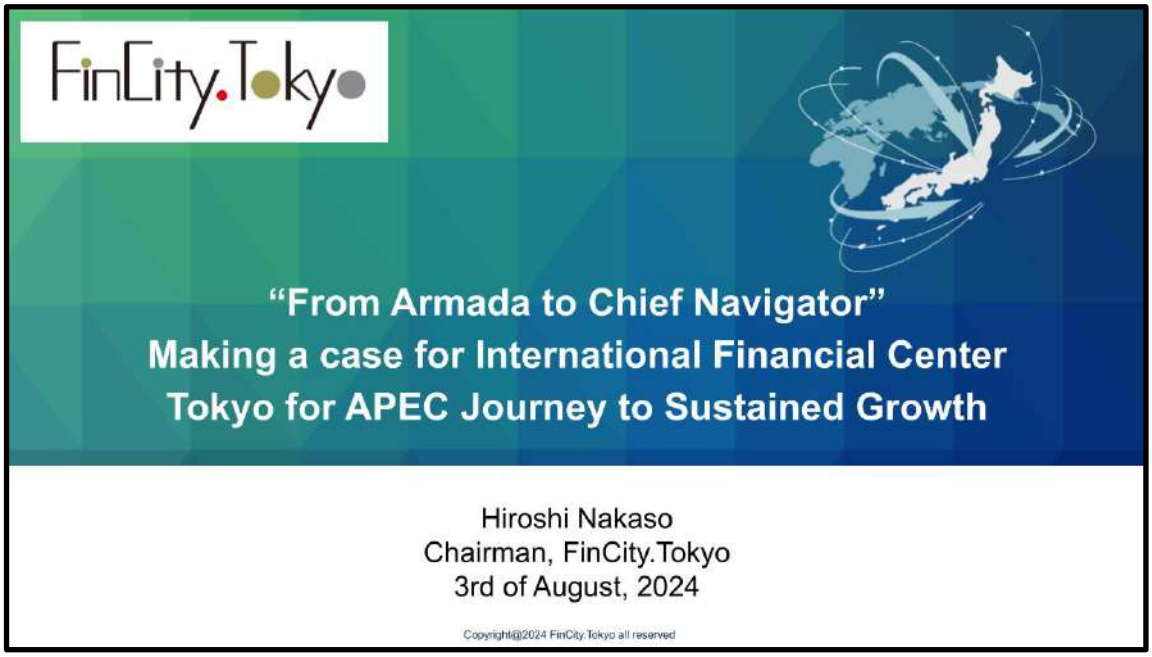
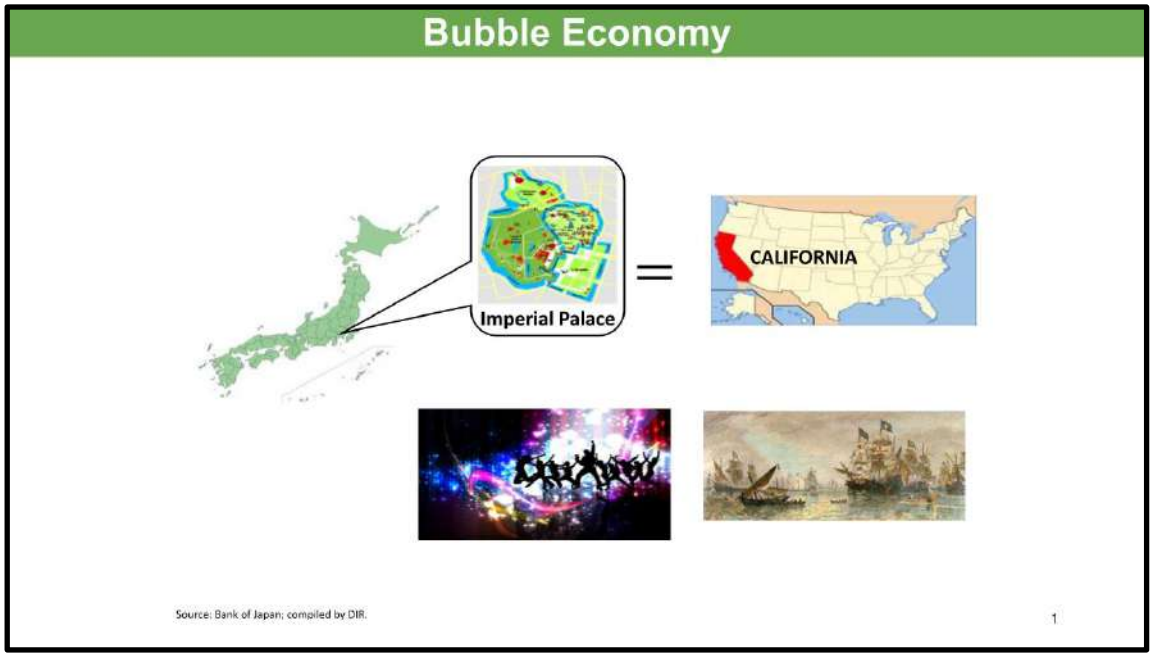
ABAC FCT Event Keynote Speech

