FRBSF Weekly Letter

January 25, 1991

Slower Growth for Foreign Banks?

Foreign bank activity in the U.S. grew steadily over the 1980s. Foreign-owned banks' assets booked in the U.S. reached $866 billion in 1990, and their share of U.S. banking assets grew from about 18 percent to nearly 22 percent in the last five years. According to a recent study of foreign competition in the banking industry, "only one broad industry group—leather goods" has a higher percent of foreign ownership than the service-oriented banking industry.

The strong growth of foreign banks has raised questions about the relative competitiveness of foreign and domestic banks in the U.S. and about whether foreign banks in the U.S. will continue to expand at a faster pace than domestic banks.

While a number of factors, such as relative economic conditions, trade patterns, exchange rates, and interest rates, will play a role, in this *Weekly Letter* the focus is on two regulatory developments that may slow the future growth of foreign-owned banks in the U.S.

Competition 2/28/91

Foreign banks are important competitors for many U.S. banks. They provide a significant portion of the trade and direct foreign investment financing in the U.S. For example, they issue over 60 percent of the dollar volume of commercial letters of credit. Their expertise in this area and their established customer relationships often give them an advantage over domestic banks.

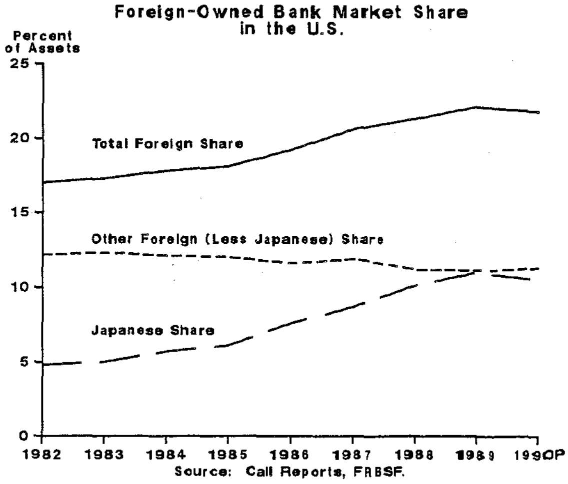
Their strong credit ratings also helped establish them as leaders in the credit enhancement markets. Again, they issue more than half of the standby letters of credit which "guarantee" commercial paper, loans, bonds, or asset-backed securities.

Japanese lead expansion

Based on the common measures of market presence—assets and commercial loans—foreign-owned banks (including commercial banks, as well as agencies and branches of foreign-owned banks) have grown twice as fast as U.S. banks over the last five years.

Most of the foreign-bank expansion in the U.S. has been by Japanese-owned banks. Over the last five years their total assets booked in the U.S. climbed from $184 billion to nearly $420 billion, and their market share soared from 6.1 percent to 10.5 percent (see Chart). While other foreign-owned banks also increased their assets during this period, from $365 to $448 billion, their market share actually declined from 12 percent to 11.3 percent. The figures are even more dramatic for the commercial lending component of assets, where Japanese banks have increased their market share by over 9 percent, to 15.4 percent.

Foreign-Owned Bank Market Share in the U.S.



Source: Call Reports, FRBSF.

WESTERN BANKING

Western Banking is a quarterly review of banking developments in the Twelfth Federal Reserve District. It is published in the *Weekly Letter* on the fourth Friday of January, April, July, and October.

Regulatory constraints

Given the significant role of Japanese-owned banks in the U.S., together with the probability that European banks will concentrate on financial integration and the "opening" of Eastern European markets, the focus on Japanese banks seems to be the key.

Regulatory developments in Japan may have begun to limit Japanese-owned banks' future expansion in the U.S. The most recent (preliminary) data show a slight decline in Japanese-owned banks' market share in the U.S. At a minimum, it suggests a slowdown in the rapid growth of Japanese-owned bank market share in 1990.

One factor that may slow the growth of Japanese-owned banks in the U.S. is the liberalization of interest rate ceilings on retail deposits in Japan. This regulatory reform probably will increase Japanese banks' reliance on domestic funding, just as deregulation of retail deposits (NOWs, MMDAs, savings and time certificates) in the U.S. allowed major U.S. banks to substitute retail deposits for wholesale funding (large CDs and other borrowings, and Eurodollar borrowings). In other words, eliminating these regulatory ceilings should reduce Japanese-owned banks' need to raise funds in offshore markets to fund an excess of domestic loans.

