

INDUSTRIAL SURVEY

Finance

Liberalization Rolls Along

For the past several years Japan's banking and securities industry has been buffeted by a wave of structural change. These transformations gained further momentum in 1986.

The first trend is the promotion of deregulation by administrative authorities. In 1986 liberalization proceeded most strikingly in the area of interest rates on large-denomination deposits. Inevitably, this had a great impact on commercial banks and other financial institutions that relied on interest-bearing deposits for their major source of funds. Interest-rate deregulation squeezed the profit margins of these institutions because regulated interest rates had been held at artificially low levels.

The second major change is the development of the securities market. Japan's financial system was traditionally characterized by indirect financing, that is, fund flows through bank deposits and loans. Over the past decade or so, however, the role of direct financing—fund flows through bonds and stocks—has expanded rapidly. In 1986, this form of corporate fund raising, including the issuance of convertible bonds, reached the highest level ever. In addition, many of the newly issued securities were acquired by financial institutions. Thus part of their portfolio was changed from loans to securities.

The third change is the simultaneous business expansion overseas by Japanese institutions and direct investment in Japan by foreign institutions. In 1986 some of Japan's biggest banks and securities companies stepped up their operations in the Euromarket, while foreign banks and securities companies established their local subsidiaries and branches in Japan.

Furthermore, excess liquidity re-



Kabuto-cho, the Wall Street of Japan, has witnessed remarkable liberalization in banking and securities.

mained the rule in 1986, reflecting the slowdown in corporate money demand. As a result, lending competition among banks intensified while stock prices, encouraged by the flow of surplus funds, soared to seemingly abnormal levels.

In this situation, securities companies, particularly large ones, made unprecedented profits. Commissions for stock trading and convertible bond underwriting recorded especially large increases. Banks' profits, in contrast, remained more or less unchanged.

Banks made progress in expanding their business in 1986. For example, many medium-sized and larger banks began dealing actively in issued bonds—the business that was decontrolled for banks only in June 1984. In addition, trust banks actively expanded their fund management trust business using trust funds and other new products.

Looking ahead to 1987, these trends in the banking and securities industry are

unlikely to change. Financial liberalization, including the relaxation of remaining deposit interest-rate restrictions, will be promoted. The weight of direct financing is expected to increase even further, while liquidity is likely to stay high. However, the upward momentum of stock prices has slowed since the autumn of 1986. If this trend continues, the issuance of new convertible bonds and the turnover of stock transactions may fall somewhat short of levels in 1986.

It is likely, therefore, that a favorable tail wind will continue to blow for securities companies in 1987, if not as powerfully as before. Banks, however, face continued shrinkage of their profit margins; they are expected to step up operations in such strategic fields as overseas capital markets, consumer credit, leasing, securities and investment consultancy in order to make up the gap.

Competition among financial institutions is likely to intensify as they seek to vault the traditional walls separating banks and securities companies. The result, however, could be a widening gap between those large banks and securities companies capable of providing integrated financial services, and smaller ones with more limited resources. Meanwhile, foreign-affiliated securities companies and trust banks recently established in Japan will find their real strength tested in the competitive Japanese market. ●

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Supply of Funds from Financial Markets

(%)

from:	1961-70 average	1971-75 average	1976-80 average	1981-85 average
Securities market	9.5	6.1	8.5	11.3
Financial institutions	87.0	91.3	88.5	85.2
Foreign capital market	3.5	2.6	3.0	3.5
Total	100.0	100.0	100.0	100.0