Roles of Finance in Economic Growth

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**Any views expressed in this presentation are those of the author, and are not necessarily the official views of the FSA.*

Outline

I. Roles of Financial Sector in Economic Growth

(1) Promoting Economic Growth

-The Action Plan for the New Growth Strategy-

- **Supporting economic activities**

  -Providing investment opportunities and means of raising fund

- **Leading the economy as a growing industry itself**

(2) Ensuring Financial Stability

- **Post crisis status report**

- **Policy responses**

II. Further Challenges for Economic Growth in Asian Countries

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(2) Ensuring Financial Stability

II. Further Challenges for Economic Growth in Asian Countries

I.(1) Promoting Economic Growth
-The Action Plan for the New Growth Strategy-

''The Action Plan for the New Growth Strategy,'' published by the Japanese FSA in December 2010, summarizes necessary measures for financial sector to promote economic growth.

Three Pillars of the Action Plan

- To supply funds to companies commensurate with borrowers' size and stage of development
- To bridge between the Japanese and Asian economies
- To provide asset management capabilities to utilize Japanese national assets safely and effectively

To supply funds to companies commensurate with borrowers' size and stage of development

>> Restoring confidence in and activating markets for emerging companies

- Encouraging use of "Green Sheet," the venue for pre-listed stocks.
- Establishing a list of companies which meets certain criteria of quality as candidates for future listing.
- Preparing venues for delisted stocks ,etc.

>> Developing debt capital markets for professional investors

- Expediting the establishment of a corporate bond market for professional investors (i.e. Tokyo Pro-Bond market).
- Simplifying disclosure requirements, and allow documentation in English.

>> Improving disclosure requirements

- Developing disclosure rules for smooth implementation of "rights offering."
- Relaxing quarterly securities report requirements.
- Reviewing guidelines of accounting standards and internal controls reporting systems to suit the actual circumstances of SMEs.

>> Expanding availability of commitment line contracts for smaller companies

>> Allowing banks and insurance companies to engage in finance leases

To bridge between the Japanese and Asian Economies

Establishing Japan as Main Financial Market in Asia

Make Japanese financial markets more reliable, convenient, and attractive to both domestic and foreign investors.

>> **Expanding the scope of English language disclosure for Foreign Companies, etc.**

• Foreign companies will be allowed to use their English language version of issuance disclosure documents and extraordinary reports.

(Currently, only continuous disclosure documents are eligible for such exemption.)

-To encourage foreign companies to raise capital in Japan

-To provide greater opportunities for Japanese investors to invest in foreign companies

>> **Promoting the establishment of an integrated exchange handling securities and other financial instruments as well as commodities**

To bridge between the Japanese and Asian Economies

Expanding activities of Japanese financial institutions in Asia

>> **Promoting policy coordination regarding financial and capital markets among Asian financial authorities**

- Conducting a survey on the status of financial and capital markets in Asia.
- Sharing experience on and lessons from financial crises and regulatory/supervisory frameworks in Japan as a reference for further development in Asia.
- Increasing input to the international discussions on financial regulatory reforms through enhanced dialogues among Asian financial authorities.

>> **Supporting activities of Japanese small- and medium-sized enterprises (SMEs) in Asia**

- JETRO and JBIC will support Japanese financial institutions to further improve information and consultation service for Japanese SMEs and their overseas subsidiaries.
- To facilitate Japanese SMEs' borrowing from foreign financial institutions: JBIC will provide loans to the local financial institutions; and Japanese financial institutions will provide loan guarantee to the borrowing SMEs.

To provide asset management capabilities to utilize Japanese national assets safely and effectively

>> Relaxing the regulation on asset allocation of insurance companies

- Abolishing the ceiling on the ratio of each type of asset held to total assets.

  ⇨ -To enable flexible asset management

>> Extending reduced tax rate on securities

- Extending the reduced tax rate (20% →10 %) for dividend income and capital gains on listed shares until 2013

  ⇨ -To activate financial markets

  -To ensure economic recovery

>> Expanding profit/loss offset scope for tax purposes

>> The Financial Services ADR (Alternative Dispute Resolution)

- The Financial Services ADR was introduced in October 2010.
- This system will work for fast, simple, neutral, fair complaint handling and dispute resolution for problems with financial institutions.

