Spain, Japan, and the dangers of early fiscal tightening

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The fallout from the recent financial crisis has been global in scope. Both the Spanish and Japanese economies have experienced similar declines in stock prices, and real economic activity. One important distinction between the two economies is real estate. In Japan real estate prices were stable prior to the recession. Spain’s recession was preceded by a decade of rapidly rising real estate prices that was fed by a large increase in domestic bank lending. Japan also experienced a collapse of stock and real estate prices in the 1990s. An analysis of Japan’s previous experience suggests that a sudden tightening in fiscal policy in 1997 played an important role in propagating that crisis.