

How Close Is China's Medium-Term Outlook to That of Japan? An Economic-Historical Perspective*

Alicia Garcia Herrero 

After decades of strong growth, China's economy began a steady slowdown around 2012. Current GDP growth is less than half of previous levels, and the trend is expected to continue. Since its real estate bubble burst in mid-2021, deflationary pressures have raised concerns that China may follow Japan's trajectory from the early 1990s. Both countries show similar structural traits: low private consumption, high savings and significant economic imbalances – China's even more so. Their policy responses have also mirrored each other: slow monetary and fiscal easing, focus on manufacturing and reliance on trade surpluses, prompting US protectionist reactions. Like Japan, China is offshoring production to counteract trade barriers. However, China differs in key ways: it is still a developing economy with more room for growth and is a far stronger geopolitical force than Japan was. This power both motivates US technological restrictions and gives China broader global leverage, especially in the Global South. Whether China will repeat Japan's path remains a crucial, open question.

Journal of Economic Literature (JEL) codes: E20, E32, E44, F41

Keywords: China, Japan, economy, lost decade, savings, imbalances

1. How to evaluate China's medium-term outlook, in particular whether it is replicating Japan's lost decade?

Since peaking at a remarkable growth rate of 14 per cent in 2007, China's economy has experienced significant slowdown, gradually decelerating to 6 per cent in 2019 and dropping even faster during the COVID-19 pandemic and thereafter. Growth now is barely 5 per cent, at least according to official statistics, and is even less (4.2 per cent) in nominal terms because of the negative growth in the GDP deflator (i.e. when inflation is taken into account). Such a rapid economic slowdown and other

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Alicia Garcia Herrero: Bruegel, Senior Research Fellow; National University Singapore, Non-Resident Senior Fellow; Hong Kong University of Science and Technology, Adjunct Professor.
Email: alicia.garcia-herrero@bruegel.org

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factors, such as the collapse of the real estate sector,¹ is behind the increasingly frequent comparison to Japan's experience in the 1990s, often referred to as 'the lost decade' (Figure 1).

Figure 1

Comparison of GDP growth rates of China and Japan



Note: Due to the temporal offset of the similar economic patterns observed in the two countries, I apply dual horizontal axes to align comparable trends. The upper time axis refers to Japan, while the lower axis corresponds to China.

Source: Natixis, CEIC

From this, the question arises: if Japan's experience then is comparable to China's today, does it offer a guide to understanding the future of the Chinese economy? Numerous studies have examined the explanations for Japan's lost decade, including fiscal inadequacy (*Kuttner and Posen 2002*), insufficient monetary policy and the liquidity trap (*Bernanke 1999; Leigh 2010*), the role of financial intermediation (*Kwon 1998; Ogawa and Suzuki 1998*), and the overinvestment that preceded Japan's lost decade and led to a low rate of return on capital (*Bayoumi 2001*).

¹ See for example Bloomberg News: 'China's Property Crisis Enters a Dangerous New Phase', 11 February 2025. <https://www.bloomberg.com/news/features/2025-02-11/china-s-real-estate-crisis-property-sector-debt-is-getting-worse>.

In a seminal paper, *Hayashi and Prescott (2002)* took a long-term perspective on Japan's economic slowdown and argued that the fundamental driving force was the transition to a new, lower growth path, brought about by a decline in total factor productivity (TFP). *Griffin and Odaki (2009)* meanwhile showed that the lack of exits by the least-productive firms, and the lack of entries by small productive firms, reduced TFP growth during the 1990s, but there was no strong evidence of misallocation of resources across incumbent firms. The finding seemed to suggest the lack of a creative-destruction process during Japan's lost decade. An econometric analysis by *Imai et al. (2017)* further found that the decline in Japan's export competitiveness during the 1990s could be attributed to a decrease in innovation and growth in export industries.

Japan's economic success after the Second World War, which resulted in it challenging the US economy in the 1980s, has received attention in China and beyond as a potential comparison to China's economic success. This is even more the case recently as Japan went through the build-up of a real estate bubble and its bursting ten years later, which resonates with what has been happening in China in the last two decades. *The question then is whether China, like Japan, will also experience a prolonged slowdown following a period of rapid growth?*

China observers have compared the experiences of the two countries carefully. *Weede (2004)* reviewed Japan's and China's development models (see also *Nogimori 2023*), while *Wu (2023)* focused on the differences. *García Herrero and Iwahara (2024)* looked at the lessons from China from the real estate collapse in Japan.

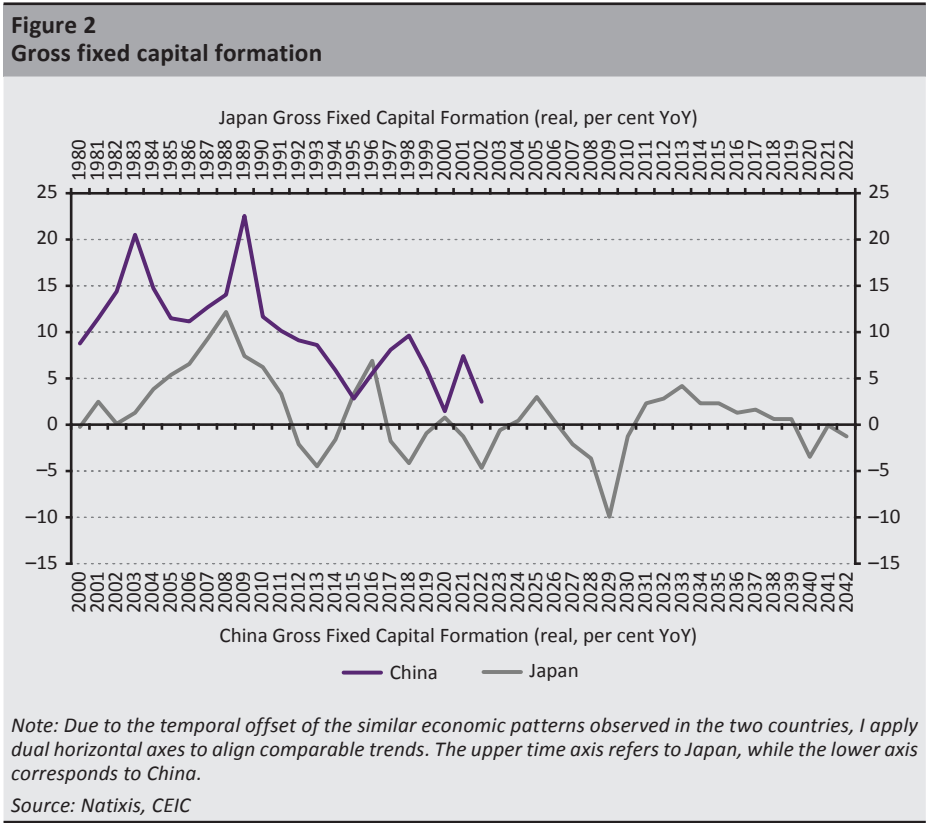
In this paper, I take a broader perspective by focusing on the savings-investment patterns of China and Japan, showing how Japan's macroeconomic imbalances in the 1980s are comparable to those of China in the 2000s when its imbalance was built up. I also examine similarities in terms of real estate bubbles, demographics and deflationary pressures), and some significant differences – especially China's military and geopolitical power and leading position in the Global South.

2. Savings-investment patterns

China and Japan have both had large macroeconomic imbalances with high savings and relatively low investment. That domestic savings could fully finance even high levels of investment and still leave excess savings made it easy for both countries to ride on an investment boom financed by artificially low interest rates. High investment was also accompanied by low private consumption in both countries.

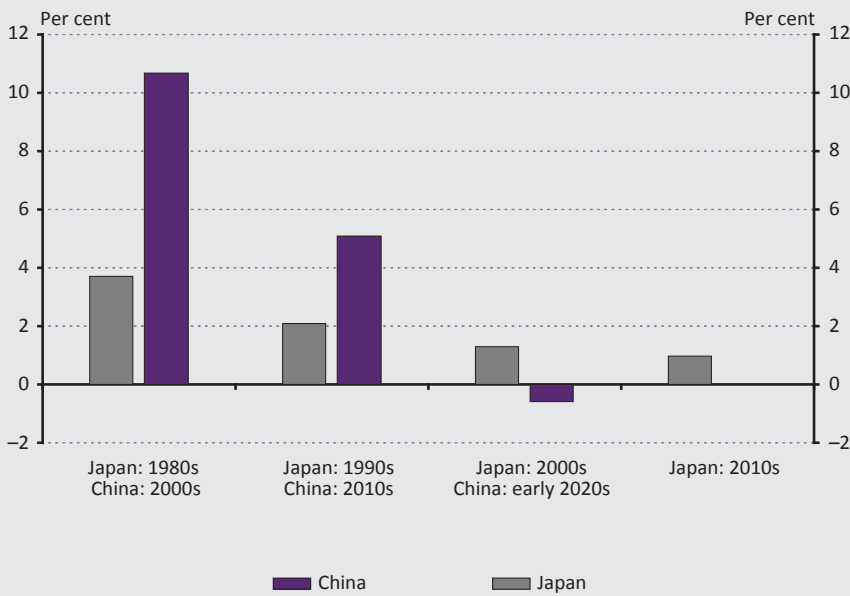
Growth in Japan’s fixed asset investment (FAI) rate declined sharply from an average of 4.7 per cent in the 1980s to only 0.34 per cent in the 1990s. In China, the growth in FAI reached 14.2 per cent after its accession to the World Trade Organisation (WTO) in 2001, fed not only by foreign direct investment in setting up manufacturing plants in China, but also by infrastructure investment (Figure 2). Subsequently, in the 2010s, China’s growth rate slowed to 7.7 per cent following the slowdown of the real estate sector.

