

# Japanese Finance—A Time of Change

**Interview with  
Bank of Japan  
Governor Satoshi Sumita  
by Ryoki Sugita**

Japan may move to prop up the yen if higher import prices or trade friction start hurting the economy. But this would not be by reimposing controls on capital flows. Deregulation is the key word in Bank of Japan policy. Once the problems of deregulation are solved, the time may be right to consider the establishment of a Tokyo offshore capital market.

**Question:** *Could you comment first on the reasons for the dollar's strength in the currency markets?*

**SUMITA:** The market rate is constantly changing, but there are two underlying trends worth mentioning. One is the confidence that people still have in the American economy. There was a brief period when it looked like the recovery might be ending prematurely, but the economy has settled down to a period of sustained growth. If anything, there is even more confidence in the U.S. economy now.

Satoshi Sumita



*Ryoki Sugita is the economic editor with the Nihon Keizai Shimbun. He joined the newspaper in 1961.*

The other main factor, at least as far as the yen/dollar relationship is concerned, is the interest differential. U.S. long-term interest rates are still 4.5% to 5% higher than in Japan, and this has a definite influence on capital flows.

**Q:** *How is the dollar's strength affecting the United States itself? Federal Reserve Board Chairman Paul Volker has indicated that the disadvantages might be outweighing the benefits.*

**SUMITA:** I would rather say that there is concern that the dollar might be overvalued. The strong dollar has helped to hold down inflation and has had other benefits for America, but there is a feeling that the dollar might be too strong. Agriculture and other U.S. export industries are hurting, and people are saying that these negative aspects must also be considered. Of course, there are still people who argue that the advantages outweigh the disadvantages, but...

**Q:** *Going back to the causes of the dollar's strength, some people in the United States, Europe, and elsewhere feel that Japan is partly responsible for the dollar's strength against the yen. But on the other hand, the yen is strong against the European currencies.*

**SUMITA:** The yen's exchange values against the European currencies are determined by the differences between the Japanese economy and the European economies, but we are all in the same fix vis-à-vis the dollar. To me, the very fact that the yen is doing well against the European currencies indicates that we are not holding it down against the dollar.

**Q:** *At the same time, the yen/dollar currency disalignment is also affecting the Japanese economy, and you yourself have spoken out on the negative impact of the yen's weakness.*

**SUMITA:** One thing that is happening is that the strong dollar is making imports more expensive for us. This has not been reflected in the wholesale price index yet—for a number of reasons—but the possibility remains that the strong dollar could be a factor triggering inflation in Japan. Even though the damage is not evident yet, the dollar's strength is taking its toll on the Japanese economy, and we have to be very careful.

One more consideration is that the combination of the yen's continuing weakness and mounting surpluses in our international balance of payments is bound to aggravate trade friction.

**Q:** *Is this true despite the strong flow of capital from Japan to the United States?*

**SUMITA:** Yes, and I am very concerned about this mounting trade friction. The fact that the yen is weaker than it really should be tends to hold down imports and push up exports, and I am not at all sure this is in Japan's best interests. Something will have to be done about this sooner or later.

**Q:** *Some people have accused Japan of intentionally holding the yen down in order to promote exports.*

**SUMITA:** That is a most unfortunate mistake. I assure you we are in no way manipulating the yen to make the exchange rate more export-favorable. We are bending over backwards to avoid that sort of thing.

**Q:** *You have already said that the strong dollar is mainly attributable to American causes. So what can Japan do to counter this? Earlier this year the two governments agreed to intervene in the markets, but we have since gotten mixed signals from Washington, and the resultant doubt that America has the heart for con-*

*certed market intervention has pushed the dollar to new heights. What can Japan do?*

**SUMITA:** At this point, the most important thing we can do is to have the central banks intervene in the markets as the situation requires. But lacking any clear guidelines as to what exchange levels we want to maintain, this intervention is used mainly to dissipate extreme fluctuations. And since it is done in response to the conditions prevailing each day, it has to be done positively and independently as the occasion demands.

In addition to market intervention, we also have a range of interest rates and other tools at our command. As I mentioned, the situation is not yet having that adverse an impact on the Japanese economy, but we would have to be ready with interest and other measures if it did, and these would be implemented unhesitatingly. We are constantly monitoring the situation.

**Q:** *When you speak of interest measures, does this mean more latitude for the special lending facility with rates higher than the official discount rate?*

**SUMITA:** Not necessarily. It would depend on the situation at the time. That is just one possibility that has been mentioned, and we are neither committed to doing that nor limited to doing only that. It depends on what the situation is at the time. We are watching it very closely, and we will be ready to respond effectively if need be.

