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Internationalization of Japanese Banking Revisited

by

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Contents

1. Introduction

From the 1970s, the international finance expanded most remarkably after the end of the World War II. As the syndicate loan clearly illustrated, banks took the lion's share of this development in the 1970s. In the 1980s, on the other hand, they had to adjust themselves to the new waves of "securitization", and both the debt problems in the LDCs and later bad loans in the developed countries largely restricted continued growth of international banking2/.

In the mid-1980s, attention has focused on the rapid growth of Japanese banking. Iwami(1989) reviewed several factors contributing to its growth, in particular, *modus operandi* of Japanese firms, striving not so much for profits as for market share (smaller profits, larger sales); behaving as a unified group within and among firms; maintaining strong ties with government etc.

Thereafter, financial circumstances changed dramatically. Since the "bubbles" in Japan burst out, banks as well as other financial institutions have been suffering from large deficits and insolvent loans. The current situation would serve to reconsider the question raised in the former paper, namely what factors actually promote international banking in the Japanese case. The share of Japanese banks, at least currently, tends to stagnate and does not cause anxiety on the part of other countries. Moveover, this paper updates the data in the former study and extends discussions further to other levels of financial internationalization: markets and currency.

Section 2 reviews the characteristics of the internationalization of banking, to compare the difference between the earlier and later stages of development. Japanese banks have had similar characteristics to the financial institutions of other developed countries. Section 3 examines the possible factors which

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2/ For the general overview on the development of the international banking, see Swoboda (1982), Llewellyn (1985) among others. The Bank of England (1992) reviews changing circumstances in the 1980s.

promote international growth of Japanese banks. In addition to the low profitability, we discuss influences from capital controls, relationships with Japanese customers, and the internationalization of currency.The last section 4 deals with function of the so called international financial intermediation, in relation to the Japanese foreign investments.

2. The Late-Starter and its Rapid Growth

2.1 Following Real Transactions (Trade and Foreign Direct Investment)

Internationalization of banks showed new stages of development after the World War II. While British banks had leading position in international business before the War, sustained by the London financial market with networks extending the world over, American banks led the way of new development thereafter3/.

The conventional explanation of internationalization are thus derived from American experience in the postwar period. On the first stage, roughly speaking up to the mid-1950s, they engaged mainly in trade finance. Then on the second stage, from the mid-1950s through the 1960s, they responded to the demand of the American multinationals, in particular, after the United States introduced capital controls in the mid-1960s, demonstrating parallel development with multinationalization of American firms, in other words "following the leader". In the 1970s, on the third stage, the international banking expanded through loopholes of regulations, which is common to the second stage. However, after the first oil crisis particularly, remarkable growth took place in the form of syndicate loans, financing current account

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3/ See for example, Yannopoulos (1983, pp.240-41).

imbalance of oil-importing countries4/. German banks had the similar tendency in the sense that the first stage was characterized by trade finance and other financial service demanded by German firms, while in the 1970s, entry into the growing international market promoted to establish foreign branches and subsidiaries, according to Neumann (1986, pp.74, 80).

Generally speaking, banks internationalize their business in following their domestic customers on the earlier stages, to provide trade finance, for example. This type of development was eminent through the 1960s, since the business with foreign borrowers grew considerably in the eurocurrency market of the 1970s.

In this sense, Japanese case was not exceptional5/. The international banking was almost confined to trade finance, and credit to the foreign subsidiaries of Japanese firms, until the liberalization of international finance in the 1980s. The first foreign branch was established by the Bank of Tokyo (reformed from the Yokohama Specie Bank) in London in 1952. Table 1 shows the development of foreign branch network thereafter, the number of branches increased in the early 1970s, parallel movement with the growth of FDI, as Fujita and Ishigaki (1982, pp.198-99) illustrated. The Japanese multinationals eagerly demanded finance for trade and working capital which Japanese banks were the sole suppliers. The security houses extended foreign branch networks as late as the early 1980s, a decade later than banks, because they intermediate security transactions, initially foreign sale of Japanese securities and later domestic sale of foreign securities as well. The necessary condition was the deregulation of cross-border capital movements.

Table 2 reveals a remarkable gap between the United States and Japan until 1980, which is not surprising. But to note is that Japanese banks surpassed

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4/ Yannopoulos (1983, pp.244-46), Fieleke(1977, pp.27-28).
5/ Kaizuka and Hata (1986) gives a good historical survey of international financial business in Japan.

German counterparts in number of branches as well as in their assets, from the early stage of overseas expansion. Naturally, this fact does not imply that German foreign economic transactions were smaller. West Germany has had larger share in world trade than Japan. Possibly, the main reason for their relative stagnation was that West Germany undertook foreign trade in its own currency (D-Mark) to a far larger extent than Japan. Around 1968, for example, the yen share of Japanese export was only 1%, while import was almost exclusively traded in foreign currencies. Germany, on the other hand, recorded 75-80% of export, and 50% of import denominated in D-Mark6/.

While Japanese overseas branches mainly engaged in raising dollar funds for trade finance, German banks did not need such business as Japanese, and accordingly had less incentives to build foreign branches. But the share of foreign profits in total was much larger for German banks than Japanese7/, which suggests also that German banks undertook foreign business largely in their own currency.

However, in contrast to the German case, "internationalization of currency" promotes, rather than hinders, international expansion of banks, as Aliber (1984, pp.666-67) stressed from American experience. In the 1960s indeed, availability of dollar funds undoubtedly raised competitiveness of American banks when controls on capital movements and foreign exchange transactions existed globally. For the Germany and Japan, where the multinationalization of their domestic firms stayed far behind the United States, the main banking business was to supply trade finance, the different degree of trade in its own currency largely affected the need for foreign branch building.

6/ Kinyu Seido Kenkyukai (1970, p.294). In 1976, D-Mark occupied 87% of export and 42% of import for Germany, while yen-share was 79% of export and 1% of import for Japan, Kinyu Kenkyukai (1979, p.234).

7/ Kinyu Kenkyukai (1979, pp.203, 258) shows that share of foreign profits was about a third for German major banks, and around 14% for Japanese banks.

2.2 Trade Finance and Foreign Loans

1) Functions of Foreign Branches

The network of overseas branches, generally speaking, performed double functions: euro-finance at the local level and fund-raising for the sake of domestic offices, until quite recently. The accounts in Table 3 show the flow of funds as follows. "Cash and deposits" on the asset side are, despite remarkable growth in the 1980s, still far smaller than "Deposits and CD" on the liabilities side, which constitute the main means to raise funds in the eurocurrency market. At the end of 1990, for example, the difference between these two items amount to 72.3 trillion yen. The balance of call funds (call money minus call loans) shows net borrowing of about 11.5 trillion yen. Aggregating these amounts with "Borrowed money", the scale of net funds for employment was as much as 89.4 trillion yen, part of which flowed back through the inter-office channel to Japan, while the rest was invested in trade related bills, securities and loans. However, to note is that the net flows back to Japan decreased remarkably in 1991, and overseas branches recorded net liabilities of 4 trillion yen to home offices at the end of 1992, suggesting the reversal of the cross-border transactions (discussed later).

In accordance with the main characteristics of the eurocurrency business, Japanese overseas branches raise funds, for the most part, in the interbank market. It is worth noting, however, that Japanese banks were the main growth element in that market in the mid-1980s8/. In the late 1970s, overseas fund raising by Japanese banks concentrated mostly in European markets, and particularly London branches were playing the leading roles. The business in London was not confined to fund-raising, but also employment on longer-terms.

"Transactions in the euro-market are so large that more than half of

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8/ Bank of England, *Quarterly Bulletin*, May 1987, pp. 234, 240.

the total assets of overseas branches concentrates in London, where the acquired funds are employed in syndicated loans etc., as well as transferred to other branches and back to Japan. Next to London, New York branches account for about a quarter of the assets abroad. Moreover, the working profit per branch is greater in New York than in London", reports Kinyu-Seido-Chosakai (1984, p.22).

