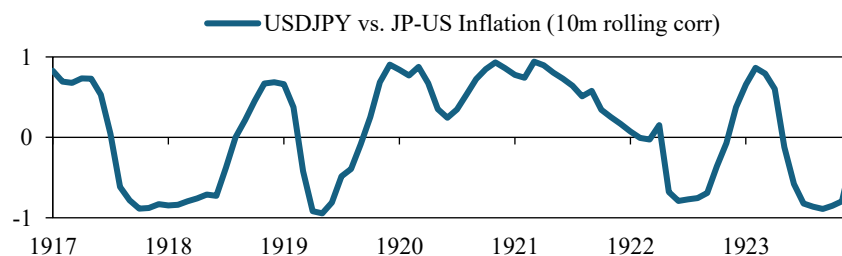
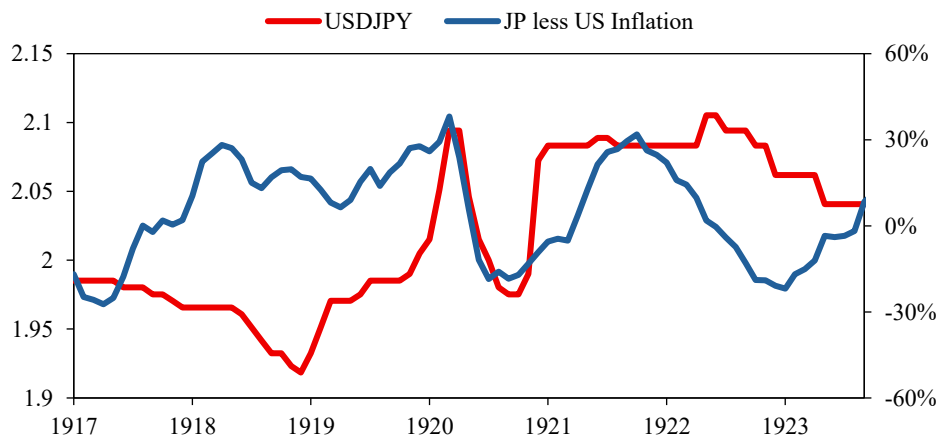
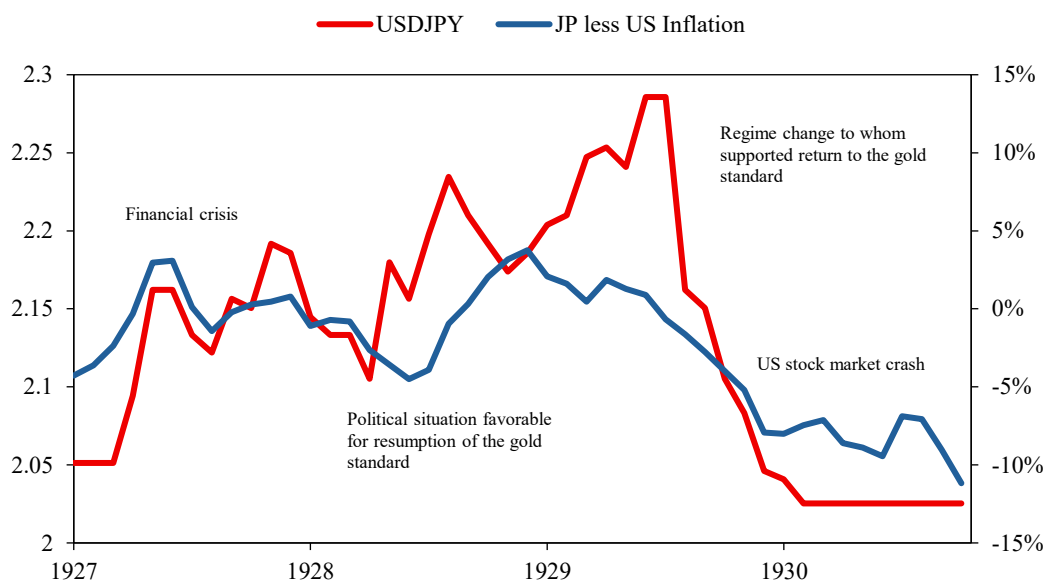


In September of 1917, right before the end of WWI, Japan placed an embargo on gold exports, which effectively ended the Yen gold standard. This meant that the Yen would now float freely against other currencies, which is exactly how currencies are traded today. However, the Japanese central bank continued to hold gold reserves requirements in relation to the currency, which acted as an anchor for the Yen despite the rate being free-floating. This was done by many other countries during WWI, as it was easier to finance war deficit-spending by printing money, which the gold standard would now allow.

Throughout 1918, the Yen rose against the dollar, which followed the slowing in Japanese inflation relative to US inflation (note spike in correlation at the end of 1918). The exchange rate broke from this correlation after the end of WWI, with the Dollar rising 6% from November 1918 to May 1920. This was likely due to optimism surrounding the US related to the end of the war. Following this, the exchange rate returned to its previous correlation (except during much of 1921) until the Kanto earthquake hit in 1923.