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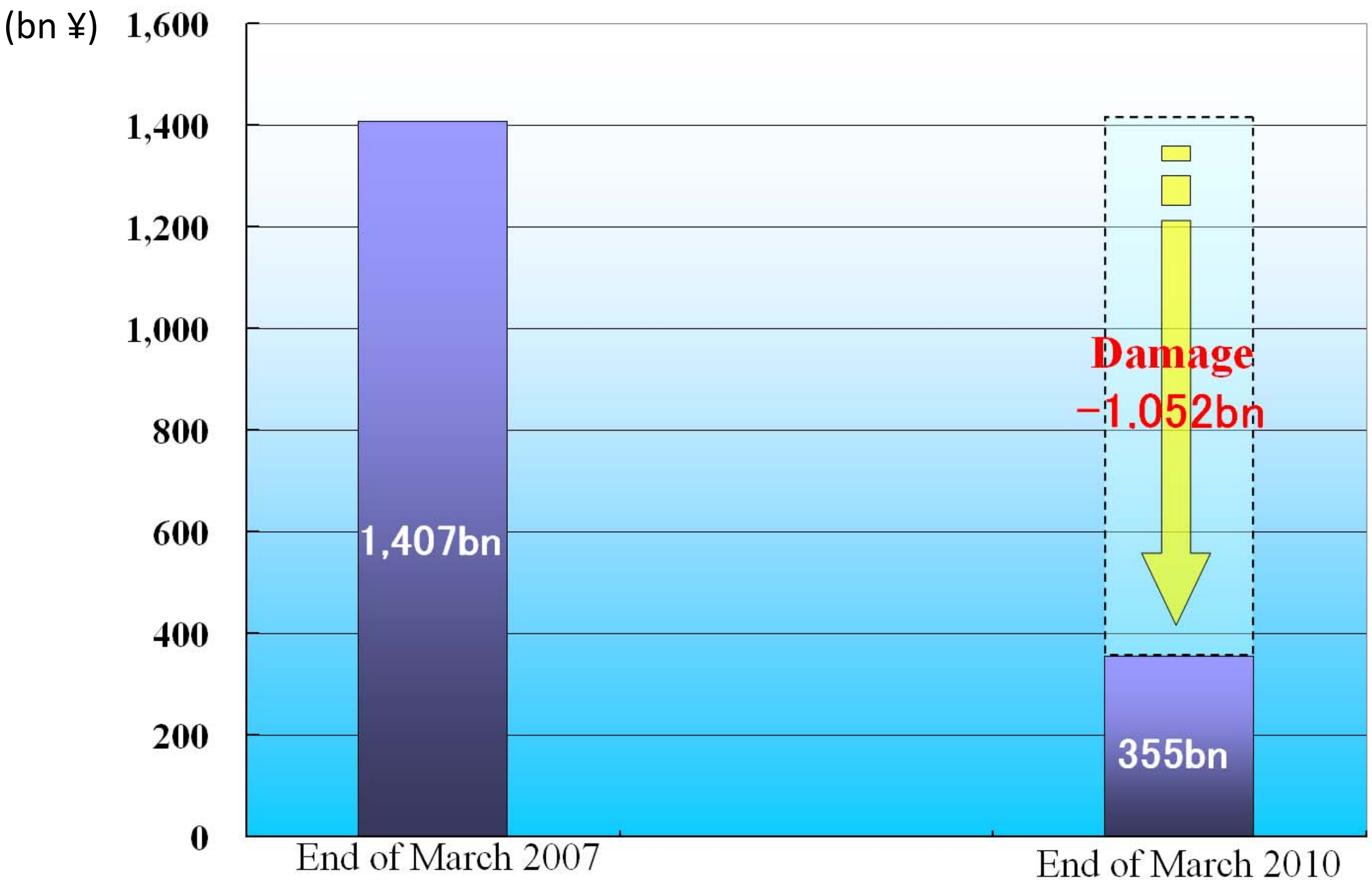
I. (2) Ensuring Financial Stability
Limited Direct Impact on the Financial Sector

Exposure to subprime-related products was limited for Japanese financial institutions.

Exposures to Subprime-Related Products (Book Value)



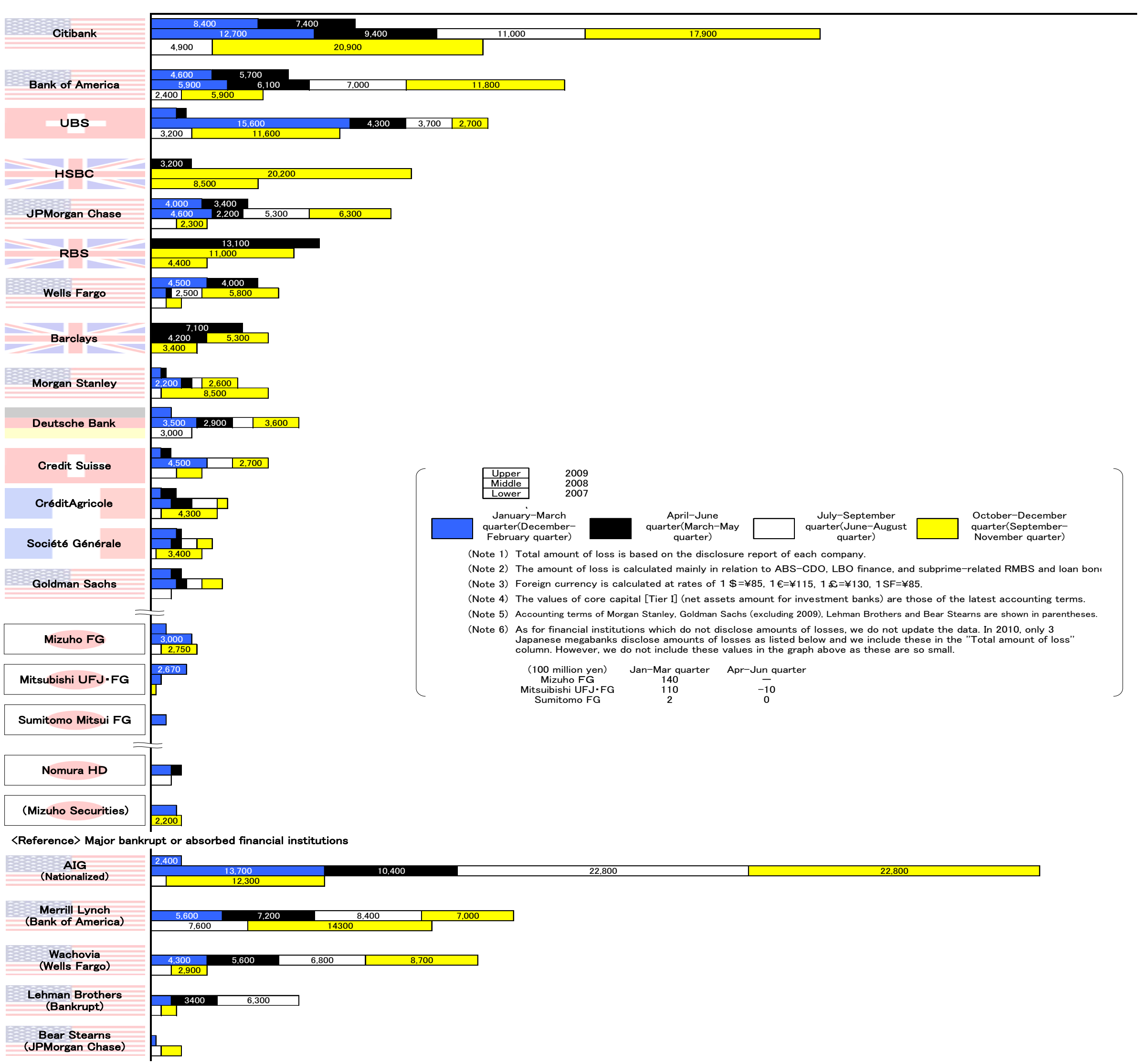
Source: Financial Services Agency, Japan

Limited Direct Impact on the Financial Sector

The loss of Japan's financial institutions from toxic assets is significantly smaller than those of the American and European financial institutions.