Branches in New York and other places than London engaged mainly in trade finance and loans to Japanese multinationals settled abroad. During the past decades, however, changes took place in the following way: 1) the trade finance system has been transformed, which naturally influences fund-employment abroad, and 2) loans at overseas branches are no longer limited simply to Japanese firms.

In the euro-market, where the main growth factor had been syndicated loans until the outbreak of the debt problems, the securities business thereafter, gained ground. The same tendency is not difficult to find in the case of Japanese banks. The scale of portfolio investments by foreign branches is far smaller than that of loans (Table 3), because the securities business is mainly carried out through subsidiaries. But portfolio investments expanded in the 1980s, through securities dealings both at home and abroad.

2) Trade Finance

Since the mid-1970s, when Japanese exports were largely (about three quarters) settled on a sight basis, the share of yen denominated exports has been increasing from less than 20% to over 35% in 1985 and nearly 40% in 1991. On the import-side, the noticeable change in the 1980s was the use of demand drafts, and the share of "usance bill finance" (the Japanese naming for trade bill finance) declined. Among the remaining "usance bill finance", the "BC usance" (bills bought at overseas branches of Japanese banks) took the place of "domestic loans" (again Japanese expressions for bills bought at domestic branches). However, the greater part of Japanese import is financed not through bill finance, but through local loans at overseas branches9/.

Among the causes of these changes, the most important is the rising competitiveness of Japanese exporters, since settlements on a sight basis and denominated in yen imply that the interest costs and exchange risks are shifted onto foreign importers. On the other hand, the share of import bill finance declined, because domestic importers gained, through "impact loans" (domestic loans in foreign currency), larger possibilities of borrowing foreign currencies.

It is no wonder that the transformation of trade finance influences the foreign positions of forex banks. The increasing share of yen-denominated export finance is reflected in the currency composition of bills bought, while the growth of shippers' usance lowers the correlation between the total value of exports and the foreign positions of forex banks. The decline of "usance bill finance" on the import side, in particular domestic loans, reduces the amounts of import bills held at home. As is shown in Table 3, the positions of trade-related bills at overseas branches was relatively stagnant and later decreased, which suggests also that loan finance is preferred to "BC usance". As the major part of trade finance is shifting away from bills towards impact loans and/or loans at foreign branches, the division between trade finance and other forms of financial transactions became obscured. The fund transfer from abroad primarily reflects various sorts of demand at home.

3) Foreign Loans (Genchi-gashi)

Foreign loans by Japanese banks used to be mainly offered to Japanese multinationals settled abroad. During the course of the 1970s, Japanese banks

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9/ MOF, *Annual Report of the IFB*, various issues.

began to take part in medium- and long-term syndicated loans. Table 4 shows the trend from the early 1970s. The total amount outstanding stagnated from 1974 until about 1977, reflecting the strict controls on foreign loans (to be discussed later), and got accelerated thereafter.

During this remarkable growth period, the yen increased from less than 20% before 1983 to reaching 45% in 1992. Whereas these yen loans were traditionally undertaken in Japan, euro-yen share, offered abroad and in Japan Offshore Market (JOM) established in 1986, is on a increasing trend after 1984. Dividing the total between the home and overseas offices, we can point out two facts, 1) still larger part is offered abroad, recently reaching more than three-quarters, but 2) the gap between home and overseas decreased, in particular in the mid-1980s, when the home offices supplied more than a third of the total. Since the loans at home largely constitute of yen-lending, this fact may suggest a rise of the Tokyo loan market in a traditional international finance. Although the figure above might include yen-transactions in the Japan Offshore Market, the share of home offices declined thereafter, reaching around 20% in the early 1990s.

As for maturities, the longer term loans grew more remarkably after 1978, but relatively stagnated after the debt crisis through, say, the mid-1980s, partly because the Ministry of Finance (MOF) controlled longer-term loans more strictly than the short-terms. After the debt crisis in Mexico and other Latin-American countries, the medium- and long-term loans were directed mainly towards developed countries, as Table 5-A shows a rapid increase to OECD countries after 1983. But such tendency is not so apparent in yen-lending, which shows a later decline in lending to Latin America and Asian countries and accordingly the share of developing countries are larger than in foreign currencies (Table 5-B).

Last but not least, within the loans to developed countries, the role of host-country-banking is becoming important. Lending in the United States is not confined to Japanese firms, but extended to local borrowers as well. In California, for example, Japanese affiliated banks, through acquisition of local banks, lend increasingly to American firms and consumers10/. In particular recently, business with Japanese customers are apt to be avoided because of small margins, according to a ex-manager of a Japanese bank in the United States.

3. Factors of Growth

3.1 Regulations and Deregulations

Observations from American multinational banks lead to the general conclusion that domestic regulations, on the one hand, and liberal financial market abroad, on the other hand, tend to facilitate the internationalization of banking11/. Japanese case is different in the sense that the governmental intervention reached up to the overseas operations, at least on the initial stage of development.

For Japanese banks, such a motivation as escaping from domestic regulations might be found in several cases, but it is probably not as important as for the Americans. Moveover, since main participants in the euro-yen market are not literally non-residents, but branches and affiliates of Japanese financial institutions, the supervising authority can easily extend regulating power to the euro-markets. One example is the strict control of foreign lending by overseas branches after the first oil crisis and the Three Bureaux Agreement of the MOF over foreign bond issues by Japanese residents (discussed below).

10/ See Kinyu Seido Chosakai (1984, p.25). Although Terrell et al (1990, p.43) argue that lending to firms in the USA are still mainly directed to Japanese affiliates, Fujita (1989, p.237) states that foreign loans extend largely to non-Japanese firms.

11/ For example, Gray and Gray (1981, pp.47-52).

Freedom from authorities was thus limited even overseas.

In the late 1970s, when the international banking developed remarkably in the euro-currency market, Japanese banks remained in the second rank. Indeed in the mid-1970s, Japanese share in London (international liabilities) stood on the third, after American and British (Table 6), but when the eurocurrency market underwent the Herstatt crisis, Japanese banks had difficulties to raise funds and to be imposed higher rates called "Japan Premium". The Ministry of Finance introduced severe controls on foreign lending; prohibiting net increase in short-term loans and new loans in mid- and long-term, from July 1974 to 1977. The Ministry of Finance worried the situation that forex banks increased rapidly foreign short-term liabilities for the payment of oil import, which may deteriorate credibility of Japanese banks12/. And the Japanese foreign loans increased after its deregulations, especially from 1978 onwards. Thus, regulations and their lift largely affected the Japanese foreign lending.

But it is misleading to argue that Japanese government supported the growth of Japanese international banking. Spindler (1984, p.148) stressed that the aggressive participation in the syndicate-loans coincided with foreign currency deposits of the government ("concealed reserves") at forex banks13/, suggesting as though this fund sustained the increased share in euro-syndicate loans. Since the government usually places deposit in the domestic offices in order to assist import finance, it cannot be used for

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12/ The short-term liabilities of forex banks are cross-border transactions by Japanese residents and accordingly its change is reported in the balance of payments statistics (monetary transactions "below the line"), while "out-out" transactions of the overseas branches are conceptually different, not included in the balance of payments statistics. But the market, generally speaking, assesses credibility of a bank from an overall balance sheet, including foreign branches.

13/ For this deposit, see Komiya and Suda (1983a, pp.213-14).

"out-out" finance in the eurocurrency market14/.

