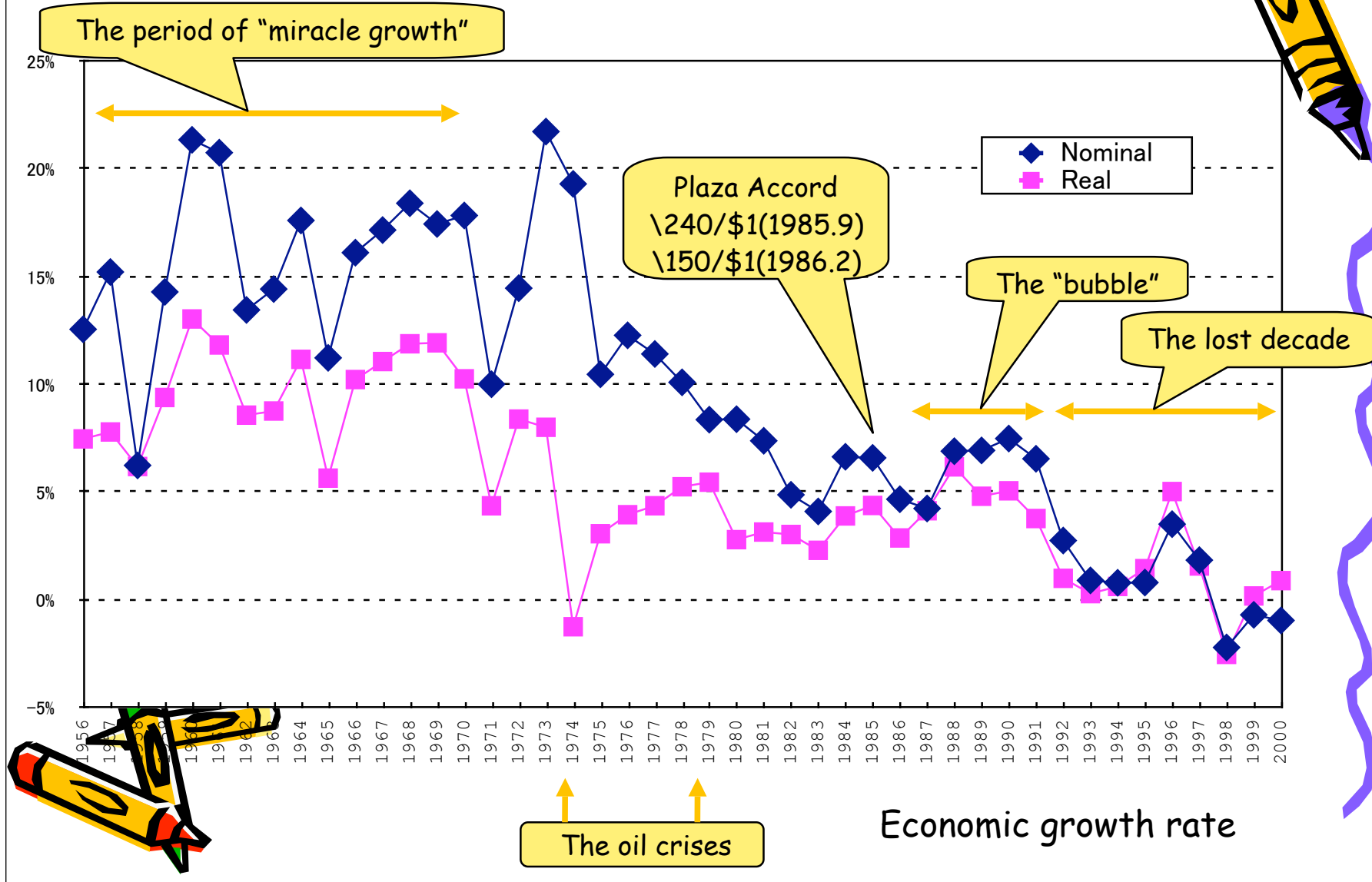
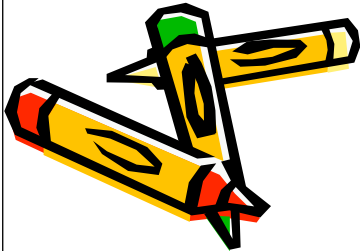


