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## **ABENOMICS BRINGS JAPAN OUT OF THE LOST TWO DECADES**

***Hajime Takata***

Prime Minister Shinzo Abe's new policy, Abenomics, is bringing about significant effects, having succeeded in changing the mindset in Japan by introducing the right measures at the right time. An economic bubble in Japan started to collapse in 1990, which led to the long-term economic stagnation arising from balance sheet adjustment, or "Japanization." On the other hand, the United States and Europe experienced balance sheet adjustments similar to Japan's after 2007 as a result of the bubble created after the late 1990s.

*The views expressed in this piece are the author's own and should not be attributed to The Association of Japanese Institutes of Strategic Studies.*

Japan's "lost decade" was supposed to move toward the exit around 2007. However, adjustment pressure from the economies of the United States and other countries, coupled with the trend toward a stronger yen, set Japan up for a "lost two decades." This paper demonstrates that Japan is taking the first step to break away from the "lost two decades," now that the adjustment in the United States that started in 2007 is finally coming to an end after six years.


Japan had almost completed the disposal of excessive debt held by the corporate sector as well as balance sheet adjustment by the mid-2000s, which resulted in the restoration of financial market functions in Japan. Around 45% of listed companies (as of 2011) have improved their financial strength so that they have substantially no debt, a figure twice that in the early 1990s. While Japanese companies' debt reduction was appropriate for balance sheet adjustment after the collapse of the economic bubble, the resulting macroeconomic phenomena were a fall in asset prices, a deflationary mindset, and deflation. The challenge for the Abe administration in overcoming deflation is to return the Japanese mindset from the "reduction mindset", which is in a way a result of "adaptation" to the changing environment, to the normal mindset of the pre-bust period. Abenomics puts an emphasis on "regime change" because the Japanese economy needs such a change in its mindset.

There are three basic approaches to balance sheet adjustment for dealing with capital base erosion: 1) debt assumption, 2) a growth strategy for securing resources for debt disposal, and 3) asset price improvement based on improved expectations. In Japan's case, the debt assumption has already been done, and the question is how the growth strategy can secure the resources for debt disposal and bring about positive expectations.

For the growth strategy, developing new products and improving productivity are among the more important steps. Abenomics has in its quiver the three arrows of a growth strategy, fiscal policy, and monetary policy, and the government has established such organizations as the Council for Industrial Competitiveness to promote its growth strategy. However, stagnant production due to excessive appreciation of the yen has substantially constrained the growth strategy for the past twenty years. Although the currencies of countries

with stagnant economies due to the collapse of economic bubbles should theoretically suffer significant devaluation, in Japan's case the yen excessively appreciated in the 1990s after the bubble burst and again in the latter half of the 2000s, which caused stagnation in corporate activities and a deflationary mindset in Japan. The big challenge for Abenomics was therefore to overcome the excessive appreciation of the yen, a key for breaking away from the deflation.

I mentioned at the beginning that Japan was taking its first step to free itself from the "lost two decades", because foreign economies, especially the US economy, can now see the path from debt adjustment to recovery after nearly six years of adjustment since 2007. As a result, the pressure for an excessively strong yen was reversed and, in terms of mindset, the Abe administration's policies have now created an environment where a shift in expectations can take place. The Bank of Japan announced a "monetary easing of a different dimension" this April, reflecting the strong will of the government and the financial and business sectors to overcome deflation.

Japan is the only developed country that experienced deflation after World War II, and Abenomics is a great monetary and economic challenge on a global scale that deals with the first such symptom in the postwar era. At the same time, one must note that Abenomics has proven effective because Japanese companies have already finished their debt disposal and possess potential capacity in terms of technologies and adaption. The resilience of the Japanese people in the wake of the 2011 Great East Japan Earthquake is another indication of such potential. Abenomics has awakened Japan's potential. The year 2013 will be remembered as a major turning point for Japan in breaking away from the "lost two decades." 

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