In Brief Economic Capsules

Japanese Banks' Customers in the United States

by Rama Seth and Alicia Quijano

Some recent studies attribute the growth of foreign banks in the United States to the increase in foreign direct investment in this country Foreign banks are said to specialize in providing services to multinational firms from their home countries.[1] This interpretation of the importance of foreign bank lending is applied in particular to Japanese banks, which accounted for over 16 percent of U S commercial and industrial loans in 1989, well over half of such loans made by foreign banks.

Available data on Japanese banks, however, provide little support for the view that foreign bank lending growth essentially reflects increased foreign investment in the United States While Japanese banks' branch and agency lending in the United States increased more than sixfold in the period between 1984 and 1989, borrowing by U.S. nonbank affiliates of Japanese firms less than quadrupled during the same period [2] As a result, loans to Japanese-owned firms may have accounted for more than three-quarters of Japanese branch lending in this country in 1984, but no more than two-fifths in 1989. Japanese banks may initially have set up shop to service Japanese customers, but in the later 1980s the banks significantly expanded their strictly U S market share

Inferences from data on liabilities and loans

We calculate the share of Japanese bank lending to U.S nonbank affiliates of Japanese companies by comparing data on affiliate liabilities and data on loans by U.S branches and agencies of Japanese banks (See the appendix for a discussion of data sources and details of the methodology.) Our estimates of the share of borrowing by Japanese firms are based on the extreme assumption that all of the bank debt of Japanese multinationals in the United States was owed to Japanese banks' branches and agencies To the extent that such affiliates borrowed from non-Japanese banks, claims of Japanese branches and agencies on firms without Japanese ownership would be even higher [3]

Our findings, presented in the chart, show the decreased relative importance of Japanese firms in branch and agency lending in the United States. Loans to these firms in all sectors taken together accounted for at most two-fifths of Japanese lending in this country by 1989, as opposed to more than three-fourths of the lending in 1984 Although only data for 1984 and 1989 are actually plotted in the chart, the intervening years

[1] See, for example, George Bentson, "U S Banking in an Increasingly Competitive World Economy," *Journal of Financial Services Research*, vol 4 (1990), pp 311-39, and Charles W Hultman and L Randolph McGee, "Factors Affecting the Foreign Banking Presence in the U S ," *Journal of Banking and Finance*, vol 13 (1989), pp 383-96

[2] A U S affiliate is a U S firm in which a foreign investor owns or controls 10 percent or more of the voting securities of the firm

[3] The overstatement of the affiliate share may be offset by any underreporting by U S affiliates of Japanese firms that is attributable in part to the rapid growth in direct foreign investment The degree of offset, however, cannot be measured Some bias is also introduced in the estimates because the data sources are not fully synchronized the bank data are reported on a calendar-year basis, while affiliate data are reported on a fiscal-year basis The direction of the bias introduced by this inconsistency is not clear since the fiscal year varies across affiliates This difference in reporting may not be of much consequence, however, since the fiscal year matches the calendar year for roughly three-quarters of affiliates from all countries

confirm the pattern of decline.[4] A breakdown of loans by category, moreover, underscores the decreasing share of lending to affiliates in the fastest growing categories of loans.

