

# Aftereffects of the Bubble Economy

By Morio Murakami

Japanese companies listed on the Tokyo Stock Exchange (TSE) saw their pretax profit fall for the third consecutive year in the fiscal year ended on March 31, 1992. In fact, their combined profit in fiscal 1991 suffered a double-digit setback in percentage terms for the first time in 10 years.

Particularly notable was the fact that even in businesses other than financial institutions such as banks, securities houses and insurance firms, pretax profit plunged as much as 15%, in contrast with a 7% drop in operating profit. Primarily responsible for this were the increased cost of interest payments, a major fall in the appraised value of stocks held, and the great loss incurred when stocks were sold. According to a survey by the Wako Research Institute of Economics Inc., the balance of non-operating accounts for all the companies listed in the First (major) Section of the TSE as of the end of March 1992 deteriorated more than ¥820 billion to register a combined deficit of over ¥2,230 billion.

## Most dramatic setback

Harder hit were non-manufacturing companies registered for trading on the over-the-counter market. Their pretax profit plunged 37%, with operating profit declining 26%. Real estate companies and the so-called non-bank businesses, such as leasing and housing loan companies, consumer loan companies and factoring firms, were affected more severely than companies of other business lines by depressed land and condominium prices and the swollen volume of unrecoverable loans, which came in addition to an inflated interest cost, a fall in the appraised value of stocks, and the loss from the sale of stocks.

Due to mismanagement of financial assets, Japanese companies were left with a combined hidden loss in excess of ¥10 trillion in *tokkin* (specified money in trust) and fund trusts as of the end of

March 1992. Moreover, the combined amount of convertible debentures and warrant bonds they have to redeem at the peak period in fiscal 1992 and 1993 will total ¥14 trillion.

The net business profit of major commercial banks—profit from their core banking business—grew during the year, as they benefited from an improved margin resulting from a series of cuts in the official discount rate. But most of the banks suffered setbacks in terms of both pretax profit and net profit. The decline in their net profit averaged almost 30%. The nation's 11 major commercial banks, known as city banks, reported appraisal losses in securities totaling well over ¥830 billion as of the end of March 1992, an amount that was five times as large as a year before. Trust banks, which incorporate stocks in their core business, suffered a 14% drop in net business profit and a 37% fall in after-tax profit.

The situation was almost disastrous for securities houses. The nation's 124 securities companies, which are all full members of the TSE, reported more than ¥245 billion in combined loss, compared with a combined ¥680 billion pretax profit in the year before. This was the most dramatic setback they had suffered since the one they experienced in September 1965. Of the 25 larger securities houses listed on the TSE, 20 reported pretax losses.

The combined value at market prices of all stocks listed in the First Section of the TSE dropped to ¥365 trillion by the end of 1990, and more recently to less than ¥300 trillion after it had climbed to a record ¥590 trillion at the end of 1989.

According to figures released in May 1992 by the Japan Real Estate Institute, land prices as of the end of March in 223 major cities across the nation were down by an average 2% as compared with the end of September 1991. It was the first fall in 17 years. The last time land prices registered a drop in a similar survey was in March 1975 when the economy was in

deep recession in the wake of the first oil crisis. Average land prices in the six biggest cities of central Tokyo, Yokohama, Nagoya, Osaka, Kyoto and Kobe plunged more than 12%, the steepest fall since the end of World War II.

In retrospect, what came to be known later as the "bubble economy" had its origin in the series of cuts in the official discount rate, a policy pursued to counter the recession caused by the appreciation of the yen following the 1985 Plaza Accord. The discount rate was reduced to a historical low of 2.5%, which resulted in inflating lending by banking institutions (see the table).

A phenomenal increase was reported in the amount of loans extended to big corporations and non-banks, many of which stood as proxy for banks. This caused stock and land prices in Tokyo and other big cities to rise dramatically. Then came the credit squeeze. A sharp fall in stock and land prices was inevitable, given the market forces of supply and demand. To put it accurately, big cities were battered by a "stock deflation" in what may be called the first phase in the bursting of the bubble economy.

## Financial system hard hit

Hardest hit by the burst were Tokyo and the adjoining metropolitan area encompassing Kanagawa, Saitama and Chiba prefectures. According to revised national economy statistics released at the end of 1990 by the Economic Planning Agency, the nation's assets (stock) were inflated by almost ¥500 trillion during fiscal 1989, which was 20% more than the year's GNP in nominal terms.

Much of the increment resulted from the rise in land prices in the metropolitan area and the increase in the value of stocks held by big businesses based in the region. As much as 60% of the nation's total stock assets as of March 1991 was held by big corporations based in the metropolitan area.

