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Deflation – A Perspective of Japan

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ABSTRACT

Governments generally refer to inflation as one of the most preferred economic indicators to assess the functioning of the economy. Governments generally fix a desirable level of inflation. Inflation may be either low or high or moderate. Inflation that is little higher or little lower than the desirable rate of inflation may not be a problem to the economy, but too high or too low an inflation is a problem to the economy. High to very high inflation or low to very low inflation are not desirable and necessitates government intervention to bring it to the desired level. High to very high inflation is hyperinflation and low to negative inflation is deflation. While the government often focuses on inflation, economists consider deflation, a sustained drop in general price levels, to be more dangerous and harder to fix. Deflation is rare because central banks work aggressively and proactively to prevent it from starting. Unlike inflation, deflation once started may turn into a deflationary spiral and become very hard to contain. This can be better understood by looking into Japanese Deflation that shook the Japanese Economy for 30 years starting from 1990s to 2020s, the Lost Decades[1]. Japan could reverse deflation not because of its own policies, though its policies were highly effective, but because of external factors, the Covid 19 Pandemic and Russia, Ukraine war that triggered inflation globally. As of early 2022, Japan is emerging from nearly three decades of chronic deflation, marking a historic shift toward inflation. This article analyses the factors that have driven Japan into deflation. What are the outcomes of deflation? What measures were taken by Japan to reverse deflation? Did they work? How did Japan come out of deflation?

Keywords: *Deflation, Inflation, Disinflation, Bubble Economy, Lost Decades, Plaza Accord, Endaka, Abenomics.*

Introduction

Definition of Deflation

Deflation is "a decline in general price levels, often caused by a reduction in the supply of money or credit. Deflation can also be brought about by direct contractions in spending, either in the form of a reduction in Government spending, personal spending or investment spending. Deflation has often had the side effect of increasing unemployment in an economy, since the process often leads to a lower level of demand in the economy. The opposite of inflation"[2].

Signals of Deflation in Japan

Japan is a highly developed mixed economy. It is referred to as an East Asian Model that blends free-market capitalism with state intervention. According to the IMF forecast for 2026, Japan is the fourth-largest economy in the world by nominal GDP and the fifth-largest by purchasing power parity (PPP). It constitutes 3.45% of the world's economy on a nominal basis in 2026. According to the same forecast, the country's GDP (PPP) per capita will be $59,207 (2026)[3].

- **Crash of Stock Markets**

The first sign of deflation in Japan came with the crash of stock market in the early 1990s.Nikkei is 225- Average Stock Market Index. On 29th December 1989, Japan's Stock Market Index Nikkei hit the highest at 38,916 as the Japanese Economy was booming due to increase in money supply and hence the price bubble in stocks and real assets in 1980s, and the same peaking in the late 1989. The first sign of deflation came with the drastic fall of the Stock Market Nikkei losing more than Rs. $2tn in value by December 1990[4]. Nikkei, which has peaked at 38,915.87 in December 1989 has almost lost 80% of its value in the past 13 years and settled at its lowest close since 24th January 1983 finishing at 7,833.99[5].

- **Fallen Asset Prices**

There was a price bubble in stocks and real assets in 1980s and peaked late in 1989 due to growth in money supply. Due to Japan's asset price deflation in 1990s, there was a mean reversion or correction back to the price level that prevailed before the asset bubble with the asset prices witnessing a fall[6].

- **Consumption Falls Continuously**

As prices fall continuously due to Deflation, consumers delay purchases in anticipation of further fall in prices leading to a destructive deflationary spiral. As consumers demand less, prices fall, profits fall, production is curtailed, incremental investments reduce leading to a destructive deflationary spiral[7].

- **GDP Plummeted**

Another feature of deflation is a falling GDP growth or negative growth. Japan experienced severe recession and that was evidenced by average real annual GDP growth plummeting from 3.8 percent in the 1980s to 1.6 percent in the 1990s, and only 1 percent in the eight years 1992-99. Japan's average growth of 1 percent was substantially lower than that of 3 percent for the same period in the United States. In fact, among G-7countries, Japan's real GDP growth in the 1990s was next to lowest; compared with the 1980s, it marked the largest decline[8].