Total amount of loss from subprime-related products

(Unit: 100 million yen)



(Note 1) Total amount of loss is based on the disclosure report of each company.

(Note 2) The amount of loss is calculated mainly in relation to ABS-CDO, LBO finance, and subprime-related RMBS and loan bon

(Note 3) Foreign currency is calculated at rates of 1＄=¥85, 1€=¥115, 1￡=¥130, 1SF=¥85.

(Note 4) The values of core capital [Tier I] (net assets amount for investment banks) are those of the latest accounting terms.

(Note 5) Accounting terms of Morgan Stanley, Goldman Sachs (excluding 2009), Lehman Brothers and Bear Stearns are shown in parentheses.

(Note 6) As for financial institutions which do not disclose amounts of losses, we do not update the data. In 2010, only 3 Japanese megabanks disclose amounts of losses as listed below and we include these in the "Total amount of loss" column. However, we do not include these values in the graph above as these are so small.

(100 million yen)	Jan–Mar quarter	Apr–Jun quarter
Mizuho FG	140	—
Mitsuibishi UFJ・FG	110	–10
Sumitomo FG	2	0

	Total amount of loss	Core capital /Net assets amount	Capital increase	Capital investor
Citibank	87,400	107,000	102,900	U.S. Department of the TreasuryAbu Dhabi Investment Authority Government of Singapore Investment Corporation (GIC), Kuwait Investment Authority etc.
Bank of America	46,800	140,000	83,100	U.S. Department of the TreasuryGeneral investors
UBS	43,500	30,000	33,000	Swiss Federal Department of Finance Government of Singapore Investment Corporation (GIC).Anonymous investors in the Middle East.Existing shareholders etc.
HSBC	30,000	105,000	16,300	Existing shareholders.
JPMorgan Chase	28,500	118,000	40,400	U.S. Department of the Treasury General investors
RBS	24,600	79,000	91,300	HM Treasury Existing shareholders.
Wells Fargo	19,500	90,000	56,000	U.S. Department of the Treasury General investors
Barclays	17,400	68,000	15,300	Qatar Investment Authority Qatar Holdings Challenger (Qatar) Sumitomo Mitsui Banking Corporation etc.
Morgan Stanley	16,100	46,000	26,200	U.S. Department of the Treasury Mitsubishi UFJ FG China Investment corporation
Deutsche Bank	14,400	44,000	14,000	Institutional investors
Credit Suisse	14,700	32,000	8,800	Qatar Holdings, etc. Major worldwide investors
CréditAgricole	11,000	38,000	10,200	Existing shareholders French government
Société Générale	9,300	44,000	15,800	Existing shareholders French government
Goldman Sachs	8,100	59,000	21,300	U.S. Department of the Treasury Berkshire Hathaway General investors
Mizuho FG	7,940	53,106	11,977	Institutional investors General investors
Mitsubishi UFJ・FG	4,000	102,246	22,887	General investors
Sumitomo Mitsui FG	1,485	62,808	28,369	Institutional investors General investors
Nomura HD	3,627	19,420	7,107	General investors
(Mizuho Securities)	4,170	5,777	4,000	Mizuho corporate Bank
AIG (Nationalized)	80,800	64,000	76,500	U.S. Department of the Treasury General investors
Merrill Lynch (Bank of America)	47,300	18,000	29,900	U.S. Department of the Treasury Temasek Holdings Korea Investment Corporation Kuwait Investment Authority Mizuho corporate Bank etc.
Wachovia (Wells Fargo)	28,100	28,000	8,900	General investors
Lehman Brothers (Bankrupt)	12,300	22,000	8,500	General investors Closed customers
Bear Stearns (JPMorgan Chase)	2,900	10,000	—	

Limited Direct Impact on the Financial Sector

Japan implemented Basel II before the global financial crisis.

Basel II Implementation Date

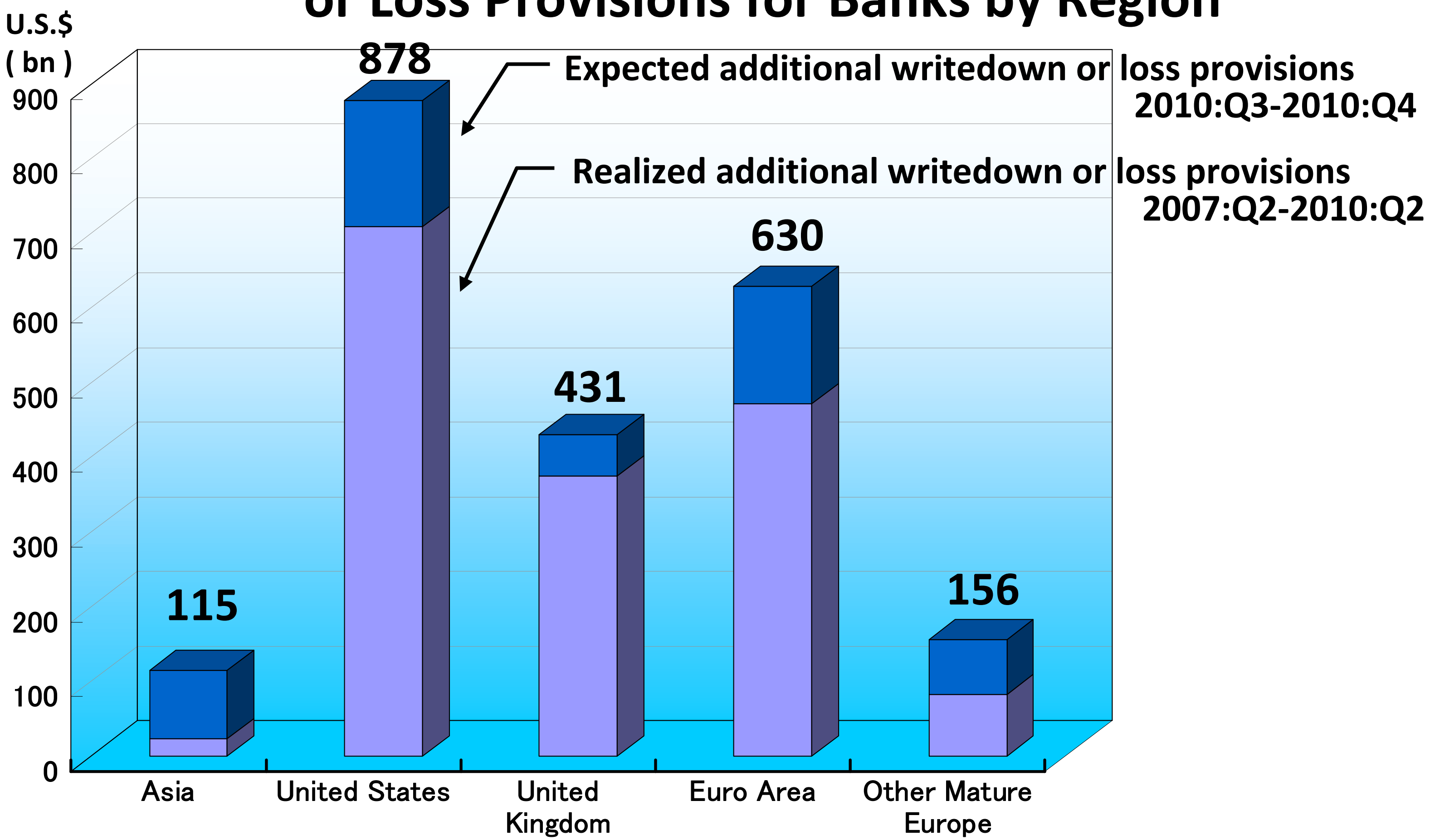
- Japan : Implemented in end-March 2007
- Canada: Implemented in end-October 2007
- Europe: Implemented in end-December 2008 (in many member countries)
- US: Yet to be implemented