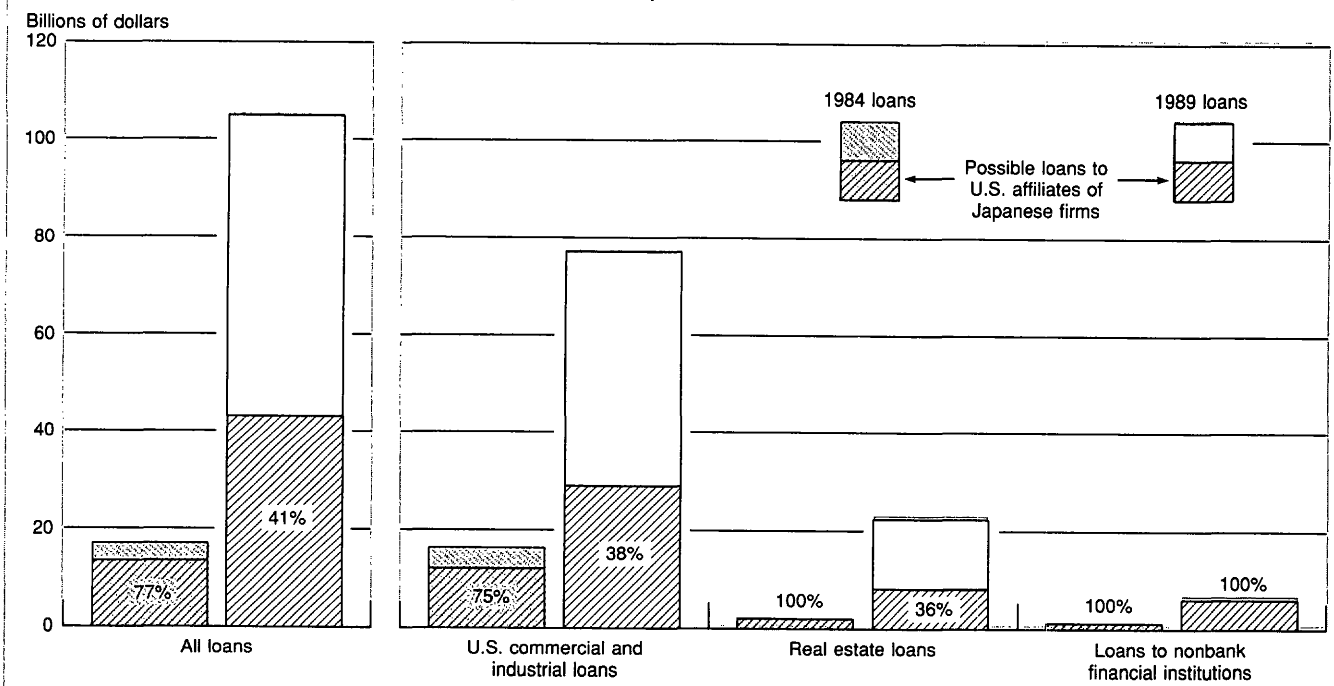
The nonfinance sectors, commerce and industry and real estate, offer clear-cut evidence of the diminished role of U.S. affiliates of Japanese firms as a customer base. At the beginning of the period under study, Japanese banks may well have relied on Japanese customers for a ready-made customer base in these sectors. In 1984, U.S. borrowing by Japanese-owned firms accounted for as much as three-quarters of the commercial and industrial loans made by Japanese banks' branches and agencies. Japanese-owned real estate firms and partnerships could have accounted for all real estate loans by the branches and agencies until 1986. But in more recent years, a different pattern emerged. Our estimates suggest that in 1988 and 1989, U.S. borrowing by Japanese-owned commercial and industrial firms and by real estate firms could account for less than two-fifths of total credit by Japanese banks' branches and agencies to each of these sectors.

This shift in the customer base did not affect one area of lending. In both 1984 and 1989, loans to nonbank finance affiliates of Japanese firms could entirely account for this category of lending by branches and agencies of Japanese banks. Such loans, however, amounted to a relatively small part of overall lending by branches and agencies: about 3 percent of their total portfolio in 1984 and 1989. Thus it appears that Japanese banks, in expanding their U.S. operations, increasingly directed their credit to U.S.-owned commercial, industrial, and real estate firms.

Nonfinance affiliates of Japanese firms do not dominate Japanese bank lending in the United States despite their heavy reliance on bank financing. Roughly half of the U.S. liabilities of these nonfinance affiliates have been, and continue to be, owed to banks (see table). This financing pattern mirrors that of nonfinancial

[4]See Rama Seth and Alicia Quijano, "Growth in Japanese Lending and in Investment in the United States Are They Related?" Federal Reserve Bank of New York, Research Paper no 9101, January 1991

U.S. Loans Made by U.S. Branches and Agencies of Japanese Banks



Sources: U.S. Department of Commerce; Federal Financial Institutions Examination Council, Reports of Condition; Federal Reserve Bank of New York staff estimates.

Notes: Chart shows bank debt of U.S. nonbank affiliates of Japanese firms as a share of loans to U.S. addressees by branches and agencies of Japanese banks. If bank debt is greater than loans, 100 percent of branch and agency lending in the category is assumed to be made to affiliates. Affiliate borrowing for 1989 is estimated.

Bank Share of Affiliate Debt
(Percent)

	1984	1989
All sectors	50	16
Finance and insurance (nonbank only)	23	5
Nonfinance	57	55
Real estate	78	80
Other industries	56	50

Sources U S Department of Commerce, Federal Reserve Bank of New York staff estimates

Notes Table reflects U S liabilities of U S nonbank affiliates of Japanese firms Figures for 1989 are estimates

firms in Japan, which owed an estimated 53 percent of their debt to banks in 1985.[5] U.S -owned nonfinancial corporate business, by contrast, owed only between one-fifth to one-quarter of its liabilities to banks during the same period [6]

An interesting sidelight to this finding is the fact that nonbank financial firms affiliated with Japanese firms rely hardly at all on bank financing Acquisition-led tripling of the balance sheets of these affiliates—predominantly securities firms—probably explains why their liability structure so closely resembles that of U.S securities firms in general.[7] In both cases, only a minor part of the firms' liabilities is owed to banks. Seven percent of the Japanese finance affiliates' liabilities has been to banks in recent years, and 4 percent to 6 percent of the liabilities of the largest U S securities firms was owed to banks between 1984 and 1989 [8]

Conclusion

In conclusion, recent growth in Japanese banks' assets in the United States cannot be solely or even largely attributed to growth in direct investment from Japan. Japanese banks may initially have followed their Japanese customers to the United States, at least in order to lend to firms in commerce, industry, and real estate Home-country relationships, however, cannot explain the recent expanded presence of the Japanese in the U S. lending market Although Japanese nonfinance affiliates rely more heavily than their U S. counterparts on bank loans, they do not account for the bulk of U S. lending by Japanese banks' branches and agencies Rather, loans to U.S.-owned firms now appear to predominate in the U.S. loan books of Japanese banks

This finding suggests that any slowdown in foreign asset growth stemming from Japanese banks' difficulty in meeting capital requirements could have a broader impact than often thought. Specifically, U S -owned firms could find themselves vulnerable to a tightening of credit by Japanese banks.

