

# The Analysis of Japan and America Real Estate Bubble Formation and Burst Process and Its Enlightenment to China

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## ABSTRACT

From the perspectives of internal factors and macro environment, the paper compares the causes of real estate bubble in Japan in the 1980s, in America at the beginning of twentieth Century and in China in recent time. It analyzes the formation mechanism of real estate bubble in Japan and America, the efforts these two countries have taken to recover economy after bubble burst. It puts forward the suggestions for preventing the excessive bubble formation in Chinese real estate market so as to promote the healthy development of Chinese real estate market.

**Keywords:** Japan, America, real estate bubble, reference, enlightenment

## 1. INTRODUCTION

The real estate issue is closely related to people's life, economic and social development situation and its significance, complexity and sensitivity are greatly highlighted with the continuous economy development and social transformation of a country. Since the reform and opening up policy is launched, especially since the housing monetization reform is carried out in 1998, China's real estate industry has developed rapidly with the acceleration of industrialization and large-scale urbanization. However, the real estate market local overheating problem that appears from time to time has been inhibiting the economic and social development. The economic phenomenon that the commodity price is greatly higher than real commodity value because of excessive speculation, that the related departments are distorted and expanded and that the economy is supported by lots of speculation activity is called as bubble economy. The bubble economy means that the asset value already exceeds the real economy and the macro-economy will loosen sustainable development ability easily. In recent time, the overheated real estate problem also appears in China and the growth rate of housing price greatly exceeds the growth rate of per-capita disposable income. However, it shall be noted that after the bubble economy develops to certain degree, the asset value will decrease rapidly because of the speculative market expectation, which is the so-called economic bubble burst. Japan and America, as the two countries whose economy development has many similarities with that of China, respectively have suffered the whole process of real estate bubble formation, expansion and burst in the 1980s and at the beginning of this century. Their experiences are always regarded as the typical warning of the real estate development. Based on the comparative study in this paper, we hope to find out a way that is suitable for China's real estate development and hope that China's real estate market can operate healthily, normally and orderly.

## 2. THE COMPARISON OF THE CAUSES OF JAPAN, AMERICA AND CHINA'S REAL ESTATE BUBBLE ACCUMULATION

### 2.1. The causes of Japan's real estate bubble

The real estate bubble appeared in the middle and late 1980s is the one with the largest scale, most serious impact and the most profound warning significance among all three real estate bubbles that have appeared in postwar Japan. The bubble formation and expansion in this period are caused by various factors.

The social and economic development provides basic conditions for the generation of the bubble. Owing to the siphon effect of hot cities on population and economic resources, Tokyo, Osaka and Nagoya become the source of overheated real estate market and the carrier of real estate bubbles.

Monetary policy and financial credit are the main causes of real estate bubble. On the one hand, after Plaza Accord is signed, the central bank of Japan greatly decreases the discount rate so as to cope with the adverse international economic environment and the Yen appreciation, which causes the rapid increase of money supply. The excessively issued currency cannot be adopted by the real economy circulation at that time and most of them are attracted to the stock market and real estate market. On the other hand, the financial deregulation encourages the speculation in land and housing investment. The government control of interest rate, capital market and credit allocation has gradually loosened, which leads to the situation that many banks issue a large number of mortgage loans, excessively participate in real estate financing and they even participate in the real estate investment speculation with the capital obtained by illegal operation.

When analyzing from the land tax system adjustment and land policy aspects, it can be seen that the income tax for the transfer of the land held by legal person for long term was reduced in 1979. In 1981, 20% income tax will be charged for the transferring of the land held by individuals for the long term. In the tax system reform in 1982, the long-term land holding period was changed from 5 years to 10 years. All these kinds of land tax reform and policy adjustment did not create effective balance and punishment on the land speculation system. Instead, these reforms fostered the expanding of real estate bubble.

The real estate opportunism tendency of the government shall not be ignored. Under the financial shortage pressure caused by the existing financial system and the inducement of larger-scale transfer payment, the Japanese government had the interest impulse to promote urban land development, infrastructure construction and indirectly supported real estate development. In addition, land development can obviously solve the financial deficits problem for local government, which led to the situation that the government turned a blind eye to the real estate bubble.

