Steady as She Goes

Interview with Yoh Kurosawa, president of the Industrial Bank of Japan, by Toshio Iwasaki, editor of the Journal of Japanese Trade & Industry

Shaken by the triple shock of lower stock prices, lower bond prices and a lackluster yen early this year, the Japanese economy seems headed for a period of adjustment and slower growth. The eruption of the Gulf crisis and the prospect of sharply higher oil prices has sent another shiver down Japanese investors' spines.

The *Journal* recently interviewed Yoh Kurosawa, elected president of the Industrial Bank of Japan in June 1990, on his views on the situation confronting Japan, the potential impact on Japanese economic growth and the responses.

The IBJ was founded in 1902 and became a private bank after the war. It was a major force in Japan's postwar recovery, getting the economy back on its feet and sustaining individual companies and industries. In recent years, it has been closely involved in the development of new industries, resource development and globalization. In a survey, financial officers at Japan's major firms said the IBJ is the bank they would turn to first in a pinch. Kurosawa sees his mission as one of maintaining and even enhancing this reputation for excellence.

Question: *The Japanese economy had been sailing along nicely for the past few years, but the situation in the Middle East has raised considerable turmoil, the stock market is down, and interest rates are up. What do you foresee?*

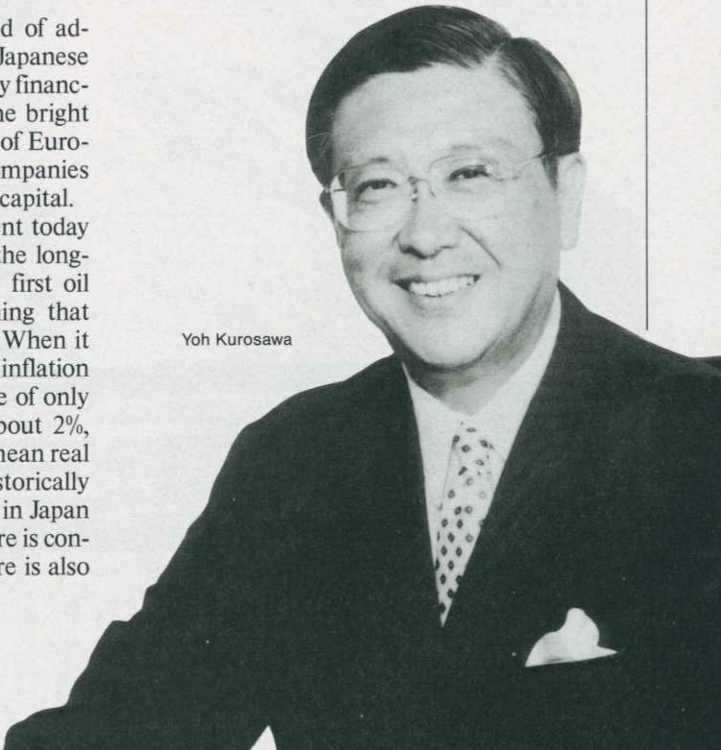
Answer: I expect a prolonged period of adjustment in which it will be difficult for Japanese companies to repeat their low-cost equity financing exploits of last year. Looking on the bright side, of course, this may mean the end of Euro-American complaints that Japanese companies benefit unfairly from their low cost of capital.

The interest rates situation is different today from what it was in the 1970s. When the long-term prime rate was 9.9% during the first oil crisis, inflation was about 15%, meaning that there was a negative real interest rate. When it was 9.5% during the second oil crisis, inflation was over 8%, leaving a real interest rate of only about 1%. This time, with inflation about 2%, long-term prime interest rates of 8.9% mean real interest rates of about 7%. This is historically very high. Real interest rates are higher in Japan than they are in the U.S. I know that there is considerable inflationary pressure, but there is also the question as to how much belt-tightening has to be done.

Oil is one of the main culprits in today's inflation, but I do not expect oil prices to go all that high. Saudi Arabia alone has several million barrels excess capacity with a little investment. When you add in other producers such as Abu Dhabi, oil prices should not go up all that much even with a protracted stalemate in the Gulf. Saudi Arabia is strongly opposed to sharply higher oil prices—not for any lofty ideals of international peace and harmony but simply in Saudi Arabia's own self-interest. They saw what happened in the 1970s, when higher oil prices stimulated conservation, exploration and the development of alternative fuels. Sitting on 100 to 200 years' worth of reserves, Saudi Arabia sees it in its own interests to hold the price of oil under $30 a barrel.

