When the Guardian's former Japan correspondent left two years ago it was a country in freefall: bankrupt, depressed and ageing. Now, after a decade of gloom, the original Asian tiger is stirring again. But is this a new bubble, or the reawakening of an economic superpower? Jonathan Watts returns to Tokyo to find out.

When I left Japan in 2003, things were looking terminally gloomy. For most of the previous seven years reporting from Tokyo, I had written an unrelenting stream of miserable stories about salarymen suicides, zombie companies and a corrupt one-party political system dying slowly from sclerosis. Throw in the ageing population, staggering debt and declining regional influence and it looked as if this was a country sinking slowly, but gracefully, into decline.

But over recent weeks, there have been stirrings, and then rumblings, of a comeback. The hangover from the "bubble economy" of the 80s, and the Asian financial crisis that followed - the so-called lost decade, which actually lasted 15 years - is said, at long, long last, to be over. And, although there have been several false dawns in the past, there is compelling evidence to suggest that this time the recovery is for real.

Japan's economy is growing. Share values have doubled from their lowest point. Employment is up, debt is down and bankruptcies are at their lowest level since 1989. Even land prices, which have fallen for 15 years in a row, appear to have hit bottom. In a few prime areas of Tokyo, some plots are actually worth more today than they were yesterday.

Exports are booming. Shoppers are opening their wallets again. Even deflation - that strange scourge of the Japanese economic system - may soon be at an end. The central bank recently made the bold prediction that the consumer price index might rise as high as zero by the end of the year. In January, it is forecast to enter positive territory for the first time in seven years.

After a surge in speculation on the stock markets, some are already having flashbacks to the late 80s. When I flew back into Tokyo early last week the first headline I saw, in the Evening Fuji tabloid, was "The Bubble is Back". Whatever happened to the suicidal, bankrupt, tortured - but actually rather comfortable - Japan I had grown to know and love?

For most of the past 20 years, views of Japan have swung between two poles: it is either said to be so strong that it is going to take over the world, or so weak ("the sick man of Asia", according to former prime minister Yasuhiro Nakasone) that it will bring the global financial system crashing down. But what about now? Does this nascent recovery mark the start of another giddy extreme? Is big wild money back? Or are we in for something cooler, safer, steadier?

I begin my quest for answers in Ginza, the area of Tokyo that became notorious in the late 80s as the world's most expensive place to party. It is an exclusive and almost uniquely Japanese world, but a friend puts me in touch with one of its leading figures: Natsumi Nakajima, mama-san (owner) of one of Tokyo's most prestigious hostess bars, Club Socie.

"It is always crowded here, but not like the bubble era," she says. "In those days, there were queues of people outside the big bars every night. If someone spent a million yen (£5,000) in one night, no one raised an eyebrow. There was one guy who used to wander around Ginza with a suitcase full of cash - at
least 10m yen - going from club to club until it was all gone on tips and drinks. Another took me and every hostess in the club to Hawaii."

In those days, the big spenders were mostly real-estate agents, construction bosses and financial brokers, and the money they blew was their own. They disappeared during the lost decade, says Nakajima, but in their place came executives and public officials who paid their way out of corporate and tax budgets. More recently, customers tend to be IT entrepreneurs and individual investors, and they are once again using their own money. (Nakajima's analysis fits almost perfectly with the trends in the macroeconomy in the past 15 years. The bubble was fuelled by speculation. Once it burst, the economy relied on exports and government spending. And now, domestic consumer demand is slowly picking up again.)

During the darkest days of the lost decade, many Ginza clubs went bankrupt and their hostesses - used to earning £60,000 a year for massaging nothing more than egos - went into prostitution. The biggest sign that the recovery is genuine, says Nakajima, is that this trend has stopped. "Now, I'd say business is not as big as during the bubble, but it is healthier. People may spend less, but they always pay now."

Talking of paying, it shortly becomes clear to me that Ginza's notoriously outrageous prices have not budged much since the bubble. Our interview finished, Nakajima presents me with the bill: 52,000 yen (£260) for one beer - one small, very ordinary beer - and an hour's chit-chat. I am too shocked to say anything. Seeing my surprise, the friend who introduced us cuts in: "It is cheap because you are here for work, not fun. They have charged you the minimum." I swallow hard and pay up.