# 7. The Bubble and the Lost Decade

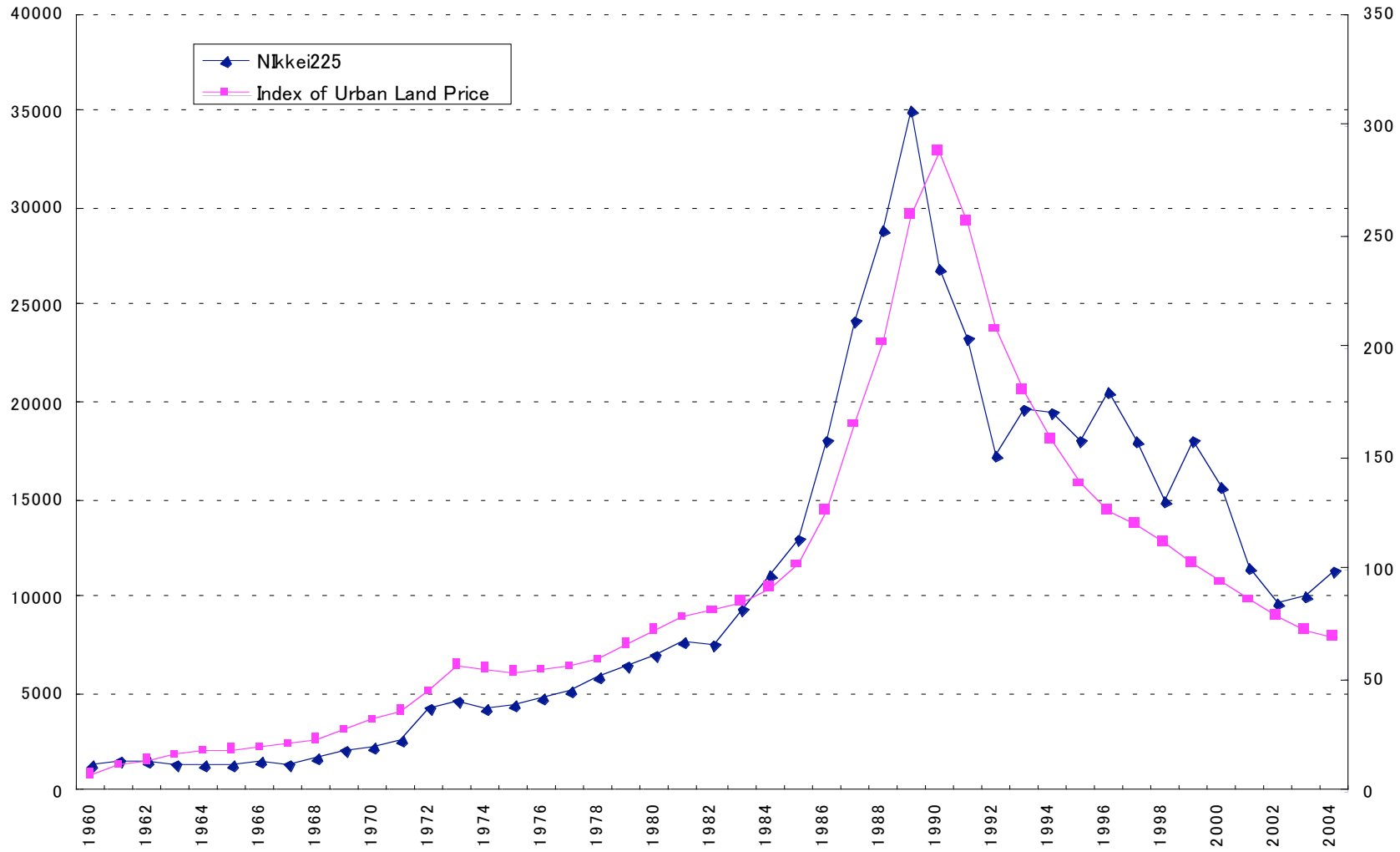
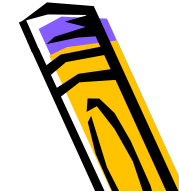


