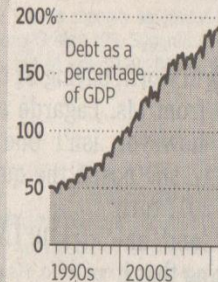
Japan agrees to restrict exports of Japanese TVs to the U.S.



Japan agrees to restrict car exports to the U.S.



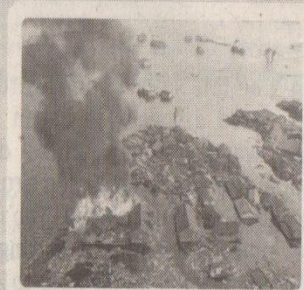
Japanese property prices peak



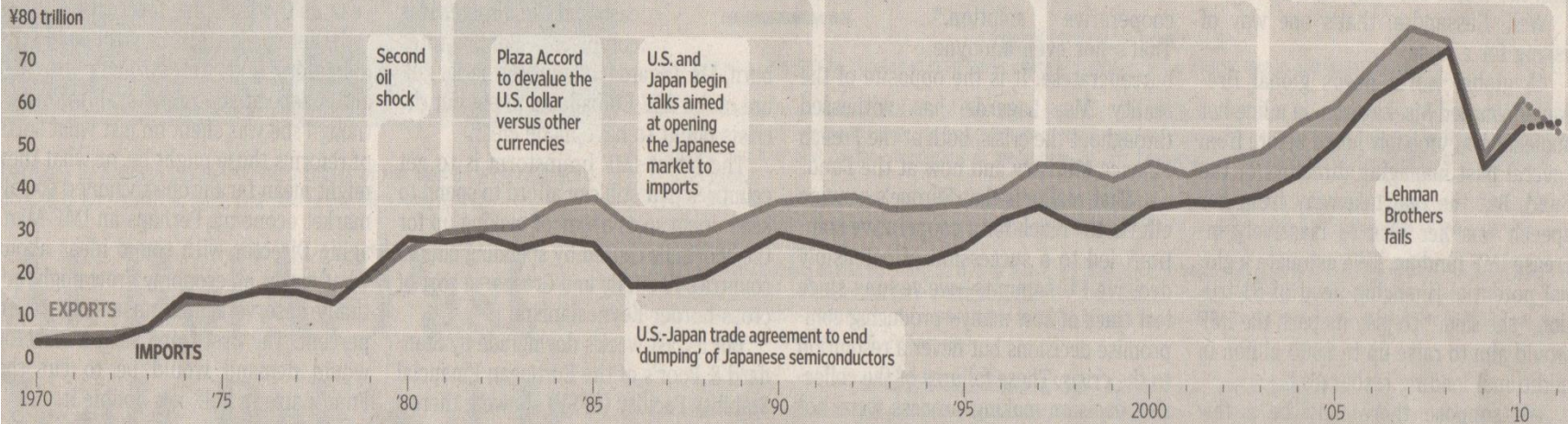
Asian financial crisis; Japan's public debt tops 100% of GDP