Regulations introduced during the two oil crises affected largely on the trade finance pattern. On both occasions, largest deficits in the overall balance ("above the line") were recorded in the first years (1973 and 1979), accompanied by the decrease in official reserves. Enormous payment for oil import increased demand for the dollar and monetary authority heavily intervened in the forex market, in order to prevent yen from large scale depreciation. In the second years (1974 and 1980), on the other hand, the official reserves turned to increase, while forex banks increased short-term liabilities. Thus, trade deficits were finally financed by the foreign borrowing of forex banks, with a certain time-lag.

During the second oil crisis, however, since the authorities did not restrict business in foreign branches, as on the first occasion, both local loans and BC usance recorded increase. Lending at overseas branches was not restricted, because eurocurrency market did not encounter severe times as in the mid-1970s and the relative position of Japanese banks had risen in the mean time. Moreover, the amended Forex Law, following the second oil crisis, smoothed short-term borrowing by the forex banks located in Japan.

The expansion of euro-finance might take the place of the relatively unfavorable domestic finance or the traditional foreign finance. Foreign-currency deposits, impact loans and foreign bond issues are all compensations for domestic finance in the narrow sense. The liberalization of euro-yen transactions since 1984 promoted to expand the share of Japanese banks in the euro-market, on the one hand, and might hinder the growth of yen-denominated foreign finance in the domestic market, on the other hand.

14/ As described above, the overseas branches used to raise funds in the eurocurrency market to flow it back to home offices. In 1978 for example, the inter-office account of the overseas branches shows net asset, in other words net fund inflow to home office, of 273 billion yen. Bank of Japan, *Economic Statistics Annual* 1989.

For example, liberated issues of euro-yen bonds surpassed that of yen-denominated foreign bonds (Samurai-bonds) which had been growing remarkably. Eurobond-issues (equity finance) by Japanese residents also reflect the inflexibilities in the domestic primary market, such as the requirement of collateral, and limits on the issue amounts and maturities15/. Despite the rapid growth of Japanese issues in the euro-bond market, the Three Bureaux Agreement (Sankyoku-gohi) limited the entry of Japanese banks (their subsidiaries for security business) to underwrite as lead-managers, remaining only co-managers with small margins. As a result, the Japanese banks' foreign subsidiaries (branches) increased underwriting of non-Japanese issues and bought large amount of FRN (Floating Rate Notes) issued by foreign banks, which later resulted in large capital loss16/.

Although Japanese banks thus used to remain minor roles in the eurobond market, the fund raising in the euro-currency market, connected with its back-flow to home offices lifted their positions. However, noticeable is the change recently taking place. Since the Three Bureaux Agreement, introduced in 1974, was largely relaxed from the spring of 1993, in accordance with financial deregulation (de-segmentation) in the domestic market, foreign subsidiaries of Japanese banks have been aggressively trying to expand underwriting of Japanese issues as lead-managers17/.

3.2 Relationships with Japanese Firms and Yen-Transactions

The "follow-the leader" type of development is based on the information characteristics of the banking industry. Banks have usually more information

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15/ Kaizuka and Shinohara (1987, pp.157-58). Takeda and Turner (1992, p.75ff). But equity bond issues overseas decreased remarkably in 1991, due to sudden drop of Japanese stock prices. Takeda and Turner (1992, Table 26 and 27).

16/ Bank of England (1987, p.521).

17/ *Nihon Keizai Shimbun*, November 20, 1994 (evening edition).

on the domestic customers and therefore business with them is a rational option to reduce risks. For the late-starter particularly, relationships with domestic customers are more important, due to lack of experiences with foreign borrowers, unfamiliar business customs, and less popularity in the international market. This disadvantage is naturally far greater at the beginning of internationalization. In this sense, it is no wonder that Japanese banks have had strong ties with Japanese firms.

> "Overseas branches of Japanese financial institution tend to concentrate on the particular areas where Japanese firms are densely located, or international financial markets where fund raising is not difficult. Consequently they compete with each other mainly for the financing of Japanese firms in those concentrated areas, often not paying enough attention to profitability." (Kinyu-Kenkyukai, 1979, p.23).

This quotation implies that the competition among Japanese banks is apt to be not solely for the sake of profitability. If transactions are mostly limited to Japanese firms, the competition for this limited number of customers is naturally apt to be keen. The above quoted report also publishes results of an inquiry, asking what element is the most important in choosing among financial institutions abroad. When Japanese firms select any banks other than the specialized foreign exchange bank (the Bank of Tokyo), the frequent answer is "the bank with the largest transactions in Japan"18/, suggesting that the relationships developed through domestic finance play an important role even in international business, or at least to say, the firms are conscious of such relationships. Under the tendency of "Ginko Banare" (away from banks), excessive service might be inevitable in order to hold the traditional financial relationships. But since the low profitability is not solely peculiar in banking, but common in other industries in Japan, we will

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18/ Kinyu Kenkyukai (1979, p.257).

discuss this problem below.

We can conclude that the rapid increase in Japanese banks' share is tightly related to business with Japanese customers. One example: until recently, fund-raising of Japanese banks led to rapid increase in their share within the London market, which caused warning against Japanese banks, as well known. Fund flows from overseas branches back to Japan, were partly employed for foreign currency loans and/or foreign portfolio investments by institutional investors.

Another example is the increased share of Japanese banks in "impact loans". Until 1980, only foreign banks were authorized to provide medium and long-term impact loans. Thereafter, this regulation was relaxed to allow for participation by Japanese banks. Short-term loans were, on the other hand, open to both foreign and Japanese banks since June 1979. Under the amended Forex Law, every type of impact loans is in principle "liberalized". Thus the business of impact loans was a newly established domain for Japanese banks. Nevertheless its growth is remarkable, by the mid-1980 particularly, Japanese banks occupied around 90% of the medium- and long-term loans (Iwami, 1989, Table 5), which had been monopolized by foreign banks. As far as the borrowers employ the funds thus acquired in trade finance, this is a modified type of traditional bank-customer relation in Japan.

Next question is the influence of currency denomination on competitiveness. As yen-denominated international finance develops, the business of Japanese banks is surely promoted. Yen transactions, such as trade finance, have, for the most part, Japanese firms as either creditors or debtors, which naturally give Japanese banks an advantage. The advantages in currency denomination is thus inseparable from those of customers' nationalities.

The reason why American banks have a comparative advantage in U.S. dollar business was pointed out as follows. 1) They have far better access to domestic dollar funds. When the euro-dollar interest rate is higher than in the U.S. markets, they have possibilities for raising cheaper funds at home. 2) In case of financial turmoil or a liquidity crisis in the euro-dollar market, they have recourse to domestic funds, in a extreme case, they can depend on "the lender of last resort" function of the Federal Reserve Board (Goodman, 1984, pp.682-83). Can we apply these explanations to Japanese banks?

Japanese banks have indeed easier access to domestic yen-funds, but this advantage has been largely reduced through liberalization and internationalization of the financial system, because foreign banks can either freely convert their own currency funds into yen or borrow in the euro-yen market. Moreover, interest rates in Japanese domestic markets and euro-yen markets are easily equalized through arbitrage transactions. The gap in fund rasing costs is, if any thing, quite small19/. As for the second explanation, the access to yen-funds is not so important in the case of an international financial disturbance. The greater the difficulties are, the more preferred is the currency that is "strong in an emergency", i.e. the U.S. dollar. The above reasons do not hold good for Japanese banks. If Japanese banks perform better in euro-yen business, apart from euro-finance in general, the main reason is probably that this business is for the moment only a minor part of international finance distinct from the major areas of keen competition among foreign banks.

The wide use of the D-Mark in international trade rather restrict than promote expanding foreign branch network by German banks, as discussed above. Despite decreasing share of national currency in short-term borrowing and long-term lending, they still largely engage in foreign transactions with the D-Mark, which is a striking contrast to the Japanese case (Tables 7 and 8).

19/ Aliber (1984. pp.669-70) emphasizes that the differences in fund raising costs are at the basis of the competitiveness in international banking.

