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Analysis of the Reasons for the Excessive Expansion of the Financial Industry——Taking Japan as an Example

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ABSTRACT
This paper focuses on the analysis of the causes of Japan's bubble economy in the late 20th century, starting from the huge trade gap between the United States and Japan. This famous Black Swan was caused by The rapid development of Japan's economy, as well as the skyrocketing yen exchange rate caused by the Plaza Agreement signed by the United States and Japan to ease the trade gap. In the end, the Bank of Japan began to cut interest rates sharply to ease the export difficulties faced by Japanese companies due to the exchange rate, which eventually led to the over-expansion of the housing market and the stock market and the bubble economy. By analyzing the Case of Japan, this paper explores how excessively loose monetary policy and Expansionary fiscal policy can step by step affect and even drag down a huge economy.

Keywords: *Asset price, Inflation, estate market, soaring stock, property prices, Financial, Stability*

1. INTRODUCTION

In the 1980s, The Japanese economy was in a phase of rapid development, the stock market was booming all the way, the housing price was constantly rising, and the exchange rate of the yen against the dollar doubled in just a few years due to the plaza Agreement, resulting in the illusion of a highly developed economy. However, due to the excessive expansion of the financial industry, the operation of monetary policy has entered a pathological development track, and Japan's economy finally began to collapse in the 1990s and fell into the unprecedented and post-bubble economic crisis. In the face of the devastating impact of the pandemic on the global economy, learning from past economic crises has become an indispensable research issue. This paper will start from the formation of the Japanese economic bubble, using the past data, the official data provided by the Bank of Japan, to analyze the formation of the Japanese economic bubble. In addition, through a thorough analysis of the causes, parallel compared Chinese economic, analyze the economic problems in China today.

2. THE HUGE TRADE GAP BETWEEN JAPAN AND THE UNITED STATES IN THE EARLY 1980S

After World War II, Japan's economy gradually recovered and grew rapidly. In 1968, Japan became the second-largest economy in the capitalist world after the United States. This rapid growth has also created imbalances in the global economic system, most notably in the United States. As early as in the early 1950s, with the gradual recovery of the economy, Japan's textile industry appeared overcapacity, while the United States was still in the postwar recovery stage, Japan began to sell a large number of textile products to the United States, until the early 1960s, the friction between Japan and the United States mainly around light industrial goods, groceries. After the 1970s, as the focus of Japan's industrial structure gradually shifted from capital-intensive industries to technology-intensive industries, the trade war between the United States and Japan gradually shifted to home appliances and automobiles. With penetration of Japanese products in all walks of life in the United States, the trade friction between Japan and the United States was further intensified after the mid-1980s, and the United States began to use the exchange rate as an important tool to

ease the trade deficit and trade friction. This led to the signing of the Plaza Agreement between Japan, Germany, France and Britain. The Main content of the Plaza Agreement was to ask the signatories to sell dollars in the foreign exchange market in a big way, which caused panic and collective selling, and then caused the depreciation of the dollar, and finally reduced the trade deficit of the United States. Due to the joint efforts of several countries, the US dollar did indeed depreciate smoothly and the Japanese yen also rose in relative terms, doubling in value in two years.

3. THE SIGNING OF THE <PLAZA ACCORD>

The rapid expansion of Japan's financial sector was largely due to the foreign exchange imbalances created by the Plaza Accord. [2] One could try to restore the link between the Japanese asset price bubble and monetary policy by asserting that a firm belief in ongoing pressure from the United States for yen appreciation in response to the United States's endemic trade deficits, rather than actual faith in the potential output measures implied, was what underlay the belief in

monetary ease and thus the boom. In 1985, Japan and the United States signed the Plaza Accord, which led to a rapid appreciation of the yen. With the yen rising against the dollar, many domestic Japanese companies face a huge disadvantage when it comes to exporting goods to the U.S. The Bank of Japan began cutting the discount rate and easing monetary policy to reduce the impact of the yen's rise on domestic companies. From 1986 to 1987, the Bank of Japan cut interest rates five times in a row, leading to an unprecedented surge in cash flow in Japan. With the influx of cash into the Japanese bond market, the Japanese financial market became more liberalized and the Nikkei index reached 38,915 points in 1989, 3.4 times higher than in 1983. At the peak of the bubble in 1989, more than 60% thought the market was not overvalued. About 30 percent of respondents still think the market is priced correctly (or even undervalued) [1] during the stock market rout. Trading volume in Japan is 1.8 times that of the New York Stock Exchange across the Atlantic. It was the financial liberalization reforms, along with banks and their low-interest rates, that flooded the real estate market, leading to a rapid rise in Japanese house prices in a short period of time. The rapid growth of Japan's domestic money supply and the rapid growth of the real estate and bond market have brought a huge economic bubble to Japan's society and economy. Real estate and stocks are worth far more than their intrinsic value, private leverage is on the rise and asset bubbles are expanding. [3] The one-month yen contract quoted by BTM showed The highest premium by 103.8 basis points on December 3, 1997, And by 58.4 basis points on November 30, 1998. In the case of Fuji Quote, Peak at 116.3 basis points on December 3, 1997, and 64.6 basis points on November 27, 1998