Japan’s real estate sector experienced an increase in value added of 3.7 per cent in the 1980s, but this slowed considerably to 2.1 per cent in the 1990s. China’s real estate value-added grew by 10.7 per cent in the 2000s, but this also slowed, reaching 5.11 per cent in the 2010s (Figure 2). The trend looks similar, but investment growth in China was always higher than in Japan, which explains why Chinese GDP growth always exceeded Japan’s. It is also true that China’s starting point, in terms of income per capita, was lower than Japan’s, meaning China had more space for growth convergence, starting with a lower level of urbanisation.



That said, China's real estate market adjustment has been more rapid than Japan's, raising concerns about a potential 'hard landing' in China's case² (Figure 3). The main risk appears to be associated with significant local government debt, in particular unofficial debt through local government financing vehicles (LGFVs) (Tao 2015). Although policymakers have taken steps to mitigate these risks, the lingering imbalances suggest that the financial system has not entirely stabilised. Japan's financial sector was mainly hit by the real estate crisis and the deleveraging of the corporate sector, less so by its local finances. Thus, the main sources of financial risk in Japan and China were and are somewhat different.

Figure 3
Real estate value added

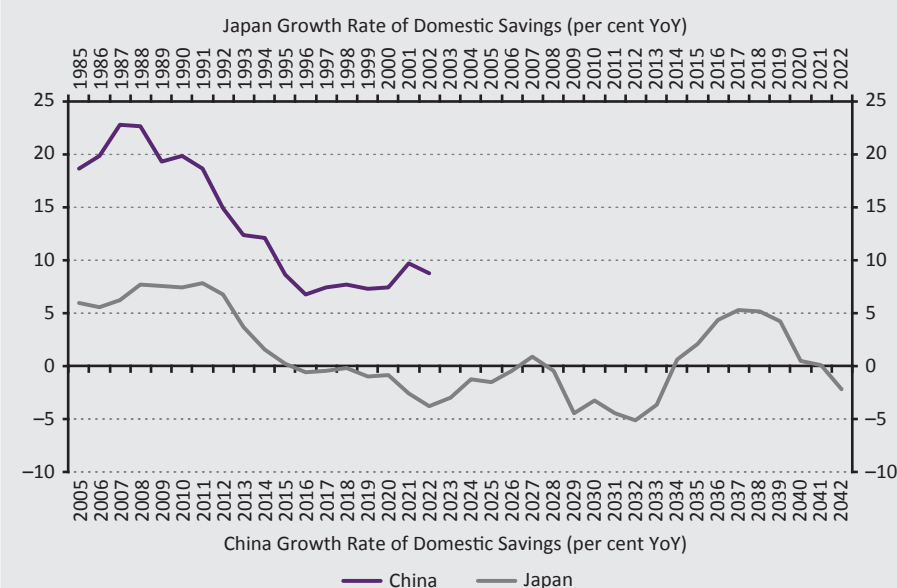


Source: Natixis, CEIC

² For example, Ann Stevenson-Yang: 'Soft or Hard? China's Property Sector Is Coming In For A Landing', *Forbes*, 17 January 2022, <https://www.forbes.com/sites/annstevenson-yang/2022/01/16/soft-or-hard-chinas-property-sector-is-coming-in-for-a-landing/>.

Generally, a decline in investment typically leads an economy to rely more on consumption, reducing the incentive for saving. This was what happened in Japan in the 1990s. Japan's total savings growth rate dropped from nearly 8 per cent to negative levels during the economic deceleration of the 1990s (*Figure 4*). This was mainly caused by plunging fiscal revenues and deflationary pressures, which led to the deterioration of fiscal accounts well beyond the effects of corporate deleveraging during the so-called 'balance sheet recession'³. China has undergone a similar trajectory since 2008, but with a lesser decline in savings. Now, China continues to rank significantly above other major economies in terms of its savings-to-GDP ratio (*Figure 5*), even after the economic slowdown, which has already to some extent corrected the savings-investment imbalance.

Figure 4
Growth rate of domestic savings

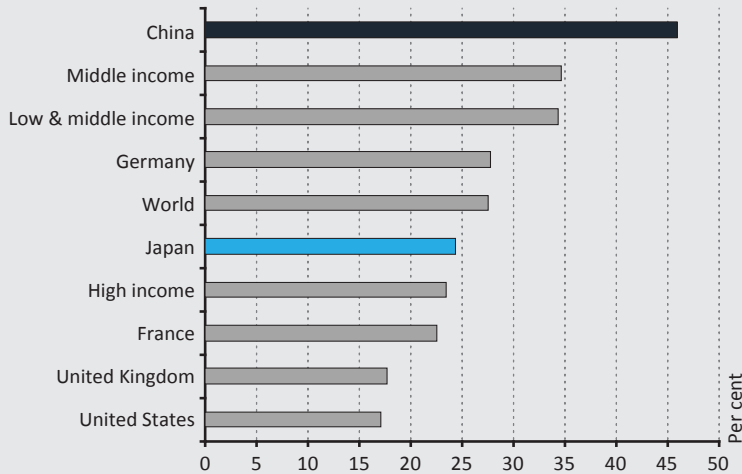


Note: Due to the temporal offset of the similar economic patterns observed in the two countries, I apply dual horizontal axes to align comparable trends. The upper time axis refers to Japan, while the lower axis corresponds to China.

Source: Natixis, CEIC

³ The term 'balance sheet recession' refers to a prolonged period of economic stagnation in which private sector firms and households prioritise debt reduction (deleveraging) over investment and consumption, often following a financial crisis. This leads to subdued aggregate demand, deflationary pressures, and a weak economic recovery despite accommodative monetary policies. The concept was popularised by economist Richard Koo in the context of Japan's post-bubble economy in the 1990s (see Koo 2023).

Figure 5
Saving rate in major economies in the early 2020s



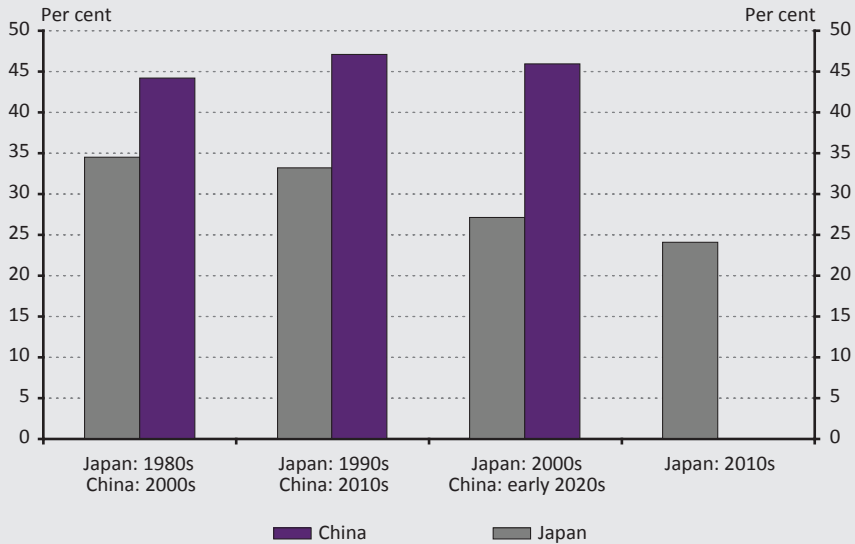
Source: Natixis, CEIC

The reasons for China's massively high savings, even surpassing Japan's, are partially related to the lack of a welfare state or, in other words, a public insurance mechanism (Yang 2012). Private insurance remains rather limited, even after the reform of China's financial sector which started in the 1990s under Premier Zhu Rongji. Beyond these factors, the high degree of uncertainty about the geopolitical environment, especially since President Donald Trump's first term and the ensuing US policies to contain China, as well as the COVID-19 pandemic, also explains why Chinese households take a precautionary perspective and still maintain higher levels of savings.

