What Lessons Can China Learn from Japan in the 90s?

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Japan's property bubble in the 1990s triggered a pro-longed balance sheet recession, leading to a period known as the "lost decades". Some investors worry that China will follow in Japan's footsteps and that the current property slowdown would lead to a similar consequence. In this article, we explore the causes of each situation and analyse their commonalities and differences.

Some investors are concerned that China will follow in the footsteps of Japan's property bubble in the 1990s and enter a pro-longed balance sheet recession. But there are a number of reasons why we are less concerned:

1. **China's homebuyers and financial sectors are relatively insensitive toward property price movements**
   China has a relatively high down payment ratio and low loan-to-value ratio (~50%)[1], which means it can tolerate much higher price drops without resulting in negative home equity and fire sales, which would further exacerbate the fall in value.

2. **Unlike Japan's case in the 1990s, China does not have high participation of real economic sectors in land speculation**
   For Japan, most large corporations from various sectors participated in land speculation in the late 1980s, with cheap funding from financial institutions. Hence, when the land bubble burst, it dragged down the whole economy, which fell into a vicious cycle of debt repayments and stagnant economic growth (balance sheet recession). However, China's land market is nationalised and, thus, has limited speculation activities. Additionally, over the past few years, Chinese regulators have pre-emptively lowered leverage within its financial system and built firewalls between banks and the property market.

3. **Compared to Japan, China's urbanisation rate is still low**

   Japan didn't have any property bubbles before its urbanisation rate reached 75%. China's current urbanisation rate is well below that level.

Nevertheless, there are some similarities we see in China now compared to Japan's 1990s era:

[1] Source: Morgan Stanley, August 2022

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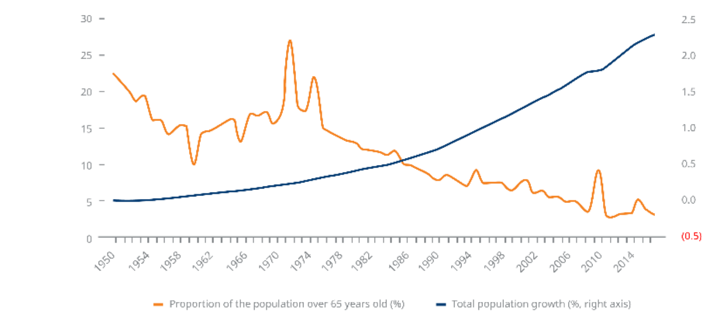
1. **Ageing population**

   Japan experienced a property downcycle in the mid-1970s. However, there was still a healthy population growth and large working age group at that time. But since then, the country began to experience a worsening ageing problem, which caused a fall in demand for housing and the subsequent bubble in the 1990s. China seems to be experiencing a similar trend to Japan in the 1970s.

Japan After the 90s: Population Growth Slowed While the Ageing Population Increased

Source: Statistics Bureau of Japan, Evergrande Research Institute, April 2019



Japan's Homebuyer Population Peaked in the 90s Then Fell

Source: Statistics Bureau of Japan, Evergrande Research Institute, April 2019

2. **Economic engine shift and metropolitanization**

   Since the 1980s, Japan's financial market open-up, especially after Plaza Accord, led to a boom in Japan's tertiary industries (primarily across financials, real estate, and retail), while manufacturing sectors lagged behind.

   This accelerated the metropolitanization of key city clusters and the unbalanced development of urban and rural housing structures. This is somewhat similar to what happened in China. With the fast development of tertiary industries (i.e. financials, real estate, internet, etc.), we began to see an under-supply of housing in high-tier cities and over-supply in low-tier cities, while rising land and labour costs are squeezing out manufacturing industries.

Making sense of recent government policies

Given the lessons from Japan's property bubble, we can understand why the Chinese government has paid more attention to declining birth rates and decided to crack down on private property developers that are mostly responsible for housing over-development in low-tier cities. Moreover, shifting more support to high-end manufacturing industries can also slow down the pace of metropolitanization and mitigate unbalanced housing development issues.

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