From 2011 to 2019, Japan's GDP grew an average of just under 1.0% per year[9]. Japan essentially didn't grow from 1993 to 2012—when nominal annual growth was negative 0.03%[10].

- **Unemployment**

Another sign of deflation is high levels of unemployment. As Deflation became clear in the early 1990s this witnessed the end of an extraordinary long expansion in Japan and also became the beginning of a prolonged slump lasting for long. This recessive period was known as the "lost decade". The Japanese labor market has lagged behind when the rate of unemployment rose from 2.1% in 1991 to a historical maximum of 5.5% in 2002[11]. The rate of unemployment hit 5.7% in July 2009, the highest level in the country's post-World War II era amid mounting job and wage cuts[12].

Systemic Reasons for Japanese Deflation

- **Japan is a High Saving Economy**

Culturally Japanese people are known for saving more. They practice minimalism. Japan became famous for high savings since the mid-1970s. There was a demographic reason for high private savings rate in Japan. Baby boomers were saving for retirement, even after they became old and retired the savings rate didn't decline. This may be one of the reasons for the bubble economy that has resulted from surplus savings as Japanese invested their money in stocks and real estate.

Savings put a dent on consumption leading to fall in prices, dent in profit margins, decrease in production, fall in employment, fall in income. Another feature was that savings didn't transform into domestic investments. Deflation in Japan crept into the banking system and people lost faith in the same, so they invested their money overseas[13].

- **Plaza Accord Created a Bubble Economy in Japan**

Plaza Accord is celebrated as a zenith of international policy coordination as it was considered the most dramatic policy initiative in the dollar foreign exchange market since Richard Nixon originally floated the currency in 1973. On 22nd September 1985 at the Plaza Hotel in New York, the US officials and their counterparts among the Group of Five largest industrialized countries, France, West Germany, Japan, United Kingdom and the United Nations of America agreed to the act of bringing down the value of the dollar by selling large amounts of dollars The value of the dollar had appreciated 44 per cent against other major currencies in the five years leading up to 1985. A combination of tight monetary policy and expansionary fiscal policy pushed up long-term interest rates which in turn attracted capital inflow and appreciated the dollar. So, the dollar appreciated by some 26% during the period 1980 to 1984 and from March 1984 to February 1985 the dollar appreciated another 17 percent. As a result of a strong dollar, US exports have lost price competitiveness and imports become cheaper and the US trade balance had fallen to record low deficit of $122 billion in 1985. Subsequent to the Plaza Accord, in two years from 1985-87, the dollar depreciated by 40 per cent and the trade balance was regained.

One legacy of the Plaza Accord is that, it is considered as a sort of conspiracy theory in Asia, symbolizing foreign economic pressure and a warning against rigid currency manipulation in modern global trade. One outcome of the Plaza Accord was the Japanese Yen appreciated not only against the dollar but also against the European currencies. The strong/appreciated yen known as Endaka, had made Japanese manufacturing uncompetitive in the world markets.

Domestically, Japan's GDP has mostly stagnated since 1990, after decades of strong growth. In between the 1985-86 appreciation of the yen, and the Japanese recessions of the 1990s, came the bubble years 1987-89, when exchange rate policy was no longer working to push the yen up, but rather to support the dollar.

Japan was not only a member and signed the Plaza Accord but also purchased dollars during the bubble years that led to excessive money growth and thereby to the soaring prices of equities and real estate in Japan[14]. The bursting of the bubble then led to the Japanese Deflation due to tight monetary control by the Bank of Japan. But one should accept the fact that as Japan signed the Plaza Accord probably it was the beginning of a downturn of the Japan's economy.[15].

- **Tight Monetary Conditions by Bank of Japan**

Bank of Japan implemented strict monetary policy. BoJ kept monetary policy loose when inflation was below zero, tightened whenever deflation ended. In Japan, 1970s was considered the bubble period, and monetary growth was very high during this period, and the stock market witnessed a speculative bubble. In 1989, the Bank of Japan brought money supply down to negative rates for a while and the stock markets crashed. Since then, the Japanese economy went into quasi-recession. This was the trigger point for deflation and at the same time the monetary growth has also been too low[16].