All in all, both China and Japan have experienced significant decreases in investment, but while Japan achieved a gradual shift from an investment-driven to a consumption-driven growth model, China has barely reduced its imbalances, characterised by high excess savings (Figure 6) and low private consumption.

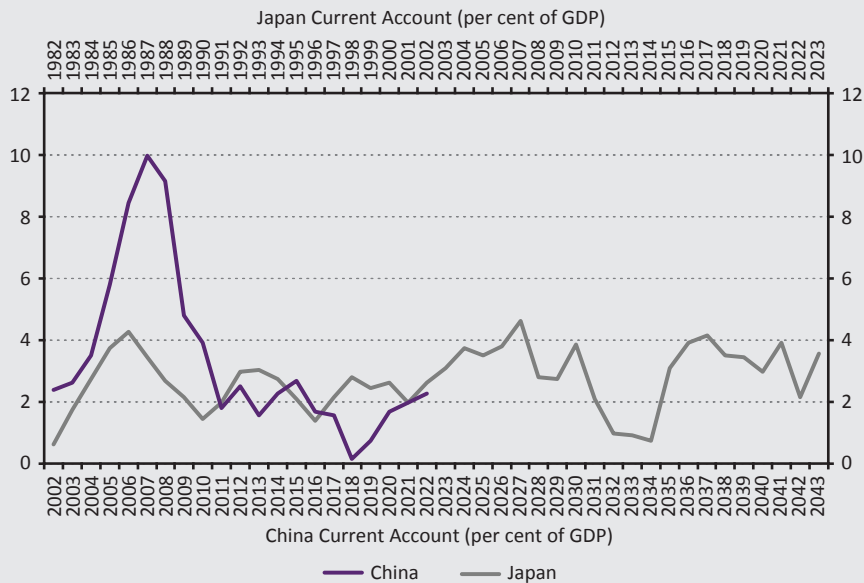
Consequently, China's savings rate continues to exceed its investment rate, leading to a persistent current account surplus. This outcome contrasts with earlier expectations that the surplus would decline as China's GDP per capita rose and imports increased, driven by a growing middle class seeking high-end consumer goods. China's current account ratio has plateaued at approximately 2 per cent, resembling Japan's situation in the early 2000s (Figure 7).

Figure 6
Savings rate in China and Japan



Source: Natixis, CEIC

Figure 7
China and Japan's current account



Note: Due to the temporal offset of the similar economic patterns observed in the two countries, I apply dual horizontal axes to align comparable trends. The upper time axis refers to Japan, while the lower axis corresponds to China.

Source: Natixis, CEIC

Finally, the containment strategy towards China adopted by both President Trump and President Biden mirrors Japan's experience in the late 1980s. In Japan's case, this containment was primarily economic, focusing more on trade than technology, as Japan had not re-established military capabilities following its defeat in the Second World War. The United States engaged in trade negotiations that heavily favoured American interests, capitalising on its significant bilateral deficit with Japan, particularly in the automobile and electronics sectors. The US also implemented tariffs and quotas on Japanese imports and pursued voluntary export restraints on specific products. In addition, the US targeted Japan's semiconductor industry, exemplified by the 1986 US–Japan Semiconductor Trade Agreement,⁴ which aimed to boost the market share of American companies. The US also pushed Japan to appreciate the yen through the Plaza Accord⁵.

The US containment strategy toward China has unfolded differently. Unlike Japan, China is perceived by the US as presenting not only an economic threat, but also military and security challenges. As a result, economic containment, such as the trade measures during President Trump's first term (*Dadush 2019*) and now being substantially reinforced during his second term, represents just one part of a broader strategy. US containment of China has also expanded rapidly to encompass technology, particularly dual-use technologies, with stringent export controls on critical sectors including advanced semiconductors. The overarching goal of the US regarding China is much more comprehensive than it was with Japan, as the US seeks to maintain its hegemonic position globally.

3. Some important lessons from Japan

3.1. The Bank of Japan's role in the bursting of Japan's bubble

With the benefit of hindsight, the BoJ's response to the equity and real estate bubbles in the 1980s was too little and too late, and possibly also a bit erratic. After lowering the policy rate from January 1986 to support growth, the Bank finally tightened from May 1989 to cool the overheating economy and stem off pressure from the bubbles (*Figure 8*). Although headline inflation was stable, bank loans accelerated by about +10 per cent annually and asset prices more than doubled during the same period. As macro-prudential policy was hardly developed at the time, the BoJ delayed responding to increasing macroeconomic imbalances.

⁴ See *Statement on the Japan-United States Semiconductor Trade Agreement*, 31 July 1986, Ronald Reagan Presidential Library and Museum, <https://www.reaganlibrary.gov/archives/speech/statement-japan-united-states-semiconductor-trade-agreement>.

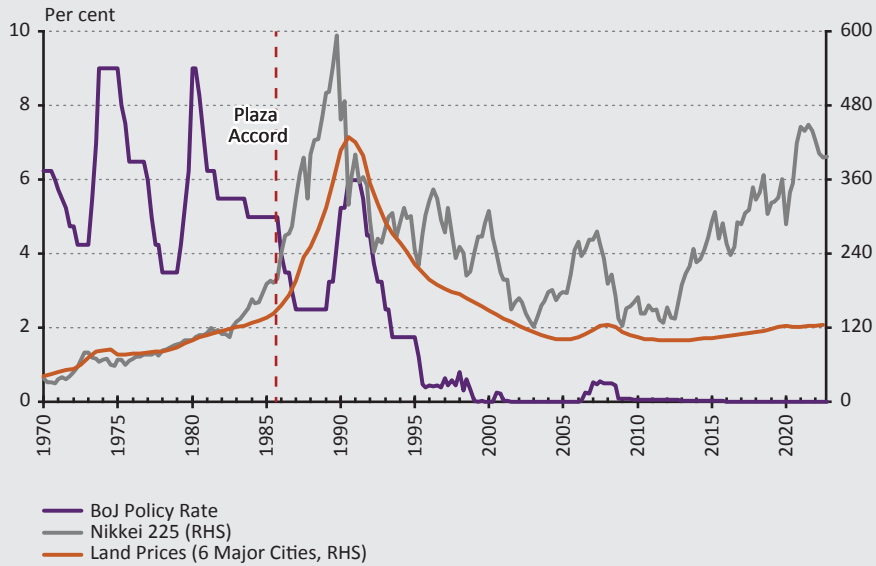
⁵ See *Announcement the Ministers of Finance and Central Bank Governors of France, Germany, Japan, the United Kingdom, and the United States (Plaza Accord)*, 22 September 1985, <https://g7.utoronto.ca/finance/fm850922.htm>.

The BoJ was also slow to react to the sharp decline in equity prices. After the Nikkei stock index dropped by 38 per cent from the peak in December 1989, the Bank finally responded by lowering the policy rate by 50 bps in July 1991. The BoJ also took more than four years to lower the policy rate to 0.50 per cent in September 1995, because it was concerned that the monetary easing would reignite the real estate bubble. This gradual easing was not enough, as monetary conditions remained tight in the second half of 1990s. The “Japan premium” increased Japanese banks’ financing cost in the international market and the Japanese yen steadily appreciated, when banks finally began to clean up their balance sheets.

After the policy rate reached 0.0 per cent in February 1999, the BoJ was confronted with the zero nominal lower bound, a belief that the policy rate cannot fall below 0.0 per cent. The monetary policy was still considered restrictive, as deflation lifted the real interest rate to about 1 per cent when the neutral rate was generally believed to have fallen below 0.0 per cent (*Figure 9*).

Finally, the BoJ introduced unconventional policy tools to address the zero nominal lower bound from 1999. At that time, the Bank declared it would keep the policy rate at 0.0 per cent until the prospect of ending deflation became clear, which is known today as forward guidance. Subsequently, the BoJ launched quantitative easing in 2001, by massively purchasing short-term government securities to expand banks’ reserves on the BoJ’s balance sheet. After introducing the Quantitative and Qualitative Monetary Easing (QQE) in April 2013 with the intention to lower the long-term bond yield and to reduce risk premiums in the equity and real estate markets, the BoJ expanded the framework by lowering the policy rate to –0.1 per cent (QQE with a Negative Interest Rate) in January 2016 to encourage banks to expand lending. In September 2016, the policy tool was re-framed by adding the Yield Curve Control (QQE with YCC) with a focus to maintain the 10-year Japanese Government Bond (JGB) yield at around 0 per cent, to lower the bond yield across the yield curve. While these policy responses ended up with a sharp increase in the size of the BoJ’s balance sheet above 100 per cent of GDP, the highest among major central bank, the BoJ finally began to see the light at the end of the tunnel on deflation in early 2022.