**Q:** *There has also been speculation that you might seek to contain the currency exchange situation by reimposing controls on the outflow of capital. Capital export controls to regulate capital movements, an interest equalization tax, and other possibilities have been suggested. What are your thoughts in this area?*

**SUMITA:** We are committed to promoting a greater international role for the yen. This was decided at last year's meeting of the U.S.-Japan yen/dollar working group, and I think any moves to regulate the flow of capital would be very counterproductive. That is not the sort of thing I would want to enter into lightly.

**Q:** *How would the U.S. and other nations' authorities react to Japan's tightening up exchange controls in order to stem this outflow?*

**SUMITA:** Nobody I have talked to has had anything to say in its favor.

**Q:** *One of the things which is sometimes pointed out in regard to this exchange problem is that Japanese capital markets have been liberalized to permit outflow but not to allow an inflow of foreign-capital participation in the Japanese market, and that this imbalance is one cause of the distortion in capital flows.*

**SUMITA:** I can see how people might feel that way from the way capital is flowing, but there is no truth to the argument. When the 1949 Foreign Exchange and Foreign Trade Control Law was overhauled in 1980, it provided approval in principle for all flows—out or in. Legally, there is no difference between Japanese money going out and foreign money coming in. Nor should there be. However, there are still a number of technical problems which tend to impede the inflow of capital to Japan. These include the fact that interest rates are regulated, that the short-term money markets are not as well developed as in the United States, and that there is not as much diversity of security instruments as in some countries, but these technical issues do not mean the market is any less free. We are still working on

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	T.T.S.	T.T.B.	D.D.B.	CASH	
				SELLING	BUYING
U.S.\$	¥255.70	¥253.70	¥252.74	¥257.70	¥251.70
Stg.f	¥315.40	¥307.40	¥305.63	¥324.40	¥298.40

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making Japan more attractive for foreign capital, but I do not think it is restrictions so much as interest rates that are the problem. Given the spreads, it is only natural that more money is going to flow out in search of high yields than flows in.

**Q:** *In working to make Japan more attractive, what aspects of capital market liberalization do you intend to focus on?*

**SUMITA:** Interest rate liberalization is a major part of capital liberalization. Beginning this spring, for example, we have started allowing certificates of deposit (CDs) in smaller denominations and for shorter maturities. We also expect to see more money market certificates (MMCs) and other flexible-rate instruments. With these changes, interest rates will be considerably liberalized for large-account depositors, and I expect that complete liberalization will not be far behind. The trend is definitely toward interest liberalization for large-account deposits, and we are moving to dismantle our interest rate guidelines.

One of the things we have to consider here is the impact this will have on postal savings and the difficulties it might create for the different financial institutions, and that is why we are moving gradually—starting with the larger-denomination paper. It used to be that interest rates did not change unless the official discount rate changed, but I think you will see more independence in interest rates in the future.

**Q:** *In a somewhat related vein, there has been talk for some time of making Tokyo an international financial center and setting up a Tokyo offshore market. What are your thoughts on this?*

**SUMITA:** One of the things sparking renewed interest in a Tokyo offshore market is the growth of the offshore Euroyen market. Since the Euroyen market has grown so big, people have asked why it should not be brought closer to Tokyo. But there are

a number of problems that have to be solved before any decision can be made.

For example, quite aside from the issue of the Euroyen market, is there really a need for a Tokyo offshore market? What purposes would be served by its creation? How would rates be determined? How would it be treated for taxation? What implications would that have for the Tokyo market? These are just a few of the questions which will have to be studied in greater detail before any conclusions can be reached on whether or how to establish a Tokyo offshore market.

**Q:** *Let me turn finally to the Japanese economy and ask what the chances are that we will be able to make the shift from export-led growth to domestic consumption-led growth this year.*

**SUMITA:** Export growth has been slowing since mid-1984. Even though exports to the United States showed very strong growth last year, this has been tapering off, and exports to China, for example, are taking up some of the slack. Overall, exports are still growing and will continue to grow at least through the first half of this year, albeit somewhat more slowly.

By contrast, Japanese corporate earnings have been good, and companies are very positive on plant investment. Consumer spending is still a little lack-luster, but the year-end holiday season was somewhat encouraging. The reports we are getting from the field indicate that consumer spending is no longer “one step forward, one step back” but is now “two steps forward, one step back.” This is not yet fully substantiated by the data, but this is the feeling we get.

With these trends, we expect the main focus for growth to shift from exports to domestic demand. The shift from export-led to domestic demand-led growth is definitely under way, but it is a gradual shift and not a sudden transformation. ●

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