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A Brief Look at the Japanese Money and Bond Markets

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Robert F. Emery

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A Brief Look at the Japanese Money and Bond Markets

Nature of the markets

The literature in English on Japan's postwar money and bond markets has been relatively scant. This paper is aimed at describing the nature of these markets as well as recent market developments. The increased importance of international capital movements in the last few years, particularly the short-term capital influx into Japan since early 1960, also adds to the current interest in knowing more about these markets.

The Japanese money market is not as broad or diverse as its counterparts in New York or London. It consists primarily of a call loan market with only a very small amount of activity in short-term government securities. There is no active market in the purchase and sale of acceptances or commercial paper. One of the factors accounting for this appears to be the desire of banks and their customers to keep their relations confidential. While a formal market in excess reserves does not exist, the smaller local banks, among others, do provide funds to the larger city banks through the call loan market. Foreign exchange holdings of banks are generally small and the marketability of government bonds is low.

To meet both short-term liquidity needs and part of the private sector loan demand, Japanese banks rely on the call money market. There are currently four short-term loan brokerage firms operating in this market. They act as brokers for bill-discounting between such financial institutions as commercial banks, and trust and banking corporations. In an effort to develop the market, the Bank of Japan extends limited credits to these firms. However, the volume of call loans is equal to only about 5 per cent of the total loans and discounts of all banks. 1/

The short-term government securities purchased by banks consist primarily of food bills, foreign exchange fund bills, and to a very limited extent, treasury bills. Food bills are issued mainly to finance government purchases of rice under the price support program. Funds raised are placed in the Foodstuff Control Special Account. At the end of 1960, food and foreign exchange bills outstanding were equal to 8 per cent of the loans and discounts of all banks. Only small amounts of these bills are held by private financial institutions because the 6 per cent rate of interest is relatively unattractive. Government financial agencies held 42 per cent and the Bank of Japan 55 per cent of these securities, with only 3 per cent held by other financial institutions. Maturities are usually for 60 days. Treasury bills are issued only rarely and as of the end of 1960 there were no issues outstanding. Even when issued, the treasury bill yield is pegged 1 to 2 percentage points below prevailing market rates for high-quality short-term paper.

The Japanese bond and debenture market is not as important in the supply of capital funds as direct bank credit. In 1960, it supplied about 25 per cent

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1/ "All banks" includes city, local and trust banks, as well as long-term credit banks. It does not include other financial institutions such as the cooperatives and insurance companies.

of the capital raised by business enterprises. Early in 1961, however, the supply began to increase rather sharply, primarily in response to a favorable public reception of the new bond investment trusts. In part, high money rates have been a restraining factor in limiting the issues of bonds and debentures.

The main bond and debenture issuers are ordinary business corporations, public utilities, public corporations, local public corporations, long-term credit banks and other special banks. Most of the underwriting of debentures is limited to the securities companies, with the banks performing only supplementary trustee functions. The primary holders of bonds and debentures are the banks, though since the first of the year individual holdings have risen substantially.

While debt issue terms are theoretically freely determinable by the issuers, underwriters, and trustee banks from a legal standpoint, the Ministry of Finance and the Bank of Japan exert *de facto* though not *de jure* control. This explains the uniformity of terms that has prevailed.

Official and private regulation

Interest rates in Japan are subject to considerable regulation by governmental and other authorities. The Government has the direct power to regulate the rates on bank loans and deposits and sufficient influence to set the maturities and yields on bonds and debentures. Legal maximum limits for credit and deposit rates are determined under the Temporary Money Rates Adjustment Law of 1947. While this law provides that the Governor of the Bank of Japan must request the advice of the Rate Adjustment Committee established by the law regarding changes in interest rates, the main decisions on rates are actually made by the highest officials in the Ministry of Finance and the Bank of Japan. "Voluntary" bank lending interest rate limits are also set by the Federation of Bankers Associations and these are usually set slightly below the maximum legal rates. The maximum rates since late January 1961 for loans on bills, and discount of commercial bills, in individual amounts less than ¥3 million, two of the most important types of bank credit, have been 7.118 and 6.935 per cent per annum, respectively.

