- The End of the Bubble Economy

The term "bubble economy" refers to the rapid rise in private demand and asset prices in Japan in the late 1980s, and their subsequent decline in the early 1990s.[5] In the midst of the bubble, land and stock prices climbed to new highs that were not sustainable by the economic fundamentals. A popular anecdote used to illustrate the extent to which Japanese land prices rose is that, in the late 1980s, the land under the Imperial Palace in Tokyo was worth as much as all the land in California, or all the land in Canada, or all the land, houses and factories in Australia.

Commercial real estate prices in Tokyo dropped 7% and 19% in 1991 and 1992, respectively.[6] Even though Japanese banks have engaged in significantly less real estate lending than North American banks, the decline in Japanese real estate prices has resulted in sharp increases in non-performing loans held by Japanese banks.[7] One option to cover the expenses of bad debts is for banks to sell assets, including their equity holdings.

In addition to the real estate decline, the Tokyo Stock Exchange index has fallen about 50% (as of June 1994) since its peak in December 1989. In and of itself, a fall in the index need not reduce the share of outstanding stock held by commercial banks. If bank portfolios are fully diversified, and changes in their values mirror those of the market, banks' shares of outstanding stock will remain unchanged.

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[5] For a discussion of the Japanese bubble economy, including factors that led to its demise, see C.F. Bergsten and M. Noland, *Reconcilable Differences? United States - Japan Economic Conflict*, Institute for International Economics, Washington, D.C., June 1993, pp. 43-53.

[6] See Bank for International Settlements, *63rd Annual Report*, Bank for International Settlements, Basle, 1993, p. 159. By comparison, commercial real estate prices fell by 18% and 13% in the U.S. North-East, and by 9% and 13% in Toronto, over the same period. There have been suggestions that land prices in Tokyo and Osaka need to fall by as much as 60% from their 1990 peak to reach a level that is sustainable by the growth of the economy. See R.W. Wright, *Japanese Finance in Transformation: Implications for Canada*, The Canada-Japan Trade Council, Ottawa, 1994, p.16.

[7] In 1992, 19% of Japanese commercial bank loans to the private sector were considered real estate loans, compared to 43% in the U.S. and 51% in Canada. See Bank for International Settlements, *op. cit.*, p. 168. The non-performing loans of Japanese banks are estimated (as of September 1993) to be close to 30 trillion yen. See "The Banks Feel the Pain", in *The Banker*, Financial Times Magazines, London, January 1994, p. 49, and "Tough on the Taxpayer", in *The Economist*, London, February 26, 1994, p. 79.