## ***2.2. The causes of America real estate bubble***

In the 1990s, American real estate price began to rise. From 2000 to 2005, the house price growth rate can reach up to 17% and it reaches the peak in the second quarter of 2005. Later, the growth rate declined rapidly and in the year 2007, the house price entered a negative growth stage.

During the bubble accumulation period, America also adopted the easy monetary policy. In order to cope with the collapse of high-tech bubble and the impact of 911 incident, Federal Reserve started to continuously reduce the federal benchmark interest rate since 2000. In addition, low interest rate and excessive fluid capital also promoted the rapid increase of America real estate price.

The innovation of financial products created more opportunities for the bubble expansion. As various financial innovations appear endlessly, the housing loan threshold was lowered for the customers. During this round of housing price rise in America, lots of innovative mortgage products appeared, which greatly decreased the down payment ratio of loan and the initial repayment pressure. In this way, the secondary-class customers who were unable to pay down payment and not able to repay the mortgage can buy house based on bank loan. In short period, this stimulated the house purchase demand.

What's more, the influx of funds from emerging economies also drove up the real estate market price. America stayed in low savings status for long time and had large trade deficits. The emerging market economies and oil production countries had excessive dollar savings and they purchased large amount of US dollar assets. In addition, after the internet bubble collapsed, the further surplus capital supply entered into real estate market, which caused the abnormal prosperity of the real estate market.

## ***2.3. The causes of China real estate bubble***

As large number of rural population migrated to the urban area, the housing demand was continuously increasing. In addition, people's strong desire for the improvement of living conditions shall not be ignored. However, due to the scarcity of urban land and the limit of supply elasticity, the urban real estate price is continuously increasing.

Under this increasing hot market environment, people kept a very optimistic expectation to the real estate market. What's more, with the accumulation of fluid capital funds in the society and the increase of residents' disposable income, real estate property became the priority choice for most people when they made large-amount investment. Therefore, the speculative demand was expanded. Under the influence of group psychology, this kind of speculation behavior became the collective behavior and was uncontrollable, which caused the real estate bubble.

Similarly, positive monetary policy played a key role in the bubble expansion. Since the year 2000, there have been five rounds of periods when China's excessive currency was developed to the peak. Among these periods, since the year 2008, the excessive currency breadth and depth greatly exceeded the previous level and then the fluid capital was accumulated in the society. Under the drive of profits, banks were willing to use real estate as mortgage and loan money to investors. In addition, banks also decreased the down payment ratio to increase leverage, which furtherly expanded the bubble.

In addition, government sold the land and then obtained non-tax revenue. Then, the real estate enterprises could obtain the land for real estate development, which could furtherly increase the government's tax income (real estate tax and construction tax). Under this situation, land transfer fee became the main financial revenue source of some local governments. In order to improve their work performance, some local officials would blow up the real estate bubble and drove up the land transfer price.

## ***2.4. The real estate bubble accumulation similarities and differences among China, Japan and America***

During the real estate bubble accumulation period in Japan, America and China, the governments all implemented expansionary monetary policy, reduced the discount rate and loan interest, which led to the accumulation of fluid capital in the society and the continuous increase of national account surplus and the inflow of large amount fluid capital into the financial market represented by real estate. During this process, banks all played an important role in boosting the momentum. Banks and related market entities all made use of the beneficial policies and supervision gap to carry out the so-called "financial innovation" and they transferred huge amount of funds to the real estate market of some hot areas through credit or financial products. In this process, banks and other financial institutions continuously invested funds into real estate development enterprises, residents and

institutional investors, which formed the capital operation situation that multiple parties participated in and supported the real estate investment and speculation. As the real estate industry had long industry chain, large fund accommodation capacity and wide economic involving scope, the government finance and social and economic development greatly depended on the real estate industry. In some regions, the local government finance income greatly depended on the real estate development. Comprehensively, during the real estate bubble accumulation period in the above mentioned three countries, the housing price was continuously increasing and people had the expectation that the price would increase continuously, which attracted new purchasers. In this way, the vicious circle that speculative investment demand was furtherly expanded and the real estate bubble constantly accumulated was formed.