As a result, I do not see any danger of rampant inflation in Japan. And given the strength of the Japanese economy, the trade surplus, the fact that oil accounts for only a tenth of total imports, the fact that we are now using less oil than we once did and all the rest, I do not think the current crisis will have that much of an impact.

Q: *There are also a number of domestic factors affecting the economy besides higher interest rates.*


Yoh Kurosawa

Would it be right to say that creeping inflation and labor shortages are the biggest ones?

A: I don't see what can be done about prices. As the price of oil goes up, this inevitably works its way through the rest of the economy. Overall, though, higher oil prices will probably not push inflation up more than 0.5% or so. Unlike in the past, higher prices in Japan now attract imports from Korea, Taiwan, Hong Kong and elsewhere – even on bulk commodities such as cement. So this makes it difficult to raise prices–especially for things like toweling, stockings and the like. Even though people talk about the cost of labor going up, it is only going up in the 3-D (demanding, dirty and dangerous)* jobs that people do not want to do. This year, the average wage increase for employees at Japanese financial institutions was only 3%. And on the 3-D jobs, the pace of increase is being held down by the influx of foreign labor. Many of these people are illegals, but they are here and they are having an impact on the labor market.

Personally, I disagree with the Japanese policy of trying to keep foreign workers out. But even if you support the official line, the question now is not whether or not to let these people in. It is what to do about the people that are here already and how we can keep this process orderly. I am not advocating just throwing the borders open and letting everyone in. I am advocating an orderly process. Seen from the other side, it might even be considered a form of assistance to the developing countries to let foreign labor fill areas of labor shortage.

Q: *What impact do you expect the situation in the Middle East to have on the already sluggish U.S. economy?*

A: The Desert Shield military operation makes the U.S. economy a whole new ball game. I don't know how much money the U.S. is going to pump into this, but there are rumors that it could run as high as $27 billion. All of this has blown Gramm-Rudman out of the water. Whether this develops into a shooting war or not, the U.S. is likely to remain in Saudi Arabia for some time, and I do not expect the U.S. government to balance its budget.

Right now, the U.S. GNP is growing about 0.7% a year. Some economists have predicted that it will be down to zero soon and that they will have to cut interest rates. But with the persistent fiscal deficit, it will be very hard for the U.S. to lower interest rates. So what do you have? Sluggish growth plus high interest rates–stagflation. The biggest losers here are going to be the developing countries, especially the Asian NIEs, and there may well be calls for Japan to pick up some of the slack.

Q: *What is your outlook for Europe, especially considering German unification pains?*

A: West Germany is finding that East Germany is in worse shape than anyone thought. Unemployment was thought to be 5%, and it turns out it is closer to 20%. Half of all East German companies are not expected to survive the shakeout. The problem is that there is no market in the West for the things they are making in East Germany. But in the long run, I am optimistic. With a total population of about 80 million, a unified Germany should be able to carry a million or two unemployed for a year or so.

Prior to unification, West Germany was spending DM40 billion directly as a result of the country's divided status. There were the costs of maintaining West Berlin, of buying freedom for political prisoners held by the East German authorities, and an open-account trade with the East. You can pay a lot of unemployment benefits with this. And for the rest, West Germany recently issued some special bonds that were bought up almost before they hit the market. So I'm not too worried about Germany.

Most of the anxiety about Germany is coming from London. Don't believe it. There will be some problems, but they are manageable. And once you achieve German unification, you have an economy that accounts for about 30% of the EC GNP. Once East Germany gets up to speed this will be close to 40%. Germany is definitely going to be a power to be reckoned with in the EC. With a new frontier in Eastern Europe and maybe even the Western Soviet Union, I expect the German economy to enjoy a renaissance. The economic outlook for Europe is good.

