

How Can Tokyo and New York Ensure Their Competitive Positions in the Future as Global Financial Market Centers?

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October 20, 2006

1. Tokyo Stock Exchange and NY Stock Exchange are expanding.

The trade volume of NYSE has been increasing sharply in the recovery of the USA economy. On the other hand, the stock market of TSE had been stagnated for more than 10 years since the burst of the bubble economy. However, when bad loan issues of Japanese banks are almost settled in the spring of 2003, TSE market has started to recover.

Especially, recently many Japanese emerging companies have been listed in the stock markets. Such a trend supports the popularity of the total market. Japanese emerging markets, Mothers (TSE), JASDAQ, Hercules (OSE) which were hinted by NASDAQ in USA have been very successful and expanding.

I would like to analyze the future of the financial markets including the stock markets and the fundamentals which support the market growth.

2. Fundamentals supporting financial market growth

Fundamentals which support financial market growth are such as follows.

- ①. The size of the economy is larger than a certain level.
- ②. Financial assets in the country have been accumulated to a certain amount.
- ③. IT infrastructures accommodate every investor with tools for global trading.
- ④. Cross-border capital transactions are liberalized totally. Property rights on investments are protected not only for domestic people but also foreigners.
- ⑤. Fair market rules and traditions are secured not only legally but also spiritually.
- ⑥. There is a foundation for fostering new industrial technologies.
- ⑦. There is a market where not only professional investors but also amateur investors can participate. Especially most of the people have a standard financial knowledge.

(1) The size of the economy, financial assets, IT infrastructure

According to international comparative statistics (C.Y.2004), the world GDP total is \$40.5 trillion, GDP of USA is \$11.7 trillion (29.0%), GDP of Japan is \$4.7 trillion (11.5%). Therefore total GDP of USA and Japan is \$16.4trillion and the share of the world GDP is more than 40%. Additionally, GDP of German is \$2.8trillion (6.8%), GDP of UK is \$2.1trillion (5.3%), GDP of France is \$2.0trillion(5.1%), GDP of China is \$1.7trillion (4.2%). The size of GDP is one of the necessary factors but not a enough condition for the establishment of competitive financial markets.

Secondarily looking at the outstanding of financial assets owned by households, USA is \$32.5trillion, Japan is \$12.7trillion, UK is \$5.7trillion, German is \$4.6trillion, France is \$3.8trillion. Looking at the ratio of financial assets to GDP, USA is 2.8times, Japan is 2.7times, UK is 2.7times, German is 1.6times, and France is 1.9times. You can understand the accumulation level of financial assets in the households is relatively higher in USA, Japan and UK. 51% of financial assets (\$13trillion, 2004.3) owned by Japanese households are cash and deposit compared with 13% by USA households. If the share of cash and deposit owned by Japanese

households changes from 51% to 13%, about \$5trillion can move from cash and deposit to stocks, mutual funds and bonds.

Japanese IT infrastructure has been developed to a high global level owing to deregulations and the government efforts. The population using internet has increased to more than 70 millions from 10 millions since 1996. More than 70% of the stock trading volume is transacted by individual investors using more than 3 million personal computers.

(2) Liberalization of cross-border capital transactions and property protection

Cross-border capital was totally liberalized in 1997 by revising the foreign exchange control law. Since the legislation, not only companies but also individuals have started to trade global capital transaction freely. And national treatments are given to foreigners to protect their properties. Paralleled to the liberalization, the drastic financial deregulation, so-called Japanese Big Bang, has been progressing. As the result of further competition, the level of the transaction fees has fallen dramatically. For a example, the level of the stock trading fees has been lowered to 1/10 from the past regulated level.

The total level of the financial transaction cost, global and domestic, is very low internationally. So, Japanese financial markets as a whole are easily accessible from global investors.

(3) Fair market rules and market disciplines

It was told the Corporate Governance (CG) of Japanese companies was weak. However, CG of Japanese companies has been strengthened every year from both legislations and corporate efforts. Corporate Social Responsibility (CSR) is becoming the important element as CG for Japanese companies to be respected socially as a profitable and sustainable company.

Japanese corporate staffs are also required to have high ethics standard and conduct standard. The realization of capitalism ethics in both companies and individuals is very important for market capitalism to be prosperous and stable.

Upon the spiritual and organizational foundations, financial markets with fair market rules and market disciplines are being formed and getting trust from global investors.