※ Under Basel II, unrated securitization exposures are deducted from capital in principle unless a bank can appropriately capture the risk profile of their underlying assets.

Limited Direct Impact on the Financial Sector

The small exposure to toxic assets limited the losses from these assets for Asian financial institutions in general.

Realized and Expected Writedowns or Loss Provisions for Banks by Region

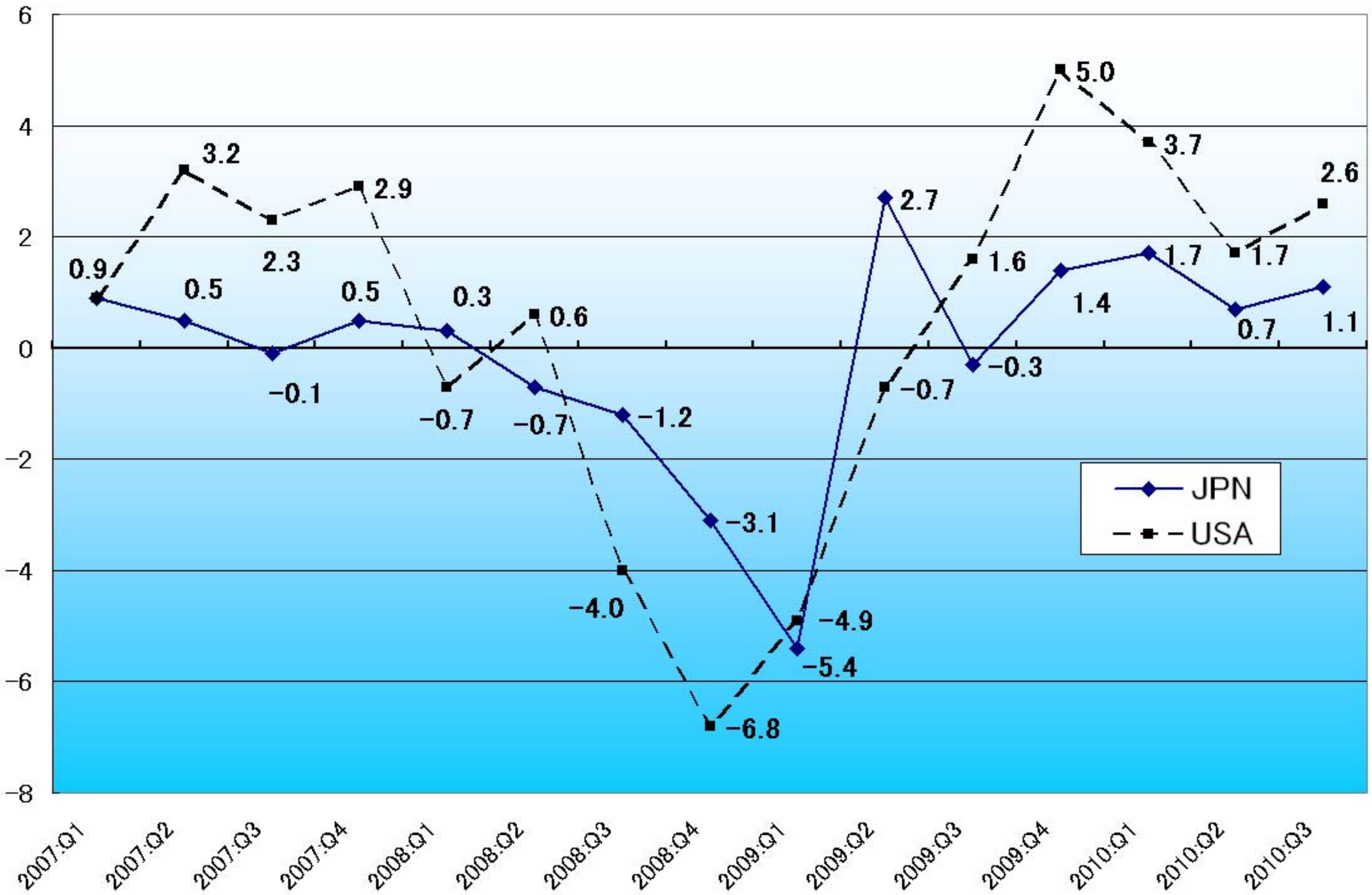


Source: IMF Global Financial Stability Report in October, 2010

Substantial Damage through the Real Economy

The global recession has led to a serious weakening of Japan's real economy through the severe contraction of external demand.

