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# Financial Decontrol Gathers Momentum

By Tomochika Chosokabe

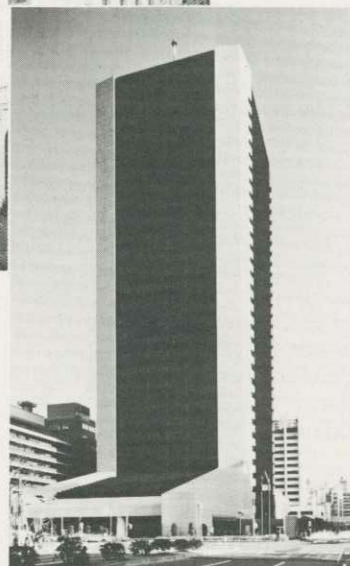
A mounting tide of internationalization and liberalization is engulfing Japan's banking industry. Government financial authorities have bid farewell to their traditional policy of defending the weak rather than seeking better financial services through competition, a policy often criticized as giving banks excessive protection—like a merchant fleet guarded by warships.

The turning point came last spring, when Japan and the United States agreed on a set of measures designed to give foreign interests access to the Japanese financial markets and accord the yen a greater role in international finance. The agreement has fanned foreign pressures for faster and more extensive liberalization, with reports on linkups between Japanese banks and their foreign com-

petitors often making front-page headlines. The banking industry also faces domestic pressures as brokerage houses and insurance companies seek new forms of cooperation. The move toward internationalization and liberalization is gathering steam.

## Profit picture worsens

Japanese banks reported record operating income on an unconsolidated basis for the second straight year in fiscal 1983, ended March 31, 1984. The only exceptions were banks specializing in long-term financing (see Table). Nonetheless, the 13 largest commercial banks—known as city banks—and 63 smaller regional banks saw earnings decline both in the first and second half of fiscal 1983 compared with



Japan's banking industry is being engulfed by internationalization and liberalization.

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the previous semiannual period. The 71 "sogo" (mutual loan and savings) banks' profits leveled off in the second half, and only the seven trust banks showed better second-half profits. All three categories of banks still finished the year ahead of fiscal 1982, but the three long-term credit banks had smaller annual profits due to a sharp earnings drop in the first half.

The banking industry is generally in good shape at present. But industry analysts predict the earnings picture will gradually worsen as interest costs rise in the wake of the intense competition induced by internationalization and liberalization. To cope with the new trend, banks must carry out a wholesale review of their operations in favor of more solid financial foundations and reduced exposure to problem loans and other risks.

Many analysts are concerned about the poor ratio of owned capital to total assets. The ratio for the top five city banks averaged 2.81% at the end of fiscal 1983, compared with 5.32% for the U.S. top five at the end of calendar year 1983, one analyst points out. Repletion of owned capital is indispensable, he adds, to cope with the higher fund-raising costs and greater lending risks involved in financial liberalization.

## New capital

Conscious of the critically low owned-capital ratio, the five largest city banks are preparing to raise new capital through the public offering of new stocks this year.

Besides foreign pressure for financial decontrol, some analysts see "domestic pressures" for liberalization arising naturally from within the Japanese economy. One is a swelling flow of funds both out of and into Japan as the increasing business operations abroad hasten economic inter-

nationalization. The trend was further fueled in December 1980 by enforcement of a new foreign exchange law, which freed capital movements in principle.

Another factor is the massive flotation of government bonds that began in 1975. This has dramatically expanded the nation's bond market, offering investors greater investment opportunities. It has also spurred the development of new high-yield investment instruments such as trust funds incorporating government bonds, and has triggered a rush to devise even more new products.

A third factor is the gradual diffusion of electronic data transmission systems, a move expected to have a far-reaching impact on banking. Banks plan to use these computer-controlled systems to manage new financial services requiring sophisticated office work, such as a product combining time deposits and endowment insurance recently unveiled by Fuji Bank and Yasuda Mutual Life Insurance Co. and other banking-insurance partnerships. The Fuji-Yasuda tie-up was only made possible by linking their computers.

The biggest bottleneck in introducing electronic systems is heavy development costs. To hold these down, joint development is under way between banks and between banks, securities companies and other types of business concern.

The agreement reached last April by the "Japan-U.S. yen-dollar committee" has no doubt had the largest impact on Japan's fledgling financial internationalization.

A number of measures have already been put into force. Last April, yen-denominated loans to overseas borrowers were liberalized and restrictions on yenbonds issued in Japan by overseas borrowers eased. Short-term Euroyen lending to Japanese borrowers was liberalized last June, enabling them to profit from pass-

ing on short-term Euroyen funds to other borrowers at higher rates. The same month saw the liberalization of conversion of foreign currency into yen. Pending measures include the decontrol of longer-term Euroyen loans. The series of steps should bring domestic interest rates closer to those prevailing overseas.

## Reshaping banking

When the Finance Ministry released its "Present State & Outlook on Financial Liberalization & Yen's Internationalization" last May in the wake of the agreement with the U.S., officials made sure to include a passage on "promotion of mergers and link-ups among financial institutions."

"There are a lot of stumbling blocks to a merger between city banks," concedes a senior ministry official. "But progress in financial internationalization and liberalization strongly requires banks to seek more efficient operations. To meet this need and ease cost burdens in installing large computers, mergers and tie-ups among smaller banks will soon become an urgent task," he adds.

Some analysts believe reorganization of the banking industry will be triggered by the approaches of foreign banks seeking prospective partners in Japan. But mergers and link-ups between credit associations and between them and regional banks are already taking place without this external pressure. The Fuji and Mitsubishi banks, both in the upper echelon of city banks, are said to be moving to co-operate in developing a new electronic information system for home banking and other progressive financial services, although officially they deny the reports. In short, the industry already appears well on the way to reorganization. ●

### Banks' Earnings in Fiscal 1983

(¥ billion)

	Operating income	Pre-tax profits	After-tax profits
City banks	992.1 ( 6)	1,076.1 ( 20)	493.5 (33)
Regional banks	602.8 ( 5)	604.0 ( 15)	253.1 (14)
Sogo banks	216.6 ( 1)	202.4 ( 5)	86.2 (12)
Long-term credit banks	159.1 (-15)	187.8 ( -6)	87.3 ( 1)
Trust banks	124.5 ( 2)	134.6 ( 3)	62.3 (20)

Notes: Figures in parentheses are percentage changes from the previous year. Operating income includes deductions to be made for loan writeoffs and for reserves for specified overseas loans.

Source: Federation of Bankers Associations of Japan