[5]Bank for International Settlements, *59th Annual Report*, June 1989, p 87

[6]Board of Governors of the Federal Reserve System, *Flow of Funds Accounts, Financial Assets and Liabilities, Year-end 1966-89*, September 1990, p 10

[7]The similarity in the liability structure of U S -owned and Japanese-owned firms emerged when Yasuda Life Insurance acquired an 18 percent interest in Paine Webber and Nippon Life Insurance

Footnote 7 continued
acquired a 13 percent interest in Shearson Lehman Brothers in 1987 In spite of the minority ownership, the U S Commerce Department classifies all of the acquired liabilities as those of the new affiliate Before these acquisitions, the bank share in affiliate financing was roughly 20 percent

[8]John R Dacey and Jackie Bazel-Horowitz, "Liability Management," *Funding and Liquidity Recent Changes in Liquidity Management Practices at Commercial Banks and Securities Firms*, Federal Reserve Bank of New York, July 1990, p 80

Appendix: Data Sources

Data on U.S nonbank affiliates of Japanese companies are from the Commerce Department series on foreign direct investment, and data on U S branches and agencies of Japanese banks are from the Federal Financial Institutions Examination Council (FFIEC) call reports The broad sectoral classification in the two data sets allows us to compare each category of loans with the borrowings of affiliates in the same sector For example, U S borrowings of affiliates in commerce and industry, estimated at $29 billion, are compared with the $77 billion in commercial and industrial loans to U S addressees made by branches and agencies (see table below) On the basis of this comparison, we estimate that affiliates could account for a maximum of 38 percent of branch and agency loans in this category (see chart) The maximum could only apply in the extreme case in which all affiliate local borrowings are from Japanese banks' branches and agencies in the United States

The Commerce Department's annual surveys of direct investment and the 1987 benchmark survey identify

Appendix: Data Sources *(Continued)*

external sources of funds for affiliates in the United States † These sources of funds are decomposed into the liabilities of affiliates owed to the foreign parent, to other foreigners, and until 1987, to U S banks and nonbanks The 1988 and 1989 U S bank liabilities are estimated on the basis of the distribution of bank and nonbank liabilities and the average growth rates by sector in previous years For this study, only data on affiliate debt to U S banks and to U.S nonbanks are used because they are the most comparable with the FFIEC call report data

The FFIEC call report data on Japanese banks' branches and agencies decompose lending by obligor commercial and industrial (both U S. and foreign residents), real estate, nonbank financial institutions, foreign governments, and purchasers of securities We exclude Japanese banks' subsidiaries from our study because of their greater independence from the parent, wider scope of activities, and acquisition-related growth, all of which point to a weaker link with Japanese firms in the United States. Were the subsidiary data to be included and the assumption that affiliates borrow only from Japanese-owned banks retained, we would find the link between Japanese banking and Japanese direct investment in the United States to be even weaker than is suggested here

Since the Commerce Department data do not reveal the ownership of the banks providing credit to the foreign-owned firms in the United States and the call report data do not identify loans made to U.S. affiliates of Japanese firms, we juxtapose the two sets of data. By assuming that all affiliate bank debt is with Japanese banks, we can infer a ceiling on the share of affiliate borrowing in Japanese bank lending

†For an explanation of Commerce Department data, see Alicia M Quijano, "A Guide to BEA Statistics on Foreign Direct Investment in the United States," *Survey of Current Business*, February 1990, pp 29-37

Juxtaposition of Two Data Sources
(Billions of Dollars)

Affiliate Debt†	1984	1989	Branch and Agency Lending‡	1984	1989
Total	14	49	Total	38	130
			To commercial and industrial firms	28	90
Commerce and industry§	12	29	U S	16	77
			Foreign	12	12
Finance and insurance	1	12	To financial institutions	1	6
Real estate	1	8	To real estate firms	0	22
			Other	9	12
			To foreign governments	8	10
			For purchasing and carrying securities	1	2

Sources U S Department of Commerce, Federal Financial Institutions Examination Council, Reports of Condition, Federal Reserve Bank of New York staff estimates

Note 1989 figures for affiliate debt are estimates

† Consists of U S bank liabilities of Japanese firms' U S nonbank affiliates

‡ Consists of nonbank loans of Japanese banks' U S. branches and agencies

§ Includes all industries other than finance, insurance, and real estate Insurance affiliates account for less than 0 5 percent of the bank debt of finance affiliates, most of which are securities firms