Interest rates on time deposits are also subject to ceilings. These ceilings are set by the Bank of Japan, with the advice of the Rate Adjustment Committee. On April 1, 1961, the maximum rates for one-year, six-month and three-month deposits were set at 5.5, 5.0, 4.0 per cent per annum, respectively. Previously they had been 6.0, 5.5, and 4.3 per cent per annum.

Because yields on new issues of public and private debentures are subject to determination by the Government, they do not reflect readily shifts in market demand and supply. The Ministry of Finance sets the terms for government securities, and while issuers of private securities no longer need the approval of the Bank of Japan Bond Issue Council, issuers do consult with, and are influenced strongly by, the Bank of Japan and the Ministry of Finance. Except for new issues, there is relatively little trading in private corporate bonds. Bond prices quoted on the Tokyo Exchange are called "picture rates" since they tend to do no more than reflect the terms of issue rather than the prices at which bonds are actually traded. Bonds are also traded in the over-the-counter market, but this market is thin, and regular quotations are not published. While the latter trading frequently consists of distress sales with some consequent depression of prices, the values involved are probably closer to the bonds' true market value than the published quotations. Yields based on prices paid in these over-the-counter transactions are fairly close to the true call money rates.[2]

The yields on both short-term and long-term government securities are fixed by the Government. Treasury bills are issued by the Government during periods when receipts are seasonally low and expenses high, but in recent years this type of seasonal shortage has been relatively rare. At the end of April 1961, the yield was 6.023 per cent per annum, the same as in the previous two years. Most treasury bills are purchased by the Bank of Japan since commercial banks find the low yield unattractive. Similarly there is no active market in long-term government securities because of the low yield. Since September 1960, the yield on these securities, which have a maturity of seven years, has been 6.432 per cent.

Certain bank credits are not subject to interest rate ceilings. These include loans secured by bills preferentially treated by the Bank of Japan or discount of these bills, loans against bills other than export advance bills and import settlement bills amounting to less than ¥1 million, and long-term loans of more than one year.

The maximum interest rate on call loans is a "voluntary" maximum set by the Bankers Associations. The rate was set by the Bankers Associations at 8.39 per cent per annum in July 1959 and in January 1961 was lowered to 8.03 per cent. While there is an attempt to regulate the call rate, there is no really effective way to enforce regulation, and the actual rates have often exceeded the ceilings.

Market influences and recent trends

Key market forces--The extent of ease or tightness in Japan's money market is a function of numerous factors, but probably the most important relate to Bank of Japan credit accommodation, government cash operations, balance of payments influences and various seasonal and cyclical forces. Changes in the volume of currency in circulation also influence the money market. While it would be difficult to state in precise quantitative terms the impact of these key forces on the money market, it is possible to assess roughly the general magnitudes of their influence.

Since early in the postwar period, Japanese banks have borrowed rather heavily from the Bank of Japan. Postwar expansion in deposits tended to lag somewhat behind the expansion of bank loans and discounts, Bank of Japan credit accommodation filling the gap. Bank loans rose sharply during the early postwar period because of heavy demand for economic rehabilitation and expansion. Investment in securities rose less rapidly.

2/ As distinguished from the published call money rates. See third paragraph of this page.

While commercial banks' liquidity needs have been met primarily by Bank of Japan loans and discounts, accommodation has at times been limited, with a resultant rationing of credit. To overcome this rationing problem, banks have relied primarily on the call money market. Local banks, trust banks and insurance companies are usually lenders, and city banks and security dealers the borrowers. In 1960, the maximum monthly expansion in Bank of Japan loans and discounts was ¥115 billion in June and the maximum contraction was ¥91 billion in April. Loans and discounts outstanding at the Bank of Japan at the end of 1960 totaled ¥500 billion.

The open market operations carried out by the Bank of Japan are relatively limited, both as to the frequency and volume of the operations, and as to the means utilized. Illustrative of these operations are those in the fall of the year when the rice crop is harvested and in December when there are large seasonal cash demands from the public. To offset the large government cash disbursements to the rice producers under the government's price support program, the Bank of Japan sells Foodstuff Certificates to the Central Cooperative Bank of Agriculture and Forestry.