Japan begins aggressive currency-market intervention to slow the yen's advance



Magnitude 9 earthquake and tsunami hit northeastern Japan

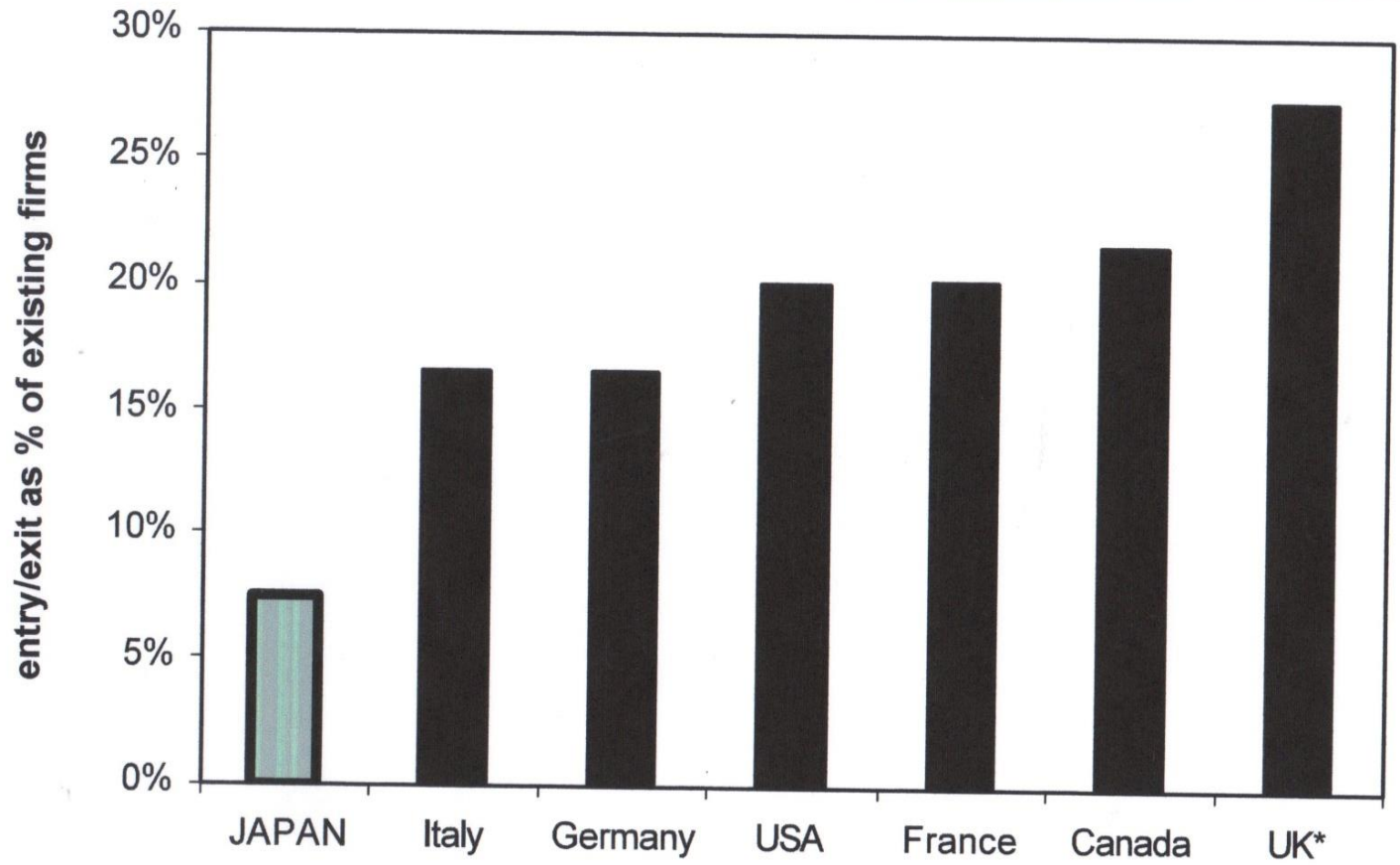


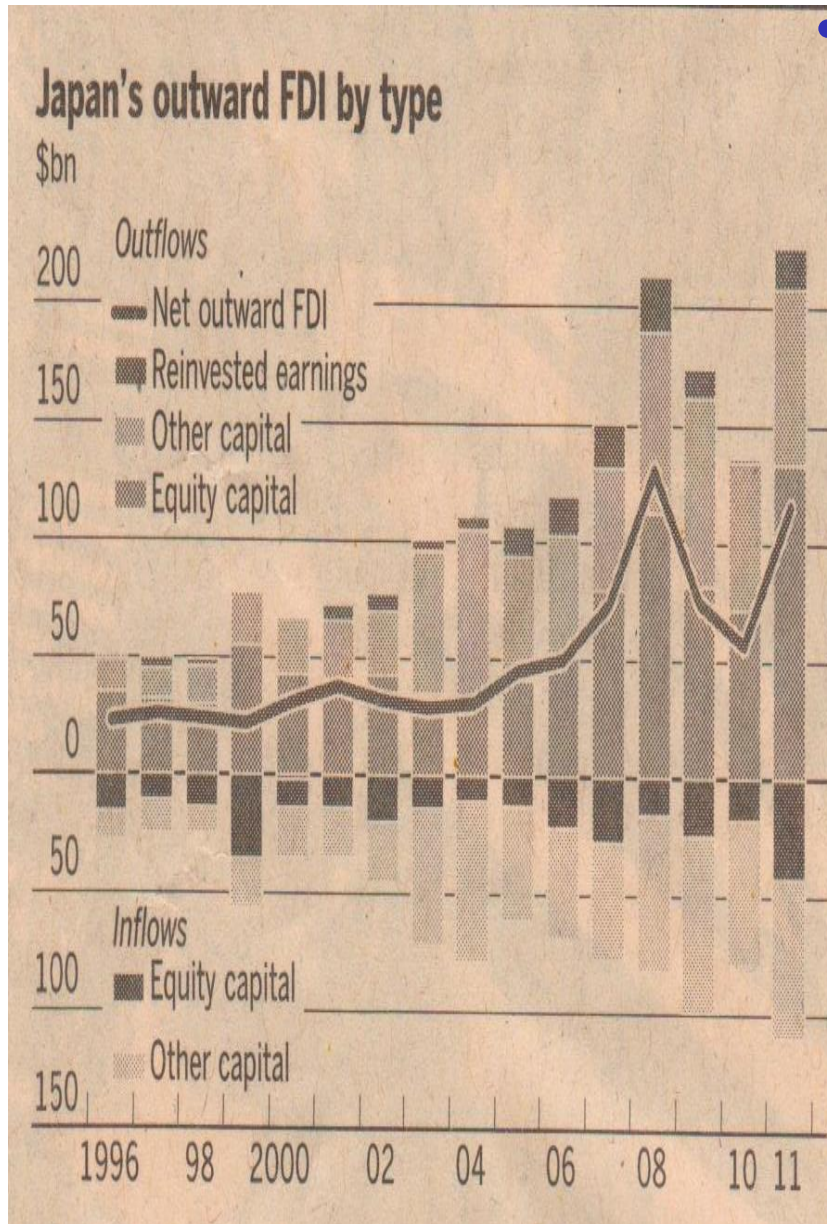
Note: ¥1 trillion = \$12.984 billion at current exchange rate; 2011 through November
The Wall Street Journal