From Armada to Chief Navigator: Making a Case for International Financial Center for APEC Journey to Sustained Growth



1: On FinCity.Tokyo and its mission

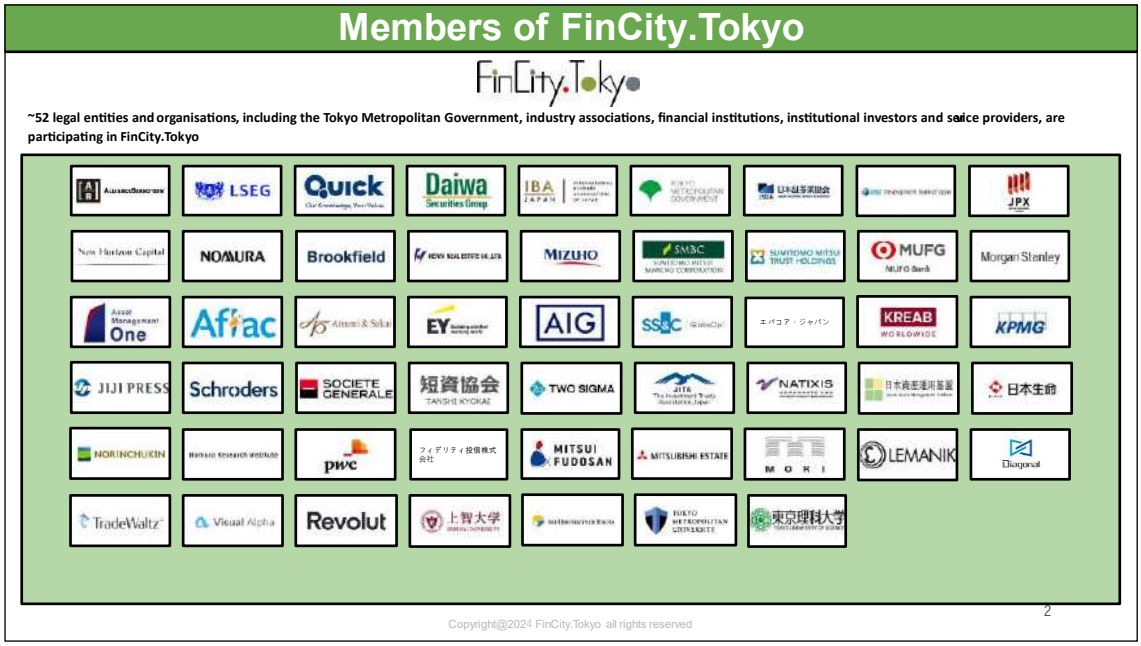
Today I would like to elaborate on why Tokyo wants to become a global financial center *again*. It is not a simple attempt to restore the glorious past. As images on Chart 1 suggest, in the late 1980s the value of the Imperial Palace in Tokyo was said to be equivalent to that of the entire State of California. I remember when I worked in the City of London at that time, the fleet of dominant Japanese financial institutions was often compared to the Invincible Armada of the 16th century. Tokyo enjoyed the fame of being the home to the powerful fleet. But that is not the kind of financial center we want to recreate. Rather, we intend Tokyo to perform the new role of supporting the economies of the Asia Pacific to remain on track to sustained growth.