To meet the public's demands for cash, the Bank of Japan in late December 1960 purchased ¥50 billion of government-guaranteed bonds from city banks with a commitment from the banks to repurchase the bonds. While December liquidity needs in previous years had usually been met by an increase in Bank of Japan loans and discounts, the banking community in December 1960 indicated a strong preference for the first method in order to avoid the penalty rates that many banks would have been required to pay on Bank of Japan credit accommodation. To reduce temporarily high banking liquidity, the Bank of Japan has also sold bills from its own portfolio since April 1958 at prices that give yields 1 to 2 percentage points higher than short-term government securities. The Bank usually commits itself to repurchase these bills, but not before a minimum of two weeks to a month. During the 1958-59 period, a high point was reached in November of 1958 when ¥24 billion of these bills was outstanding.

A second major influence affecting the money market is the impact of the Government's net cash receipts from, or disbursements to, the public. April, July, and the fourth quarter of the calendar year have regularly been periods of net cash disbursement. Bank of Japan operations are continually aimed at offsetting to a certain degree these net receipts or disbursements in order to lessen sharp, undesirable impacts on both banks and the money market. During 1960 the maximum net government disbursement was ¥129 billion in December and the maximum net receipt was ¥133 billion in January.

A third influence relates to the balance of payments. In times of surplus, there is, of course, a net easing effect from this sector. During all of 1960 the foreign sector was in surplus, hence contributing to increased liquidity in the money market. The maximum inflow occurred in September when it totaled ¥32 billion.

Recent trends--During the 1950's Japan experienced four periods of upward expansion in the business cycle. The third boom was counteracted in the spring of 1957 when the Bank of Japan's basic discount rate was raised to a peak of 8.4 per cent per annum and restrictive fiscal measures were implemented.3/ In 1958, after considerable readjustment and a decrease in production, the Bank of Japan discount rate was lowered in three steps in June and September of 1958 and February of 1959 to 6.94 per cent. The discount rate was raised to 7.3 per cent in December 1959 when it appeared that the boom, which began in mid-1958, was threatening to become excessive. In August 1960 and January 1961, the rate was lowered to 6.94 and 6.57 per cent, respectively.

Interest rates on Japanese bank loans and discounts since early 1957 have tended to move in the same general direction as the Bank of Japan discount rate. The composite rate for loans and discounts fell from a peak of 8.64 per cent in May 1958 to a low of 8.06 per cent in September 1959.4/ The rate then moved up to 8.22 per cent in April 1960 where it remained until July 1960. Following the lowering of the Bank of Japan discount rate in August, the rate moved down to 8.08 per cent in December 1960.

As a rough indication of the relative ease or tightness in the money market, the trend in Bank of Japan loans and discounts, and bank funds available for credit, are revealing. There was a decline in Bank of Japan loans (as measured by the change over a one-year period) from the spring of 1957 through the fall of 1958, a period of monetary restraint. During the latter half of 1958, commercial bank funds available for loans and investments rose more rapidly than credit demands as the effects of the monetary restraint continued to be felt. The funds-utilization ratio of all banks dropped from 94 per cent at mid-1958 to 92 per cent at the end of the year, but subsequently began to rise as new credit demands exceeded the supply of new loanable funds.5/ To offset this tightening in the money market, Bank of Japan loans began to rise after the second quarter of 1959.