Henry Terrell, a Senior Economist with the Federal Reserve Board recently presented evidence supporting this hypothesis. In congressional testimony he noted that the growth of Japanese banks in the U.S. was *not* funded by raising low-cost funds in Japan and lending them through their affiliates in the U.S. Instead, Terrell indicated that aggregate net sources of funds data show just the opposite pattern. He noted that interest rate controls led to a shortage of deposits in Japan, which created incentives for Japanese banks to shift assets overseas and to fund them there as well. Japanese banks' overseas operation, including their U.S. affiliates, were actually *net lenders* of funds to their parents, not net borrowers. This is also consistent with the observation that Japanese banks' U.S. affiliates raised most of their funds in the U.S. He also provided evidence that as deregulation has proceeded, Japanese banks have reduced their head office borrowings from overseas affiliates.

Therefore, liberalization of deposit interest rate ceilings in Japan could increase their domestic deposits and thereby slow the growth of Japanese-owned bank assets in the U.S.

Capitalization

More stringent international capital standards and risk-based capital requirements also are likely to constrain foreign and domestic banks alike in their ability to expand rapidly. Indeed, in a recent Loan Officer Survey conducted by the Federal Reserve, foreign-owned agencies and branches "put somewhat more emphasis on their capital positions as an element in their decision to exercise more [credit] restraint."

Moreover, in the case of Japanese banks, the sharp decline in the Japanese stock market has reduced the value of Japanese banks' "hidden reserves," or unrealized gains on equity investments, thus lowering their market capitalization, and probably further constraining their growth prospects.

Summary

These regulatory developments may signal slower growth ahead for foreign banks in the U.S. Liberalization of Japanese deposit interest rate controls should increase the proportion of domestic banking activity and interbank transactions that can be funded in Japan, and reduce the need to shift business to the U.S. Still, while this may affect the asset growth of Japanese banks, it may have a smaller impact on the amount of credit extended to borrowers in the U.S.

At the same time, more stringent capital standards and the reduction in "hidden reserves" are likely to limit the ability of Japanese banks to increase loans and assets as rapidly as they have in recent years. Thus, while foreign banks will continue to be a significant presence in U.S. banking markets, recent regulatory developments are likely to reduce their appetite for further rapid expansion in the U.S.

Gary C. Zimmerman
Economist

REGIONAL BANK DATA

SEPTEMBER 30, 1990

(Not Seasonally Adjusted, Preliminary Data)