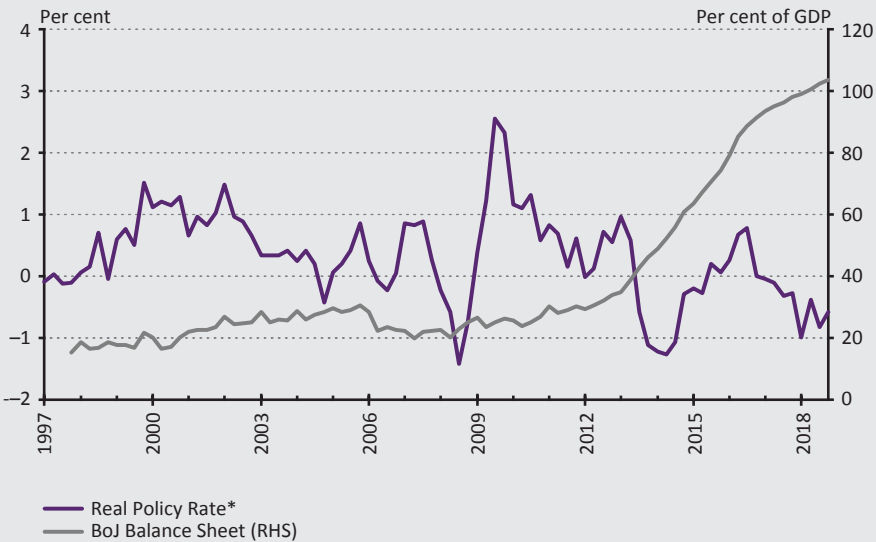
Figure 8
Japan: BoJ & asset prices



Note: On the right-hand scale: 1980Q1=100.

Sources: INDB, NATIXIS

Figure 9
Japan: BoJ policy rate & balance sheet



Note: *Adjusted for VAT hike

Sources: NATIXIS, INDB

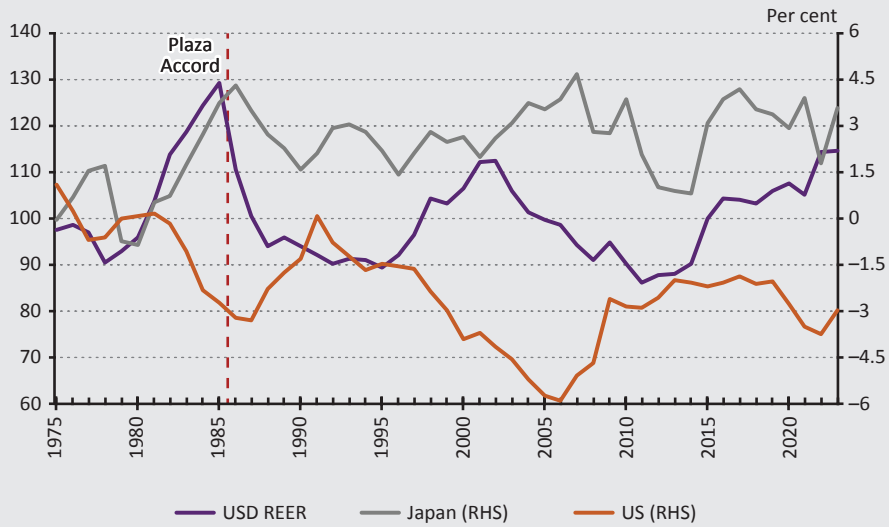
3.2. Yen appreciation: a structural factor behind Japan's lost two decades

The Plaza Accord in 1985 was arguably an important turning point for the Japanese economy. From the early 1980s, high interest rates and large fiscal deficits under the Reagan administration resulted in an appreciation of the US dollar. It was also widely argued that tight regulations in Japan prevented capital inflow, which undervalued the Japanese yen. As a consequence, the USD real effective exchange rate (REER) appreciated by about 25 per cent from 1981 to 1985, which in turn expanded Japan's current account surplus and the US's deficit (*Figure 10*). To alleviate the macroeconomic imbalances, in September 1985 Japan signed the Plaza Accord to devalue the US dollar along with the G5 nations. As the central banks coordinated interventions in the foreign exchange market, the yen rapidly appreciated from USD/JPY=237.1 in August 1985 to USD/JPY 139.7 in April 1987 (*Figure 11*). To counterbalance the severe headwinds for exports and to support growth, the Bank of Japan (BoJ) slashed the policy rate from 5.00 per cent in 1985 to 2.50 per cent in February 1987. The monetary stimulus ended up fuelling optimism on the Japanese economy, which ultimately resulted in twin bubbles in the real estate and equity markets.

After the bubble burst around 1990, the strong yen weighed on the economic recovery through different channels, characterising Japan's lost two decades. The appreciation of the yen not only reduced exports but also increased competition with cheaper import products from Asia. As domestic demand also stagnated during the post-bubble period, corporate profitability deteriorated further, reducing nominal wages, which in turn led to falling inflation. As deflation became embedded in expectations, manufacturing companies reduced investments due to the higher real interest rate, while expanding foreign direct investment in Asia, which resulted in the hollowing out of the Japanese economy. These developments complicated the BoJ's policy decisions after lowering the policy rate to 0.0 per cent in 1999.

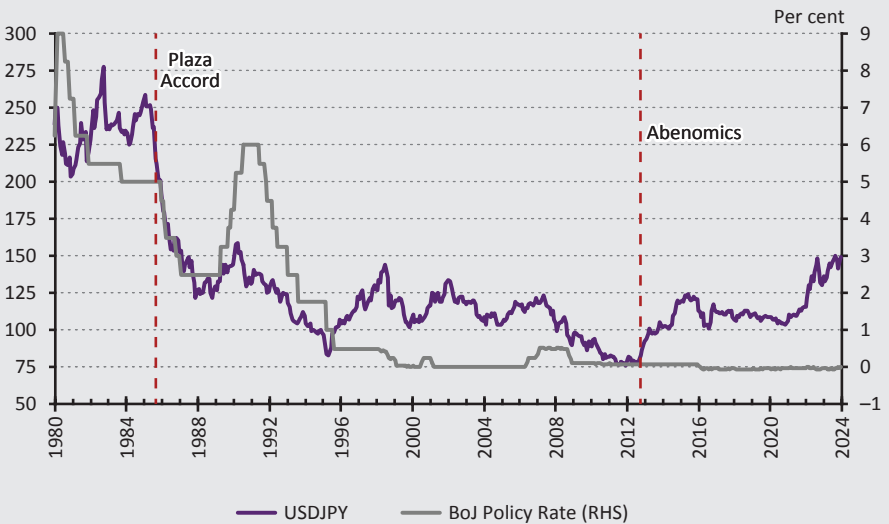
The trend in the yen finally reversed after the BoJ raised the inflation target to 2 per cent from 1 per cent in January 2013. While the monetary policy with the Quantitative and Qualitative Monetary Easing (QQE) under Abenomics depreciated the yen to around USD/JPY=115, the momentum accelerated from early 2022 on the back of a widening monetary policy differential between the US Federal Reserve (Fed) and the BoJ. While the Fed tightened to contain surging inflation, the BoJ kept its monetary policy accommodative to meet the 2-per cent inflation target in the medium term.

Figure 10
Japan: REER and current account (GDP ratio)



Sources: Datastream, NATIXIS

Figure 11
Japan: BoJ policy rate and exchange rate



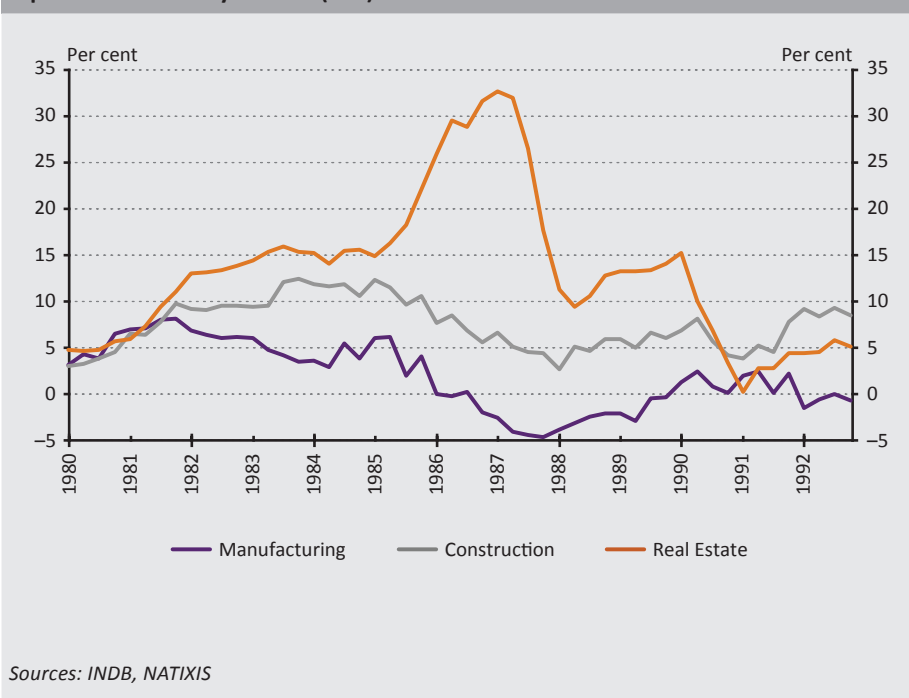
Sources: NATIXIS, INDB

3.3. Japanese banks: Decade-long trial and error to heal from the housing market crisis

In the 1980s, Japanese banking policies became increasingly misaligned, contributing to a significant asset bubble. Following financial deregulation, large companies began raising money from financial markets, reducing their dependency on banks. This pushed banks to find a new customer base, leading them to lend aggressively to the real estate sector. The Ministry of Finance's "convoy system," which ensured failing banks were merged rather than allowed to go bankrupt, further encouraged this reckless behaviour by increasing moral hazard.