- **Insolvent Companies**

Banks lent to companies and individuals that invested in real estate. As real estate values dropped, these loans could not be paid, even the collateral land couldn't pay off the loan. National Banking Regulators directed banks to delay recovery of loans hoping that asset prices would improve. Some banks even made more loans to those companies that used to service the debt they already had. In the process, banks were maintaining an "unrealized loss" until the assets were completely revalued and/or sold off (and the loss realized) and this in turn continued the deflationary spiral in the economy[17].

- **Fear of Insolvent Banks**

Banks had large percentage of 'non-performing' loans. Banks did not receive payments on them but have not even written off and couldn't lend more money. Banks had to increase their cash reserves to cover the bad loans.

Japanese people lost faith in banks as they felt that they would collapse, so they preferred to buy United States or Japanese treasury bonds and gold instead of saving their money in a bank. This curtailed the availability of liquid money for lending and therefore no investment, no employment and no economic growth. People also diverted their money into real estate, since it inflates land prices, further slowing growth as the money didn't go as investment[18].

- **Imported Deflation**

Japan imported deflation by importing Chinese and other countries' inexpensive consumable goods and inexpensive raw materials, many of which reached all time real domestic price minimums in the early 2000s. These countries were witnessing fast growth along with lower wages. Thus, as prices of imported products were low, Japanese producers had to reduce their prices to match these prices to remain competitive. This also led to further decrease in prices in Japan further intensified deflation[19].

- **Unfavorable Demographics**

Japan is facing the problem of low birth rates and an aging society. The Japanese have high life expectancy and low birth rate as the youth of Japan are preferring to be single. Less population, aging population and low birth rates have a severe impact on consumption.

According to Ministry of Internal Affairs and Communications, the number of Japanese people living in Japan has fallen below 120 million in 2026 for the first time in 42 years. As of 1st January 2026, the population of Japanese residents in Japan stood at 119.74 million, down 0.76% from the previous year. The population of Japanese residents has been declining for 17 consecutive years since peaking in 2009, according to the survey, which began in 1968.

According to World Bank, the median age in Japan is 49.9 years, has the second-oldest population in the world after Monaco. The total fertility rate — the average number of children a woman is expected to have during her lifetime — dropped by 0.01 from a year earlier to 1.14, the 10th straight year of decline. The number of babies born in the country fell by nearly 15,000 to just over 670,000, the lowest figure since records began in 1899[20].

- **Tsunami & Earth Quakes**

The destruction, human tragedy and economic impact following earthquake and tsunami in Japan are huge. Tsunamis & Earthquake have immense impact on Japanese Economy, Global Economic Outlook and Financial Markets. In 2011, the damage to the economy's capital stock is at around $240 billion, which is more than double the damage following the Kobe earthquake in 1995. GDP declined by 0.9% on the previous quarter in the first three months of 2011. For the year, GDP growth is expected to be about 1 percentage point lower than earlier estimates[21].

Implications of Deflation

- **For the Government:** Deflation makes a dent to the revenue generated by the government. Lower prices could mean lower tax revenue for any government[22].
- **Saving Increases, Consumption Decreases, Leading to a Deflationary Spiral:** Once the citizens of a country take cognizance of deflation, though they are happy with falling prices, they will be very pessimistic about losing their jobs at the macro level. This would lead to more saving as a precautionary motive and less consumption. This would shrink demand and would induce further fall in prices leading to a classical vicious deflationary spiral[23].
- **Consumers Postpone Their Purchases in Anticipation of Further Decrease in Prices:** Rival big homebuilders such as Mitsui & Co. and Misawa in Japan have no takers for their latest homes in 2001 despite a price war that crunched prices by 28%, consumers postponed their purchases in anticipation of further decrease in prices. This is even though Misawa and rival homebuilder S x L Corp. in 2001 triggered a price war for a new home by as much as 28%. Consumers wanted to postpone their purchase in anticipation of further reduction in prices in the coming years[24].
- **Consumers Buy Low-Cost Product Categories and Do Not Indulge in Brand Loyalty:** Consumers of Japan ditched brand loyalty to cheaper product alternatives that were available from abroad. Japanese indulged in buying cheap South Korean Electronic goods which they never did before[25].
- **Corporations moved their production to low- cost centers such as China:** Toshiba of Japan has moved facilities to China to produce goods intended for export back home. In March 2001, Sony announced that it would shutter most of the remaining domestic production facilities of its ailing Aiwa consumer electronics subsidiary, with its plants in China picking up the slack. Matsushita Electric Industrial Co. and NEC Corp etc. followed suit. These moves have further reduced employment opportunities in Japan[26].
- **Deflation feeds into the banking system of the country:** Japan's deflation has fed into the banking system as loans were lent to real estate investors by holding land as collateral. Depressing prices of land increased the debt load of big banks and crippled the banking sector[27].
- **Japan Lost its Comparative Advantage in Exports of Electronics:** Ever since 1994 electronic parts and components (ep&c) has been Japan's second leading export. The Global