		DISTRICT	ALASKA	ARIZONA	CALIF.	HAWAII	IDAHO	NEVADA	OREGON	UTAH	WASH.
ASSETS AND LIABILITIES -- $ MILLION (ALL COMMERCIAL BANKS)											
ASSETS	TOTAL	485,738	4,445	29,629	337,044	17,392	8,425	14,259	23,269	11,592	39,684
	FOREIGN	41,804	1	N/A	39,078	2,297	N/A	N/A	N/A	90	338
	DOMESTIC	443,934	4,444	29,629	297,966	15,095	8,425	14,259	23,269	11,502	39,346
LOANS	TOTAL	353,696	1,955	18,852	253,633	10,225	5,734	10,371	16,090	7,374	29,462
	FOREIGN	34,942	7	N/A	33,645	1,163	N/A	N/A	N/A	N/A	127
	DOMESTIC	318,754	1,949	18,852	219,988	9,061	5,734	10,371	16,090	7,374	29,335
	REAL ESTATE	154,952	765	6,812	118,127	4,326	1,545	2,577	5,352	2,783	12,665
	COMMERCIAL	76,736	708	3,504	52,220	2,758	1,475	1,440	5,374	1,697	7,562
	CONSUMER	56,810	280	5,062	31,262	1,302	1,588	5,908	3,339	2,128	5,942
	AGRICULTURE	5,793	4	464	2,811	45	756	23	411	148	1,130
	INTERNATIONAL	374	N/A	11	356	0	N/A	N/A	6	N/A	0
SECURITIES	TOTAL	44,251	1,790	4,478	21,708	3,585	1,606	1,789	3,520	2,144	3,631
	U.S.T.S.	13,155	1,091	1,470	5,946	1,263	410	648	703	497	1,128
	SECONDARY MARKET	19,465	278	1,862	10,554	1,527	728	474	1,662	1,137	1,244
	OTHER SEC.	11,631	422	1,146	5,209	795	469	666	1,155	511	1,259
LIABILITIES	TOTAL	454,541	3,965	27,617	316,181	16,379	7,865	13,170	21,637	10,783	36,945
	DOMESTIC	412,736	3,964	27,617	277,103	14,082	7,865	13,170	21,637	10,693	36,606
DEPOSITS	TOTAL	386,385	3,497	25,190	267,428	15,328	6,738	8,582	18,074	9,284	32,263
	FOREIGN	35,002	1	N/A	32,439	2,138	N/A	N/A	N/A	90	335
	DOMESTIC	351,383	3,496	25,190	234,990	13,190	6,738	8,582	18,074	9,194	31,928
	DEMAND	79,218	1,005	4,374	56,407	2,218	1,136	2,092	3,386	1,700	6,900
	TIME AND SAVINGS	272,165	2,491	20,816	178,583	10,972	5,602	6,490	14,689	7,493	25,029
	NOW	32,979	259	2,297	20,811	1,294	759	901	2,301	1,101	3,257
	MMDA	68,275	464	4,605	46,801	2,136	1,050	1,864	3,556	1,527	6,272
	SAVINGS	31,604	374	1,358	22,065	1,444	392	862	1,444	835	2,832
	SMALL TIME	79,903	724	10,102	45,280	1,813	2,699	1,224	5,562	3,179	9,321
	LARGE TIME	59,111	652	2,436	43,481	4,283	685	1,640	1,818	846	3,269
OTHER BORROWINGS		44,237	424	1,860	28,909	561	1,043	3,850	2,818	1,332	3,441
EQUITY CAPITAL		31,197	480	2,012	20,863	1,013	560	1,088	1,631	809	2,739
LOAN LOSS RESERVE		7,654	39	666	5,663	148	91	239	232	144	431
LOAN COMMITTMENTS		199,189	533	9,682	150,361	7,515	1,963	2,160	8,094	2,901	15,980
LOANS SOLD		58,198	27	335	56,965	136	42	66	302	19	307
ASSET QUALITY -- PERCENT OF LOANS (LARGE COMMERCIAL BANKS)											
LOAN LOSS RESERVE (ALL BANKS)		2.16	2.01	3.54	2.23	1.45	1.59	2.30	1.44	1.95	1.46
NET CHARGEOFFS, TOTAL		1.09	0.64	2.07	1.11	0.05	0.24	3.27	0.50	0.92	0.43
	REAL ESTATE	0.24	1.17	2.06	0.12	-.01	0.08	0.39	0.20	0.52	0.37
	COMMERCIAL	0.60	0.11	4.15	0.49	-.09	0.22	1.83	0.51	1.65	0.19
	CONSUMER	2.04	0.45	2.14	1.96	0.51	0.59	4.94	1.14	1.20	0.91
	AGRICULTURE	-.39	N/A	-.03	-1.1	-.06	-.07	0.41	0.35	0.31	0.80
PAST DUE & NON-ACCRUAL, TOTAL		4.40	4.91	7.90	4.41	1.08	1.85	8.84	2.97	3.80	3.02
	REAL ESTATE	4.00	6.82	13.2	3.57	0.70	1.97	3.07	4.48	6.41	3.90
	COMMERCIAL	5.19	5.01	12.6	5.53	1.03	2.50	9.17	2.76	2.54	2.51
	CONSUMER	3.54	1.85	2.00	2.93	2.12	1.80	11.5	1.59	2.42	2.12
	AGRICULTURE	5.58	48.7	10.6	7.17	5.71	1.26	0.41	2.48	2.65	2.97
EARNINGS AND RETURNS -- $ MILLION, YEAR-TO-DATE (ALL COMMERCIAL BANKS)											
INCOME	TOTAL	41,023	340	2,295	28,525	1,259	662	1,918	1,829	940	3,256
	INTEREST	34,190	289	1,890	23,618	1,121	589	1,568	1,569	827	2,719
	FEES & CHARGES	1,777	16	120	1,215	27	33	42	106	49	169
EXPENSES	TOTAL	35,071	274	2,352	24,205	1,032	556	1,576	1,517	826	2,734
	INTEREST	18,998	147	1,090	13,282	653	336	688	865	466	1,470
	SALARIES	6,402	62	457	4,485	192	87	148	292	126	552
	LOAN LOSS PROVISION	2,401	8	259	1,547	17	12	294	83	52	129
	OTHER	7,270	57	545	4,891	170	120	445	276	182	584
INCOME BEFORE TAXES		5,917	66	-58	4,289	227	106	342	312	111	521
TAXES		2,066	17	-23	1,565	82	34	121	95	33	142
NET INCOME		4,004	50	-34	2,868	146	73	221	217	79	385
ROA (%)		1.10	1.51	-.15	1.13	1.15	1.17	2.01	1.26	0.90	1.31
ROE (%)		17.1	13.8	-2.2	18.3	19.2	17.3	27.1	17.7	13	18.8
NET INTEREST MARGIN (%)		4.16	4.33	3.60	4.07	3.68	4.06	8.01	4.09	4.14	4.24