The real estate sector was central to the bubble, underpinned by the "myth of land" – the belief that land values would never fall. After the Bank of Japan expanded monetary policy following the 1985 Plaza Accord, real estate prices tripled. In this frenzied environment, banks aggressively expanded loans to the real estate sector, often using the appreciating land as collateral (*Figure 12*).

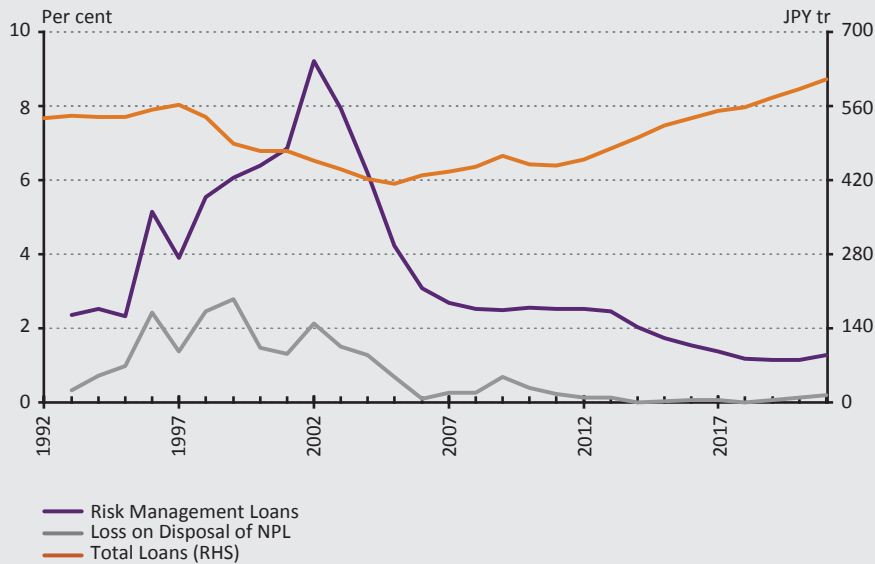
Figure 12
Japan: bank loans by sectors (YoY)



When the bubble burst in the early 1990s, banks were slow to respond. Confident in the “myth of land,” they expected a temporary price dip and refrained from writing off non-performing loans (NPLs), making inadequate provisions. This inaction was compounded by lax accounting rules and the belief in an eventual government bailout under the convoy system. As a result, banks continued to lend to “zombie” real estate and construction firms while restricting credit to new, productive sectors, which damaged Japan’s economic productivity.

The 1997 financial crisis, which saw a major bank fail, was a crucial turning point. It became clear the government could not bail out all institutions. In response, Japan introduced legal frameworks like the 1998 Financial Revitalisation Law and the 2002 Financial Revitalisation Programme, shifting from discretionary policy to a law-based system and ending the convoy system. This forced banks to properly assess creditworthiness and write off NPLs. Consequently, bank loans finally bottomed out around the mid-2000s, a full decade after the bubble’s collapse (*Figure 13*).

Figure 13
Japan: banks’ non-performing loans (FY, ratio to total loans)



Sources: FSA, INDB, NATIXIS

4. Is China following Japan's trajectory?

Is the saving-investment pattern in China, similar to what happened previously in Japan, leading to a similar growth trajectory of a rapid deceleration after the bursting of a bubble?

Kohsaka et al. (2002) argued that the Bank of Japan (BoJ) went too far in hiking rates between 1988 and 1989. This was done to dampen further growth in asset prices and contributed to the bursting of the bubble. In the same vein, one can argue that the monetary policy of the People's Bank of China (PBoC) in the run-up to and during the pandemic was also too tight, at least when compared to the rest of the world. This, together with additional regulatory tightening such as the so-called "three red lines" for real estate developers⁶, rapidly cooled investment enthusiasm. More details were discussed in *Subsection 3.1.* on the behaviour of the Bank of Japan.

While the BoJ did cut interest rates after the bubble burst, it did so very gradually, reaching zero only in 1999, even though deflationary pressures were persistent, especially for producer prices. In other words, Japan's real interest rates remained stubbornly high after the bubble burst until Governor Haruhiko Kuroda moved to negative interest rates in late 2016 with a huge additional expansion of the BoJ's balance sheet⁷ (*Figure 14*). A similar pattern can be found for China since the PBoC kept interest rates high after the real estate bubble burst in mid-2021. Even though the economy was running below potential with deflationary pressures, especially for producer prices, the change in the PBoC's policy stance has also been very gradual.

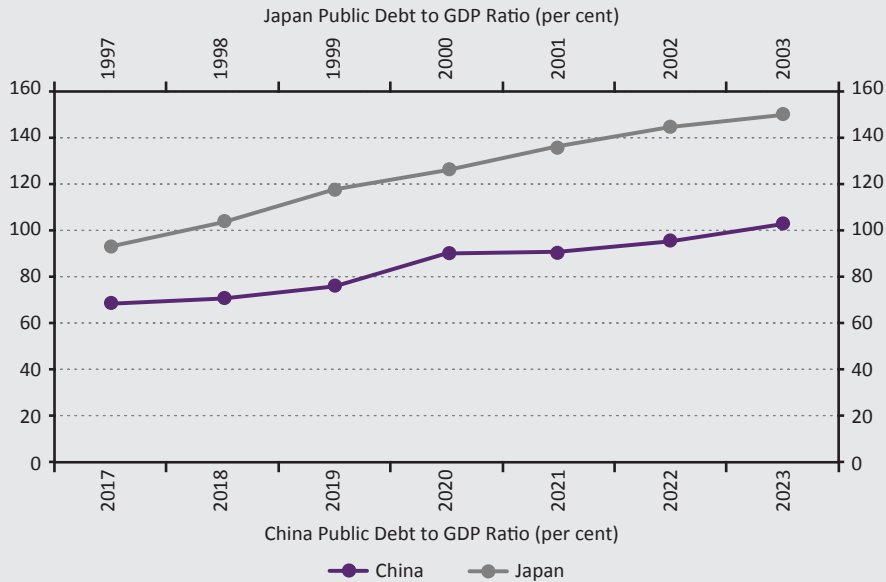
On the fiscal front, Japan has accumulated public debt very rapidly since the bursting of the bubble, reaching levels above 230 per cent of GDP today. China is following the same path of accumulation of fiscal deficits, piling up public debt (*Figure 15*). However, China has become very careful about the debt problem, especially at local government level, and has started to restrict fiscal spending. As such, China's fiscal stimulus has also been limited, even though the pile-up of debt has already become so noticeable that the government continues to implement measures to address it. In November 2024, it issued a stimulus package worth USD 1.4 trillion, including a debt swap of hidden local government debt (in the form of local government financial vehicles) into official local-government debt⁸. Such swaps, which have been happening for some time already, aim to reduce the financial risk embedded in the accumulation of excessive debt, especially non-official debt.

⁶ The "three red lines" policy is a set of financial guidelines for real estate developers in China. The policy was introduced in August 2020 to help control the real estate sector's debt and improve its financial health (*Yang et al. 2023*).

⁷ See Bank of Japan statement of 29 January 2016, *Introduction of "Quantitative and Qualitative Monetary Easing with a Negative Interest Rate"*, https://www.boj.or.jp/en/mopo/mpmdeci/mpr_2016/k160129a.pdf.