This earthquake hit in September of 1923, which destroyed much of Tokyo in Yokohama which were then and still now major economic centers. From then until the end of the year, the Yen only fell 1%. The real impact hit the yen in 1924, with the currency falling 19%. This happened since the Japanese had to sell Yen and buy Dollars in order to pay for imports to rebuild the country. Recovery of the exchange rate was inevitable once the Japanese had enough supplies to rebuild. The depreciated Yen would also assist in this recovery via increased competitiveness.



The Yen rate topped out at 2.05 in early 1927 and soon fell 9% against the dollar until the summer of 1929. This downtrend involved:

- A financial panic struck Japan in 1927 at the same time the US experienced an economic boom, sending the Yen down 5.1%.
- A brief recovery followed this due to a political situation which was favorable to the restoration of the gold standard (which would be at a parity of 2.02 USDJPY)
- The rest of the downtrend was likely due to money and credit creation following the financial crisis, along with Japanese military operations in China in 1928 (which had a depressing effect on foreign trade), and disappointment from the fact that the Yen didn't end up getting put back on the gold standard.
- Overlying dynamic of Japanese inflation rising relative to US inflation, which was related to Japan cutting interest rates as the US raised interest rates.

Following a regime change in May 1929, speculators slowly pushed the Yen back up to parity (+11%), as the regime supported switching the Yen back to the full pre-war gold standard. By the time the new administration suspended the embargo on gold and brought back the gold standard in 1930, the speculators had already brought the Yen back to its prewar par. This rise in the Yen was also related to Japanese inflation falling much sharper and earlier than US inflation over the period.

A few months after the October 1929 US stock market crash, the Great Depression struck the US, which eventually spread to the world, including Japan. One of Japan's biggest exports was cotton, and the depression in the US meant a large decrease in demand for their product. However, prices fell enough to sell the same quantity as before the depression struck, which was likely a big part of why it was milder to begin with than other countries (note the dynamic mentioned at the end of the last paragraph). Regardless, Japan still suffered

during this time. The exchange rate did not change at all from these developments as both the US and Japan remained on the gold standard.

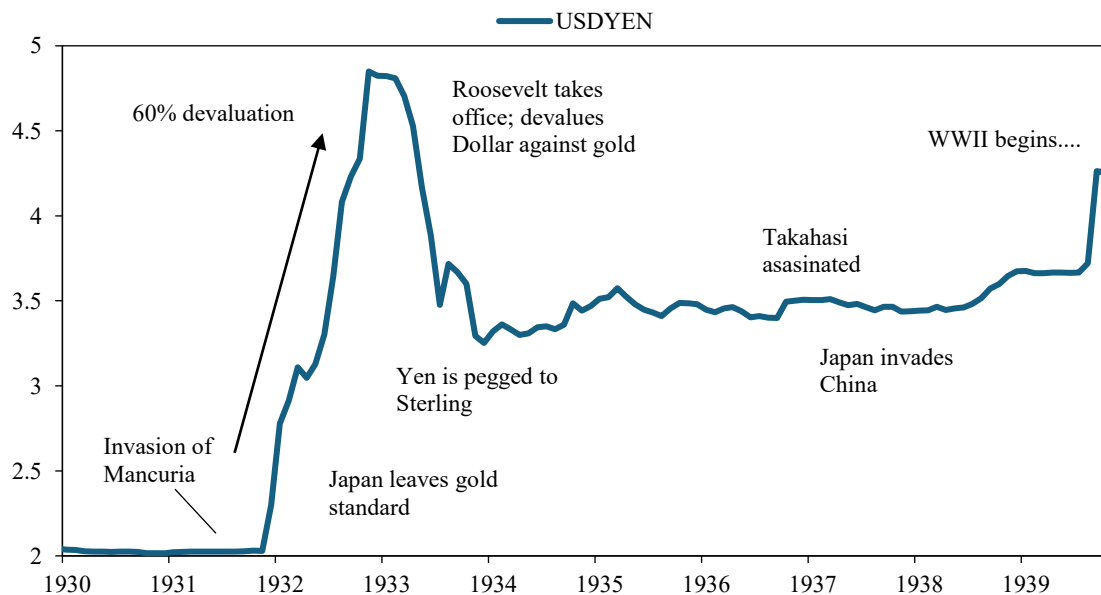
Finally, in December of 1931, a new administration took over which included a new minister of finance, Takahashi. Takahashi ended up pursuing Keynesian-style policies which brought Japan out of depression:

- (1) Ended the gold standard and floated the Yen, allowing for devaluation and expansion of the money supply
- (2) Deficit spending
- (3) Lower interest rates

With expansion of the money/credit and lower interest rates, the Yen devalued and inflation soared. News articles from the time also noted deteriorating respect for Japan on the international stage due to its various military conquests it was making in Asia at around the same time. However, these conquests would prove stimulating in the short term (due to the deficit spending) and the long run as these conquests would provide export markets for Japanese goods.

The Yen then began to fall in 1933, as Japanese inflation began to turn down and US inflation began to rise, which was associated with the US leaving the gold standard, and devaluing the dollar, along with other economic measures taken by the Roosevelt administration to reignite the economy. Note the Yen exchange rate was very closely correlated with the inflation differential throughout this entire period between 1932 and 33.

Lastly, in April 1933, the Yen was pegged to Sterling.



*Additional Charts*

