Japan’s Lost Decade: From Crisis to Recovery

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Asia and Pacific Department
International Monetary Fund
We revisit Japan’s “lost decade” for potential insights about the global outlook.

My presentation looks back and discusses:

1. Three recovery attempts during Japan’s crisis:
   - 1997 – recovery derailed by Asia Crisis.
   - 2000 – recovery foundered again
   - 2003 – recovery sustained

2. What was different about the third episode?

Next presentation will discuss implications of Japan’s experience for current global outlook and policies.
Japan’s crisis spanned a dozen years with three phases of downturn and recovery...

**Phases in Japan's Banking Crisis**

*Real GDP growth; in percent*

- **Phase 1:** Crisis outbreak and fragile recovery followed by withdrawal of fiscal stimulus.
- **Phase 2:** Renewed stress and 2nd recovery attempt followed by monetary tightening.
- **Phase 3:** Renewed stress followed by sustained recovery as private demand supported by financial and corporate restructuring, and export boom to China.

Source: Haver Analytics.
Production and labor market indicators tell the same tale of two incipient pickups followed by a sustained recovery.
What did the “Heat maps” show about the recovery at the time?

The Three Phases of the Lost Decade: Recovery Heatmaps

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Legend:
- **Recovery**: The indicator is improving for at least 4 consecutive months.
- **Green Shoot**: The indicator is improving for at least 2 consecutive months.
- **Stabilizing before**: The indicator has improved for one month only, or still deteriorating but at a slower pace than before.
- **Deteriorating**: The indicator is deteriorating, and at a faster pace than before.

The Three Phases of the Lost Decade:
- **First Recovery attempt**
- **Second Recovery attempt**
- **Sustainable Recovery attempt**
Episode 1: signs of recovery allowed fiscal stimulus to be withdrawn -- then Asian crisis struck.

**Fiscal Stimulus and Growth**

- **Fiscal stimulus (percent of GDP)**
- **Real GDP growth (RHS)**

Sources: Ministry of Finance; Cabinet Office; and IMF staff estimates.

1/Defined as the change in structural balance
Episode 2: economy on the mend again, but reversal after global IT crash – policy stimulus reintroduced

Japan: Policy Rate and Stock Market Index

Source: Haver Analytics.
Episode 3: only at third attempt in mid-2003 did lasting recovery take hold, led by domestic demand.

Japan: Contributions to GDP Growth

Source: Haver Analytics; and IMF staff calculations
What was different about Episode 3?

- External shock was positive
- Progress with financial sector reforms
- Progress with repairing corporate sector balance sheets
External environment very favorable for exports, especially to China

Export Value Growth (y/y percent change)

Contribution from China
Financial sector: more aggressive approach to reducing NPLs and recapitalizing banks.

**Non-Performing Loans**
(In billions of yen)

- 1995: 10,000
- 1996: 20,000
- 1997: 30,000
- 1998: 40,000
- 1999: 50,000
- 2000: 60,000
- 2001: 70,000
- 2002: 80,000
- 2003: 90,000
- 2004: 100,000
- 2005: 110,000
- 2006: 120,000
- 2007: 130,000

**Risk Management Loans**

Source: Financial Services Agency of Japan.

**Bank Capital and Lending**
(In percent)

- Tier 1 ratio (major banks)
- Credit growth (year-on-year percent change, RHS)

Sources: Haver Analytics; and Bank of Japan.
Corporate sector: progress with deleveraging helped to lift investment.

**Japan: Corporate Leverage and Investment**

- **Corporate Debt-to-Equity Ratio (in percent)**
- **Private fixed investment (percent of GDP, RHS)**

Source: CEIC Data Company Ltd.
Note on Exit -- Monetary Policy: BoJ able to smoothly unwind its balance sheet

Bank of Japan Assets

(In trillions of yen)

Sources: Haver Analytics; and Bank of Japan.

Public Debt
(In percent of GDP)

Source: Cabinet Office; and IMF staff calculations.
How Does the Great Recession Compare with the Lost Decade? Potential Implications for the Global Outlook

Istanbul
October 6, 2009

Anoop Singh
Director
Asia and Pacific Department
International Monetary Fund
We will place Japan’s experiences in the current global context.

1. What can Japan’s experiences tell us about the likely durability of the global recovery?

2. What do they imply about the appropriate policy stance?
Advanced economy heat maps resemble somewhat Japan’s two early recovery attempts...

Recovery Heatmaps: Japan Then, Advanced Economies Now

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In Emerging Asia, aggressive stimulus and inventory adjustment helping offset weak external demand.

**Recovery Heatmaps: Japan Then, Emerging Asia Now**

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Potential Implications of Japan’s Experiences for the Global Outlook

“Green shoots” do not guarantee a recovery.

Financial fragilities can magnify effects of adverse shocks on the economy.

Weak global environment could limit prospects for an export-led recovery.
Potential Implications of Japan’s Experience for Policies

- Policy stimulus should be maintained for now, but no panacea

- Underlying financial problems need to be addressed for a durable recovery to take hold.

- Clear exit plans can help reinforce confidence.

  – Role for developing cooperative and coordinated exit strategies.