Development of Real GDP (Quarterly), Seasonally Adjusted Series

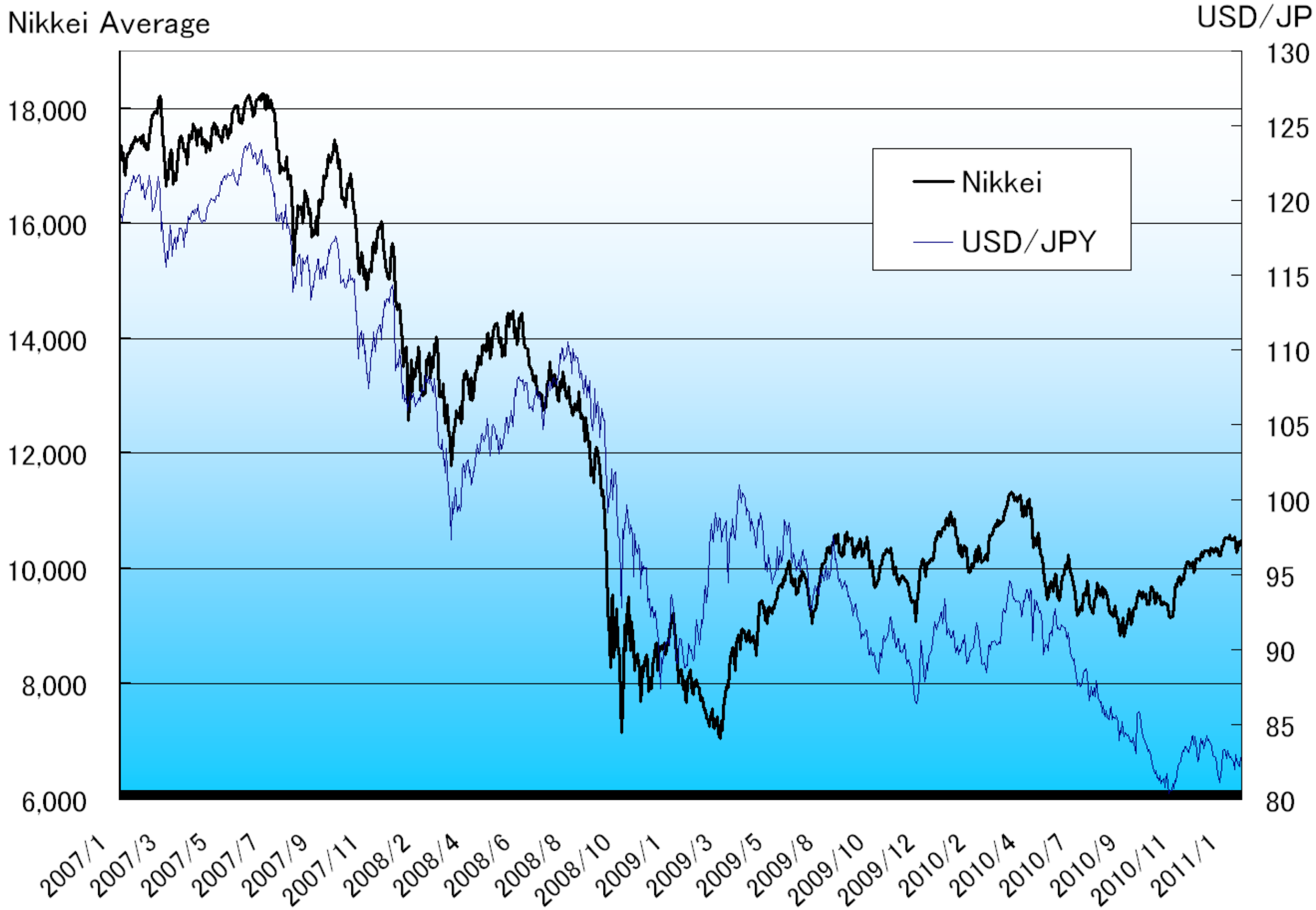


Source：Bloomberg

Substantial Damage through the Real Economy

- Yen appreciated sharply vis-a-vis U.S. dollar.
- Stock prices dropped in a similar manner.

Nikkei Average and Exchange Rate (USD/JPY)

