

The Lost Decade and the Coming Decade

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Lost Decade (1993-2003)

- Low growth
 - Average growth rate 1% (compare it to 4% of 1973-1992)
- Financial Crisis
 - Banking crisis of 1997-98; 2002-2003
 - Political turmoil (frequent change in prime ministers and coalitions), 1993-2001
 - Mushrooming fiscal deficits
- Deflation
 - Negative inflation rate, 1998-2005

Compounding Reasons

- Bubble burst. Stock prices and Land prices in 2003 was only 1/6 to 1/5 of the peak (1989).
- Policy Mistakes
 - Monetary policy (not relaxed enough, 1991-1997; major mistake in tightening in 2000)
 - Fiscal policy, too tight, 1997
 - Financial supervision policy. Did not resolve nonperforming loans (NPL) problem, 1995-2003. Prolonged and expanded financial crisis.
- Lessons from Japanese deflation is now learned by other central banks

Koizumi Reform

- Strong leadership
- No additional fiscal stimulus
- Turning point in financial policy by Minister Takenaka
- Other reforms (mixed results)
 - Highway building corporations (more rhetoric than real)
 - Postal service/saving reform (remains to be seen whether they shrink or expand)

Economic Recovery, 2004-present

- First time to have 3% growth in two years in a row (two failed attempts, 1996 by fiscal stimulus, and 2000 IT Stock bubble)
- Stock price recovery (doubled in 2003-2005)
- Deflation may be finally over (unless the Bank of Japan makes another mistake)
- Financial sector has become healthy
 - Low NPL ratio
- Corporate profits are high; finally wages are increasing in 2006

Coming Decades

- Bright side
 - Wealth effects from increasing stock price and (finally) land prices
 - Smaller government (thanks to PM Koizumi)
 - Growth in China and Asia—spillover effects
- Risks
 - Low birth rate and aging society
 - Fiscal unsustainability: Government debt/GDP ratio, 160%, highest in the advanced countries
 - Deteriorating security (income disparity?)
 - Deteriorating education (no work or low skill jobs only for the young?)

Policy Challenge

- Globalization and Regionalization
 - FTA with Asian neighbors—stimulating both exports and imports
 - Foreign workers, esp. health care
- Mobilizing women workforce
 - Needs to support in care of the elderly, child care, and household chores—foreign workers?
- Extending retirement
- Reducing fiscal deficits/debts in the future