# The happiest time and the worst time

- For these 20 years, Japan's economy has experienced the very short happiest time and the very long worst time.
- In fact, the former was an illusion. But it left serious burdens to cause the latter, the long severe depression.
- In this depression, some myths about Japan's economy were dispelled; permanent perfect employment, equal income distribution, land as the most precious asset etc.
- And this depression caused structural changes in some parts of Japan's economy.



# "The bubble"



# Why the bubble occurred

## -- Background

1. **Big companies left banks in 1970s.**  
Banks began to make riskier loans, especially to real estate agents.
2. **The government and BOJ slackened supervision**  
in the global trend of deregulation.
3. **A Japanese myth** about the price of land



# The plaza Accord

1. The ministers of G5 countries met at the Plaza hotel in New York.
2. To help the US economy get out of the "double deficits", they agreed to control the world economy in the direction of weaker dollar and stronger yen/mark.
3. Immediately after the Plaza Accord, the value of yen began to soar.
4. Fearing a depression, BOJ adopted **ultra loose monetary policy**.



# Why the bubble burst

- ▶ Because it was a "bubble" (an illusion).  
Sooner or later it would have burst.  
But, it was kept alive too long and burst too suddenly.
- 1. In 1989 and 1990, **BOJ** suddenly raised the official bank rate five times in a row from 2.5% to 6%. (Cf. "Black Monday" in 1987)
- 2. In 1990, the **Diet** passed the bill to "control over loans on real property".



# And, BAD LOANS remained

- At first, in the beginning of 1990s, many people **still believed** that the bubble would soon **revive again**.
- Banks kept on **lending more** money to already almost bankrupt companies, which increased the total amount of BAD LOANS.
- At the same time, banks made some kind of "**window-dressing**" about their balance-sheets.



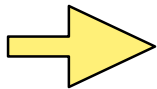
# And the result was... a huge amount of BAD LOANS



	1992	1994	1996	1998	2000
不良債権処理額	16398	52322	77634	136309	61076
1992年度以降の累計	16398	107442	318768	587660	718177
不良債権残高	127746	125462	217890	296270	325150

全国銀行の不良債権処分損の状況

(森永卓郎「日本経済50の大疑問」より抜粋, 単位:億円)



If you want to know more in detail about “the bubble”, the following is a good reference; “Time to arise from the great slump”, The Economist, July 20th, 2006.

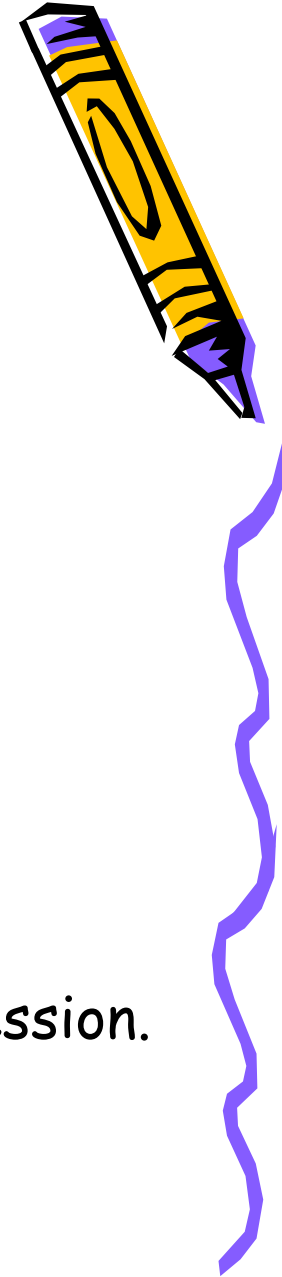


[http://www.economist.com/finance/displaystory.cfm?story\\_id=7189583](http://www.economist.com/finance/displaystory.cfm?story_id=7189583)