Financial Crisis (GFC) an outcome of Subprime Mortagage Crisis refers to the period of extreme stress in global financial markets and banking systems between mid-2007 and early 2009. GFC badly affected the Japanese Economy. Japan's comparative advantage in ep&c tumbled after the GFC and was attained by Korea & Taiwan. By 2017 Taiwan and South Korea each exported more than twice the value of ep&c that Japan did[28].

With the onset of Global Financial Crisis, the New Taiwan dollar depreciated making their exports price competitive and at the same time Japanese Yen started appreciating creating a dent on Japanese exports. Both the currency movements had a double negative impact on the profitability of Japanese semiconductor producers. Though the Yen depreciated and the New Taiwan dollar appreciated, still Japanese electronic parts and components makers never regained their past glory of competitiveness. They lost their competitive advantage to Korean and Taiwanese producers. Though the Yen depreciated in 2012, Japanese semiconductor producers couldn’t maintain or retain the competitiveness in the industry as it required massive incremental investments in physical capital and R&D. With the onslaught of deflation on the Japanese Economy, consumption was falling, prices were falling and there was pressure on the profit margins of the industry. Following the profitability shock, Japanese firms could not sustain investment at the pre-deflation levels. Investment in tangible fixed assets by Japanese electronic parts and components firms tumbled and never recovered. The ‘endaka' shock, where the Yen's value is higher than that of other currencies triggered hysteresis effects that contributed to a long-term decline in the industry. While Taiwan and Korean electronic parts and components firms have witnessed profitability increases, prices of Japanese producers in 2019 remained below their prices of 2005. Rising profits of Taiwanese and Korean Electronics firms made them pump in incremental investments into the industry to maintain the newly acquired comparative advantage in producing ep&c[29].

- **Suicides of Men:** Suicide rate in Japan has in general always been higher than in other countries. In Japan, suicide is not viewed through the lens of religious sin or moral failing as it is in the West. Historically, Japan has shown a complex cultural tolerance towards suicide, sometimes viewing it as a morally responsible choice or an honorable way to restore dignity after a failure[30]. However, the modern Japanese perspective is shifting dramatically. The general population is increasingly viewing suicide not as a romanticized act of individual freedom or sacrifice, but rather as a critical public health crisis and the result of extreme social and economic pressures.

In Japan life insurance covers even suicidal deaths and the nominee can claim the insurance policy. Suicidal deaths after the waiting period are only considered for claims. The sudden and significant increase in the number of suicides in 1998 was observed primarily among unemployed middle-aged men and individuals facing some form of economic or financial crisis. Especially middle-aged men facing bankruptcy and/or unemployment committed suicide so that their family can claim insurance for sustenance[31].

The annual number of suicides in Japan increased dramatically from 24,391 in 1997 to 32,863 in1998 and remained above 30,000 until 2011. Although the number of suicides attributed to financial issues has decreased overall since 2009, such issues remain a major factor in middle-aged men committing suicide. For instance, in 2012, a total of 1,138 men in their 40s committed suicide for financial reasons and 1,211 for health issues – these being the two most common causes of suicide. Among men in their 50s, 1,264 and 1,200 faced financial and health issues respectively.

In 2008, around the time of the economic downturn precipitated by the Lehman Brothers bankruptcy, 4,850 young adults in their 30s committed suicide in Japan, this number being the highest since 1978 when statistics were first recorded. In addition, a major reason for suicide among those in their 20s is “failure to find a job”, and the number of suicides committed for this reason has continued to increase since 2007.This suggests that the increased number of suicides among Japanese closely associated with the economic downturn[32].