<Chart 1:Japan's bubble economy in the 80s>

Before going into the details about Tokyo's new financial role, let me briefly introduce what kind of organization FinCity Tokyo is. It is a public-private partnership established in 2019 to promote Tokyo as an international financial center, under the Tokyo Metropolitan Government's initiative.

The members who support this initiative include major financial institutions, the Tokyo Metropolitan Government, JPX Group, real estate companies, industry associations, venture companies, and universities, as shown on Chart 2. The membership expanded from 30 at its inception to 52 currently.



<Chart 2: FinCity.Tokyo's membership (as of 3rd of August, 2024)>

We have been working to attract prominent financial firms and highly skilled professionals to Tokyo in collaboration with JFSA and the Tokyo Government since 2022. The table on Chart 3 is an excerpt of our past achievements in this project. So far, we have attracted 10 asset management firms, with total assets under management of $1.3 trillion.

Foreign Firms attracted by FinCity.Tokyo(excerpt)

- FinCity.Tokyo attracts foreign companies that contribute to the improvement of Tokyo's investment chain.
- Since 2022, we have attracted 10 asset management companies, with approximate total of 1.3 trillion USD in assets under management.

(an excerpt of asset management firms we attracted)

Company	AuM
Allspring Global Investments	476 billion USD
HS Group	2 billion USD
Harrison Street	55 billion USD
Investcorp	50 billion USD
TA Associates	45 billion USD

Company	AuM
Ares	378 billion USD
Capstone Investment Advisors	11 billion USD
Fiera Capital	120 billion USD
General Atlantic	71 billion USD
Warburg Pincus	83 billion USD

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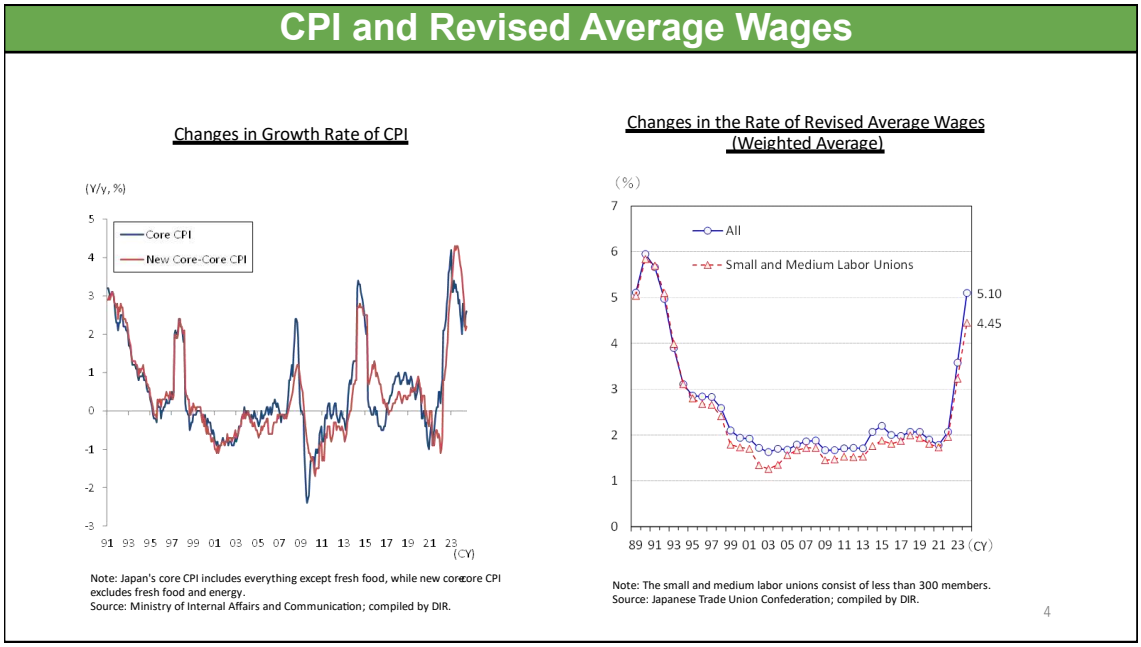
<Chart 3: the list of asset management firms attracted by FinCity Tokyo>