China's urbanization level was obviously lower than that of Japan and America at that time, which meant that China's urbanization still had great potential and it would greatly and continuously support the real estate market development at present and in the future. In America, the land mainly belonged to private ownership, and only small amount of land was owned by the state. In Japan, the land supply organizations were relatively diversified and scattered and the land was owned by individuals. However, in China, the land was owned by the state and thus, the local government was the monopoly controller of the land use rights.

### **3. THE LESSONS AND ENLIGHTENMENT LEARNED FROM JAPAN AND AMERICA REAL ESTATE BUBBLE BURST**

#### ***3.1. The Japan real estate bubble burst***

As the urbanization process was going to end, the new and potential housing demand was greatly decreased in Japan. The urbanization rate had a turning point in the middle of 1970s and then in the 1980s, the urbanization process would going to end. At that time, the new and potential housing demand was greatly decreased and it could rarely support the Japan real estate price.

The government began to realize that real estate bubble would bring serious damage to the society and economy and therefore they had to actively puncture the bubble. Japanese authority started to adopt a series of retrenchment policies from May, 1989, and then they continuously increased the discount rate and loan interest, and continuously implemented the monetary tightening policies in the short term. The intensive financial credit policy adjustment and unprecedented control policy led to the contraction of fund supply and the improvement of credit threshold. Later, the government started to control the overheating phenomenon of real estate market by adjusting the land income tax and strictly controlling land transaction, which increased the land ownership cost and the tax burden.

The above mentioned factors reversed the market expectation and accelerated the burst of real estate bubble. The increase of ownership cost and the stricter regulation of land transaction caused speculative purchasers to sell the land.

#### ***3.2. The burst of America real estate bubble***

Owing to the concern of inflation, the Federal Reserve has raised the federal fund rate for 17 times since June, 2004. As most of the subprime loan was the loan with floating interest rate, the reset loan interest was increased with the increasing of the benchmark interest rate, which caused that the loan repayment pressure was greatly increased for many people with subprime loan. At that time, the housing mortgage institutions did not effectively evaluate the credit risk of the applicant and the low threshold limit or even the none threshold limit caused the high risk that the most of subprime loan customers may have default. From 2005, America real estate market started to have the situation that the market price deviated from the sales situation. From the middle of 2006, the America real estate market appeared the obvious turning point characteristics. Then in 2007, America housing price started to decrease for the first time since the America great depression, which marked that America real estate bubble started to burst. The burst of America real estate bubble greatly affected America economy growth speed.

#### ***3.3. The enlightenment of real estate bubble burst to China***

Extruding the real estate bubble in time is an option that shall be faced directly in the economic and social development process. However, whether to extrude the bubble actively or extrude the bubble by gradual digestion and absorption need to be confirmed furtherly based on the detail national conditions and the development stages. From the Japanese experience, it can be seen that actively puncturing the bubble is a relative intense method to end the crazy real estate speculation, based on which, Japan furtherly conducts economic mechanism and market system purification and reorganization. During the bubble extrusion process, China shall control the good strength, pace and balance and shall maintain the good continuity and stability of the policy. China shall actively take measures to absorb and solve the local overheating problem but shall not puncture the bubble. Instead, China shall dilute and melt the existing bubbles by releasing the demands and potential demands that appear in new urbanization process and the residents' income increasing process.

The establishment of a comprehensive financial supervision system can prevent the excessive bubble expansion and the final bubble burst. The financial supervision is aimed to ensure moderate total credit amount, rational credit structure and to ensure that the financial institutions can operate legally so as to reduce the system risk to the lowest level.

Based on the real estate bubble of America, it can be seen that the excessive financial liberalization and the very loose financial control will promote the appearance and development of real estate bubble. Thus, the financial liberalization shall take the strong and stable bank system as foundation and shall be guaranteed by the powerful finance supervision system.

Similar to the appearance and expansion of real estate bubble in Japan and America, the China's current situation is also the result caused by the interweaving and overlapping of multiple factors. This determines that to cope with the real estate market overheating problem and to solve the real estate bubble risk in time, multiple factors like land, finance and government finance shall be comprehensively considered, and the multiple real estate demands shall be realized so as to realize the good supply and demand balance in the real estate market.