Measures Taken by Japan to Control Deflation

The Government of Japan and Bank of Japan (BoJ) have tried various Fiscal Stimulus, Monetary Policies and Abenomics to Reverse Deflation.

Monetary Policies

Bank of Japan implemented various conventional and unconventional monetary policies to reverse deflation Japan for almost three decades. At times these monetary policies were effective but not sustainable. The various conventional and unconventional monetary policies implemented by BoJ are dealt below:

- **Target of 2% Inflation:** BoJ targeted an optimal rate of inflation of 2%[33]. Economists like Paul Krugman have recommended that the Japanese Central Bank should announce that it will target certain rate of inflation and work towards the same and suggested 4% inflation target[34].
- **Bursting of the Bubble:** In May 1989, in order to burst the bubble economy and to prevent inflationary tendencies and to attain price stability, the BOJ raised the discount rate five times, and its level reached 6 percent in August 1990, which was higher than the level at the time of the Plaza Accord[35].
- **Zero Interest Rate Policy (ZIRP):** In February 1999, the BoJ introduced the Zero Interest Rate Policy (ZIRP). By August 2000, the BoJ felt that the current economic conditions had improved and hence rolled back ZIRP and reinstated the same in early 2001 as the economy weakened. To reinforce ZIRP policy initiative a new policy the Quantitative Easing Policy (QEP) was also initiated to purchase long-term JGBs to increase the monetary base. The BoJ committed to maintain ZIRP until core inflation is set in the economy[36].
- **Quantitative Easing Policy (QEP):** In early 2006, the economy could witness growth and inflation, even the problem of non-performing loans was also resolved. In March 2006, BoJ decided to exit QEP and reintroduce overnight interest rate as the main policy tool. Along with exit from QEP, the BoJ introduced a new monetary policy framework that would improve policy predictability and flexibility[37].
- **Overnight Rate:** In 2008, Japanese Economy reported low inflation once again due to the collapse of Lehman Brothers in September 2008 which led to the Global Financial Crisis (GFC), in response, the BoJ lowered the overnight rate to the Zero Lower bound (ZLB)[38].
- **Comprehensive Monetary Easing (CE):** In October 2010 BoJ reverted to quantitative easing by introducing its Comprehensive Monetary Easing (CE) framework. The CE framework re-introduced ZIRP together with an asset purchase program consisting not only of JGB purchases, but also risky assets to reduce term and risk premia. BoJ's response to GFC was less intense relative to US Federal Reserve & European Central Bank[39].
- **Quantitative and Qualitative Easing (QQE):** In April 2013, just a few months after raising the price stability target to 2 percent, the BoJ introduced Quantitative and Qualitative Easing (QQE), a significant scale-up of CE consisting of a sharp increase in purchases of JGBs and risky assets. Under QQE, the BoJ explicitly committed to increase its annual purchase JGBs holdings by about ¥50 trillion per year. The new strategy was successful. In the second half of 2014, the economy started weakening due fall in oil prices and weak demand following the consumption tax rate hike in April 2014. In October 2014, BoJ responded by raising the annual increase of JGB holdings from ¥50 trillion to ¥80 trillion. Despite QQE was implemented to the threshold limit, economy weakened further in 2015[40].
- **Negative Interest Rate Policy (NIRP):** BoJ in an unconventional way, in early 2016, introduced its Negative Interest Rate Policy (NIRP). NIRP was introduced to divert excess reserves into consumption so that inflation would rise and achieve the inflation target. The efforts of NIRP were doubted with rising global growth concerns and financial stability concerns during the first half of 2016 that led to lower stock prices, continued yen appreciation, weak credit demand[41].

Even after introducing QQE, inflation was still below the targeted level for the last three years, when reviewed in the summer of 2016. After a comprehensive review of the monetary policy by BoJ, instead of aiming for a quick reflation, the BoJ switched to a more protracted reflation approach that was seen as more compatible with the highly adaptive nature of inflation expectations[42].