2: Tokyo's Relative Advantage as a Financial Center

2-1: Back to the world with positive interest rates

There is a stronger momentum among both the public and private sectors of Japan to uplift Tokyo's financial role. We envision Tokyo to become a leading city of sustainable finance that contributes to achieving sustained growth, which is the common goal for economies across the Asia Pacific region. I believe Tokyo is well-qualified to serve that end. Let me cite three relative advantages that make me think so.

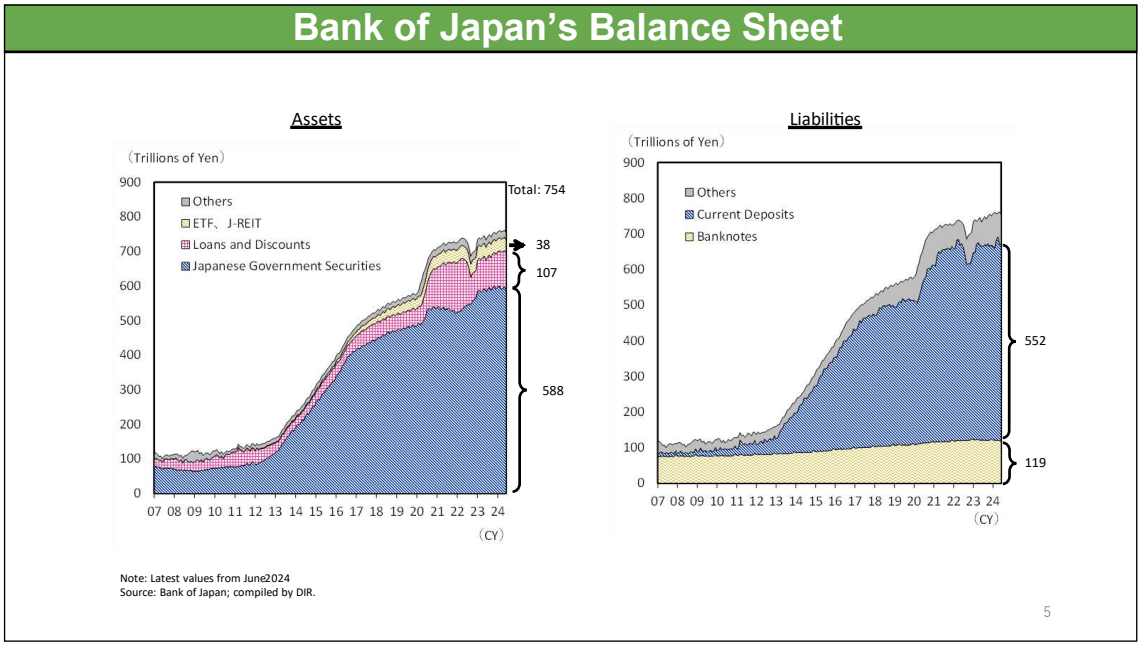
First and foremost, Japan's economy seems to be on track to sustained growth for the first time since the asset bubble burst three decades ago. Inflation rates remain elevated as you see on the left graph on Chart 4, which paved the way to wage increases. The projected annual wage growth reached 5.1% this year, which is the highest in decades as shown in the graph on the right-hand side. Against this background, the Bank of Japan (BoJ) in March judged that the price stability target of 2% would likely be reached in a sustainable and stable manner and decided to embark on monetary policy normalization by lifting all the unconventional policy measures that had been employed for a long time.



