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The Realities and Relevance of Japan's Great Recession

In a public lecture at the London School of Economics today, Adam Posen - external member of the Monetary Policy Committee and senior fellow at the Peterson Institute for International Economics - considers the Japanese economic experience of the late 20th century and its relevance for other advanced economies today.

Adam Posen argues that:

- Japan's Great Recession was the result of a series of macroeconomic and financial policy mistakes. It was largely avoidable once the initial shock from the bubble bursting had passed. This is demonstrated by the under-appreciated strength of Japan's recovery once policies were reversed in 2002-03.
- Japan actually had a number of structural advantages that made its stagnation all the more avoidable, particularly with respect to fiscal policy. Structural deficiencies in Japan's financial system and in its corporate governance offset these when the deflation persisted.
- The aberration in Japan's recession was not the behaviour of growth, which is best seen as a series of recoveries aborted by policy errors - a sawtooth, not a flat line. Rather, the surprise was the persistent steadiness of limited deflation, even after recovery took place. That is a more fundamental challenge to basic macroeconomic understanding than is commonly recognised, and more research is needed.
- The UK and US economies are at low risk of turning Japanese in the sense of having recurrent recessions through macroeconomic policy mistakes - but deflation itself cannot be ruled out. The UK worryingly combines a couple of financial parallels to Japan with far less room for fiscal action to compensate for them than Japan had. More active investors and greater openness in the UK than in Japan may be able to turn this around.
- One major problem which Japan did not face during its Great Recession was poor prospects for external demand and the need to reallocate productive resources across export sectors. The UK, US, and many Euro Area economies do now face this challenge simultaneously, which may limit the pace of, and our share in, the global recovery.

Adam Posen says: "Ultimately, my main analytical point is for people to stop thinking of 'turning Japanese' as a syndrome, some sort of strange condition into which an economy can fall. Instead, we should think of Japan's Great Recession as largely demonstrating the validity of much textbook, even old fashioned Keynesian, macroeconomics - and thus amenable both to comprehension and, within limits, avoidance, or at least amelioration."

Key Resources

The Realities and Relevance of Japan's Great Recession - Neither *Ran* nor *Rashomon* – Full speech

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech434.pdf>