In 2020, global economic activity came to a standstill as COVID-19 pandemic spread across the world. The BoJ responded with continued monetary accommodation and expanded support to finance firms and maintained stability in financial markets. The Bank adopted measures to maintain the smooth functioning of financial markets and incentivize the provision of credit. These measures included an expansion of asset purchase schemes such as JGBs, commercial paper and corporate bonds, exchange-traded funds, scaling-up of special funds-supplying operations to facilitate financing of corporates, and the enhancement of U.S. dollar liquidity provision with five other major central banks[43].

Fiscal Policy Measures

The Government of Japan also implemented some fiscal stimulus measures to counter Deflation. The same are as given below:

Fiscal Stimulus Measures

During the 1990s, Japan introduced many of fiscal stimulus packages totaling to ¥140 Trillion. These packages included credit guarantees and public investment. Public Investment of ¥40 trillion (8 percent of 2000 GDP) was spent on support for small and medium-sized enterprises (SMEs) and employment assistance on the spending side, as well as tax measures. In the late 1990s, Japan introduced a special credit guarantee program that provided 100 percent coverage to banks against losses. These guarantees reached nearly ¥30 trillion (6 percent of GDP) by 2001[44].

The share of social security spending including support for the elderly was increased. Cash vouchers worth (¥0.7 trillion) were distributed in 1999 to households that were potentially liquidity-constrained.[45]

The government also implemented sizable tax cuts, primarily on income but with mixed results. In 1994, a tax cut of about ¥5.5 trillion (1.1 percent of GDP) was enacted. However, in 1997, in response to rising government debt, the budget raised the consumption tax rate by 2 percentage points and abolished the temporary part of the earlier tax cut, raising the overall tax burden by some ¥7.0 trillion (1.4 percent of GDP). In the wake of the sharp economic contraction that followed, the government again changed course and reintroduced a temporary income tax cut of about ¥4.0 trillion in 1998, followed by another tax cut of ¥6 trillion in 1999[46].

On an average, public works accounted for about 40 percent of Japan’s fiscal stimulus measures in the early 1990s, they included spending on roads and bridges, In the late 1990s, public investment spending included IT-related infrastructure. Although the returns from such public investment projects may have been low, they appeared to have served a safety-net purpose, by creating jobs during the downturn[47].

Despite the seemingly significant fiscal stimulus, the economy remained largely stagnant until the early 2000s. Between 1993 and 2000, average growth rate was slightly above 1 percent, and tax revenue remained almost flat, leading to larger fiscal deficits. Over this period, the general government deficit averaged more than 5 percent of GDP. As a result, net debt increased sharply to 60 percent of GDP in 2000 from about 15 percent of GDP a decade earlier[48].

The fiscal stimulus measures of the government couldn’t meet the targets and fetch the desired results. It was felt that government is competing against private industry and usurping private investment dollars. Since 1992, 60 trillion Yen ($600 billion) worth was into public works spending. In 1998, for example, Japan produced a 'stimulus' package of more than 16 trillion yen, over half of it was spent on public works that would have a quashing effect on an equivalent amount of private, wealth-creating economic activity. Overall, Japan's 'stimulus' packages added up to over one hundred trillion yen and yet failed as it didn’t give room for private investment. The 'stimulus' money that was intended to cure intensified the problem[49].

Abenomics

On 26th December 2012, Shinzo Abe came to power as Japan’s Prime Minister for the second time. He promised economic reforms to shake the country out of its decades-long slump. "Abenomics" has three principal components/ three arrows.[50]

Three arrows are (i) an aggressive monetary policy, (ii) fiscal consolidation and (iii) a growth strategy. On January 2013, The BOJ set the price stability target at 2%. (year-on-year rate of change in the consumer price index).

- **An Aggressive Monetary Policy:** The first arrow was an unconventional monetary policy where the Bank of Japan (BOJ) initiated unprecedented asset purchase program. This is considered to be a gigantic experiment in Monetary Policy and the Heart of Abenomics. Through the policy of quantitative easing, or (QE) BoJ injected liquidity into the economy and for the first time pushed some interest rates into negative territory. The bank undertook an initial round of

QE in 2013. But with inflation stagnating below 1 percent into 2017, the bank has moved into a second, open-ended phase of QE consisting of $660 billion in yearly asset purchases. BoJ continued the asset purchase program with an intention to reach 2 percent inflation target. The scale of purchases were unmatched anywhere in the world and the value of the assets held by the BOJ has exceeded 70 percent of GDP.