<Chart 4: CPI and Revised Average Wages in Japan>

Years of monetary accommodation left the BoJ's balance sheet size at an

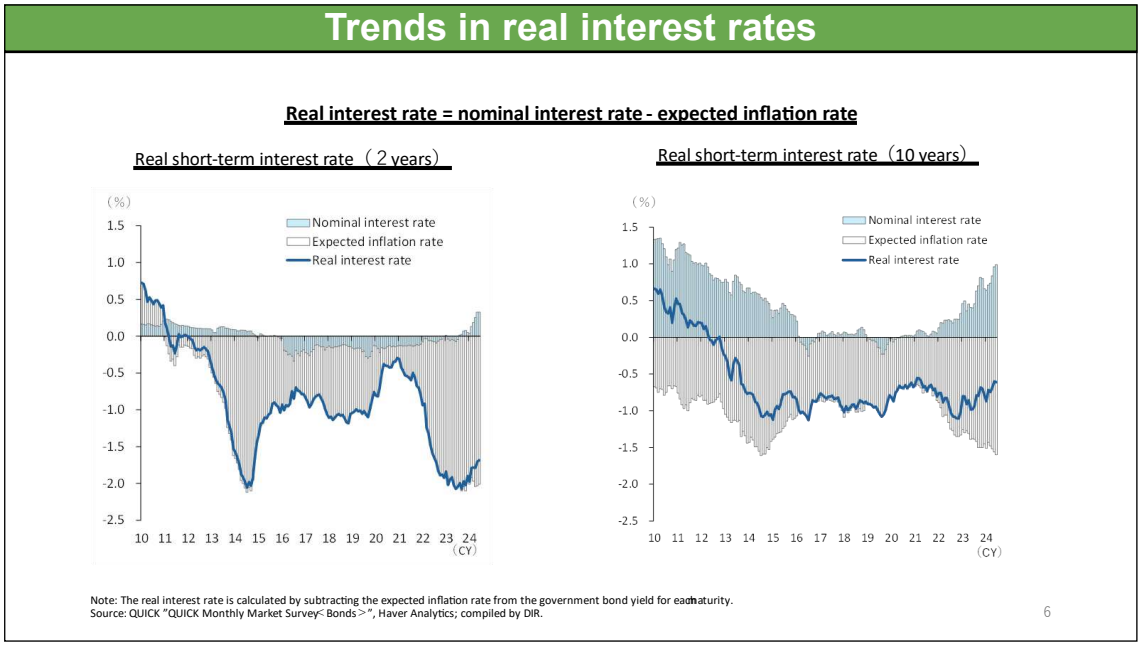
unprecedentedly large size. As shown in graphs on Chart 5, the balance sheet stands at ¥760 trillion, which is 7.6 times as large as the size before the Global Financial Crisis. The biggest component on the asset side is government securities, the outstanding of which stands at ¥590 trillion accounting for almost half of the total outstanding. On the liability side, the overwhelming portion is the current account balance or reserves.



<Chart 5: Bank of Japan's Balance Sheet>

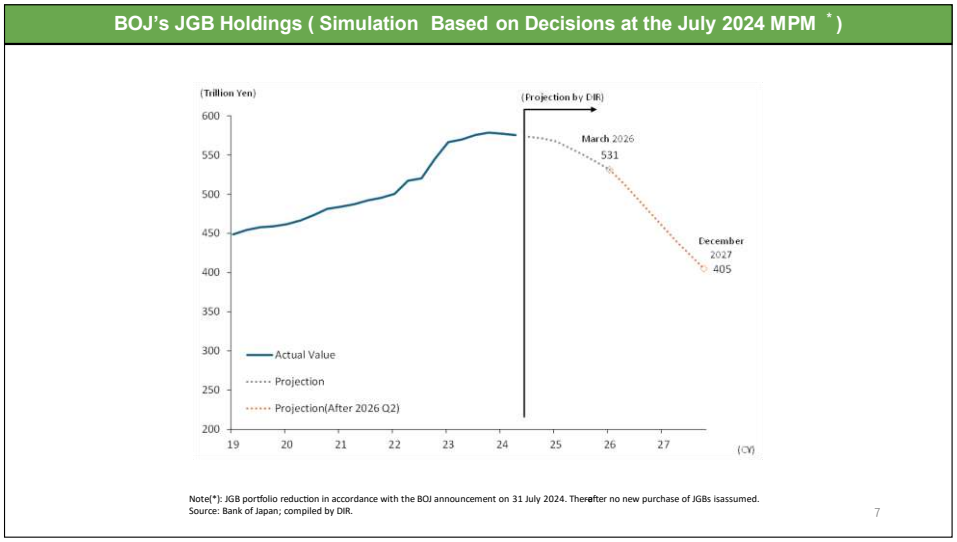
Monetary policy normalization comprises two pillars. One is raising the policy rate to be paid on the current account balances to guide the money market rates to the target range. The other is QT or downsizing the balance sheet size.