⁸ <https://www.reuters.com/markets/asia/what-you-need-know-about-chinas-14-trillion-debt-package-2024-11-10/>

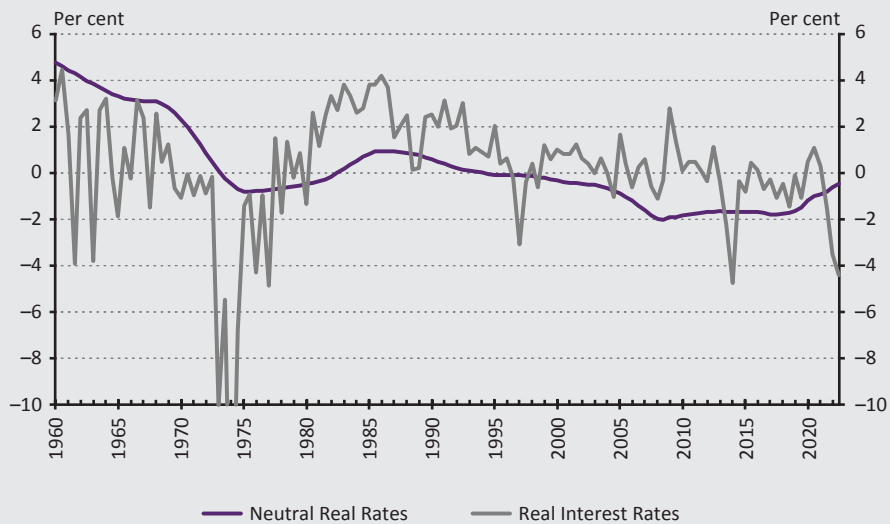
Figure 14
China and Japan's public debt-to-GDP ratio



Note: Due to the temporal offset of the similar economic patterns observed in the two countries, I apply dual horizontal axes to align comparable trends. The upper time axis refers to Japan, while the lower axis corresponds to China.

Source: Natixis, CEIC

Figure 15
Japan: neutral rate



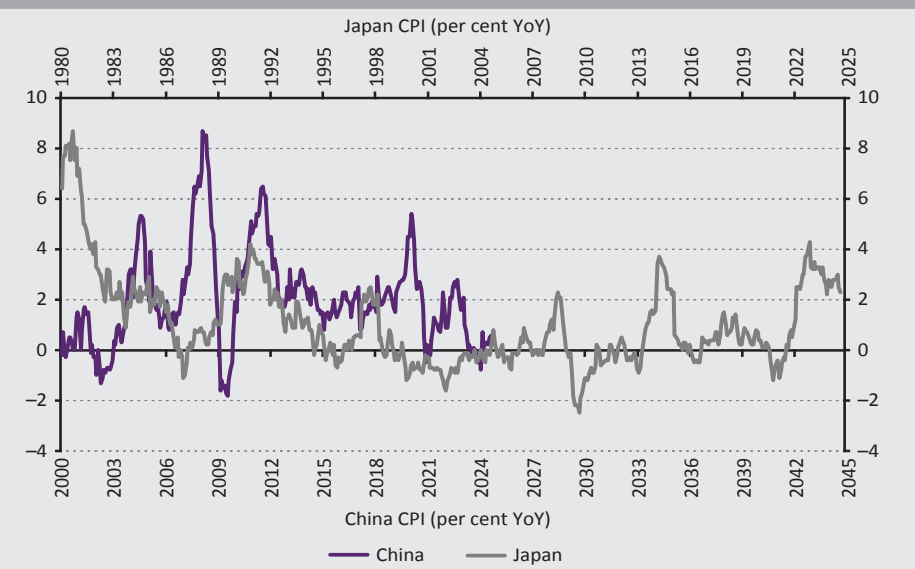
Source: NATIXIS

The other similarity is that both Japan and China doubled down on industrial policy as a response to the structural deceleration. In particular, the Japanese government set up a programme of financial assistance to banks (injecting over 18 per cent of GDP by 1998) (Fujii and Kawai 2010) and tax incentives for specific industries deemed strategically important, including information technology, biotechnology and environmental technologies (Callen and Ostry 2023). It also promoted financial support for research and development (R&D) and public-private partnerships. Japan’s massive industrial policy did not stop the reduction in the share of manufacturing in the Japanese economy and, most importantly, Japan’s declining innovation ranking (Figure 16) (Fukao and Kwon 2005). China is following the same route, increasing its R&D expenditure and carrying out special projects to support high-technology sectors.



Stemming from the excessive focus on manufacturing and industry, both economies have suffered deflationary pressure, especially in producer prices. Japan endured prolonged deflationary pressure, whereas China has experienced two distinct periods of deflation: first in 2015 and again starting in 2022 (Figure 17 and 18). China managed to mitigate the deflationary pressures in 2015 through a stimulus, but has been more hesitant to follow the same route during the second episode.

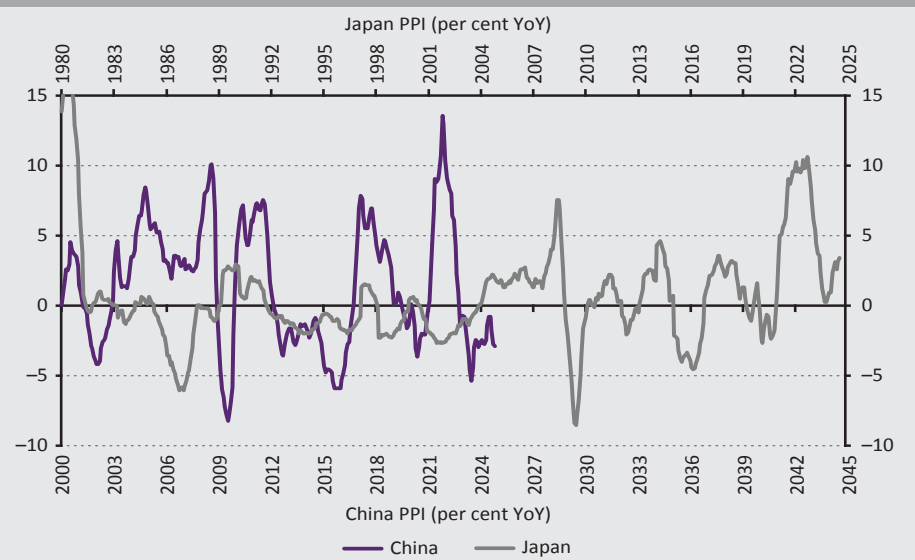
Figure 17
China and Japan's CPI comparison



Note: Data as of October 2024. Due to the temporal offset of the similar economic patterns observed in the two countries, I apply dual horizontal axes to align comparable trends. The upper time axis refers to Japan, while the lower axis corresponds to China.

Source: Natixis, CEIC

Figure 18
China and Japan's PPI comparison

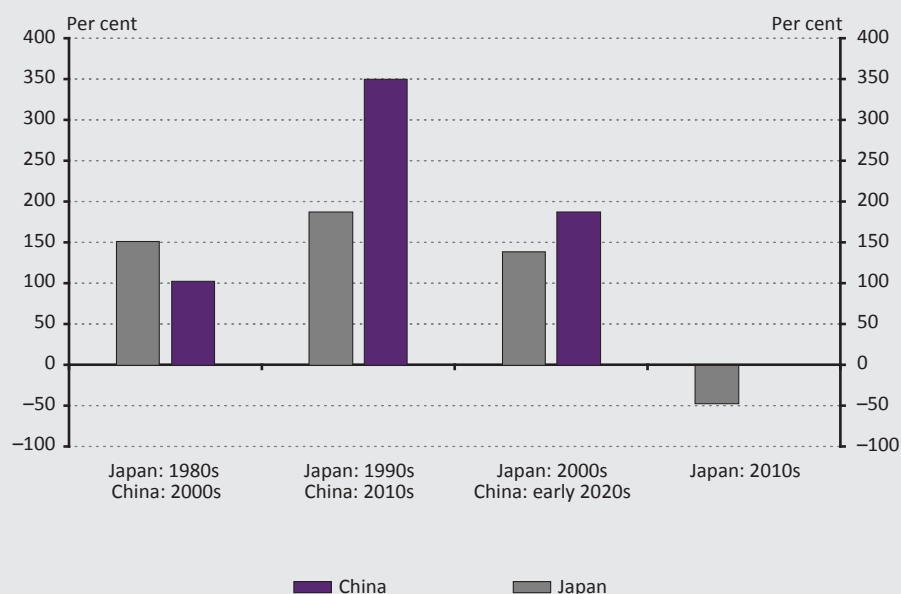


Note: Data as of October 2024. Due to the temporal offset of the similar economic patterns observed in the two countries, I apply dual horizontal axes to align comparable trends. The upper time axis refers to Japan, while the lower axis corresponds to China.