With Japan's economy remaining weak, in January 2016, BoJ made an unconventional move of introducing negative interest rates in a fresh bid to spur lending and investment. The BOJ's negative rates, as well as its asset purchases continued till 2018[51].

- **Fiscal Consolidation:** Under Abenomics, the second arrow, Fiscal stimulus began in 2013 with economic recovery measures. Out of 20.2 trillion yen ($210 billion), of which 10.3 trillion ($116 billion) was direct government spending. Abe's hefty stimulus package, Japan's second-largest ever, focused on building critical infrastructure projects, such as bridges, tunnels, and earthquake-resistant roads. A separate 5.5 trillion-yen boost followed in April 2014, and after the December 2014 elections, Abe pushed through another spending package, worth 3.5 trillion yen[52].
- **Growth Strategy:** The third arrow the Growth Strategy was aimed at reviving Japan's competitiveness. The structural reforms were aimed at slashing business regulations, cutting corporate taxes, reforming the labor market, increasing work force diversity and modernizing industry and agriculture[53].
- **Abenomics is a Mixed Success:** Shinzo Abe came to power in December 2012 with a promise to revive the economy of Japan. During that lost decade, the Government of Japan has taken to relentless spending to stimulate growth, kept taxes low and as a consequence ended up running a massive fiscal deficit year after year from 1991 onwards. By the time Abenomics was introduced in 2013, Japan had amassed debt of 232 percent of gross domestic product (GDP) which is the highest by any country[54].
- **The Wins:** Abenomics has been to some extent effective in plugging the fiscal hole. Abenomics implemented significant increases in value-added tax with a consistent decline in government spending as a proportion of GDP, these moves have helped to bring back the budget deficit to manageable levels.

Abenomics brought several "wins" on the macroeconomic front. The rate of unemployment fell from 4 percent in 2012 to just 2.2 percent before the Covid 19 pandemic. Shinzo Abe's Government created four million jobs before his departure in September 2020. Since the end of 2012 Nikkei 225 index nearly doubled in seven years and large firms could get support from the equity markets and could became profitable. Yen depreciated against dollar, was stable and could provide some respite to exporters.

From 2014, Abe implemented key governance measures designed to enhance the competitiveness of Japanese firms. Japanese firms could attract more foreign investment, including raising the number of independent external directors, requiring the disclosure of risk-management and governance policies, strengthening external monitoring processes and improving accountability to shareholders. This is evident through the proportion of companies listed on the first section of the Tokyo Stock Exchange (TSE/TYO) having at least two independent directors rising from 21.5 percent in 2014 to more than 95 percent.

Abenomics third arrow structural reform was on raising growth by increasing worker productivity as well as labour force participation. The best of these reforms was women participation in workforce, by 2020 Abe expected that 30 percent of women would participate in leadership positions. Three million women joined the work force in 2019 than in 2012. Even foreign workers participation increased in Japan. This is considered to be a note worthy move as Japan's ageing population is set to trigger an estimated 40-percent reduction of its working population by 2055. But while three million more women were working in 2019 relative to 2012, most of their jobs have been part-time roles rather than leadership positions, Women continue to earn about three-quarters as much as men[55].

- **The Fails:** Abenomics couldn't contain some hardcore problems that it was intended to resolve. Throughout the Abenomics era, age-old problems that the policy sought to resolve have persisted. Barring 2014, inflation has remained almost consistently below 1 percent and has also entered negative territory on more than one occasion; wage growth has followed a similar pattern. Consumption and investment growth was weak. With the onset of the coronavirus pandemic in 2020 the economic activity of Japan was severely affected[55].

Abenomics did create growth and avoided the worst-case scenarios for the Japanese economy. The successor of Shinzo Abe, Yoshihide Suga continued Abenomics. But while it did have such notable successes, inflation remains below target, debt remains sky-rocketed, and reforms on the whole have not delivered as much as expected/targeted. But perhaps when viewed in a global context and with the systemic problems Japan has, Abenomics can be regarded in a more positive light[56].

How did Japan Reverse Deflation?

Despite of Japan trying every possible measure to end deflation, it couldn't put an end to deflation through internal policy measures, it was the external factors that favored Japan to end deflation.