Sources: Japan Ministry of Finance; Ministry of Foreign Affairs; WSJ Market Data Group; FactSet Research Systems; WSJ research; Photos: Getty Images (car exports); Associated Press

- **The big Japanese firms. Stable or unstable ?**

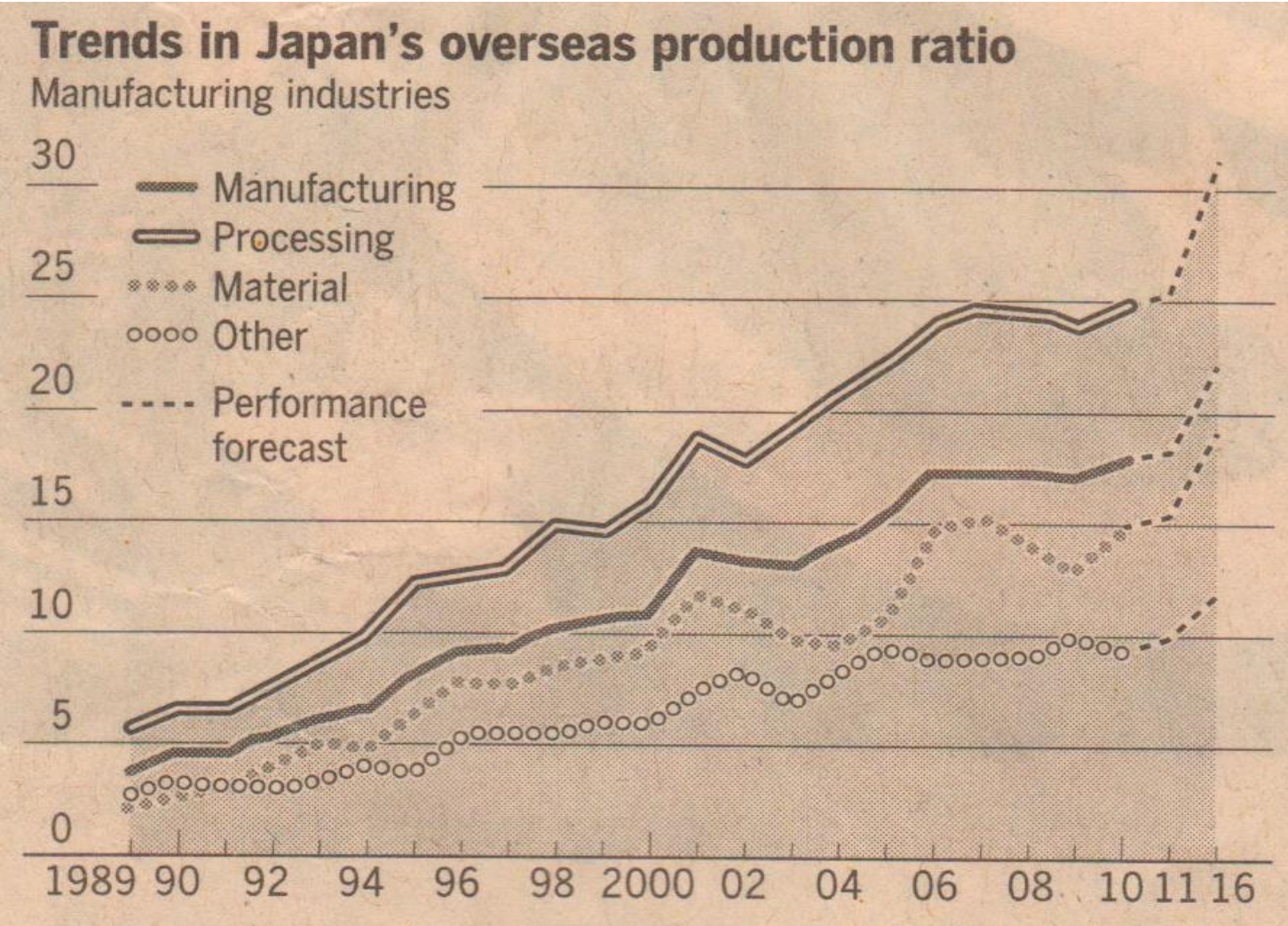
Firm Turnover Lags in Japan





- Japanese FDI grew from around \$201 billion in 1990 to approximately \$963 billion in 2011, a nearly four-fold increase. Meanwhile, the worldwide increase of global outward FDI stock has grown nine-fold, from nearly \$2.1 trillion to almost \$21.2 trillion over the same period.