#### **4. THE ECONOMY RECOVERY PROCESS IN JAPAN AND AMERICA**

##### ***4.1. The efforts taken by Japan to realize economy recovery***

The serious economic crisis caused by the breaking of real estate financial industry chain caused fatal impact on Japan and Japanese people suffered the adverse effects caused by economic bubble for nearly 10 years. Japan economy was recovered until they launched the bubble removing development policy in 2001. Firstly, Japanese government cleaned up the balance sheet of commercial banks which greatly decreased the ratio of non-performing assets in the bank system. Secondly, the reform of financial supervision system and the strengthening of financial supervision effectively prevented and resolved the financial risks.

Japan had realized the important impact of non-performing assets when they just started to reform and they took active measures to solve this problem. One important reason that Japan can realize success was that they promoted bank reform and the security market restore to prevent the non-performing loan, based on which they continuously digested and solved the existing non-performing loans. They strengthened the integrated finance monitor system centered by the finance department, strengthened the risk control, improved the information disclose system and firmly protected the investors' benefits, which could prevent and avoid the financial risks. However, on the other hand, they also had certain limits and problems. For instance, the finance department conducted too strict inspection on the finance institutions, which caused some negative impact on the treatment of non-performing assets.

##### ***4.2. The efforts and discussions conducted by America to realize economy recovery***

The subprime crisis appeared in America in 2008 gradually

caused the global financial crisis and governments around the whole world all took active measures to cope with this situation. America also launched a series of policies, through which, America economy started to recover in the third quarter of 2009 after the three-quarter recession. When analyzing from the momentary policies, it can be seen that Federal Reserve launched three rounds of quantitative easing policies from 2008 to 2012 and purchased large amount of national debts and then America realized the great change from stopping decline and stabilizing enterprises to powerfully recovering the economy. When analyzing from the fiscal policy aspect, since 2008, various tax decreasing, government investment, financial supervision and reform, medical insurance reform and relief constituted the main contents of the expansionary fiscal policy. Then, America also established a series of laws which formed the legal foundation for the expansionary fiscal policy.

However, it shall be noted that the economic structure imbalance was not improved in America. After the manufacture industry was recovered, the great liquidity caused by loose monetary policy still existed.

##### ***4.3. The reference significance of the two countries' economy recovery experience to China***

During the economic growth and economic structure adjustment process, the large amount of surplus monetary capital shall be handled carefully to avoid the excessive economy bubble. In addition, to ensure the healthy development of all financial system aspects, China shall avoid large amount of surplus capitals flowing into real estate industry and other fields with high virtualization degree. Instead, China shall use these surplus capitals to explore new real economy fields. While promoting the development of real economy field, China shall intervene the real estate field rationally so as to promote the healthy development of real estate industry.

Under the background of relative economy surplus and economy structure adjustment, increasing domestic demand is a precondition to ensure the stable economic growth of a country. To increase the domestic demand, firstly China shall ensure the continuous increase of national income and shall improve the national people's consumption confidence, which requires to maintain stable political situation, good employment condition and healthy social security system. In addition, constantly promoting bank reform, making more efforts to solve the bad debts caused by economic bubble and decreasing the ratio of non-performing assets are the important conditions to guarantee the healthy and sustainable economic development.

#### **5. CONCLUSION**

To solve the overheating problem of local real estate market, China has launched the financial policy to take real estate

price as one of the monitor objects. When the asset price is greatly increased and the real estate bubble will form soon, the effective market control is very necessary. All the problems appear during the real estate formation and burst process in Japan and America show that market participants are not fully self-regulated. On the one hand, this is caused by the situation that people simply believe the land price will continuously increase but will not decrease because the Japanese real estate industry keeps good development prospect for long time and people believe that they can make money as long as they buy lands. On the other hand, this is also affected by the risk factors caused by American financial systems. Therefore, it is very necessary to establish valid risk control system, popularize market risk knowledge, implement effective risk control measures and establish necessary information release system. What's more, in addition to emphasizing the monetary policies that can affect total economic volume, China shall also pay attention to the structural credit policy because the serious asset price imbalance will absorb excessive monetary investment and then aggravate the resource allocation distortion.

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