A general tightness has characterized the money market since September 1959, when the composite interest rate for loans and discounts began to move up. The call market rate was at the maximum of 8.39 per cent per annum from August of 1959 to January 1961, when it was lowered to 8.03 per cent. In some months in 1960 and subsequently, however, demand has been so strong that some call loans have been made at rates in excess of the agreed maximum.6/

Bank lending rates eased in the fall of 1960 following the reduction in the Bank of Japan discount rate. Two of the most important rates are for loans on bills and discounts of commercial bills. As measured by the mode, or most frequent rate, the interest rate for loans on bills dropped from 8.40 per cent early in the year to 8.03 in the last half of 1960. The rate for discounted bills remained at 7.67 per cent throughout 1960 except for April when temporarily strong demand pushed the rate up to 8.40 per cent. The median rate for loans on deeds dropped from 9.49 per cent in August, where it had held

3/ The 8.4 per cent rate refers to the Bank's basic discount rate on commercial bills eligible for rediscount at the Bank of Japan.
4/ This composite interest rate covers loans and discounts of "all banks." It is an average of the contract interest rates weighted by the outstanding amounts at different interest rates as of the end of each month.
5/ This is sometimes called the "overloan position" since at times in the past loans and investments have exceeded deposit and capital liabilities. As used above, the ratio expresses bank loans, discounts and security holdings as a percentage of total deposits, debentures issued, capital and reserves.
6/ See Oriental Economist, September 1960, p. 488.

steady for two years, to 9.13 per cent in September and throughout the rest of 1960. The commercial bank standard, or prime rate, is the rate for discount of commercial bills eligible for rediscount at the Bank of Japan. Since this rate is pegged at the same level as the Bank of Japan discount rate, the former was lowered in August and also in January 1961 when the Bank of Japan lowered its discount rate.

On April 1, 1961, interest rates on a broad variety of deposit, savings and trust accounts, the rates on long-term bank loans, and the effective yields on various bonds and debentures were lowered. This action, which had been contemplated for several months, was motivated by the Government's long-run policy of bringing the level of interest rates closer to those in Western money markets and also helping to implement the plan for doubling Japanese national income in the coming decade.

Industrial and long-term bank loan rates were reduced from 9.125 to 8.700 per cent. Time deposit, savings and trust account rates were lowered from 0.1 to 0.5 percentage points. The yields on bonds and debentures other than securities of the National Government were lowered from 0.2 to 0.4 percentage points. The yield on new issues of bank debentures was lowered from 7.6 per cent to 7.3 per cent. Yields on new issues of local government bonds and corporate debentures were reduced from 7.720 to 7.354 per cent and from 7.831 to 7.408 per cent, respectively.

Foreign short-term capital and the money market

Flows of foreign short-term capital, which of course influence the relative degree of tightness or ease in the money market, were of major significance in 1960. Various liberalization measures were taken during the year which had the effect of facilitating the inflow of foreign capital, with the result that a large proportion of the $502 million gain in officially reported international reserves reflected the capital inflow. In 1960, the net influx of foreign short-term capital, as measured on an exchange transactions basis, was $409 million, which served to reduce some of the tightness in the market. The surpluses on trade and current account, also measured on an exchange transactions basis, were $147 million and $111 million, respectively.

In February of 1960, the number of import commodities eligible for import usance (acceptance) financing was significantly increased with a resulting expansion in the volume of usance credits. This contributed to the $180 million short-term capital inflow in the first-half of 1960 compared to an $80 million inflow in the same period a year earlier. In addition, lower interest rates in New York and London contributed to an increase in the volume of foreign currency usance bills and a decline in the volume of yen import settlement bills during the first half of the year. The monthly volume of usance bills rose from $186 million in January to $262 million in June 1960. After mid-year, the premium on dollar futures and the high interest rate on pound sterling usance bills tended to make yen import settlement bills more attractive.

Early in 1960, Japanese branch banks in Europe began to attract substantial dollar deposits, offset by dollar denominated liabilities to the depositers.[7] Part of these deposits are used by Japanese banks in the United States to accommodate their customers, often branches of Japanese trading firms requiring dollar financing, part are held as a reserve, and part are transferred to Japan. By mid-year, the level of these deposits had reached about $113 million, and they constituted a fairly significant source of finance. The use of these funds in 1960 was attractive since their cost was about 4.75 per cent for three months and 5.5 per cent for six months funds. They could then be loaned at rates of from 7 to 10 per cent in Japan.

On July 1, 1960, the Japanese established limited exchange convertibility for non-residents through the introduction of non-resident free-yen accounts. Holders of account balances are allowed to freely convert their holdings into foreign exchange. The move did not constitute the establishment of complete non-resident external convertibility since, among other things, yen balances previously acquired by non-residents were not allowed to be converted into foreign exchange and a waiting period for capital repatriation was still required.