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MARKET SHARE STATISTICS

DEPOSITORY INSTITUTIONS REQUIRED TO HOLD RESERVES WITH THE FEDERAL RESERVE ON A WEEKLY BASIS

PERCENT OF COMBINED MARKET TOTAL FOR NOVEMBER 1990, BY REGION

	DISTRICT			ALASKA			ARIZONA			CALIF			HAWAII		
DEPOSIT TYPE	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU
TOTAL DEPOSITS	51	45	5	74	4	22	80	15	6	45	52	4	69	28	3
DEMAND	92	3	4	99	0	1	94	1	5	92	4	4	93	4	4
NOW	63	30	7	59	5	35	86	5	9	58	36	6	73	26	1
SAVINGS	50	33	17	36	3	62	59	11	30	49	38	12	53	38	9
MMDA	66	31	2	90	7	2	92	6	1	61	36	2	82	18	0
SMALL TIME	32	65	3	76	8	16	72	25	3	24	74	3	42	55	3
LARGE TIME	44	54	2	95	3	3	86	10	4	39	59	2	83	16	2

	IDAHO			NEVADA			OREGON			UTAH			WASH		
DEPOSIT TYPE	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU
TOTAL DEPOSITS	87	10	4	69	28	4	72	22	6	79	8	13	56	37	7
DEMAND	92	1	7	99	1	0	95	1	4	93	3	5	92	5	3
NOW	88	9	3	76	15	9	79	14	7	84	3	13	64	24	12
SAVINGS	77	11	11	66	18	16	56	25	20	58	5	37	46	21	33
MMDA	94	6	0	82	16	2	84	12	4	84	6	10	68	30	2
SMALL TIME	84	14	2	46	51	3	57	38	5	76	14	10	43	53	4
LARGE TIME	83	10	6	65	34	0	81	14	5	79	11	10	49	50	1

CB = COMMERCIAL BANKS; SL = SAVINGS & LOANS AND SAVINGS BANKS; CU = CREDIT UNIONS; MAY NOT SUM TO 100% DUE TO ROUNDING

INTEREST RATES ON DEPOSITS AND LOANS AS OF NOVEMBER 1990 (%)

TYPE OF ACCOUNT OR LOAN		DATE	US	DISTRICT	ARIZ	CALIF	HAWAII	IDAHO	OREGON	UTAH	WASH
MONEY MARKET DEPOSIT ACCOUNTS		SEP90	6.20	6.11	5.77	6.30	5.72	5.96	6.47	6.26	5.86
		OCT90	6.19	6.09	5.76	6.28	5.72	5.95	6.35	5.98	6.11
		NOV90	6.09	6.05	5.90	6.25	5.63	5.96	6.23	5.99	6.05
92 TO 182 DAYS CERTIFICATES		SEP90	7.58	7.16	6.90	7.54	6.72	7.47	7.16	7.50	6.91
		OCT90	7.53	7.11	6.71	7.46	6.67	7.41	7.17	7.41	6.95
		NOV90	7.40	6.99	6.65	7.34	6.67	7.29	6.94	7.23	6.90
2-1/2 YEARS AND OVER CERTIFICATES		SEP90	7.88	7.62	7.36	7.72	7.91	7.93	7.51	7.85	7.66
		OCT90	7.81	7.61	7.43	7.67	7.95	7.89	7.48	7.75	7.59
		NOV90	7.69	7.48	7.39	7.61	7.82	7.78	7.27	7.56	7.58
COMMERCIAL, SHORT-TERM*	AVE. RATE		9.77	10.36	9.72	10.59	9.72	9.96	10.48	9.93	10.11
	AVE. MAT. (DAYS)		59	103	78	234	78	133	69	68	89
COMMERCIAL, LONG-TERM*	AVE. RATE		10.82	10.31	10.75	11.11	12.02	N/A	10.96	11.63	8.66
	AVE. MAT. (MONTHS)		50	36	32	51	52	N/A	31	43	18
LOANS TO FARMERS*	AVE. RATE		11.51	10.64	10.44	10.53	N/A	10.88	10.81	11.82	11.35
	AVE. MAT. (MONTHS)		9	5	6	5	N/A	5	6	21	5
CONSUMER, AUTOMOBILE	AVE. RATE		11.62	12.23	12.63	13.29	N/A	12.00	11.18	11.56	11.47
CONSUMER, PERSONAL	AVE. RATE		15.69	15.98	16.75	19.79	N/A	13.50	14.11	15.05	14.89
CONSUMER, CREDIT CARDS	AVE. RATE		18.23	18.75	18.00	19.44	N/A	N/A	19.24	21.00	17.93

SOURCES: SURVEY OF TERMS OF BANK LENDING AND TERMS OF CONSUMER CREDIT; MOST COMMON INTEREST RATES ON SELECTED ACCOUNTS.
* DATA ARE COMPOUNDED ANNUAL RATES.