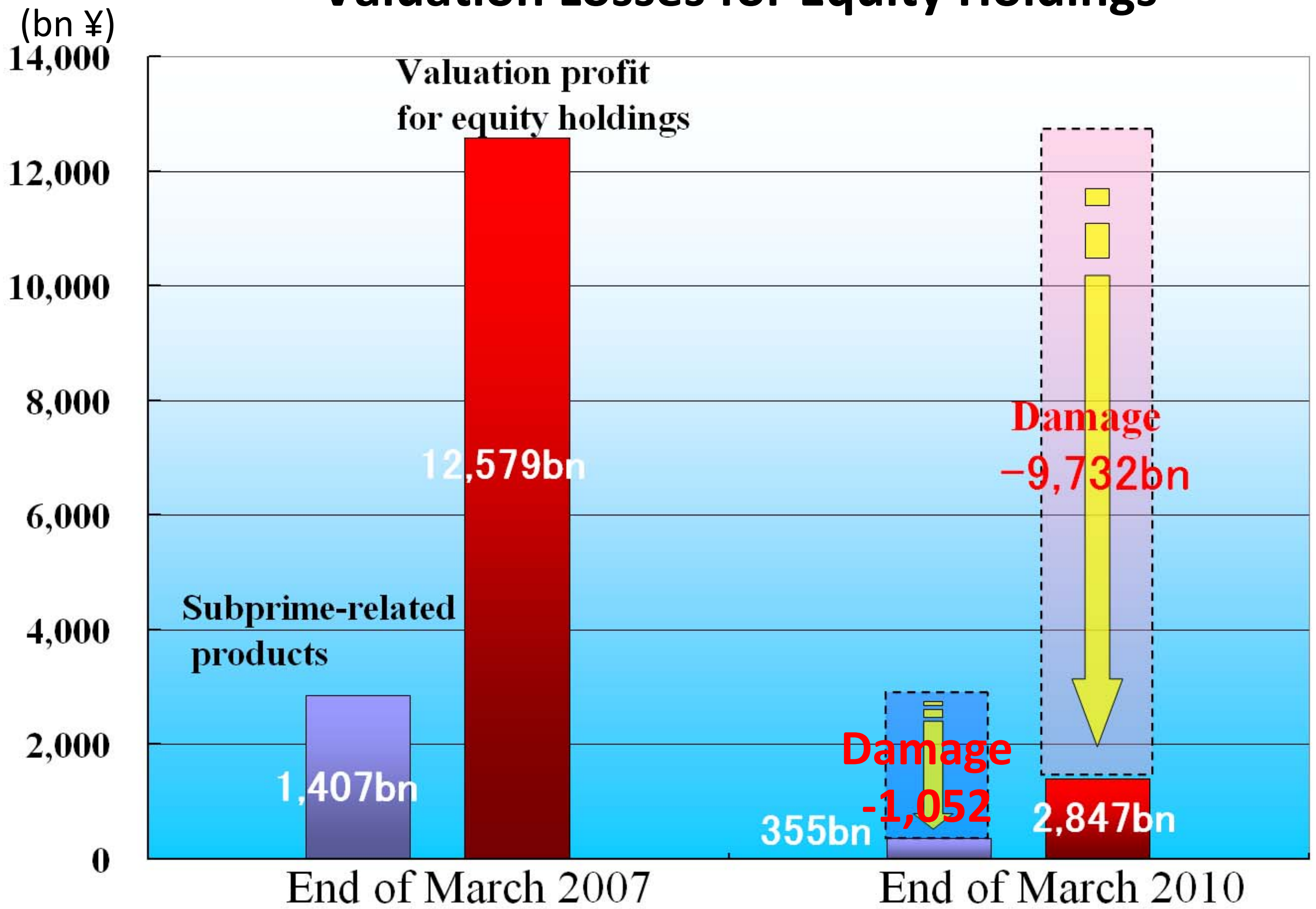


Source: Bloomberg

Substantial Damage through the Real Economy

Valuation losses of equity holdings for Japanese financial institutions were about 10 times larger than those of sub-prime related products.

Valuation Losses for Equity Holdings



Source: Financial Services Agency, Japan

Substantial Damage through the Real Economy

Relatively large equity holdings by banks entailed significant risk.

Bank Equity Holdings and Bank Assets (All Banks in Japan)

(Billion yen)

	Equity Holdings (market price)	Ratio of Bank Assets
2005	27,734	3%
2006	33,240	4%
2007	33,869	4%
2008	25,606	3%
2009	18,404	2%

Source: Bank of Japan

11 Major Banks: Profit and Loss

In FY 2008:

- Operating profits from core businesses covered losses from the disposal of NPLs.
- However, net income turned negative because of huge losses on equity securities.

(Billion yen)

	FY 2007	FY 2008	FY 2009
Operating profits from core business	3,277	2,660	2,930
Loss from disposal of NPLs	-411	-1,911	-966
Net profits/losses on equity securities	-41	-1,561	62
Net income	1,453	-1,607	1,159

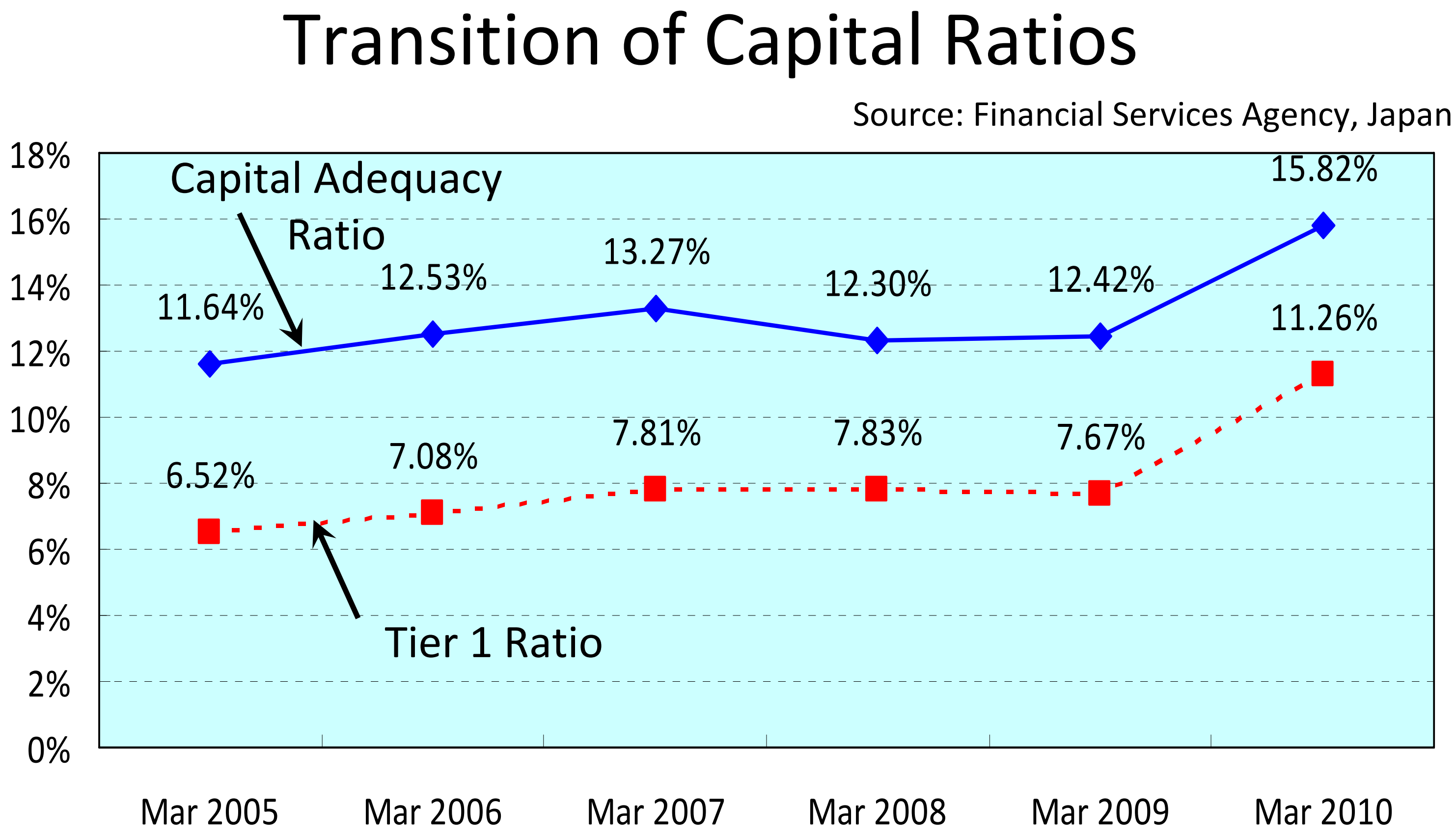
※ FY 2007 is the 12 month period ending in March 2008.