Source: Natixis, CEIC

Another relevant similarity is the use of export markets as an outlet for excessive manufacturing capacity. Japan tried to mitigate its structural slowdown by expanding overseas markets, leading to a current account surplus (*Figure 19*), but that effect faded away and had even disappeared after twenty years as Japan became more of a tourist destination than an exporter of manufactured goods. So far, in the wake of its slowdown, China still maintains a significant current account surplus, with particular improvement in higher-end technology exports.

Figure 19
Share of goods surplus as a proportion of current account surplus

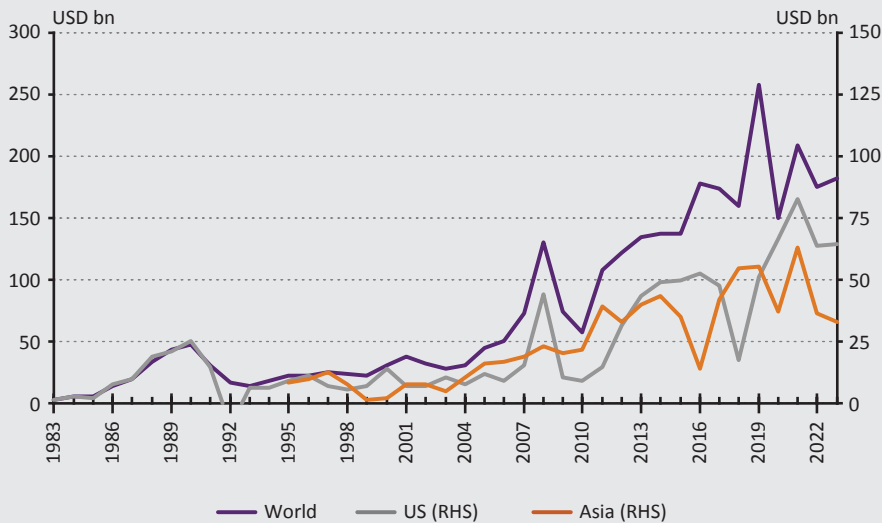


Source: Natixis, CEIC

Japan and China both decided to expand investment overseas through foreign direct investment (FDI) and lending. For Japan, FDI emerged as the primary channel for expansion, with Southeast Asia and China as key destinations under the “flying geese” strategy (*Kojima 2000*). In addition to greenfield investments in manufacturing, Japan also pursued mergers and acquisitions, which became particularly feasible, and not expensive, when the yen appreciated following the Plaza Accord. The bursting of Japan’s economic bubble further accelerated its shift toward acquiring overseas assets, driven by a steep decline in domestic growth and persistently high labour costs within its manufacturing sector (*Figure 20*). Meanwhile, Japanese banks emerged as significant global overseas lenders, including in Latin America before its major sovereign crisis in the 1980s.

China has also significantly expanded its overseas presence, primarily through lending, with a particular emphasis on infrastructure financing. Its cross-border lending efforts have predominantly targeted emerging economies, especially those involved in China's flagship Belt and Road Initiative. Compared to Japan, China's greenfield investments in manufacturing are a relatively recent development, with the developed world selected as a key destination to expand markets and to acquire technology assets.

Figure 20
Japan: outward FDI (flow)



Sources: NATIXIS, JETRO

5. What might make China different from Japan?

While there are many parallels between Japan in the 1980s and 1990s and China today, significant differences exist. Some of these favour China, while others suggest its situation could be even more challenging than Japan's was.

A key distinction is the level of outbound investment. Japan established itself as the world's largest net external creditor decades ago and maintains this status through substantial foreign direct investment (FDI) and portfolio flows. By contrast, China's surge in outbound FDI from 2013 to 2016 has since slowed considerably (*Figure 21*).

Furthermore, China has never fully liberalised capital outflows, leading to much more limited overseas portfolio investment (*Figure 22*).

This structural difference impacts their economic resilience. Japan’s significant income from overseas investments has been vital in sustaining its current account surplus. China’s surplus, however, is predominantly driven by trade, with minimal net income from foreign investments (*Figure 23*). This makes China more vulnerable to the rising tide of protectionism from the US and the European Union (*García Herrero – Vasselier 2024*). Additionally, with Chinese wages still lower than Japan’s were at a similar stage, relocating production overseas is a less straightforward strategy, as the wage differentials are not as advantageous.

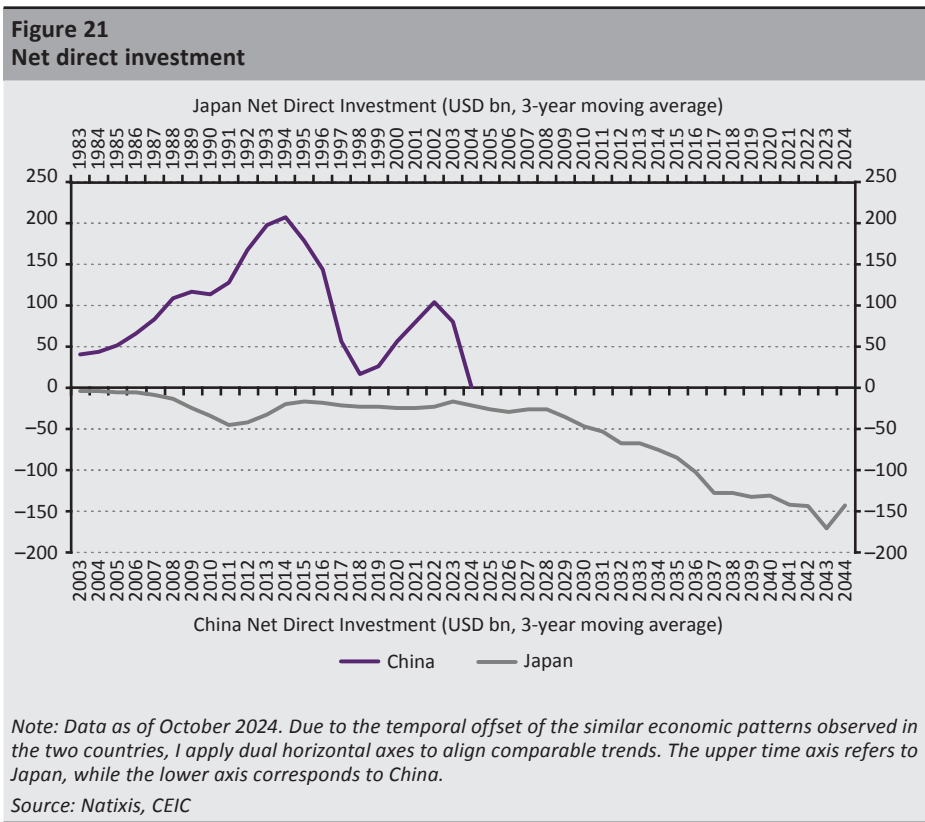
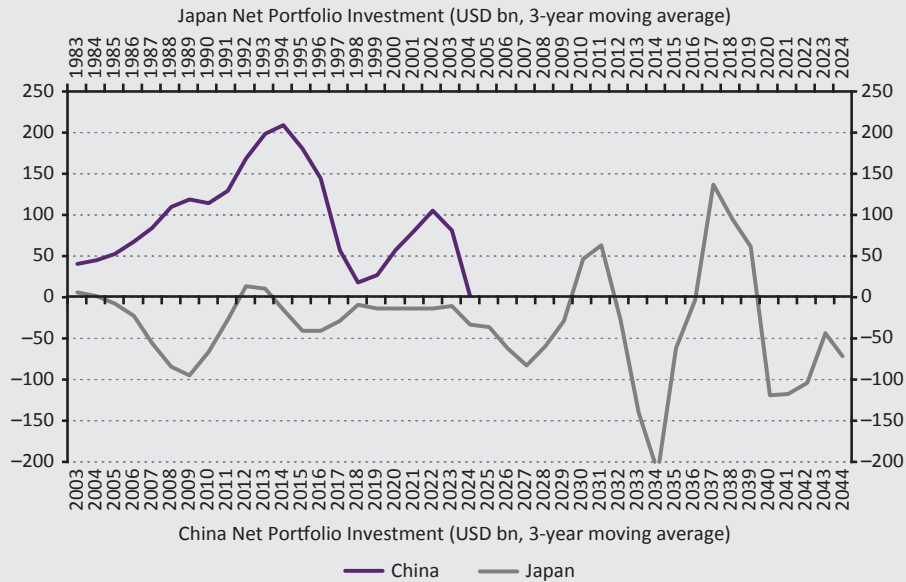


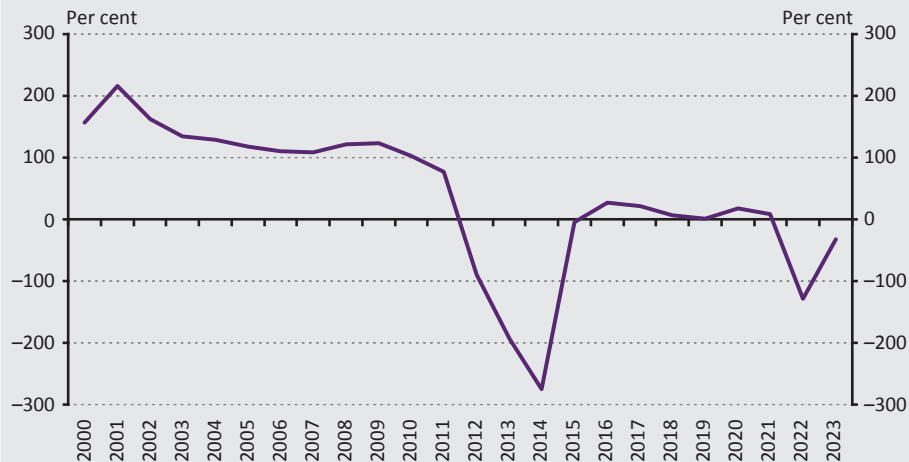
Figure 22
Net portfolio investment



Note: Data as of October 2024. Due to the temporal offset of the similar economic patterns observed in the two countries, I apply dual horizontal axes to align comparable trends. The upper time axis refers to Japan, while the lower axis corresponds to China.