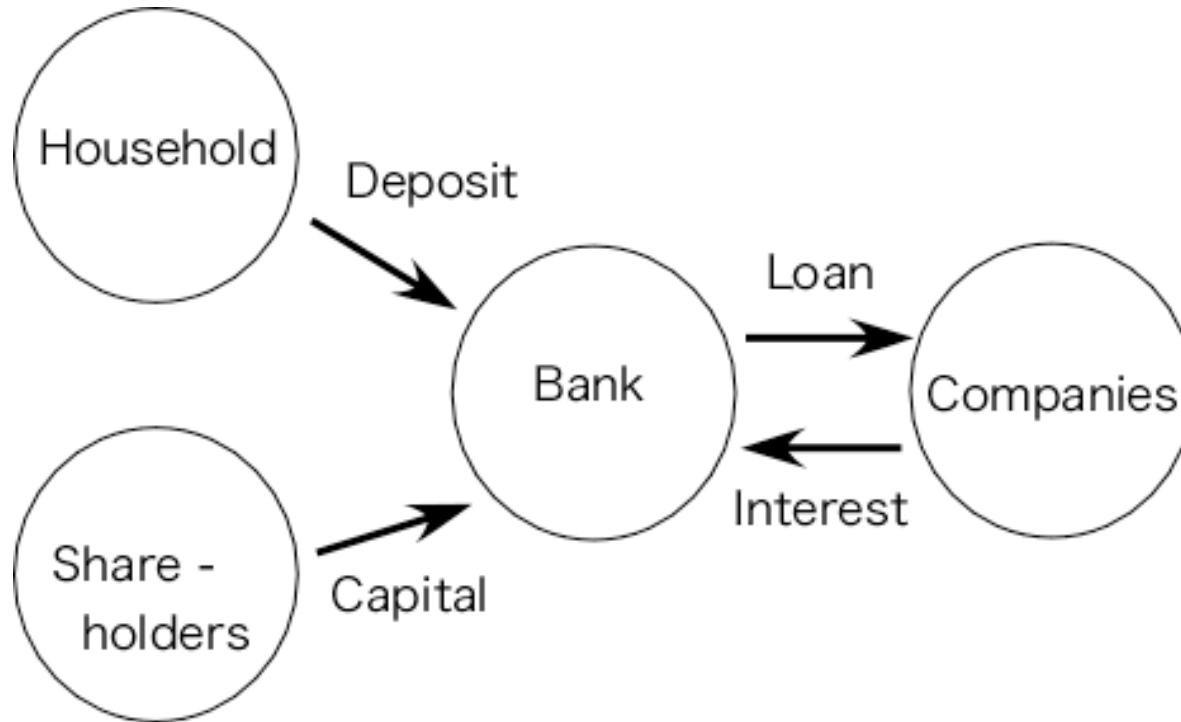


# The Debt Deflation

- The assets prices drastically fell.
  - Consumption declined.
  - Investment declined.
  - Many companies went bankrupt.
  - The unemployment rate soared.
- The general prices/wages decreased.
- The real burden of debts increased.
- The vicious cycle started.
- The vicious cycle caused serious economic depression.



# The Role/Job of Banks



- Capital(equity capital) is the bank's own disposable fund.
- Banks earn profit by the interest payment from debtors.
- When debtors go bankrupt, banks can not get the interest , let alone getting back the principal.
- In such case, banks have to break down the capital to compensate the loss.