## Changes in Official Discount Rate (%)

1986	January	4.50
	March	4.00
	April	3.50
	November	3.00
1987	February	2.50
1989	May	3.25
	October	3.75
	December	4.25
1990	March	5.25
	August	6.00
1991	July	5.50
	November	5.00
	December	4.50
1992	April	3.75

Banking institutions, securities houses and non-bank firms, deeply involved in stock transactions in these corporations, are concentrated in the region. With these institutions heavily damaged, it could be said that the second phase of the collapse of the bubble economy signaled that a "crack" was appearing in the existing financial system.

The Ministry of Finance put the combined amount of claims in arrears held by 21 major banks as of last spring at ¥7 trillion to ¥8 trillion, and those not recoverable due to lack of collateral at ¥2 trillion to ¥3 trillion. However, many analysts believe that actual figures may have been much bigger, considering the manipulation of books by some of the banks.

The combined latent profits on stocks held by the nation's 11 city banks dwindled to some ¥10 trillion from more than ¥40 trillion in their peak period at the end of September 1989. A senior economist of the Banque Nationale de Paris was quoted as saying, "If the amount of bad loans held by Japanese banks was between ¥7 trillion and ¥8 trillion as calculated by the Ministry of Finance, its possible impact on the Japanese economy would not be very serious. But if the amount was as big as ¥30 trillion as estimated by some banking officials, then its impact could be serious indeed."

Japanese financial institutions are now working hard to meet the Bank for International Settlements capital-to-assets ratio by curbing fresh loans and taking in subordinated loans that carry higher interest rates. Major banks are also ex-

tending assistance to minor financial institutions, non-bank firms and securities firms in hopes of preparing the ground for a new restructured financial system.

Securities houses, with the backing of major banks, are going all-out and dedicating themselves to reorganize and restructure the entire industry through rationalization efforts. More than other financial institutions they are aware of the need to redefine and correct their business ways and policy and accordingly play a positive role as a mediator to help business corporations raise funds on the stock market.

Insurance companies were also affected by the slump in stock and land prices, though to a lesser extent than banks and securities firms. Life insurance companies in particular were forced to cut dividend payments to policyholders for the second consecutive year, as they saw hidden profits on stocks they hold drastically reduced and the return on their asset management trimmed. Some smaller life insurance companies had the hidden profit on their stocks reduced to almost zero. Like other financial institutions, they also face difficult problems as the nation's financial system goes through a restructuring process.

### Corporate investment being curtailed

The metropolitan area accounts for almost 30% of the nation's total work force. The ratio is much higher when it comes to the GNP. A hard blow to such a region inevitably affects the nation's overall economic activity. In recent months there have been delays in the implementation of urban development projects in the metropolitan area, such as those promoted by local governments in Tokyo, Yokohama, Chiba and elsewhere. Interest originally shown by business corporations taking part in those projects has turned less enthusiastic since they saw the value of their assets greatly reduced. They, too, feel uncertain about the future of the economy.

Most of the much-publicized resort development projects and theme park schemes have lost their initial momen-

tum. Encouraged by new legislation on resort development, such projects were launched at designated sites in 35 prefectures across the nation. Now two-thirds of those projects have been either reduced in scale or partially canceled.

This is quite natural, considering that big businesses and financial institutions based in the metropolitan area have been deeply involved in those projects. When they start retrenching costs, they begin by looking into and reassessing big projects, unnecessarily allocated staff, and advertisement and entertainment expenses.

Some 2,180 major companies polled by the *Nihon Keizai Shimbun* in early June said they planned to cut by almost 10% the number of new graduates to be employed from universities, two-year colleges or high schools next spring. It will be the biggest curtailment since 1987, when Japan was hit by a recession caused by the appreciation of the yen. Major recruitment cutbacks are being planned by telecommunications, office equipment, newspaper publishing, broadcasting, publication, advertisement, airline, printing and information software companies. They have subsequently been joined by electrical machinery manufacturers, automakers, financial institutions, securities houses and real estate companies. These companies plan a drastic reduction in employment of all university graduates with the exception of science and engineering majors.

A good number of employees, mainly women office workers, have been laid off at securities companies. The securities industry's total employment had peaked at 167,000 as of June 1991. By March 1992, there was a cut by more than 16,000. The industry's total employment is now estimated to be well below 150,000, even when new recruitment next April is included.