Non-resident free yen accounts receive the same interest rate as regular time deposits in Japan, which are relatively high. Banks receive a special rate of 5.48 per cent for deposits of three months or more. This is the rate paid to Japanese branch banks abroad which maintain deposits with their head offices. Between July 1, 1960 and February 28, 1961, non-resident accounts rose to $217 million, fed largely by conversion of $114 million in Euro-dollar deposits into non-resident free yen. Beginning in September, there was a sharp drop in the rate of increase of Euro-dollar deposits, but since early in January the level of deposits has risen substantially.

Several additional recent steps have further facilitated capital movements. At the end of August, the ceilings on unsecured borrowing by Japanese foreign exchange banks from foreign banks, mainly American, were eliminated. This step was reportedly taken in response to a request from those Japanese foreign banks which had no branch offices in London and therefore could not accept Euro-dollar deposits. On November 12 the Government also decided to authorize, more or less automatically, impact loans in any amounts for any purpose with maturities ranging from six to twelve months. Previously such loans were limited to those financing plant and equipment investment in key industries with maturities of one year or more.

Also, on November 12 the maximum term for import usance credit was raised from three to four months. Since then usance credit has expanded by over $200 million. The net effect of these various moves has been to ease somewhat the general tightness that has been prevalent in the money market since September 1959.

On May 1, 1961, the authorities took special steps to encourage non-resident purchases of Japanese securities. Special arrangements were made so that non-residents can now liquidate investments and repatriate the proceeds without any minimum waiting period. In effect, this creates a system of "security yen" (similar to the United Kingdom "security sterling" arrangement).

7/ These are the so-called Euro-dollars. For a discussion of transactions in Euro-dollars, see the Monthly Review, New York Federal Reserve Bank, November 1960.

Under this new arrangement non-residents are allowed to purchase yen to make investments in Japan from other non-residents who have yen which was obtained through the liquidation of investments. The exchange rate for such transfers is determined by market factors and is not held at the rate for the spot yen by official intervention. In addition, the minimum time period for repatriation of funds invested by non-residents in Japanese securities at the official rate of exchange was reduced from four to two years on May 1, 1961.

Conclusion

From the foregoing, it is evident that the Japanese money market is relatively narrow, not including such important components as an open market in commercial paper or acceptances. In addition, an active market in short-term government securities is precluded by the Government's policy of pegging the interest rate on these securities about 2 per cent below prevailing rates on high-quality short-term commercial debt. It would appear that in the coming years the growth of the economy would benefit from an expansion of the market to include a larger variety of short-term credit instruments.

Under present conditions, the Japanese money market, which consists almost exclusively of a call loan market, is quite different from those in New York and London. Call loans are short-term and serve mainly to supplement liquidity needs not met either by Bank of Japan credit or liquidation of certain bank assets, and to some extent to meet private sector loan demand. Since the call loan market in part consists of credit supplied by Japan's local banks to the city banks, it bears some similarity to the Federal Funds market in the United States.

In general, interest rates in Japan, including the call loan rate, are less sensitive to demand and supply forces than in the New York or London money markets. This is primarily because of the legal and voluntary regulation of rates detailed earlier. Money ease or tightness, however, is influenced by such important factors as government cash operations, Bank of Japan credit accommodation, strong or weak business demands for credit, and the balance of payments position. Of these main factors, government cash operations and Bank of Japan credit accommodation would appear to be the most important, at least in 1960. Foreign short-term capital inflows were also important in 1960 and recently.

Because of the controls over interest rates and bond yields, interest rate movements are not always a sensitive indicator of changes in the demand and supply of funds in Japan. The controlled rates are probably not usually at wide variance from the natural rates. When they are, they are breached, as in the case of the call rate, or circumvented by such devices as requiring a certain percentage of a loan to be held as a deposit in the case of loans to businesses. There is a question as to whether any real benefits are gained for the economy by these controls.