Prices in Ginza may still be high, but because everything is always compared with life during the bubble, many people in Japan - still 20 times richer than China - feel their country has become a model of prudence. "We don't waste money like we used to," says Kenji Ohashi, my taxi driver the next day. "All the older guys in my company complain that things are not like they were during the bubble. Then, everyone used taxis because their companies picked up the tab. Now people are more cautious because it is their money. And the competition is tougher because there are more cars on the road. But things are better than they were five years ago."

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We are on our way to Roppongi Hills, the sleek new mega-development at the centre of Japan's comeback. Conceived in the bubble, but left dormant for most of the lost decade, this vast $2.2bn office, residential and cultural complex was once seen as a white elephant that threatened to trample Japan's fragile economy. Before it opened in 2003, many analysts predicted that it would flood Tokyo with office space, pushing down prices and forcing rivals out of business. Instead, it has coincided with a resurgence of the city's commercial property market, and as confidence has gone up, vacancy rates have gone down - from 9% in 2003 to 4% this year.

Japan's new economy has gravitated to Roppongi Hills. The 51-storey main tower is now the headquarters of the country's fastest growing and most aggressive internet and investment firms: Yahoo, Rakuten, Livedoor and Murakami Fund. These firms have been causing waves by trying to buy up the nation's baseball teams and TV companies - the face and voice of "old Japan". The adjacent residential blocks - designed by Terence Conran - are now home to the country's most talked-about businessmen, and they pay millions of yen a month in rent.

Between Roppongi's business and residential areas lies Keiyakizaka Street. Until two years ago, no one had heard of it, but it's now a contender for the title of the world's most upmarket shopping arcade. The pavements are full of beautiful young men and women with pedigree spaniels and chihuahuas; they shop here for Versace dresses, Harrods menswear, La Perla underwear and Emma Hope shoes.

At the height of the bubble, the Japanese art world spent its time loudly snapping up overpriced Van Goghs and Monets (which were then quietly sold off during the lost decade). But in the main tower of Roppongi Hills, the Mori art museum provides clues as to how the cultural scene has shifted since then. The museum is showing an anything but traditional exhibition by Hiroshi Sugimoto, which mixes photographs of museum displays with theatre and architecture. "The bursting of the bubble was the best thing that happened to contemporary art in Japan," says the director, David Elliott, who is English - the
first non-Japanese director of an art museum in Japan. "It got rid of a lot of nonsense and arrogance. And it brought in a new generation of artists and a new language that was more critical. The market for contemporary Japanese art used to be outside the country, but now it is becoming stronger domestically. There is a new generation of collectors."

If Roppongi Hills is any guide, Japan is definitely back. But it has changed. This Japan is more globalised than traditional. Apart from the kanji signs and the rice paddy on top of one of the buildings, Roppongi Hills could be anywhere in the world. "We are praised as a symbol of economic recovery, but we are also criticised for not being Japanese enough," says Michiko Kishi, public relations manager of the Roppongi Hills developer, Mori Building. "We are a base for change. Tokyo needed something new or it would have lost its status as an Asian business centre. We would have been overwhelmed by Singapore, Hong Kong, Shanghai and Seoul."

Japan's recovery has been heavily influenced by its changing relationship with the outside world. Politically, it has drawn closer to America, even offering troops for peacekeeping missions. This was unthinkable in 1989, but it is crucial now to ensure supplies of oil. When George Bush arrives in Tokyo tomorrow, there is no doubt that he will be visiting America's staunchest ally in Asia.

Economically, Japan is increasingly intertwined with China. Mori Building is a pioneer in this respect. The company's biggest new overseas investment is in Shanghai, where it is funding the construction of what will be the planet's tallest building. Once completed in 2008, the World Financial Centre will stretch half a kilometre into the sky.

Mori Building is by no means alone. Many Japanese companies are moving into China to build manufacturing plants or to exploit the world's fastest-growing market. Despite the rising political tensions between these two powers, there would have been no comeback by Japan - and far less growth in China - if they had stopped trading. Tokyo's exports to Beijing have surged to 8 trillion yen in the past few years and now account for 13% of all overseas shipments.

"China is a very important factor in Japan's recovery and is becoming more so," says Kiichi Murashima, an economist at Nikko Citigroup. But there are other reasons why the situation has improved. "The excess debt, excess capacity and excess labour that built up during the bubble era have largely been removed. At the minimum, Japan's economy has more staying power than it had during the lost decade. It is now more resilient to external shocks."