4. THE WEALTH EFFECT OF SOARING STOCK AND PROPERTY PRICES

4.1 Bubble formation in Japan's financial markets

Japan's stock market has soared because of the bank of Japan's falling interest rates and increasing policy lending. From 1985 to 1989, the Nikkei 225 index reached a peak of 38,915 points in five years, with an increase of 391.4% and an average annual increase of 78%. The total market value of the stock market rose to 611 trillion yen, equivalent to 1.48 times of GDP. Some optimists in Japan argue that such rapid growth signals the dawn of a new economic era, the long-term result of rapid real growth rather than the short-term result of bank rate cuts. They believe that such rapid growth will continue, which is reasonable from the fundamental point of view. Of course, there are other voices in the market that this is just a temporary bubble, but this idea has not been taken seriously, and the optimists have prevailed. So the widespread spread of the idea has further attracted more investors. People have deposited in the bank money into the stock market: financial institutions will actively invest in the stock market; Companies are also pouring money into the stock market. [4] The yen's rise also inflated Japan's financial assets, with banks lending unbridled and excess capital expanding and buying abroad. From 1985 to 1990, there were 21 overseas mergers and acquisitions of Japanese companies that exceeded 50 billion yen and even more.

4.2 Bubble formation in Japan's real estate market

To hedge against export woes caused by a rising yen, the Bank of Japan began cutting interest rates from 6% to 2.5% and encouraging Japanese companies and individuals to borrow. Therefore, Capital poured into the property market, because lower interest rates and encouraging lending have made it cheaper to buy and sell the property.[5]The low level of lending rates itself is desirable for borrowers. Yet given the ongoing changes in the financial environment, it is difficult to expect the low interest rate policy framework to function in a stable and efficient manner over the long term. Moreover, the continued existence of the framework itself is now weakening banks ’ inter-temporal risk-sharing function by restricting their profits. It also harms the sound development of capital markets. Most of the money went directly into the stock market and real estate. This led to rising house and stock

prices that diverged far from their intrinsic value, leading to the formation of Japan's huge bubble.

4.2.1 The blind participation of bank funds

As the prices of land and real estate have been rising, banks generally believe that as long as there is real estate as collateral, no amount of money will be risky, so real estate loans as the best loan projects. Institutions such as real estate and construction companies need the most money to invest in development. Banks, in turn, lent unbridled mortgages and financed property.

4.2.2 Excessive investment speculation

As the price of real estate appreciates rapidly and the profits are high, Japanese enterprises and individuals have been investing and speculating in real estate. Big Japanese firms, in particular, are reluctant to be left behind, and some are deeply involved in real estate. Many used the money to buy and sell land and property at huge profits, driving up real estate prices.

5. CONCLUSION

The trade surplus between Japan and the United States was undoubtedly one of the most critical factors leading to Japan's economic crisis, from the Plaza Accord to the soaring yen, the Japanese economy into a virtual boom. The boom was buoyed by speculation, a surge in the stock market, a surge in the real estate market, and a flood of cash as banks cut interest rates to encourage lending. Optimists were too optimistic about the Japanese stock market and investors piled into it. However, the rapid development of the economy was a lack of industrial support, which led to the bursting of the Japanese economic bubble.

After this economic crisis in Japan, the enlightenment left for later generations is also worth pondering. The Japanese government lacked an understanding of the depth of the recession, its policies lacked foresight, and the severe impact of the collapse of the "bubble economy" and bad loans. Under the excessively loose monetary policy, led to the bubble gradually increased. Obviously, it is not desirable to ignore the actual situation of macro-control, blindly put excessive money into the capital market is not desirable. Without the support of industry, no matter how prosperous the capital market is, it will only be a bubble.

China's current economic situation is somewhat similar to that of Japan in that the RMB has been appreciating in recent years and China has been engaged in quantitative easing. This can also be seen in China's housing market. In first-tier cities such as Shanghai and Beijing, housing prices have increased dozens of times in the past two decades. However, due to the low labor cost in China, Even after RMB appreciation for more than 10 years, China still maintains a surplus position in the trade with US. However, the economic growth is sluggish and manufacturing investment has reached the limit of its marginal benefit. To offset the effects of the bubble and delay the outbreak of the economic crisis, China must reduce the domestic money supply, otherwise, China will eventually go the way of Japan.

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