

A photograph of two Japanese mountain goats (Capra bedfordi) in a snowy, wooded environment. The goats have thick, greyish-brown fur and small, dark horns. They are looking towards the camera. The background is a snowy forest with bare tree branches.

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# Asian challengers snap at Tokyo's heels

GERARD LYONS

**I**n the 1980s there was little doubt as to which were the world's three great financial centres: New York, London and Tokyo. They housed the world's largest equity markets and were responsible for the bulk of foreign exchange and bond business.

New York still maintains its pre-eminent position in North America (although there are other key financial centres such as Chicago, home to the world's largest and most liquid futures market), but there have been interesting developments surrounding London and Tokyo in recent years. Many questions have been raised about London's supremacy in Europe and Tokyo's dominant position in Asia, and while London seems to have weathered the storm, Tokyo is still encountering problems.

London has always remained competitive, benefiting from continued innovation and investment in new products. By contrast, Tokyo's financial success, particularly in the 1970s and 1980s, stemmed from its economic strength. As the world's second largest economy it is home to some corporate giants. It has a huge pool of savings to be invested. And as Japan's trade surplus grew it became the world's largest exporter of capital. These factors suggest Tokyo will remain a key financial centre, but economic success is not the only factor that counts. As London has shown, a financial centre needs to be competitive. And, despite the uncertainties of the British economy, London has remained a premier financial centre.

**TOKYO'S RECENT PROBLEMS** have stemmed partly from the aftermath of the Bubble economy. The bursting of the Bubble brought a collapse in the equity market and the subsequent sluggish pace of economy recovery has prevented the equity market from recovering. In particular, trading volumes remain light, preventing any rebound in profits. But just as importantly Tokyo has failed to see off the competition from elsewhere in Asia, particularly from Singapore and Hong Kong.

The number of foreign stocks listed on the Tokyo Stock Exchange has fallen. Some international firms have moved their Asian head offices from Tokyo to Hong Kong. And as China opens up, Hong Kong could

become the dominant equity market in the region, replacing Tokyo. Also, transactions in the Tokyo foreign exchange market have not risen as rapidly as elsewhere, with Singapore now becoming increasingly important.

The yen's strength makes Tokyo an expensive location for foreign firms, but the real problem is the slow pace of deregulation. And here Japan's financial sector has proved no different from other areas of the economy, with many regulations controlling what could be done, and by whom.

**JUST AS ELSEWHERE** in the economy, deregulation is now taking place in the financial sector, but the pace of financial market deregulation has been painfully slow and this has contributed greatly to Tokyo's recent problems. By contrast, Singapore and Hong Kong, its two main competitors in Asia, are completely deregulated, with lower costs and little red tape. Moreover, the authorities there have been keen to court international finance, to attract business. This competition is not only affecting established business; it also signals that Tokyo is losing out on potential new markets, such as in derivatives where the Singapore futures exchange, Simex, is dominant in the region.

Increased competition following change in a heavily regulated sector could cause some firms to go out of business. Fear of severe dislocation and problems has contributed to the slow pace of Tokyo's deregulation, as different groups try to protect their vested interests. The security companies, for instance, are keen to prevent banks from being allowed to encroach on their business. The fact that the economy is still only recovering from the recession is a further factor behind the slow pace of change in the financial sector. Clearly if all firms were very healthy they would manage change more easily. But the banks are still struggling to write off bad debts, whilst sluggish turnover in the stock market means that many equity firms are finding conditions tough.

The recent loss in business from Tokyo to other financial centres has not been seen as a problem in Japan. It is necessary to recognise that in Japan the financial sector is not always seen as being as important in its own right as, say, the financial sectors in





*Bank of Tokyo foreign exchange trading room, Tokyo.*

*photo: Mike Blank*

Singapore and Hong Kong appear to be. Japan's financial sector has always been seen as providing a supporting role to industry. That role was a key aspect in the setting up of the system and helps explain why different banks or financial organisations fulfil different roles. Different types of banks service different areas of the economy, with the three long-term credit banks being established to provide long-term capital to industry. There is also the presumption in Japan that as the economy recovers and deregulation takes place, Tokyo will be able to recoup some competitive advantage. The slow pace of both economic recovery and deregulation suggests this will take time.

There have been big changes in the financial system recently. At the end of last year some of the large City banks were allowed to establish security subsidiaries in Japan. And this January the US and Japan agreed to allow foreign institutions greater access to Japan's pension fund, mutual fund and corporate bond markets. Given the large size of savings, this opening up of Japan's markets allows foreign firms a potentially large market to increase their share in.

Tokyo will undoubtedly remain a key financial centre, on account of Japan's economic might and its role as the world's major exporter of capital, particularly in the next few years. But continued deregulation is essential, particularly if Tokyo is to remain Asia's main financial centre. And its position would undoubtedly be enhanced if the yen became the Asian region's reserve currency.

By contrast, the movement towards a single European currency in the late eighties and early nineties was the catalyst for debate as to whether London would be replaced as Europe's main financial centre, perhaps by Frankfurt. Uncertainty as to whether the UK would endorse a single currency and the feeling that things would gravitate towards the centre of the Continent appeared to be the justifications for questioning London's position. I've always felt such worries were overdone and they appear to have died down somewhat. I still have my doubts about whether a single European currency is likely. But if it does occur, the positioning of the European Central Bank in Frankfurt need not undermine London's position; after all, location of the US Federal Reserve Board in Washington has had limited impact on New York. The fact that international financial companies continue to establish their European headquarters in London and add to their already large amount of sunk costs here is testimony to general confidence in London's future.

In coming years, New York and London look set to remain dominant in their regions. With Japan's economic might pointing to Tokyo remaining a key financial centre, the real issue is whether deregulation and change will allow it to see off the strong challenge from Singapore and Hong Kong.

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