There are signs, albeit small ones, that irrational exuberance might once again be inflating asset values. On the Tokyo stock exchange, trading volumes are now higher than they were during the bubble period. The aggregate market value of shares has bounced back to 80% of its peak. And in many cases, it is hard to see why. Earnings per share are still far lower than in Europe or the US. The main corporate beneficiaries of the surge in equity values have not been global players - such as Toyota, Canon and Matsushita - who have restructured. Instead, it is regional banks, insurance companies, steelmakers and construction firms, many of which have changed little since they were written off as "zombies" five years ago.

"This is not a real recovery. It's just wish fulfilment," says a foreign hedge-fund manager who asks to remain nameless. "The zombies have come back. There's a new bubble in the domestic stock market."

A raft of veteran Japan watchers, such as Bill Emott and Jesper Koll, say this is nonsense. They argue that the economy has genuinely become leaner and more competitive. In the political heartland of Kasumigaseki, it is not hard to find supporters of this rosy view - even among MPs who were formerly outspoken critics of a system that has been dominated by one party, the Liberal Democrats, for 50 years.

"The lost decade is definitely over now. We've had a few fake comebacks before, but this one is for real. Japan is recovering," says Taro Kono, the new vice minister for justice. "We have changed. The old systems have been torn down. In the economy, banks and businesses talk of profits now instead of size.
In politics, the factions are no longer important. Our party actually represents the people. Japan is becoming a real parliamentary democracy.”

Not surprisingly, Kono credits his boss - the prime minister, Junichiro Koizumi - for restoring national confidence. Arguably the most dramatic sign of change came in September when the premier called a snap election, recruited a team of "assassins" to stand against opponents in his own party, and won a landslide victory on a campaign to reform the post office. This brilliant piece of political theatre, unimaginable five years ago, has convinced the public that the country at last has a strong leader.

Koizumi has been fiercely criticised, particularly in China and Korea, for visiting the controversial Yasukuni shrine, which honours, among Japan's many war dead, a number of war criminals. But in this too, he has correctly read the mood of a country that is growing more nationalistic even as it becomes more globalised. It is an insecure, inward-looking reaction; a sign that today's Japan is less sure of itself than 15 years ago. Then Tokyo was the world's biggest aid donor and the unrivalled power in Asia. Now it is cutting back on its largesse every year and arrogance is impossible. Never has Japan been more politically dependent on the US and more economically reliant on China.

"Japan is regaining its confidence, but it is not yet back to the levels of 1989," says Kono. "At that time we almost conquered the world economy, but now, because of China's rise, we cannot even dominate the region. Even though business is improving, the big new firms are domestic-orientated. We don't have any rising new corporate stars that look likely to become global champions as was the case 15 years ago."

At least one of those old sluggers is still on top form. Toyota has gone from strength to strength over the past 15 years by ignoring almost all the conventional wisdom of the 90s. While other firms restructured, it expanded. Instead of shifting production to China, it ramped up capacity in Japan. Rather than merging with foreign firms and calling for advice from overseas managers, it stuck closely to its own way of doing things. The result is that it exported a record 2m cars in 2004. And within three years, it is expected to overtake General Motors as the world's biggest auto manufacturer. If any place in Japan is enjoying a boom, it is Toyota city, near Nagoya.

But elsewhere, the picture is mixed. During the bubble, everyone was racking up profits. But today the gap between the winners and the losers is growing. Toyota is doing well, Sony is suffering. Tokyo is prospering, Osaka is still in the doldrums. There are new millionaires working in Roppongi Hills. There are also new homeless people sleeping in Shinjuku Park.

As I head back to my home in Beijing, I wonder whether I have found a richer Japan simply because I have been - for the first time - looking for one. But then, perceptions help to shape economies and almost everyone I have met on this trip agrees that the lost decade is really over. But they also agree that the peaks of 1989 cannot return. Japan may be back, but it is a more timid, more realistic creature. Its new economy is modest, mixed, a little confused. If anything has changed in the past 15 years, it may well be that Japan has finally become - in the words of one of the most influential politicians of this period, Ichiro Ozawa - an "ordinary country".

Japan no longer makes for great headlines about miracle growth and terrifying risk; those dubious accolades now go to China. But perhaps Tokyo should not worry too much. It appears to be prospering rather well out of the limelight.

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