Source: Financial Services Agency, Japan

** 11 major banks consist of Mizuho Bank, Ltd, Mizuho Corporate Bank, Ltd, Mizuho Trust & Banking Co. Ltd, Sumitomo Mitsui Banking Corporation, The Bank of Tokyo-Mitsubishi UFJ ,Ltd, Mitsubishi UFJ Trust and Banking Corporation, Resona Bank, The Chuo Mitsui Trust and Banking Company, Limited, The Sumitomo Trust & Banking Co., Ltd, Shinsei Bank, Ltd, and Aozora Bank, Ltd.*

11 Major Banks: Capital

The capital ratios of 11 major banks were not severely affected by the global financial crisis.



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Short-Term Measures Taken in Japan

In U.S. and Europe, **extraordinary actions with massive public support** were taken such as:

- *Large-scale Capital Injection*
- *Temporary Bank Nationalization*
- *Credit Guarantees by Governments*

On the contrary, **in Japan**, **policy measures** taken against the global financial crisis **focused on maintaining financial intermediary functions** because of:

- *Relative Soundness of Financial System*
- *Severe Weakening of Real Economy*

Short-Term Measures Taken in Japan

Thus, **short-term policy measures taken in Japan** included:

- **Strengthening Financial Intermediary Functions**
  - *The enforcement of the revised Act on Special Measures for Strengthening Financial Functions*
  - *¥ 309 billion has been injected into 11 regional financial institutions*

- **Helping Banks to Reduce Equity Holdings**
  - *Resuming the operations by the Banks' Shareholding Purchase Corporation to purchase stocks directly from banks (about ¥ 523 billion) at market price outside the market.*
  - *Similar action by BOJ (about ¥ 388 billion)*

- **Facilitating Financing for SMEs**
  - *To encourage financial institutions to accommodate requests from SMEs to ease credit terms on existing loans*

Medium-Term Measures Taken in Japan

Before the Global Financial Crisis…

- **Banks** had been **under rigorous regulation and supervision** to ensure their financial soundness to prevent systemic risk.
- **Securities firms** had been considered **remote from systemic risk** and hence had been **under less stringent prudential regulation and supervision**.

Impact of the Lehman Failure on Japanese markets

- **Experienced certain fail or delay** in securities and derivative transactions.
- Thanks to clearing system and DVP practice, there was **limited market-wide effect for bonds and stocks**. Markets normalized within a few weeks.
- For **OTC derivative** markets, which **did not have central clearing system**, market normalization was **delayed and more painful**.

Medium-Term Measures Taken in Japan

Lessons Learned

- **"Systemic risk"** turned out to be **no longer peculiar to banking sector**.
- **Central clearing is useful** to contain risks.

Medium-Term Measures Taken in Japan

Enhanced prudential regulation of securities companies

>> Introducing early warning system (2008)

- In cases where a financial instruments business operator **meets the prescribed criteria** regarding:

  - Changes in the capital adequacy ratio
  - Changes in prices of securities

- Supervisors shall strive to **quickly identify risks** by holding a hearing and requiring the submission of a report.

>> Strengthening group-wide regulation and supervision of securities companies (Amendment of the FIEA, 2010)

- Large securities companies with total assets worth above a trillion yen

  a) **Capital adequacy requirements** on a **consolidated basis**

  b) Authority to order **collection of reports from and inspection of parent, subsidiary, and sister companies** of the securities companies

Medium-Term Measures Taken in Japan

>> OTC Derivatives (Amendment of the FIEA, 2010)

- OTC derivative transactions that **<u>need to be cleared at CCPs</u>** are determined no later than November 18th 2012.

  -Those OTC derivative transactions **<u>need to be cleared by domestic CCPs:</u>**

  a) for which **<u>clearing criteria relate closely to the bankruptcy procedures</u>** under Japanese law.

  b) of which **<u>transaction volume</u>** in Japan is **<u>above a certain level</u>**.

  \- Others can be cleared by domestic CCP, foreign CCP or domestic CCP and foreign CCP under link arrangement.

>> Reducing of settlement risk of JGB trading and stock lending

- Introducing fail charge practice in November 2010.
- Shortening settlement Cycle from T+3 to T+2 by early part of 2012.
- Trust Banks to be covered by JGBCC by mid-year 2014.

  ⇒most of JGB trading will be cleared at JGBCC.
- DVP settlements for securities lending will be in place in January 2014.