The Bundesbank (1986, p.34) stated three causes for the relative stagnation of German international banking: 1) the consideration of profitability, 2) deregulated domestic market lowers the necessity for banks to go abroad, 3) the monetary authority was reluctant to allow new financial products, until 1985. Although the third factor is found not only in German, but also in Japan, restriction on new financial products may have hindered German "universal banking" to realize their potential advantages. For the second point, however, German financial system does not seem to have been more liberalized than Japanese20/. Comparison with German banks shows that the internationalization of the currency does not necessarily lead to the growth in international banking. That Japanese banks expanded their share despite limited internationalization of yen, leads to discussions on the first factor, profitability.

3.3 Low Profitability or Low Cost?

Having examined several factors which might influence banking opportunities, but nothing has more importance than the nationality of the customers. Then, what is the basis of the competitiveness in business with non-Japanese, mainly undertaken in euro-markets? The possible answer would be low spreads, which have been a matter of much argument concerning Japanese international banking. No one could deny that in the 1970s and 1980s, this factor was one of the most prominent characteristics.

The first reason for low profitability lies in the nature of finance and banking industry, which requires credibility based on experiences, or long-term relations. In addition, "economies of scale and scope" constitute

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20/ See Iwami (1994).

barriers to enter21/. Secondly, "follow-the leader" pattern of development leads to business concentration by those banks of countries with competitive industries. For banks of late-starter, sale at low price is a rational strategy to enter the market. But even after the Japanese banks acquired larger share, their strategy does not show a clear change.

To our regret, the data on international business, especially its profitability, are quite unsatisfactory. Figure 1 shows the profitability of both international and overall business. Unfortunately, basic data for estimating the international assets is lacking from 1986 onwards. Despite lower profit rate, the profit share of international business in total increased, because banks shifted larger part of assets to international domain22/.

However, according to some bankers, the profits acquired from international business have been, for the past several years, highly evaluated in view of the unfavorable domestic business. The growth in assets (not only international, but also domestic) began to be decelerated from around 1989, mainly because of the Basle capiatl adequacy guidelines. This regulation itself was introduced in order to put a brake on the aggressive entry of Japanese banks. Since capital gains of financial assets are included in the equity part, accepting demand from Japanese side, the sudden decline of stock prices increasingly took effect. To raise profits with smaller assets, banks cut off less profitable business, naturally including international business23/.

Researchers attribute the growth of Japanese banks to low cost of capital rather than low profitability24/. The problem is how to measure cost of

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21/ Aliber (1991, pp.187-190) stresses these characteristics, but excludes international banking, since there is no regulation to enter. However, if "economies of scale and scope" actually exist, this effect would be found in international market as well.

22/ For the estimating method, see Iwami (1989).

23/ This is more or less a general tendency among major banks of developed countries, Bank of England (1992).

24/ Aliber (1991, pp.196-97), Takeda and Turner (1992, p.93). For a survey of discussions on the capital cost in Japan, see Frankel (1991).

capital. A conventional way is the weighted average of the borrowing and equity cost. When the cost of capital is defined as the expected profit over the unit of stock at current price, as Zimmer and McCauley (1991, pp.34-35), then low cost of capital leads to the similar argument as the low profitability in terms of total assets, the mere difference is the selection of numerator, whether expected or realized profit, and denominator, whether stock capital or total assets. Formalizing the situation that competition through low prices (spreads) are possible, because the share holders do not regard rate of return seriously, this is a well known characteristics of Japanese firms. Whatever the result of estimating capital cost, the low profitability undoubtedly promoted Japanese banks' growth overseas, from reasons below.

Firstly, overseas branches of Japanese banks undertake business with funds raised mainly in the international market, where the cost of borrowing is similar to the banks of most developed countries25/. Even if cost of borrowing or equity would be low in Japan, overseas branches used to send funds back to home offices, as the net cross-border flow between them indicated. As far as foreign lending by Japanese home office is in foreign currency (dollars), low cost does not hold.

Secondly, to the extent that the foreign lending is provided with the cheap yen fund, the cost advantages benefit banks in Japan. But this advantages could be equally attributed to (Japanese branches of) foreign banks, and as discussed above, increased scale of arbitrage transactions tend to reduce differentials in fund-raising cost among major financial markets.

Recently, the fall of stock prices actually had depressing effect on Japanese international banking, but it is because of the Basle capital adequacy regulation rather than direct effect of the increased capital cost.

25/ Zimmer and McCauley (1991, p.35).

4. The International Financial Intermediation

Up to now we have not spoken of the possibility that the surplus on Japanese current accounts might cause an expansion of international banking. Because the surplus on current accounts is a result of an excess in domestic saving (saving minus investment), such deposits at banks as are not employed internally, would be forced to flow outward over the borders. If this causality exists, the growth of Japanese international banking is facilitated by the internal pressure of excess saving. Does this kind of reasoning really hold good?

First, looking at Japanese capital accounts, we find that long-term capital flows in the opposite direction to short-term capital. In the 1980s, the net outflow of long-term capital was increasing, while short-term capital transactions on private accounts (in particular, net foreign positions of forex banks) was negatively growing since 1984. These two facts imply that banks performed maturity transformation through net foreign positions of "borrowing short and lending long" and that they did not passively act as agents of one-sided capital outflows26/.

Second, the international business of Japanese banks is not only composed of the "cross-boarder" transactions shown in the balance of payments statistics, the greater part is in the domain of the overseas branches, for the most part, "out-out" transactions. Thus the rapid growth of international banking should not be considered as an automatic result of the surplus on current accounts, rather, it is facilitated by the active efforts of banks to enlarge their business possibilities.

To overview the movement of Japanese capital account, let's begin with the

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26/ Teranishi (1987, pp.172-6). Table 9 and 10 tell that this function appeared at the latest from the early 1970s an.

long-term capital transactions. In the 1980s, both the inflow and outflow increased, but the increase in inflow was more remarkable, reflecting the fact that the inflow had been more strictly regulated shortly before the amended Forex Law of 1980 27/. Of the long-term capital outflows, the greater part consisted of FDI and loans until around 1983, and thereafter portfolio investments took the lead (Table 9).

The portfolio investments were promoted by the growing pension fund of life insurance companies and trust account of banks (Table 11). Their foreign investments grew rapidly, after the upper limit on this amount was lifted successively from 1986 on. Between 1981 and 1985, against the background of the yen depreciation, Japanese government had restricted capital outflows (portfolio investments) despite the amended Forex Law. The institutional investors were accordingly obliged to buy foreign currency bonds issued by Japanese firms (Sushi Bonds) and to deposit in foreign currency 28/. In 1986, when this upper bound restriction of foreign portfolio was relaxed, they naturally enlarged portfolio investments in U.S. Bonds with higher returns.

Japanese banks, on the banking account, engaged in portfolio investments in larger scale than the life insurance companies until 1987. However, banks could not directly employ domestic deposits in foreign assets, due to regulations on net foreign exchange holdings 29/, and had to raise funds in foreign currency for investment, in other words "out-out" investments. Even without this regulation, the principle of holding "square positions" of

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27/ To counterbalance the yen appreciation before the second oil crisis, the Japanese government had restricted inflow and promoted outflow of capital.

28/ For the regulations and their reforms, see Fukao (1989). Kawai and Teruyama (1991) analyzed the behavior of institutional investors.

29/ Since regulations on the spot exchange holding was lifted in July 1984, the net sum of spot and forward exchange amount is limited. Currently (August 1993), forex banks should not "hold the total net foreign exchange exposure of more than 1 million U.S. dollars, at the end of each working day". MOF, *the 17th IFB Annual Report*, 1993, p.102.

foreign exchange would make the behavior of banks different from other institutional "yen-investors".