Policy rate will be raised carefully in order to avoid unintended market disruption given the fact Japan hasn't experienced rising interest rates for almost two decades. As you see in charts on Chart 6, real interest rates, calculated after subtracting inflation rates from nominal interest rates, remain deeply negative both for short-and long-term interest rates. A rate hike Wednesday and another hikes or two do not materially change the situation. Therefore, you might argue what the BoJ is up to, at least for now, is not necessarily monetary tightening but withdrawal of monetary accommodation.



<Chart 6: Trends in real interest rates>

In terms of QT, the BoJ also announced on Wednesday it will embark on reducing the outstanding of its JGB holdings. Specifically, the BoJ will run down the JGB as they mature. The speed of reduction will be controlled by monthly new purchases, which will be reduced in steps from the current ¥6 trillion to ¥3 trillion by Q1 of 2026. The chart on Chart 7 shows the simulated trajectory of the BoJ's JGB portfolio. The pace of reduction is moderate, declining only to ¥ 531 trillion by Q1 of 2026, which is a mere 7.7% reduction. Assuming the BoJ shifts to a more radical strategy stopping new purchases entirely thereafter, the pace of reduction naturally accelerates, but the JGB portfolio still remains as large as ¥405 trillion at the end of 2027. So it is likely that the long process of balance sheet reduction will continue even after the policy rate has reached its terminal rate.



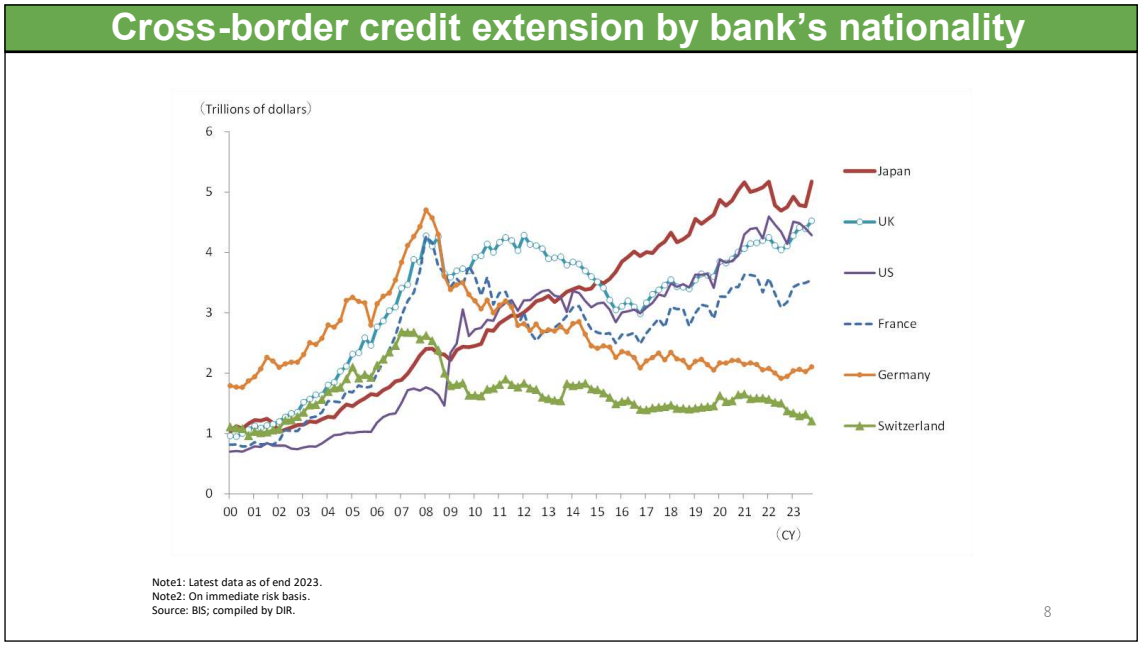
< Chart 7: BOJ's JGB Holdings (Simulation Based on Decisions at the July 2024 MPM) >

