4b: report (currencies)

Eric Brockett, BankZero Regional Manager [Click here and type , Assistant Manager Currency Risk Instructions For this assignment you will write a 300- to 500-word memo to Eric Brockett assessing foreign currency risk. Your report should

briefly describe the similarities and differences between the U. S. financial system and the Japanese financial system

explain whether the factors listed in the report below are likely to cause appreciation or depreciation of the yen/dollar exchange rate

describe how the changes in the exchange rate would affect the demand for dollars by foreign companies. That is, are these changes likely to affect the amount of foreign deposits in the bank? Why, or why not?

Be sure to

delete these instructions before sending this file to your faculty member

when you save the document, include your last name, first name, and assignment title in the filename (e. g., smith_john_assignment1a)

Comparison of the US financial system with Japanese financial system

The structure of commercial banking industry in the United States is radically different from that in other industrialized nations. The United States is the only country that is just now developing true national banking system in which banks have branches throughout the country.

One result is that there are many more banks in the United States than in other industrialized countries. In contrast to the United States, which has on the order of 10, 000 commercial banks, every other industrialized country has well under 1000.

Japan, for example has fewer than 100 commercial banks – just 1 percent of the number in the United States, even though its economy and population are half the size of the United States. Another result of the past restrictions on branching in the United States is that our banks tend to be much smaller than those in other countries.

Compared to the financial system in the United States, Japan has more legislative independence. The Bank of Japan is not formally independent of the government, with the ultimate power residing with the Ministry of the Finance. In addition, Ministry of Finance bureaucrats alternate with officials from the Bank of Japan as governor of the bank.

However, by tradition it is understood that the government should not override the Bank of Japan's decisions about monetary policy, and the government has never invokes the provisions allowing it to override the bank.

What are the factors causing the appreciation and depreciation of the Japanese Yen?

Japan was latecomer to the banking crisis. As in other countries, financial disclosure and monitoring the regulators did not keep pace with the new financial environment. The result was that banks could and did not take excessive risks, and when property values collapsed in the early 1990s, the banks were left holding massive amounts of bad loans.

For example, Japanese banks decided to get into the mortgage lending market by setting up the so-called jusen, home mortgage lending companies that raised funds by borrowing from banks, and then loaned these funds out to households. Seven of these jusen are now insolvent, leaving banks with $60 billion or so of bad loans.

The Japanese seem to be going through the same cycle of forbearance as occurred with the United States. It has proved difficult to arrange bail out packages to close down insolvent banking institutions, and so, not surprisingly, regulators have been reluctant to close them down. Bank regulators have promised that none of Japan's largest 21 banks will be allowed to fail, an admission of a too-big-too-fail policy similar to that found in the United States.

Describe how the changes in the exchange rate would affect the demand for dollars by foreign companies. That is, are these changes likely to affect the amount of foreign deposits in the bank? Why, or why not?

In the analysis, we treat the United States as the home country so domestic bank deposits are denominated in dollars. For simplicity, we use francs to stand for any country's currency, so foreign bank deposits are denominated in francs. The theory of portfolio choice suggests that most important factor affecting the demand for domestic (dollar) deposits and foreign (franc) deposits is the expected rate of return for these assets relative to each other.

When Americans or foreigners expect the return on dollar deposits to be high relative to the return on foreign deposits, there is a higher demand for dollar deposits and a corresponding lower demand for franc deposits. To understand how the demands for dollar and foreign deposits change, we need to compare the expected returns on dollar deposits and foreign deposits.

Milton Friedman and Anna Jacobson Schwartz, A Monetary History of the United States, 1867-1960