The increase in portfolio investments commenced from the early 1984, when the regulations on the upper bound of foreign portfolio still existed, and continued to grow until the first half of 1987, despite the depreciation of the dollar. Banks, at first on banking account and then on trust account, took the initiative in the earlier phase, while the life insurance occupied major share in increase from 1986 to 1988, along with the deregulation of the foreign investments. To note is the fact that the depreciation of the dollar had already commenced from 1985, before the above deregulation was introduced.

Why did institutional investors continue to buy U.S. Federal Bonds despite the decline of the dollar exchange rate? How did they expect the mid-term trend of yen/dollar exchange rate and the return of the U.S. Bonds? As is well known, the life insurance companies thereafter suffered from large capital loss, due to dollar depreciation. We have to note that unless institutional investors had strong incentives for foreign investments, deregulation could not have promoted large scale outflows of capital. Moreover, deregulation may have been rather a result than a cause30/.

One explanation goes as follows. The Insurance Law determines a policy of life insurance companies to pay dividends solely from investment income and not from capital gains. Because of this regulation, the pressure for competition with other financial institutions forced life insurance companies to acquire U.S. Bonds with higher interest rates. The capital loss resulted from dollar depreciation could be compensated from capital gains in domestic

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30/ It reminds us of the debate on "Pillenknick" in the former West Germany. People conventionally explained that the birth rate declined because the contraception pills were introduced. But the pills would not have caused slower birth rate, if women had no incentives to take them. There were other reasons for women to avoid pregnancy and having children, and the liberalization of pills was the result of these factors, stressed feminists.

stocks31/.

The second explanation is the discretionary guidance by the Ministry of Finance which put priority on the U.S.- Japan relation, and worried about the hard landing scenario of the dollar depreciation. The institutional investors expected potential gains (favorable treatment, for example) from obediently following the MOF guidance. The third answer is the portfolio diversification. The former restrictions had prohibited financial institutions to pursue a long-term strategy of investing a certain proportion in foreign securities32/.

For the first explanation, the problem is how to assess the investors' expectation on the dollar exchange rate and domestic stock prices, and the required length of time horizon for investment. The *ex post* explanation is not always the same as the *ex ante* motive on the part of the investors. Assuming that the portfolio adjustments take a certain time, the third as well explains the time lag between the depreciation of the dollar and the trend of investment. But it is still questionable whether the actual time lag corresponds to the period necessary for the portfolio adjustments. The Japanese investors, including financial institutions as well, do not always follow a rational strategy as financial economics would imply. According to a financial manager of a life insurance company33/, they did not have "a systematic principle" of investment and eagerly wanted an outlet for their ever growing money provided by the pension funds and households. And this fact is not inconsistent with the second explanation above.

The short-term capital account are composed of trade finance, loans (within one year), and portfolio investments (Gensaki, for example). In Japanese

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31/ Okina(1990), Kawai and Teruyama (1991, p.170).

32/ For example, Frankel (1989, p.224ff).

33/ Interview on June 23, 1992. Moreover, life insurance companies were not allowed to have enough means to hedge. Kawai and Teruyama (1991, pp.207-08).

balance of payment statistics, changes in international positions of forex banks are excluded from the short-term account, separately reported in the monetary movements, on the assumption that forex banks, along with monetary authorities, passively take part in the balance of payment adjustment. But since the limit on the "yen-conversion" was relaxed in 1980 and finally lifted in 1984, forex banks actively pursue arbitrage transactions in terms of interest rate differentials and exchange rate changes.

Including changes in positions of forex banks in the short-term capital account in the broader sense, Japanese balance of payments showed until quite recently characteristics of "borrowing short and lending long", which corresponds to the financial intermediation hypothesis. While "the minority view" on the American balance of payments in the 1960s had short-comings in underestimating credibility problem of the dollar overhang, it is true that the key-currency country has liquid liabilities on the one hand, and long-term assets, on the other hand34/. However, the most important difference from the major creditor countries in the past (Britain before the World War I and the United States in the post-World War II period) is whether or not the national currency of the creditor country is used35/.

The "borrowing short" was caused by the 1) mid-and long-term foreign lending, 2) domestic impact loans, and 3) investment in the United States, of these three the last was the main cause in the 1980s. Then, comes out another ques-

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34/ This aspect is stressed by "the minority view" of Despres, Kindleberger and Salant (1966). While the key-currency country holds liquid liabilities to the rest of the world, it has also liquid assets in the form of trade finance etc. Therefore, its net international liquid position is not necessarily negative. Britain before the World War I, for example, is thought to have square positions on the average over the business cycles. Bloomfield (1963, pp.73-4).

35/ Tavlas and Ozeki (1992, pp.17-30) defines the function of a "World Banker" as international financial intermediation with its own currency, and argues that Japan is not yet arrived at this stage. Nakao (1991) named Japanese international finance as the "Matagashi Taikoku (Intermediary Financial Power)", with almost similar implication.

tion, why Japanese banks borrowed in foreign currency (dollars), in stead of buying dollars in the foreign exchange market with the yen-fund (domestic deposits) ?

If investors buy dollars for final investment, with the yen-fund in the foreign exchange market, they cannot avoid exposures to currency risk. In Japan, the largest investors (life insurance companies) and the supplier of the dollar (forex banks) are separated. Because the Ministry of Finance restricted insurance companies to borrow in dollars, thereby hedging against currency risk, and the forex banks, on their part, are limited to have net foreign exchange exposure over a certain amount. To the extent that banks invest in foreign portfolios on their own accounts, borrowing is a rational means of not only hedging, but following the MOF guidance. Over the amount of their own foreign investments, they have two options, whether to borrow in dollars or buy in the foreign exchange market, since restrictions on foreign exchange transactions were largely relaxed. Their decision on this option depends on the expected change in the dollar exchange rate, interest differentials and the transaction cost.

From 1988 on, the fund inflow to forex banks decreased, and the short-term capital account in the broader sense (including net foreign positions of forex banks) showed net outflow in 1991, when the long-term capital account registered surplus (Table 9 and 10). Foreign investors increased purchase of Japanese bonds and stocks, while Japanese banks reduced short-term liabilities. The foreigners invested in Japan, anticipating that unusually low level of Japanese security prices and yen exchange rate would rise, while forex banks could reduce short-term liabilities, reflecting their efforts to decrease international assets. The characteristics of Japanese capital account seen from the early 1970s onwards, "borrowing short and lending long", was not something "structural", but could be modified relatively in a short time through the price mechanism. In a similar way, if the Japanese security prices and yen exchange rate turn to be too high, then "borrowing short and lending long" reappear, in fact, the long-term capital account reports net outflow in 1992 and 1993. The "borrowing short" in dollars will increase again as far as the transaction cost in dollar remains to be lower in dollar than in yen.

5. Concluding Remarks

The Japanese international banking is characterized as a late-starter and rapid growth. In the post-war years, the demand from Japanese firms promoted international business of banks, in the form of trade finance and foreign loans. From the 1980s on, the financial arbitrage transactions apart from those based on real transactions gained ground, but behind this change, we have to note that the financial service demanded by Japanese firms and institutional investors largely enlarged the business opportunities for Japanese banks, thereby enhancing anxiety on the part of Anglo- American financial world. The competition through low-prices is one of the necessary business strategies for a late-starter, not confined to banking industry.

The internationalization of banking can be stimulated when the domestic financial market and/or currency are not widely used internationally. The best example is the foreign branch building by Japanese banks in the post war years. As the surplus in current account grows and regulations on cross border financial business are relaxed and finally lifted, the international business is further promoted. But the international finance in yen has still disadvantages compared with the dollar, as the "in-out" capital transactions are related to investment in the United States.

Now, Japan is facing to rapid aging process, and another side of the coin might be the decreasing competitiveness. Nevertheless, if the aged society still succeeds in keeping competitiveness, then net saving, or surplus in current account, will raise the international position of the Japanese financial market and yen. Then in the long-run, both the "lending long" and "borrowing short" may be carried out in yen. Possibilities for this scenario are discussed in Iwami (1994).

