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The Collapse of the Bubble and the Economic Crisis in Japan

This case study describes the formation of the bubble economy in Japan from the second half of the 1980s, its collapse in the 1990s, and the economic crisis known as the "lost decade."

I. The Formation of the Bubble

In Japan, share prices began rising sharply in 1986 and land values in 1987 (see **Figure 1** and **Figure 2**). These soaring asset prices were due in large part to the excessively lengthy and large-scale monetary easing of the second half of the 1980s. Even when asset prices had begun rising, the Bank of Japan (BoJ) reduced the official discount rate[1] from 3 percent to 2.5 percent in February 1987 (see **Figure 3**). And even after the surge in asset prices had become obvious, it left the official discount rate unchanged for two years, until June 1989.

At the time, the BoJ was cautious about moving to tighten credit because it feared a return to the "high-yen recession" (June 1985 – November 1986[2], see **Figure 4** and **Figure 5**), which was caused by a steep appreciation in the yen from 1985. The BoJ was also concerned about another plunge in the U.S. stock market (after Black Monday in October 1987). The BoJ attempted to steer the yen downwards by keeping interest rates low for a long period of time, and reduce the risk of investment in U.S. stocks by keeping bearishness concerning the dollar in check[3]. Another reason the BoJ was hesitant to tighten

This case study was prepared (in June 2011) by Professor Hiroshi Nakamura of the Graduate School of Business Administration, Keio University, based on publicly available information as well as suggestions and comments from Professor Shigeru Tanaka of the same graduate school, and was designed to be used as a basis for class discussions.
The English version was translated under supervision of Hiroshi Nakamura of the Graduate School of Business Administration, Keio University.
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[1] Following the liberalization of interest rates in 1994, the policy rate was changed from the official discount rate to the uncollateralized call rate (i.e. the interest rate on short-term (one year or less) loans made by financial institutions in the call market). To reflect this change, from 2006 the term "official discount rate" was replaced with "basic discount rate" and "basic loan rate" in official statistics (see **Addendum 1: Notes on the Money Stock and Monetary Policy**). For the sake of consistency, however, this case study uses the term "official discount rate."

[2] The period of the high-yen recession was determined by the Cabinet Office's working group of indexes of business conditions.

[3] If the dollar is expected to fall, the value in yen of U.S. stocks (which are denominated in dollars) will be expected to drop. West Germany, on the other hand, had moved to tighten credit one year earlier than Japan, in the middle of 1988. See the "Annual World Economic Report" (1990, country profiles section) from the Economic Planning Agency.