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Indispensable conditions for the development of financial markets

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This year, the IIMA is going to celebrate its 20th anniversary of its inception, but just before that, the IIMA established a new record since its establishment. That is the number of nationalities with which the IIMA members had human interactions during the year. Those include only contacts with persons with whom the IIMA staff had a face-to-face communication for substantial hours, excluding those just participated in international conferences. The number amounted to 48 countries, 10 from advanced countries of Europe, the US and Australia, 8 from Asia, 2 from Latin America, 16 from Middle East and Northeast Africa, and 12 from Southern Africa.

The biggest factor for these abundant communications is the strengthened external support of the Japanese government on the financial matters, to which the IIMA staff had an increased involvement as financial engineer.

When explaining the framework of financial system to persons from countries on a different stage of development, we've got a renewed notion that there are many things that we have too much taken for granted. One of them is the importance of banking system in a lot of ways. Accurate and speedy operations and fair and transparent pricing of interest rate and exchange rate are indispensable to the system. It is the existence of these essentials that encourage the people to deposit their financial assets with the banks. The collected money in this way enables the mere "system" to become a "market" that various entities actively take part in.

One of the ASEAN countries has had a problem of inactive foreign exchange transactions in the interbank market. They cited the absence of brokers and price makers as its cause but a closer look suggested that the biggest factor would be the absence at all of people's trust in the banking system. Among the exporters, there was no trust in the banks as a counterpart of foreign exchange transactions. Normally the exporters who earned foreign currencies would complete their business by exchanging at banks those foreign currencies into local currencies. They would not do such an ineffective thing as to look for the importers by themselves who needed the same amount of dollars to exchange. In that country, however, operations of the banks are so much incorrect and ineffective that few people are willing to bring their foreign exchanges to the banks. The needs for selling and buying foreign exchanges that occur in many phases of national economy are not concentrated to the banking system.

The more concentrated in a market the transactions are, the lower will become the transaction cost. That is a merit of the market transaction. In a country where neither exporters nor importers bring their foreign exchanges to the banks, it is hard to foster a foreign exchange market for whatever other measures are implemented.

Another member of the ASEAN has had a problem of very slow growth of bond market. On inquiry, it was found that the large companies have no incentives to issue bonds because such companies can get a bank loan with a substantially low interest. Investors also seem to see no special attractiveness on investment in bonds because they can get high interest rate on the bank deposits.

Lower loan rates and higher deposit rates than the yields in the bond market are inconceivable as an average status of financial markets. Probably the loan rates to large companies have been set too much advantageous to them at the expense of other companies which are possibly obliged to pay substantially higher interest rates. Or there might be some fiscal subsidiaries to enable the banks to offer interest rates so much deviated from market principles. In any case, it is hard to say that the banking system has contributed to the development of sound competitive environment of the macro economy. In such an environment, there will be a doubt on how much successful results could be attained for the fostering efforts of bond market whether by setting up rating agencies or by fostering institutional investors.

A country in North Africa has a big presence of shadow banking sector and we had a concern that it may have impeded the development of a sound economy and finance. Shadow banking, however, may have been produced in a way from necessity because the authorized financial institutions hesitate to take part in the world of high-risk high-return business. Why do they hesitate? It is because they can earn a thick profit margin from borrowers with low risks by institutional factors, including excessive official protection, which have made a distortion in the interest rates. In such a cozy environment, therefore, they don’t have any needs to expand their business into a high-risk financial business.

A financial system is mutually connected with each part and therefore in fostering the system it is important for us to always pay attention to the whole system without focusing only on a specific part. What is to be looked at in the whole system, therefore, will be whether the market principle with fair competition is working in a banking system that is responsible for the most basic functions of finance such as deposit, loan and settlement, and whether that is contributing to the stability of the system as a whole.

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