Table 1 Overseas expansion of Japanese Financial institutions

(branch, subsidiary, offices)

Banks

Year	1950-55	1956-60	1961-65	1966-70	1971-75	1976-80	1981-85	1986-90
branch	13	15	19	8	46	37	53	127
subsidiary	3	1	1	3	36	33	84	130
office	4	5	9	17	106	97	217	170
total	20	21	29	28	188	167	354	427

Security Houses

Year	1950-59	1960-65	1966-70	1971-75	1976-80	1981-85	1986-90
branch	--	--	4	9	6	1	--
subsidiary	--	4	4	20	18	22	53
office	--	--	5	15	20	46	63
total	--	4	13	44	44	69	116

Source: MOF, *Annual Report of IFB*, various issues.

Table 2 Overseas expansion of banks

	United States			Germany		
Year	number of branches	assets 100 mil.$		number of branches	assets 100 mil.DM	100 mil.$
1960	131	35		3	-	
1965	211	91	-	-	-	
1970	536	526	-	5	-	
1975	762	1759	1765	34	240	93
1980	787*	3105*	4011	74	949	522
1985	916*	2897*	4580	99	1951	623
1987	868*	3420*	5186	102	2276	1266
1988	849*	2750*	5058	108	2780	1583
1989	819*	2640*	5454	118	2971	1580
1990	n.a.	n.a.	5569	128	3568	2208
1991	n.a.	n.a.	5489	128	3998	2407
1992	n.a.	n.a.	5425	146	4701	2902

	Japan		
Year	number of branches	assets 10 bil.yen	100 mil.$
1955	15	-	-
1960	31	-	-
1965	50	-	-
1970	58		
1975	101	1431	482
1980	139	3843	1695
1985	189	12018	5038
1987	226	13216	9140

1988	250	14013	11034
1989	272	17558	13506
1990	304	19022	12681
1991	327	16293	12068
1992	345	14993	12028

Note:* federal reserve member banks only. Assets are calculated with exchange rates at year end.

Source: Yannopoulos (1983, Table 3), Neumann (1986, Table 2), Deutsche Bundesbank (1988). Deutsche Bundesbank, *Monthly Report*. Kinyu-Kenkyukai, *Kongo ni okeru wagakuni no kinyu kikan no arikata*(1978, p.182), BOJ, *Economic Statistics Annual*, *Federal Reserve Bulletin*, *Statistical Abstract of the United States*.

Table 3 Principal Accounts at Overseas Branches of All Banks

(year end, 10 billion yen)

Assets

year	Cash Deposits	Call loans	Securities	Trade bills	Loans	Inter offices
1976	290	60	26	215	381	212
1980	1432	285	89	346	1090	240
1985	4984	366	906	459	2821	968
1990	6823	366	1032	376	7509	240
1991	5311	201	856	291	7346	6
1992	4618	176	762	270	7232	-

Liabilities

year	Deposits CD	Borrowed Money etc.	Call Money	Acceptance Guarantee	Inter offices	total
1976	845	219	273	216	21	1431
1980	2691	231	537	279	22	3843
1985	8927	750	801	1399	6	12018
1990	14057	560	1511	2252	-	19022
1991	12251	481	1156	1899	-	16293
1992	11097	534	830	1560	402	14993

Source: BOJ, *Economic Statistics Annual*, various issues

Table 4 Foreign loans by Foreign Exchange Banks

(year end, billion dollars)

Year	foreign currencies	yen*	euro-yen**	total*
1973	13.3(100)	-		13.3(100)
1974	16.6(99.4)	0.1(0.6)		16.7(100)
1975	17.8(98.9)	0.2(1.1)		18.0(100)
1976	17.4(98.3)	0.3(1.7)		17.7(100)
1977	18.3(96.8)	0.6(3.2)		18.9(100)
1978	30.0(88.5)	3.9(11.5)		33.9(100)
1979	43.6(82.6)	9.2(17.4)		52.8(100)
1980	54.9(85.8)	9.1(14.2)		64.0(100)
1981	74.3(84.5)	13.6(15.5)		87.9(100)
1982	92.6(85.7)	15.5(14.3)		108.1(100)
1983	102.6(83.3)	20.6(16.7)	0.8(0.6)	123.2(100)
1984	123.0(79.7)	31.4(20.3)	2.4(1.6)	154.4(100)
1985	134.4(76.5)	41.2(23.5)	6.0(3.4)	175.6(100)
1986	169.1(69.0)	75.9(31.0)	18.7(7.6)	245.0(100)
1987	218.2(61.6)	136.3(38.4)	55.9(15.8)	354.5(100)
1988	275.5(59.9)	184.8(40.1)	85.1(18.5)	460.3(100)
1989	337.3(58.4)	240.5(41.6)	132.2(22.9)	577.8(100)
1990	392.8(59.5)	267.0(40.5)	173.2(26.3)	659.8(100)
1991	399.7(56.0)	313.7(44.0)	212.2(29.7)	713.4(100)
1992	403.9(54.9)	331.5(45.1)	237.7(32.3)	735.4(100)

Year	short -term	mid-long -term	domestic branches	overseas branches
1973	6.0(45.1)	7.3(54.9)		
1974	8.0(47.9)	8.7(52.1)		
1975	9.1(50.1)	8.9(49.4)		
1976	9.2(52.0)	8.5(48.0)	5.3(29.9)	12.4(70.1)
1977	9.4(49.7)	9.5(50.3)	5.0(26.5)	13.9(73.5)
1978	12.0(35.4)	21.9(64.6)	9.4(27.7)	24.5(72.3)
1979	15.1(28.6)	37.7(71.4)	9.8(18.6)	43.0(81.4)
1980	22.9(35.8)	41.1(64.2)	19.0(29.7)	45.0(70.3)
1981	34.6(39.4)	53.3(60.6)	18.3(20.8)	69.6(79.2)
1982	41.0(37.9)	67.1(62.1)	23.9(22.1)	84.2(77.9)
1983	45.6(37.0)	77.6(63.0)	30.8(25.0)	92.4(75.0)
1984	60.0(38.9)	94.4(61.1)	38.4(24.9)	116.0(75.1)
1985	67.7(38.6)	107.9(61.4)	64.5(36.7)	111.1(63.3)
1986	92.8(37.9)	152.2(62.1)	86.2(35.2)	158.8(64.8)
1987	141.0(39.8)	213.5(60.2)	125.7(35.5)	228.8(64.5)
1988	174.8(38.0)	285.5(62.0)	139.9(30.4)	320.4(69.6)
1989	252.3(43.7)	325.5(56.3)	128.9(22.3)	448.9(77.7)
1990	287.0(43.5)	372.8(56.5)	159.2(24.1)	500.6(75.9)
1991	332.3(46.6)	381.1(53.4)	169.2(23.7)	544.2(76.3)
1992	356.6(48.5)	378.8(51.5)	155.2(21.1)	580.2(78.9)

Note: * including euro-yen. ** sum of loans to residents and to non-residents. Yen loans are converted into dollar with exchange rates at the year ends. Short-term loans are calculated as total minus mid- and long-term loans, domestic loans as total minus overseas loans, respectively.