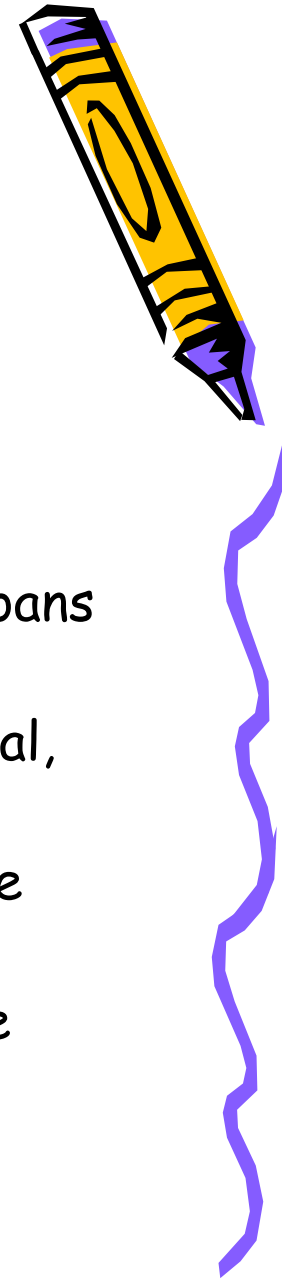
# Basel I and Credit Crunch

- BIS regulation ( Basel I )

$$\frac{\textit{equity capital}}{\textit{risk assets}} > 0.08$$

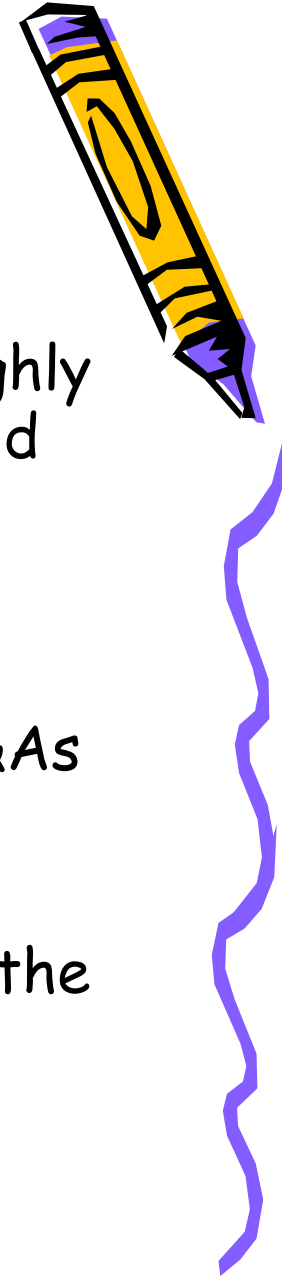
*risk assets = total amount of loans + ...*

- Through the 1990s long severe depression, many companies went bankrupt and a huge amount of bad loans emerged.
- To dispose of bad loans, banks consumed equity capital, which lowered the above ratio.
- Banks tried to reduce the denominator. Banks became reluctant to lend money to small companies.
- This caused a credit crunch in the 1990s, which made more companies bankrupt.



# Public money injection

- March 1998 and March 1999, the government injected public money into the big banks (roughly about 10 trillion Yen) to save them and to avoid credit crunch.
- Now, bad loans problem is almost resolved.
- The big banks become still bigger through M&As to make the three mega-banks.
- Three mega-banks are now in pretty good condition. But they have not fully payed back the public money.



## Another cause for the lost decade

- Some people point out another cause for "the lost decade".
- Decline of **international competitiveness** of Japanese manufacturing industries.
  - **Decline of technical progress**
  - **High production cost mainly due to high wages**



# Concluding remarks

- According to the government official announcement, Japan emerged from the depression in the beginning of the 21<sup>st</sup> century, and it has been keeping a good business condition since then.
- But, even now, we are not sure about that.
- In addition, we have to note that Japanese economy has seen some drastic structural changes during these 15-20 years.