A report released in June by the Ministry of International Trade and Industry said that some 1,660 major companies polled planned to trim their investment in fiscal 1992 by an average 1.4% as compared with the previous year. This means the companies revised their investment plans downward. In a similar MITI survey toward the end of 1991, they had re-

plied that they would spend 1.2% more on the average. This will be the first curtailment in five years and the biggest since fiscal 1972, when these companies reduced their investment by 5.7%. Major cutbacks are being planned by paper-pulp, cement, chemical, electronics and automobile companies.

The fact that companies are spending less on advertising and entertainment is evident from the reduced earnings reported by advertising, newspaper, broadcasting, publication and printing firms and slow business conditions at exclusive bars and nightclubs in Tokyo.

Another set of MITI figures indicates that sales have been much slower at department stores than at superstores. The index of sales at department stores fell to 95.4 in March 1992 against the base figure of 100 for 1985. Hardest hit have been stores in the big cities, around Tokyo and Osaka. They have reported especially slow sales of menswear, furniture and household electrical equipment. Sales of gift coupons have slowed down more markedly at department stores than at superstores.

Department store sales for April, announced in late May, were equally bleak. Sales of expensive items such as paintings and jewelry posted year-on-year declines for 10 months running from July 1991. The price of paintings, which along with stocks and land were once called the "Three Star Bubble Items," has now fallen to the levels of four to five years ago.

## Positive effect of bubble economy

So-called smaller firms purchase goods from department stores for corporate business purposes. The slow sales apparently reflect the reduced orders placed by smaller companies in big cities which were also hit by the slump in stock and land prices. An increasing number of smaller firms in the regions around Tokyo, Nagoya and Osaka have turned pessimistic about the prospects for the economy. A report announced in May by the Small Business Finance Corporation said that the business outlook diffusion index—the differential between the num-

ber of corporate managers taking an optimistic view and that of those with a pessimistic view—stood at minus 16.8 in the January-March quarter, the lowest in nine and a half years.

The number of bankruptcies involving liabilities of more than ¥10 million per case exceeded 10,000 in fiscal 1991 for the first time in four years. The number of failures caused by the depressed stock and real estate prices was 2.2 times more than the year before. Notable at the same time was a 94% jump in the number of failures caused by slow sales, difficulties in collecting receivables, and accumulated bad debts. A majority of these recession-type failures involved smaller businesses.

All these statistics indicate that the economic slowdown, triggered by the drop in stock and land prices, first hit the metropolitan area and then spread to big cities in other regions. Similarly the impact was first felt by big businesses and then by smaller businesses. The whole process began with the bursting of the bubble, which has gradually developed into a recession.

Many businesspeople felt that the Japanese economy began worsening around November 1991. A prevailing view these days, however, is that the latest cycle of expansion that began in November 1986 actually hit a peak in March 1991. The weak demand being experienced by the semiconductor, electrical appliance and auto industries after heavy investment is symptomatic of a recession.

Japan posted a current account surplus surpassing \$90 billion in fiscal 1991, with its trade surplus zooming to \$113 billion. The customs-cleared trade surplus hit a record high of \$49 billion in the first half of 1992. The surplus resulted from the recession in Japan, which gave impetus to exports of its products. The recession was also marked by a decrease in imports of high-priced commodities such as paintings and jewelry. The recession has even resulted in reductions in imports of such items as crude oil, some raw materials and machinery due to slackness in normal production activities. Overseas investment also tumbled.

Spring wage raises and summer allow-

ances in 1992 grew year on year at the lowest rate in four years, which, coupled with poor corporate performance, is going to depress the government's tax revenues.

As the decrease in the nation's capital stock caused by declining stock and land prices gradually began to hit the nation's economic activities, trade frictions have become an international problem and financial policy has become a controversial domestic issue.

However, it must be remembered that the economic phenomenon known as the "bubble economy" had a positive side, too. During the bubble period, some 2 million more houses were built than usual, ¥320 trillion was spent in rationalization, investment in modernization and in the introduction of high technology. It is also undeniable that increased demand for expensive commodities helped raise living standards, including the cultural side of life.

The current post-bubble recessionary economic situation, as shown by the low jobless rate, high equipment operation rate, growing demand for services and stable wholesale prices, is much more bullish than in past recessions.

A string of reshuffles of top executives is taking place in listed companies this year in what is regarded as a break from the Japanese corporate tradition of replacing top executives in odd-numbered years. This reflects Japanese companies' determination, under new leadership, to raise morality, refocus on core business, develop more consumer-oriented products and pay greater heed to the community and environment. Individuals have also curtailed their extravagant spending and now concentrate more seriously on work and home affairs.

What, ultimately, was the bubble economy—and its total and true picture? Maybe more time will be needed to obtain an accurate picture of the phenomenon, including exactly when it started and when it ended.

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