Source: MOF, *Annual Report of the International Finance Bureau*, BOJ, *Economic Statistic Annual.*

Table 5-A Mid- and Long-term Loans in Foreign Currencies

(100 million dollars, year end)

	1983	1986	1990	1992	1992 / 1983
International Organization	9 (1.5)	14 (1.5)	13 (0.5)	11 (0.4)	1.22
OECD	229 (39.1)	422 (44.5)	1922 (74.0)	1982 (71.8)	8.66
East Europe	33 (5.6)	78 (8.2)	77 (3.0)	64 (2.3)	1.94
Latin America	218 (37.2)	282 (29.7)	214 (8.2)	238 (8.6)	1.09
Asia	73 (12.5)	118 (12.4)	328 (12.6)	399 (14.4)	5.47
Mid-Near East	3 (0.5)	8 (0.8)	11 (0.4)	28 (1.0)	9.33
Africa	19 (3.2)	26 (2.7)	29 (1.1)	31 (1.1)	1.63
Others	1 (0.2)	1 (0.1)	5 (0.2)	9 (0.3)	9.00
Total	586 (100)	948 (100)	2599 (100)	2762 (100)	4.71

Source: MOF, *Annual Report of the International Finance Bureau*, various issues.

Table 5-B Mid- and Long-term Loans in Yen*

(100 million dollars, year end)

	1983	1986	1990	1992	1992 / 1983
International Organization	1230 (24.9)	1845 (17.4)	2307 (15.3)	2119 (16.6)	1.72
OECD	1311 (26.5)	4026 (37.9)	8016 (53.1)	6698 (52.4)	5.11
East Europe	392 (7.9)	676 (6.4)	482 (3.2)	407 (3.2)	1.04
Latin America	494 (10.0)	1586 (14.9)	1460 (9.7)	1280 (10.0)	2.59
Asia	625 (12.6)	1931 (18.2)	2393 (15.9)	1922 (15.0)	3.08
Mid-Near East	29 (0.6)	18 (0.2)	20 (0.1)	14 (0.1)	0.48
Africa	409 (8.3)	525 (4.9)	384 (2.5)	315 (2.5)	0.77
Others	1 (-)	13 (0.1)	28 (0.2)	31 (0.2)	31.00
Total	4941 (100)	10619 (100)	15090 (100)	12786 (100)	2.59

*including euro-yen. Source: MOF, *Annual Report of the International Finance Bureau*, various issues.

Table 6 International Liabilities of Banks in London,

(Share of Nationalities, %)

Year	U.S.	U.K.	Japan	Others	Consortium	London's share*
1975	38	21	13	23	6	29.3
1976	37	20	13	25	6	26.9
1977	35	21	12	27	6	25.6
1978	32	21	13	28	6	24.7
1979	29	23	16	27	5	25.6
1980	25	23	20	27	5	26.4
1981	22	23	23	29	4	26.3
1982	22	22	25	28	4	26.2
1983	21	22	26	29	3	25.2
1984	18	20	29	30	3	24.3
1985	16	19	31	31	3	23.7

Source: Bank of England, *Quarterly Bulletin*, September 1986, Table D and G.

Note: * share in world total of international loans.

Table 7 German Financial Institutions: foreign assets and liabilities.

(billion DM)

Short-term

	Assets			Liabilities		
year	total	DM	share(%)	total	DM	share(%)
1968	15.4	7.7	50.0	15.1	12.8	84.8
1973	26.2	11.4	43.5	33.9	18.3	54.0
1978	47.2	19.8	41.9	69.6	42.4	60.9
1983	67.2	35.3	52.5	85.9	47.7	55.5
1987	180.3	119.9	66.5	106.2	56.3	53.0

Long-term

	Assets			Liabilities		
year	total	DM	share(%)	total	DM	share(%)
1968	16.1	15.8	98.1	2.1	1.2	57.1
1973	27.4	26.0	94.9	9.3	5.4	58.1
1978	80.9	74.6	92.2	38.6	28.9	74.9
1983	126.1	111.1	88.1	70.3	48.1	68.4
1987	165.9	146.0	88.0	96.8	67.6	69.8

Source: Deutsche Bundesbank (1988, p.300), *Monthly Report*, various issues.

Table 8 Japanese Forex Banks: Foreign Assets and Liabilities

(year end, billion dollars)

	mid- and long-term			short-term					
	loans			assets			liabilities		
year	total	yen*	share(%)	total	yen	share(%)	total	yen	share(%)
1973	7.3	-	-	10.0	0.4	4.0	13.5	0.6	4.7
1978	21.9	4.5	20.5	21.4	1.9	8.9	36.7	7.2	19.6
1983	77.6	21.5	27.7	72.1	8.6	11.9	107.3	13.7	12.8
1987	213.5	106.6	49.9	320.2	157.5	49.2	530.1	180.6	34.1
1989	325.5	109.1	33.5	627.8	308.5	49.1	894.6	318.4	35.6
1991	381.1	115.3	30.2	640.8	339.0	52.9	803.5	248.5	30.9
1992	378.8	93.8	24.8	599.9	336.8	56.1	684.7	185.1	27.0

Source: MOF, *Annual Report of the international finance Bureau*, BOJ, *Economic Statistics Annual*.

Note: * including euro-yen, converted with exchange rates at the year-end.

Table 9 Long-term Capital Balance (billion dollars)

Year	FDI	Trade finance	Loans	Portfolio Stocks	Bonds*	Capital Outflow	Inflow	balance
1970	-0.26	-0.78	-0.55	0.19		2.03	0.44	-1.59
1971	-0.15	-0.86	-0.57	0.75		2.23	1.15	-1.08
1972	-0.55	-0.31	-1.88	-0.49		5.02	0.53	-4.49
1973	-1.95	-1.06	-3.35	-2.58		8.47	-1.28	-9.75
1974	-1.81	-0.68	-1.37	-0.93		4.06	0.18	-3.88
1975	-1.54	-0.06	-1.13	2.73		3.39	3.12	-0.27
1976	-1.88	-0.57	-1.20	-0.11	-3.07	4.56	3.58	-0.98
1977	-1.63	-1.40	-0.79	-0.79	-1.41	5.25	2.06	-3.18
1978	-2.36	-0.16	-6.31	-0.93	-1.89	14.87	2.48	-12.39
1979	-2.66	-1.26	-8.27	-0.25	-1.35	16.29	3.32	-12.98
1980	-2.11	-0.74	-2.78	-6.76	-2.60	10.82	13.14	2.32
1981	-4.70	-2.75	-5.27	-5.68	-1.23	22.81	13.13	-9.67
1982	-4.10	-3.25	-8.08	-2.40	-0.29	27.42	12.45	-14.97
1983	-3.19	-2.58	-8.47	-5.47	-7.35	32.46	14.76	-17.70
1984	-5.98	-4.93	-12.00	-3.66	-19.94	56.78	7.12	-49.65
1985	-5.81	-2.79	-10.51	-1.67	-41.37	81.82	17.27	-64.54
1986	-14.25	-1.88	-9.31	-22.81	-78.63	132.10	0.63	-131.46
1987	-18.35	-0.54	-16.31	-59.71	-34.13	132.83	-3.70	-136.53
1988	-34.70	-6.96	-15.29	3.82	-70.47	149.88	18.95	-130.93
1989	-45.18	-4.01	-4.68	-10.89	-17.15	192.12	102.87	-89.25
1990	-46.27	0.69	16.93	-19.53	14.50	120.77	77.18	-43.59
1991	-29.80	4.38	24.59	43.20	-2.23	121.88	158.50	36.63
1992	-14.49	5.29	8.28	11.74	-37.93	57.96	29.50	-28.46
1993**	-9.12	4.57	-3.00	7.19	-35.07	27.33	-7.57	-34.90

Note: minus means net outflows. * including foreign bonds (yen denominated etc.), ** through September.

Source: BOJ, *Economic Statistic Annual, Balance of Payments Statistics Monthly*.