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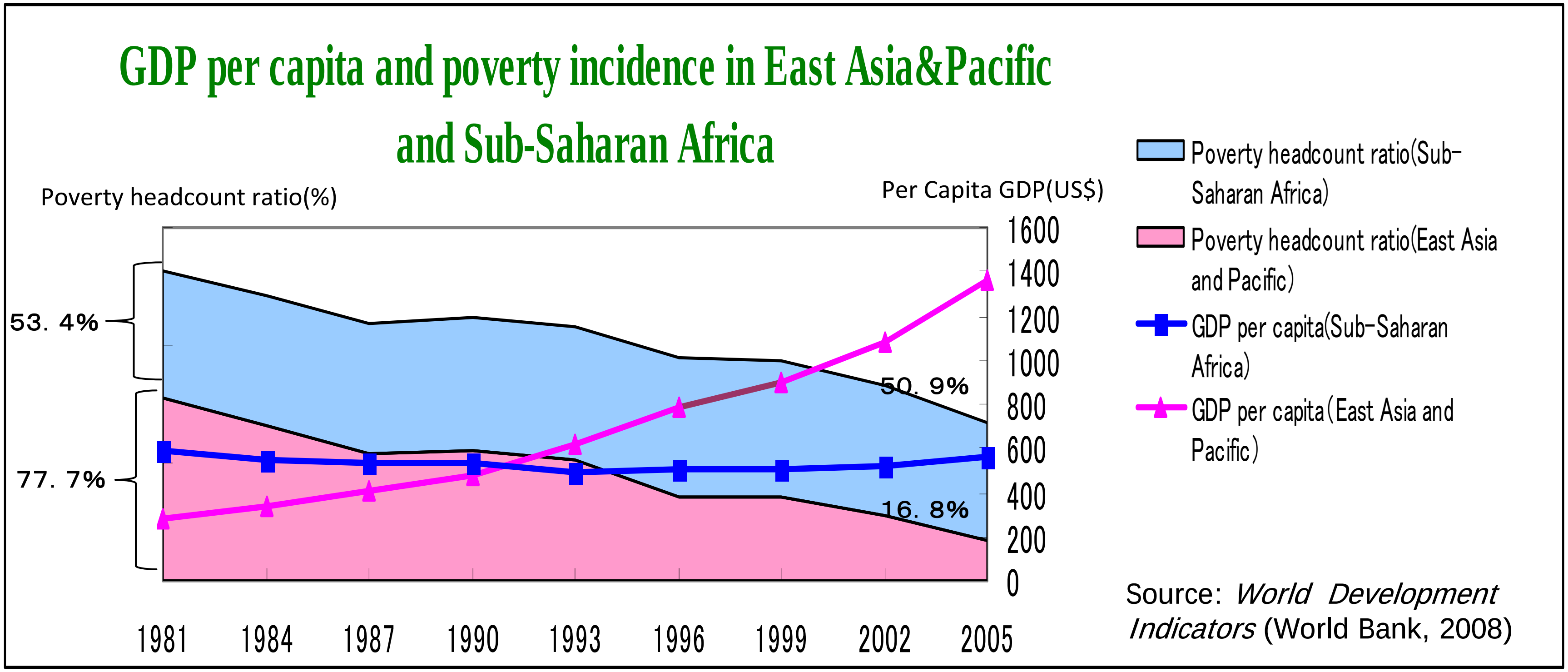
Japan's contribution to Asia's Impressive Economic Growth

➢ Japan's ODA, combined with trade and investment, has supported Asia's economic growth.
✓Poverty population (earning less than US$1 per day) in Asia has decreased by more than 700 million.
【Characteristics】
✓Focus on economic/social infrastructure building and human resource development.
-supported the development of the investment environment and the creation of the vibrant private secto
✓Timely assistance to areas suitable for the promotion of trade and direct investment.
✓Contribution to productivity growth in Asia (together with trade and investment).



Poverty headcount ratio: proportion of the national population whose incomes are below US$1 per day

Japan's contribution

(USD 100 million)

	2005	2006	2007	2008	2009
Current Account	1,657	1,705	2,104	1,566	1,421
Foreign Direct Investment	▲ 422	▲ 568	▲ 514	▲1,063	▲628
Outward Investment (Net)	▲ 454	▲ 501	▲ 735	▲ 1,308	▲746
Inward Investment (Net)	32	▲67	221	245	118
Foreign Portfolio Investment	▲ 133	1,275	731	▲ 2,925	▲2,164
Outward Investment (Net)	▲ 1,964	▲ 710	▲ 1,234	▲ 1,896	▲1,602
Inward Investment (Net)	1,831	1,985	1,965	▲ 1,029	▲562
Foreign Reserve (Excluding gold)	8,342	8,796	9,527	10,093	10,222

Source ： IMF, Datastream
（note） ▲ refers to outflow

China’s welcome new addition

(USD 100 million)

	2005	2006	2007	2008	2009
Current Account	161	253	372	436	297
Foreign Direct Investment	678	603	1,214	943	343
Outward Investment (Net)	▲ 113	▲ 178	▲170	▲535	▲439
Inward Investment (Net)	791	781	1,384	1,478	782
Foreign Portfolio Investment	▲ 50	▲ 675	187	427	387
Outward Investment (Net)	▲ 262	▲ 1,104	▲ 23	328	99
Inward Investment (Net)	212	429	210	99	288
Foreign Reserve (Excluding gold)	8,215	10,694	15,302	19,492	23,888

Source ： IMF, Datastream
（note） ▲ refers to outflow

Preparations on the Receiving Side

- IMF WEO update (July 2010)

"Lower risk appetite could initially <u>reduce capital flows to emerging and developing economies</u>"

			(Projections)	
	2008	2009	2010	2011
World Output	3.0	-0.6	4.6	4.3
Developing Asia	7.7	6.9	9.2	8.5
China	9.6	9.1	10.5	9.6
India	6.4	5.7	9.4	8.4
ASEAN-5	4.7	1.7	6.4	5.5

- IMF GFSR (Oct 2010)

"…some countries in Asia and Latin America continue to experience <u>a potential buildup of risks stemming from strong capital inflows</u>"

Preparation on the Receiving Side

- **Lessons from the Asian Financial Crisis**

  - Excessive dependence on foreign short-term borrowings can make the financial sector vulnerable and can cause economic instability.

  - Asia must be prepared to use financing productively

- **Items Necessary**

  - Regional arrangements as financial safety nets

  →Chiang Mai Initiative (CMI)

  - Mobilizing domestic savings and receiving finance from secure fund sources

  →Asian Bond Market Initiative (ABMI)

Developing bond markets in Asia through ABMI and ABMF

>> Asian Bond Markets Initiative (ABMI)

- Aims to:
  - Develop robust bond markets;
  - Avoid the double mismatch of maturity and currency; and
  - Re-channel more Asian savings into the Asian economies.

>> ASEAN+3 Bond Market Forum (ABMF) (launched in 2010)

- Aims to:
  - Assess the existing regulatory frameworks, as identified by the participants, and their recommendations on how to foster harmonization of regulations and market practices that facilitate cross-border bond transactions in the region;
  - Enhance dialogue between the private sector and ASEAN+3 officials to develop bond markets in the region and improve harmonization, standardization, and integration; and
  - Provide opportunities to exchange knowledge, expertise, and experience among the private and public sector in the region.