(4) New industrial technology

Stock markets for emerging companies like Mothers have been taking new venture companies developing new business by using IT or biotechnology or utilizing the chance of various deregulations. It would be impossible for venture companies to be emerging without the foundation of new industrial technologies and without emerging stock markets. After the burst of the Japanese economy, few Japanese banks made loans to venture companies. The only way remaining for venture companies to raise money is the stock markets. Emerging stock markets like Mothers are one of the engines to push the Japanese economy to recover and made the world economy more vigorous.

(5) Individual investors

Looking at the distribution of stock holders, 27% of total stocks are owned by foreign investors, 26% are owned by domestic institutional investors, 19% are owned by domestic individual investors. The share of stocks owned by large banks decreased from 15% to 5% in ten years.

On the other hand, the share of stocks owned by foreign investors increased from 12% to 27% in ten years. The share of stocks owned by domestic individual investors was 19% constantly for 10 years.

Looking at the share of trading volume, you can see another view. The share of trading volume through brokers by foreign investors is about 50%, the share of trade by domestic individual investors is about 40%. Foreign investors and individual investors are main players in Tokyo market. Especially most of the trades in emerging stock markets are made by individual investors. Individual investors are engines to supply much liquidity into the markets. Active participation of individual investors is essential for forming the markets with high liquidity.

3. Prospects for the future

Total capitalization value of stocks listed in the world stock markets (C.Y2005) is around \$31trillion. As the break down of distribution, NYSE is \$13.3trillion (43.0%), TSE is \$4.6trillion (14.8%), NASDAQ is \$3.7trillion (11.6%), LSE is \$3.1trillion (9.9%) and Euronext is \$2.7trillion (8.7%). The total share of Japan and USA is around 70%. This is the share of cash markets. The share of derivatives markets is quite different from that of cash markets.

To keep the current ranking of TSE, No2 of the world market, TSE has to make the big efforts in the two points as follows.

(1) Enhance the capacity and speed of the trading system

TSE has started to make preparation for developing the next generation trading system until 2009. The target of the new system is not only to enhance the capacity corresponding to sharp increase of the trading volume, but also to make the transaction speed the highest in the world, corresponding to computer programming trades or algorithmic trades. Recently the method of orders has been changing dramatically. Investors try to reduce market impacts by slicing the large amount order into small orders, try to execute orders for large baskets of stocks simultaneously and try to make complicated arbitrage trades by using computer programs. Users of such program trading have been expanding from large institutional investors to Hedge funds and individual investors.

TSE has to catch up with the new trend of the trades.

(2) Variety of financial instruments listed in the market

In the normal Diet session of this year, Securities Exchange Law was totally revised into Financial Instruments and Exchange Law. In the context of the new law, the legal name of Stock Exchange is changed to Financial Instrument Exchange. It does not mean only the change of the name, but the Exchange can deal with not only the traditional securities but also comprehensive financial products. Substantially the restrictions over the financial products which can be listed in Stock Exchanges are removed by the new legislation. TSE can build any new Exchange business model by its effort.

Japanese economy has been stagnating for more than 10 years because of the bad loan problems of Japanese banks. One of the big reasons for the bad loan problems is that the Japanese financial system depends too much upon the indirect financial system, namely banking system. The role of the banking system in the Japanese financial system is still large. However, banks should adopt the market functions to evaluate their portfolio or to manage their credit or market risks as much as possible.

Both financial and non financial institutions should restructure their portfolios timely according to the change of economic situations to achieve the most appropriate portfolios. However, if there are no markets for them, it is very difficult for banks or companies to assess the value of their assets and to trade their assets smoothly. The markets for liquidated assets among big investment banks might be useful to achieve the optimum portfolios and diverse the various risks. And more open markets like Exchanges should be more useful to achieve such purposes.

Not to repeat again the Great depression in 1929 or the Burst of the Japanese bubble economy in 1990's, we should build the liquid markets for most of the financial products to assess the true value of the assets and to trade them smoothly. Under the new Financial Instruments and Exchange Law, Stock Exchanges can contribute to build such markets actively.

TSE has been enhancing the competitiveness for existing financial products listed in the market. And toward the future, TSE will contribute to Japanese and world financial markets aggressively, through expanding the variety of listed financial products including financial derivatives.

The intense cooperation between TSE and NYSE will make the world financial markets more effective and active in the future. (The opinions in the sentence are not the views of TSE, but my own views.)