And also producing more overseas



Japanese Corporate Survey

Return on Corporate Assets



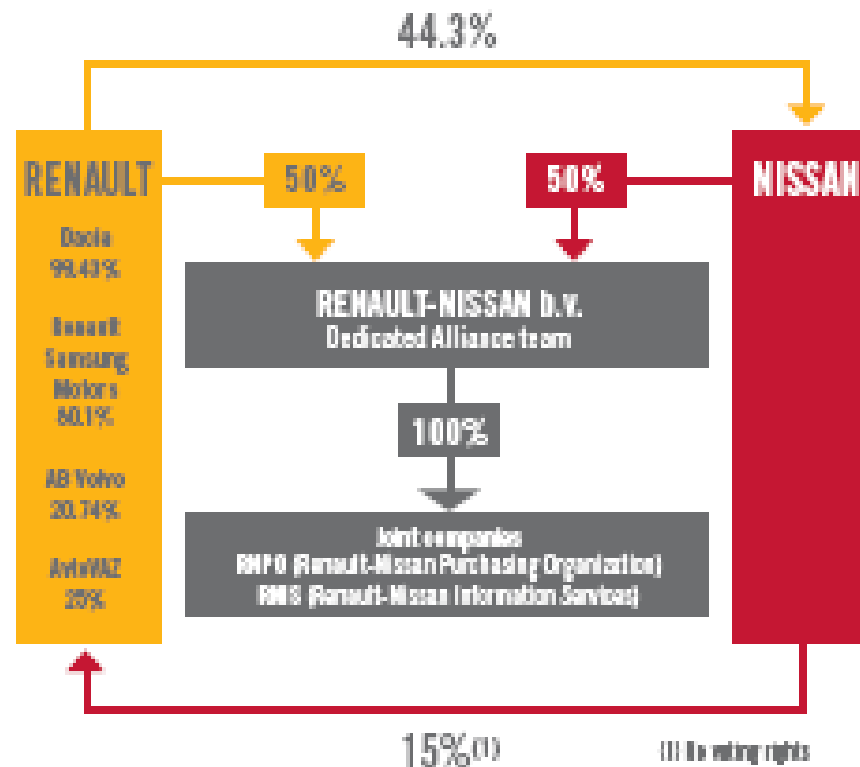
Sources: Ministry of Finance; and IMF staff calculations.

Changing Corporate Japan

- Downsizing also for global leaders (Matsushita, Toshiba, Hitachi) and more foreign investments

- Higher propensity to looking for foreign capital
- (early 2000's foreign institutional investors controlled 1/5 of the largest Japanese listed companies; strong pressure over managers to improve disclosure)
- Changes in corporate governance: cross-shareholdings down from 20 to 11 %
- the share of stable shareholders (those holding shares for the sake of long-term business relationships) fell by half over the past 10 years to about 25% of the total
- Confirmation of State institutions such as Ministry of International Trade and Industry, later Ministry of Economy, Trade and Industry

- Only a few hostile takeovers after 2005 (out of 3.500 listed companies)
- Foreign capital also in big firms: the Nissan case



The end of “neuko”, lifetime employment ?

- Are Japanese firms in the interest of shareholders or in the interest of protecting their human resources ?
- While lifetime employment is often touted as one of the main pillars of the Japanese employment system, in practice, it applies only to a small proportion of the labor force.
- Large firms in Japan have been trying to accomplish their restructuring and downsizing targets by relying heavily on transfers of their employees to their subsidiaries and related firms and hiring cuts, thus avoiding layoffs.
- Last, the burden of downsizing appears to fall disproportionately on young workers and middle-age workers with shorter tenure.

- The end of the “old” industrial relations: more flexibility and mobility among young generations: bifurcation between good jobs and bad jobs, or more specifically, young persons entering bad jobs, and older persons remaining in good jobs. This has resulted in the erosion of employment stability among young workers and its resilience among older workers

Figure 15. ...While the Unemployment Rate — Particularly Among Youth — Has Drifted Higher Since 1990

Employment Rates (Seasonally Adjusted)