Q: *The IBJ has a very strong background in corporate finance, but there has been talk that its future may be imperiled by the impending financial deregulation.*

A: Actually, we are way ahead of this. The IBJ has changed considerably over the years. Today, our lending is only 20% to manufacturing, 10% to the electric power utilities and 70% to other sectors. This represents a considerable restructuring and repositioning–without sacrificing our traditional strength–and it parallels the restructuring of Japanese industry.

Q: *Given the Japanese economy's strength and the strong capital demand, the IBJ seems well positioned. But your capital procurement costs are bound to increase with higher interest rates. This is*

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*In Japanese, these are the 3-K jobs, the three Ks being *kitsui*, *kitanai* and *kiken*.

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true of all banks, but especially of banks such as the IBJ that rely on the sale of bonds.

A: We are issuing bonds at 8.0% and lending at 8.9%. This gives us a spread of only 0.9%. But even more important is the fact that Japan's big blue-chip companies are now borrowing less than they were before. About 40% of the companies listed on the Tokyo Stock Exchange's First Section are in the black in their financial accounts. They don't need to borrow from the banks. Of course, the other 60% are net borrowers, but that is still only 60%.

Our emphasis has to be on that 60% and the smaller firms–smaller in the sense of not being listed on the TSE First Section. Five years ago, we had a client list 4,000-long. Now it is over 8,000. And in the not-too-distant future, we plan to up this to 10,000. There are still lots of very strong companies out there that want and need to borrow money. In addition, we are helping to provide the financing for major public-sector projects such as waterfront development, industrial parks, airports and the rest. Also there are private-sector nonmanufacturing developments such as theme parks where we are involved from the very first steps. We are engaged across the entire economic spectrum.

Q: *Your own business career displays a broad international experience. How do you see the IBJ developing its international business?*

A: International business now accounts for about 30% of our business. Much of this is growth as our clients have gone global. We have no intention of expanding our international operations just for the sake of raising this percentage. We are treading very carefully. As our clients go global, we are going with them.

So it is impossible for me to give you any dates for when we will be up to 40%, 50% or any other target figure. Nor do I see any imperative to raise the international share of our business. Not only is there considerable country risk, there is also a movement for each bank to concentrate on what it knows best. American banks are pulling back from overseas operations–not only in Latin America but also in Europe.

Q: *Is this because they are afraid they will get burned?*

A: More than that, it is because of the realization that profitability suffers in areas where you are a stranger. At home, you know the market and the players. Elsewhere it is harder to judge.

Q: *The massive debt owed by the developing countries is another aspect of international operations. I know there are differences among the different banks, but this is a problem for the banking industry as a whole. What is the answer?*

A: This problem first surfaced in 1982. At the time, there were two aspects to the problem. One was the fear of an international financial crisis replete with bank failures, and the other was that the developing countries might go under. In the last eight years, banks have built up reserves, have written off some of their loans, and have otherwise provided against this contingency. Banks are in pretty good shape today. For Japanese banks, loans to the developing countries account for only about 15% of capital. At one point, it was close to 100%.

But the developing countries' problems remain. Mexico, Argentina, Brazil and the rest still have debts worth four or five years of annual foreign exchange earnings. There does not seem to be any light at the end of some tunnels. I know that Mexico, the Philippines, Venezuela, Costa Rica and others are working their way out from under their debts, but what are we to do about countries such as Brazil and Argentina? The Brady Plan is a start, but that is just a start and there is no overall resolution in sight.

Q: *Part of your international experience was the Harvard Business School's Advanced Management Program course–after being named managing director.*

A: I had spent a lot of time in Germany–going twice for a total of about seven years–and am used to working with Europe. I even sang with the Städtische Musikverein Düsseldorf for a while. But I had never lived in the United States, so I jumped at the chance. Probably the most valuable thing I learned at Harvard was how to talk with Americans and how to argue effectively in the American context. We did this every day. At the time, the Harvard professors were telling their students to learn from Japan. And the students were complaining that Japan's advantages were in dumping, cheap labor, government subsidies and other unfair practices. So I was constantly on the spot defending and explaining Japan. It was good practice.

Q: *I suspect this was also good network-building.*

A: Americans like to argue and they like a good argument–win or lose. In Japan, an American-style argument would sour the relationship. But not in the United States. Americans are willing to admit that they are wrong, and they respect someone who can make a convincing argument. This something else that I learned. It was a very productive three months for me.