- **Covid -19 Pandemic Aftermath Impact:** The aftermath of the Covid-19 pandemic brought inflation to skyrocketing heights across advanced economies that have not witnessed for decades. There were supply chain disruptions not only due to Covid 19 but also Russia-Ukraine war resulting in a 'supply shock'. Post Covid 19 pandemic, many countries have come out with unprecedented policy stimulus that triggered multi decades unseen demand shock. These factors drove inflation rates to multi-decade highs in many countries[57].
- **Currency Depreciation & Inflation Spike:** As Japan was reeling under deflation, Japan seemed to be an exception in the inflationary environment. However, after major central banks began to hike interest rates to contain inflation, the interest rate gap with Japan widened, the Japanese Yen (JPY) depreciated sharply, prompting a wave of price pressures in Japan as well.

The sharp currency depreciation added to global price pressures, pushing Japanese consumer inflation to a peak of 4.3% year-over-year in January 2023, a level that had not been reached in Japan in over three decades. The increase in inflation allowed the BoJ to finally end negative rates for the first time in 17 years, and to raise rates twice since then, although still at a low of 0.5%[58].

- **Shunto Agreement:** Shunto agreement is an annual agreement as an outcome of yearly negotiations between labor unions and corporate leaders. In mid-2024, growth in wages adjusted for prices/inflation began to recover because of the "Shunto Agreement" that led to average wage increases of 5.1% that year, the largest in 33 years[59]. Rising living expenses along with structural labour market tightness, in turn, empowered labor unions to negotiate significant wage increases for three consecutive years: 3.6% in 2023, 5.1% in 2024, and 5.3% in 2025, the highest in three decades. This wage growth focus represents a profound shift away from Japan's historical focus on job security to stronger compensation demands[60]. Wage growth at the macro level improves purchasing power of households and support for consumption, along with upward pressure on prices and profit margins for firms.
- **Latest Annual Inflation Rate:** Bank of Japan targets an inflation of 2%. For decades, the nation grappled with deflation or very low inflation, often averaging below 1%. In 2022, the average CPI reached 2.5%, followed by 3.27% in 2023.Japan's average annual inflation rate for the calendar year 2024 stood at 2.7% (all items Consumer Price Index). Japan's average annual inflation rate for the calendar year 2025 stood at 3.2%. Japan's inflation rate stands at 1.5% as of May 2026 less than the targeted inflation of 2% by BoJ[61].

Conclusion

Japan remains a classy example for Deflation. Deflation threatened Japan for three decades. We can consider Deflation to be a great threat to a country after analyzing the traumatic experiences of Japan. During the lost three decades, the Government of Japan & Bank of Japan have tried every possible way to reverse deflation, but Japan failed miserably in containing deflation. The Government of Japan & Bank of Japan have implemented conventional and unconventional monetary policies, fiscal stimulus measures and Abenomics. Both Government of Japan & Bank of Japan were very effective and vigilant, but still they couldn't reverse Deflation and landed in a vicious cycle.

Japan is mired with inbuilt/systemic problems like ageing and low population, low birth rates, tsunamis and earthquakes. Added to that, Japan being a member of G5 countries signed and implemented the Plaza Accord. During the same period Japan even bought huge amounts of depreciated dollars. It was felt that these factors must have set in a bubble economy. Countries should be very cautious while resorting to unprecedented, unconventional monetary policies that negate the basic principles of macroeconomics

Though other countries may not have Japan specific problems, but countries must assimilate the fact that Deflation once set is not very easy to reverse. Countries should cautiously monitor Inflation and any continuous falling Inflation is a signal to exercise caution. Before setting into Deflation itself, countries should use their monetary and fiscal policies effectively to counter the onset of Deflation. For hugely populated countries countering deflation may not take such a long time. After understanding the systemic problems of Japan, a country like Japan should be over cautious compared to any other country that faces Deflation.

It was aftermath of the Covid 19 pandemic and the Russia Ukraine war that triggered supply shocks and demand shocks globally that brought Inflation across advanced economies to sky rocketing heights. These external/global factors also impacted Japan by triggering the long-awaited Inflation in Japan. Japan's struggle with Deflation is a lesson to learn for every economy.

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