Source: Natixis, CEIC

Figure 23
Japan's share of goods surplus as a proportion of current account surplus



Source: Natixis, CEIC

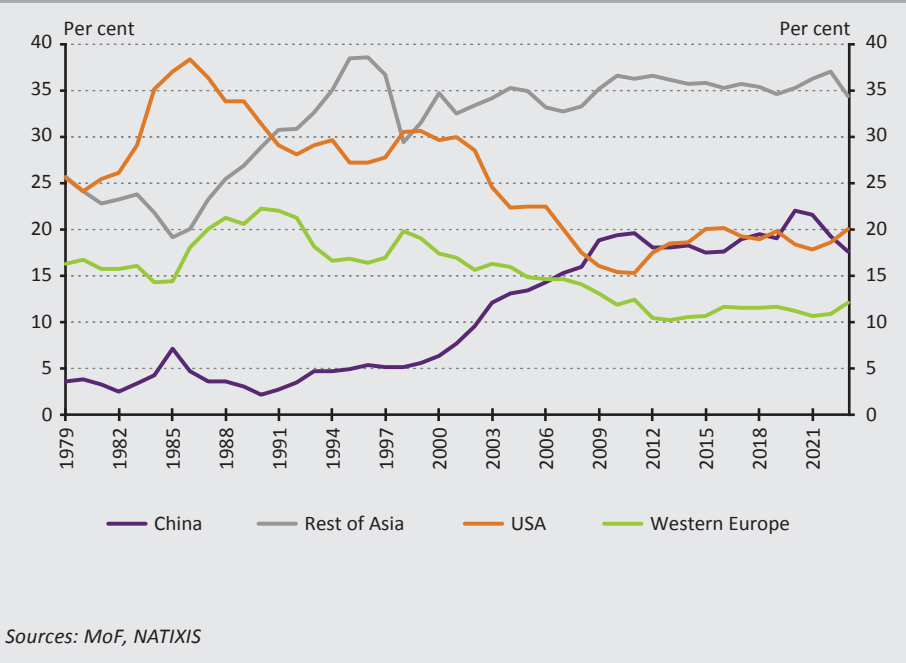
Japan's exchange rate policy was also different to that of China today, at least so far. Japan accepted a sudden, rapid appreciation of the yen after concerted intervention pushed by the US in the mid-1980s under the Plaza Accord. The consequences of the strong yen were analysed in *Subsection 3.2*. China has so far avoided any push from the US Treasury to appreciate its currency and has generally kept the renminbi relatively weak to foster external competitiveness. Capital controls are still important tools for China to achieve this goal, while Japan abandoned them a long time ago.

Another significant difference lies in the impact of the real estate crisis on the banking sectors of Japan and China. Japanese banks were significantly more exposed to real estate developers than their Chinese counterparts today (see *Subsection 3.3.*), as regulations in China have limited the ability of banks to finance real estate ventures. While Chinese banks have less direct exposure to developers, they are heavily exposed to local government financial vehicles (LGFVs), which have been instrumental in funding real estate and infrastructure projects, but are currently facing serious financial difficulties. Similarly to Japanese banks, Chinese banks are experiencing a shrinking interest rate margin, which is impacting their profitability (*Garcia Herrero – Ng 2024*).

In summary, while China has thus far managed to mitigate the effects on its banking sector of its economic deceleration and real estate market adjustments, it remains uncertain whether it will ultimately follow in Japan's footsteps. The ongoing decline in bank profitability and the emerging risks to asset quality could pose significant challenges in the future.

Internationally, their approaches diverge starkly. Japan, with its diminished post-WWII political status, has largely played a subdued role in global governance, historically aligning with US policies without forging its own path (*Figure 24*). China, conversely, has adopted an increasingly assertive posture. Through initiatives like the Belt and Road, it has actively expanded its economic, soft and even hard power globally, seeking to rally support from the Global South. This strategy could be beneficial, but also exposes China to direct US containment measures. Consequently, China's pursuit of self-reliance, particularly in critical sectors like semiconductors, is more proactive than Japan's ever was.

Figure 24
Japan: exports by country (share)



Finally, China's technological trajectory may be different. It has achieved breakthroughs in critical fields, suggesting it is closer to the global frontier than Japan was at a comparable stage, reinforcing its push for technological independence amid US pressure. However, the crucial question is whether these advances can boost overall productivity. Current data indicates that China's TFP) has been declining during its economic slowdown (*Cerdeiro – Ruane 2022*), raising doubts about whether technological innovation can offset the country's ongoing structural deceleration.

5. Conclusions

The comparative analysis of China's current economic trajectory and Japan's experience in the 1990s reveals both striking parallels and critical divergences that will shape China's medium-term outlook. Both economies experienced rapid growth followed by a pronounced slowdown, underpinned by similar structural features: high savings rates, low private consumption and significant macroeconomic imbalances. In both cases, these imbalances were exacerbated by real estate bubbles and subsequent corrections, as well as by policy responses that were often slow or insufficiently forceful to address underlying vulnerabilities.

One key similarity lies in the savings-investment dynamic. Like Japan in the 1980s, China's high domestic savings have long financed outsized investment booms, particularly in infrastructure and real estate, while private consumption has remained subdued. As investment growth has slowed, both countries have faced the challenge of rebalancing toward consumption-driven growth. However, China's adjustment has been less pronounced: its savings rate remains exceptionally high, and the shift toward greater consumption has been limited, leaving persistent current account surpluses and continued reliance on external demand.

The real estate sector has played a pivotal role in both economies' slowdowns. Japan's bubble and its aftermath led to a protracted period of stagnation, while China's more recent real estate correction has been sharper and more rapid, raising concerns about a potential "hard landing." Yet, the sources of financial risk differ: Japan's crisis was rooted in corporate and banking sector deleveraging, whereas China's vulnerabilities are more closely tied to local government debt and opaque financing vehicles. Despite policy efforts to contain these risks, China's financial system remains exposed to lingering imbalances.

Demographic trends and deflationary pressures further reinforce the comparison. Both countries have faced aging populations and declining labour force growth, contributing to slower potential output and increased deflationary risks. In Japan, these factors contributed to the so-called "lost decade," while in China, they threaten to constrain future growth and complicate policy responses (*Garcia Herero 2024*).

However, the differences between China and Japan are equally consequential. China remains a developing economy with greater scope for catch-up growth, urbanisation and productivity gains. Its geopolitical position is far stronger than Japan's was in the 1990s, affording it more leverage in global affairs, particularly in the Global South. This geopolitical strength has also made China the target of a broader and more intense containment strategy by the United States, encompassing not only trade but also technology and security. Unlike Japan, which faced primarily economic containment, China must navigate a more complex and adversarial international environment.

Policy responses have also diverged. While both countries initially relied on gradual monetary and fiscal easing, China's policy toolkit is more extensive, and its leadership has shown a willingness to experiment with unconventional measures. Nevertheless, the effectiveness of these policies is constrained by structural factors, such as the lack of a comprehensive welfare state, which perpetuates high precautionary savings, and the slow pace of financial sector reform.

In summary, while China exhibits many of the symptoms that led to Japan's lost decade – slowing growth, real estate correction, high savings and deflationary pressures – it also possesses unique strengths and faces distinct challenges. Whether China can avoid a prolonged stagnation will depend on its ability to accelerate structural reforms, rebalance toward consumption, manage financial risks and adapt to an increasingly complex global environment. The lessons from Japan's experience are instructive, but China's path will ultimately be shaped by its own policy choices, institutional evolution and geopolitical strategy.

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