Foreign Exchange Markets: Singapore vs. Tokyo

By Sakamoto Sakae

In the last issue (November/December 1994) I took up the theme of the hollowing out of Tokyo's capital markets. This time I would like to touch upon the hollowing out of the Tokyo foreign exchange market. During the period of the bubble economy (from the latter 1980s through the early 1990s) Tokyo was one of the world's three leading foreign exchange markets along with London and New York. With the recent declines in trading volume, however, it is far from being one of the three top and is becoming just a local Asian market. Can the Tokyo forex regain its former glory?

A foreign exchange manager for a certain city bank says, "The volume of transactions on the Tokyo forex has declined by about 40% compared to its peak. Because currency transactions are diverse and complicated a simple comparison is difficult, but it appears that trading volume on the Tokyo market has recently dipped below those on the Singapore market."

During the bubble period, Japan's institutional investors (primarily life insurance firms) invested heavily in U.S. government bonds. The average business also became actively involved in overseas real estate investments and corporate takeovers. The massive yen sales and dollar purchases that resulted conversely bore fruit in the form of remittances to Tokyo involving large dollar sell-offs and yen purchases.

Along with exchange transactions related to imports and exports, these capital shifts quickly swelled the number of currency trades, contributing to greatly increased bank commissions.

However, investments in foreign bonds and real estate have now abruptly chilled. Life insurance companies, which learned a lesson from exchange losses for the strong yen and weak dollar and rapidly falling stock and property prices (collapse of the bubble), are now cool to securities or property investments in Japan and, of course, overseas. According to a source at a leading life insurance firm, 80% to 90% of life insurance companies' current investments are in yen-based loans to foreign and domestic firms. The foreign exchange market will not revive under these circumstances.

Attention focused on BIS study

In April 1992 the Bank for International Settlements (BIS) conducted a survey of currency trading in leading markets: London had a \$300 billion average daily level of transactions, New York \$190 billion, Tokyo \$130 billion, Singapore \$76 billion, and Hong Kong \$60 billion. Trading volume on the Tokyo market was more than twice that of the other major Asian markets and was on a par with both the London and New York exchanges. The preceding comment by the city bank's foreign exchange manager is an estimate based on this BIS survey and the recent lackluster market in Tokyo.

Reaction to the bubble economy is not the only factor affecting the inactivity of the currency markets in Tokyo. Similar to the theories regarding the hollowing out of the capital markets, high office rents and personnel expenses (market infrastructure costs) in Tokyo have also played a role. Further, advances in telecommunications technology that have made currency trading possible anywhere are also said to be another reason for the decline in transactions on the Tokyo foreign exchange market.

A more in-depth supplementary explanation of the relationship between advances in telecommunications and currency transactions is probably needed here. In classical inter-bank transactions, trading was handled through brokers, but "electronic broking" (computerized broking), a transmutation of the brokerage business, has recently been widely adopted and banks are increasingly dealing directly with each other without using brokers ("direct dealing").

The preceding BIS statistics cover spot and swap transactions of dollars and all other currencies as well as bank trades with customers. The foreign exchange trading volumes published daily by the Bank of Japan are the total yen-dollar transactions between banks through brokers (recently \$10-15 billion a day) and, as such, are much narrower in scope than the BIS statistics.

Since this BIS foreign exchange survey is carried out once every three years, the next one should be conducted in April 1995. The city bank foreign exchange manager mentioned above notes, "Whether trading in Tokyo picks up or not depends on whether or not the economy improves." Japan's economy has been on track for a recovery since mid-1994. However, if this does not tie in with energized foreign capital transactions Singapore (and, depending upon the circumstances, Hong Kong) might rank higher than Tokyo in the BIS survey.

Increasing debate over hollowing out

As I mentioned in the previous issue, the three points generally raised as manifestations of the hollowing out of Tokyo's capital markets are an increase in the number of Japanese stock transactions on London's international stock exchange system (Stock Exchange Automated Quotations—SEAQ International), meaning that London is gobbling up the Tokyo Stock Exchange's (TSE) trades; Asian, particularly Chinese, companies are bypassing the Tokyo exchange and actively listing on the New York exchange (neglecting the TSE, one of Asia's leading markets); and companies listed in the foreign section (primarily top European and American firms) on the TSE are increasingly leaving the market

Some foreign financial institutions have begun to shift their Asian business outlets to Hong Kong or Singapore, leading to fears of a hollowing out of Tokyo's markets.

(undermining the TSE's footing as an international market).

However, some have recently indicated the opinion that these arguments might be too simplistic. An executive from a think tank connected with a leading securities firm says, "Even when London dealers trade on the TSE, the transactions are shown as having been carried out in London for statistical purposes so the volume of Japanese stock transactions on the SEAQ appears larger. Also, whatever the nationality, it is natural for international blue chips to trade in London."

In other words, it is inaccurate to say that an increase in Japanese securities transactions in London (the equivalent of 15% of the TSE,according to one account) is equal to a reduction in transactions on the TSE. Rather, it is natural that leading Japanese companies' stocks trade in London.

The Japanese securities industry cites the existence of securities transaction taxes as a factor in the hollowing out of Tokyo's capital markets and is campaigning to repeal the tax, but the above comment will probably throw water on the argument that the tax is the source of the trouble.

Samurai vs. dragon bonds

The same think tank executive also notes, "For Asian companies promoting the globalization of their businesses and trying to raise capital in the world's three top markets (the U.S., Europe and Asia) there is not much point in listing on the TSE, which is also in Asia." He points out that it is not that they are slighting Tokyo, but merely trying to avoid duplicate listings in Asia.

Moreover, with regard to moves by foreign companies to delist their stocks from the TSE, he comments, as follows, that it is because Tokyo does not function as a capital procurement market. "As has been noted, the high cost of continued listing, particularly the expense required to draft financial statements in Japanese, is probably why foreign companies are withdrawing from Tokyo, but that is not the only factor. You can also see that since only one company listed in the foreign section made a public offering of new shares since the beginning of the 1990s, Tokyo does not function as a capital procurement market. Japan has the world's largest trade surplus and its capital markets are in serious shape."

All of this serves as an argument for the need to revise common beliefs regarding the hollowing out of the capital market.

This executive notes four additional manifestations of hollowing out. First, Nikkei Index futures transactions are shifting from Japan (the Osaka Securities Exchange) to Singapore (the SIMEX).

He says, "This is because the Japanese authorities have tightened regulations due to anxiety regarding the effects of futures trading on spot transactions."

Second, flotations of highly-rated "samurai" bonds (foreign-issued yen-denominated bonds offered in Japan) have fallen off and the market for "dragon" bonds (bonds issued in Asian countries other than Japan and listed on two of either the Hong Kong, Singapore, or Taiwan exchanges) has grown.

On this point he notes, "This is because samurai bonds have a high issue cost while, on the other hand, American securities firms are strong in Asian markets."

Third, foreign financial institutions are departing Tokyo for Hong Kong and Singapore. Subject to this shift are foreign exchange and options transactions. He notes, "The reasons for the shift are high personnel costs and office rents."

Fourth, *gensoki* repurchase transactions of bonds are being shifted from Tokyo to London due to the high transaction taxes levied on these kinds of trades in Japan. JIJI

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