Table 10 Balance of short-term capital and monetary movements

(billion dollars)

	short-term capital (I)				monetary movements	short-term capital(II)	changes in international
	trade		portfolio	(1)	(2)	(1)+(2)	reserves
Year	finance	loans	investments	sum	forex banks	total	
1970	0.66	-	-	0.72	-0.37	0.35	(a)0.90
1971	2.32	-	-	2.44	2.53	4.97	(b)10.84
1972	1.91	-	-	1.97	-1.98	-0.01	(c)3.13
1973	2.56	-	-	2.41	3.97	6.38	-6.11
1974	1.26	-	0.24	1.78	8.20	9.98	1.27
1975	-1.02	-	0.00	-1.14	1.88	0.74	-0.70
1976	0.01	-	0.00	0.11	0.62	0.73	3.79
1977	-0.81	-	-0.03	-0.65	-1.68	-2.33	6.24
1978	1.32	-	0.01	1.54	2.24	3.78	10.17
1979	2.49	-	-0.03	2.74	4.02	6.76	-12.69
1980	2.07	0.02	0.28	3.14	13.14	16.28	4.91
1981	-1.40	0.06	3.40	2.27	6.39	8.66	3.17
1982	-0.22	0.16	-1.43	-1.58	0.04	-1.54	-5.14
1983	0.35	-0.05	-0.70	0.02	-3.57	-3.55	1.23
1984	-2.11	0.29	-3.38	-4.30	17.56	13.26	1.82
1985	-1.37	-0.12	0.53	-0.94	10.85	9.91	0.20
1986	-1.46	3.87	-3.70	-1.61	58.51	56.90	15.73
1987	-0.24	27.37	-3.24	23.87	71.80	95.67	39.24
1988	-0.83	16.90	1.90	19.52	44.46	63.98	16.18
1989	-2.52	26.00	-3.30	20.83	8.59	29.42	-12.77
1990	0.95	29.59	-6.29	21.47	-13.63	7.84	-7.84
1991	-1.54	-14.22	-9.43	-25.76	-93.45	-119.21	-8.07

1992	-0.95	-3.07	0.63	-7.04	-73.00	-80.04	-0.30
1993*	-0.10	-6.74	-5.10	-10.98	-28.95	-39.93	27.08

Note: for (2), plus means increase, and minus means decrease in net foreign liabilities of forex banks. (a) including SDR (122 million dollars), (b) including SDR (128 million dollars), (c) including SDR (160 million dollars). * through September.

Source: BOJ, *Monthly Statistic of Balance of Payments*, various issues.

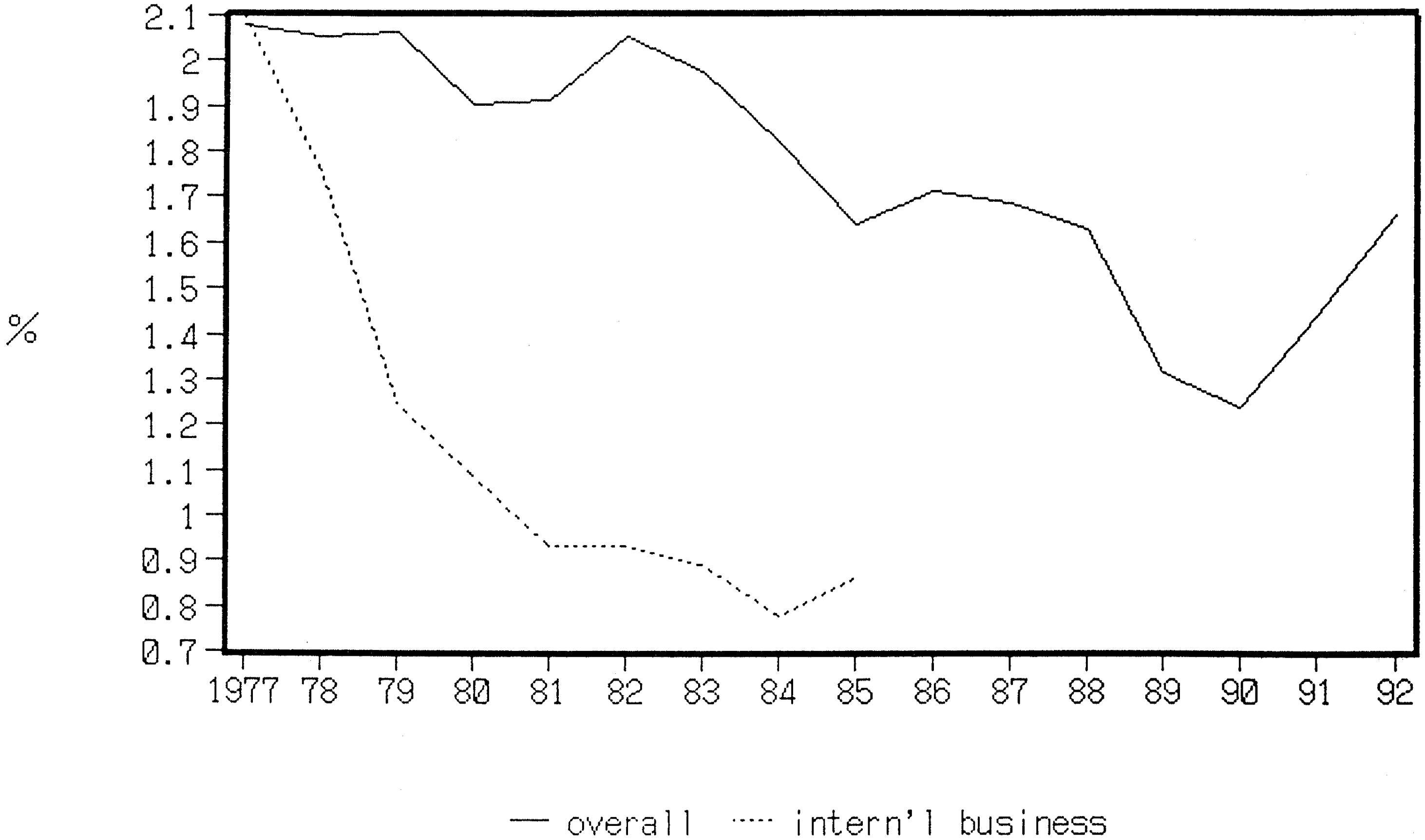
Table 11 Foreign Portfolio Investments by Institutional Investors

(100 million yen)

	Amounts (year end)				Annual increase			
	All Banks				All Banks			
	Banking Accounts	Trust Accounts	Life Insurance	Non-life Insurance	Banking Accounts	Trust Accounts	Life Insurance	Non-life Insurance
1970	344							
1971	584				240			
1972	2657				2073			
1973	5317				2660			
1974	5832				515			
1975	6238	284			406			
1976	6389	316			151	32		
1977	6869	546			480	230		
1978	7666	934	2029		797	388		
1979	9111	1458	5776		1445	524	3747	
1980	10622	1726	6818	1932	1511	268	1042	
1981	14303	3319	11232	2355	3681	1593	4414	423
1982	21189	5596	19019	3360	6886	2277	7787	1006
1983	27215	9439	29272	5709	6026	3843	10253	2349
1984	44143	14359	38416	8195	16928	4920	9144	2486
1985	73267	34611	47719	10224	29124	20252	9303	2029
1986	95158	62130	73065	13759	21891	27519	25346	3535
1987	106195	78718	103427	17449	11037	16588	30362	3690
1988	110828	81688	130857	20453	4633	2970	27430	3004
1989	152073	103057	171626	26670	41245	21369	40769	6217
1990	183903	111459	172188	31215	31830	8402	562	4545
1991	159422	132178	174278	31931	-24481	20719	2090	716
1992	148687	140793	172058	36314	-10735	8615	-4020	4383

Source: BOJ, *Economic Statistics Annual*, *Economic Statistics Monthly*.

Figure 1 Gross Profit/Asset Rate of City Banks



Note: Data for overall business is calculated as gross profit (*Kinyu Zaisei Jijo*) over total assets (BOJ, *Economic Statistics Annual*), estimates for international business is from Iwami (1989).

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