Thus, overall policy normalization will be pursued very carefully. Nonetheless, it is a dramatic turnaround to a world with positive interest rates. The steady economic growth and inflation outlook argue in favor of the view that Japan's economy is now ready to take on a bigger role in the global economy.

2-2: Tokyo as an Onshore International Financial Center

Tokyo's second advantage is that it is an "Onshore international Financial Center" with both a multi-layered industrial base and a robust financial system. Japan's deep-tiered supply chains stretch well beyond its national boundaries. This makes Tokyo's cross-border financial support to domestic and overseas industrial firms a natural role. Financial-wise, Tokyo boasts of the concentrated infrastructure that comprises legal and accounting firms, fail-safe payment systems and a myriad of financial institutions including institutional investors and banks.

Our banking system suffered a major setback as a result of the home-grown banking crisis of the 1990s after the asset bubble burst. But thanks to the banking supervision system and the safety-net arrangements developed from the painful experiences of the past, Japan's banking system weathered the Global Financial Crisis and the Pandemic disruption unscathed. They perform a bigger role in global finance, as reflected in the chart on Chart 8, which shows Japanese banks today are the largest cross-border lender by nationality.



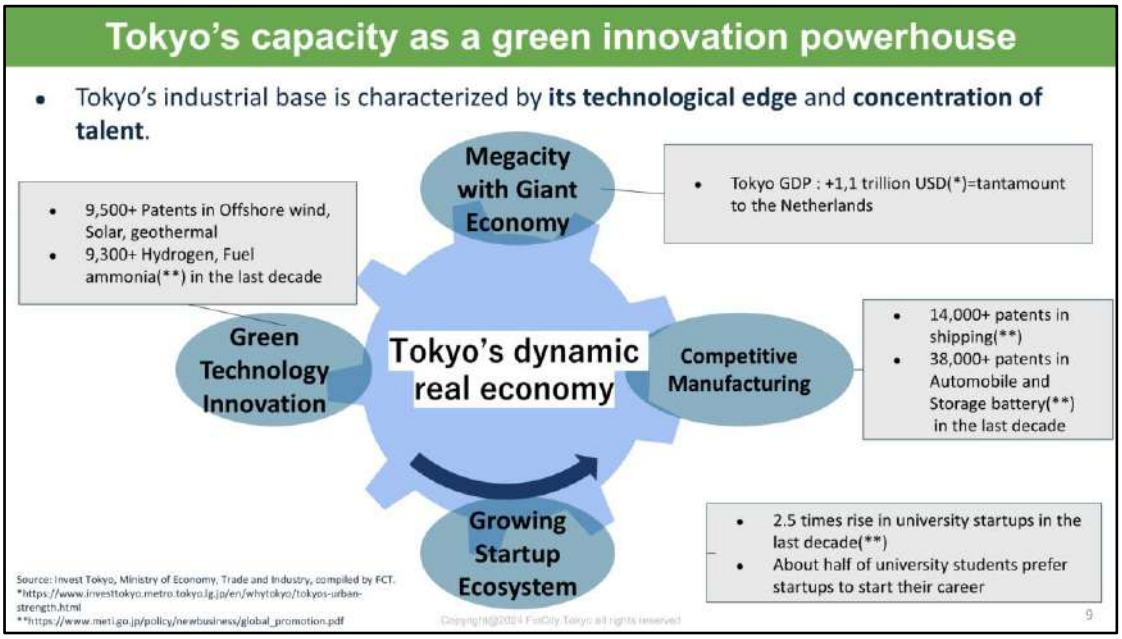
<Chart 8: Cross-border credit extension by bank's nationality >

2-3: Tokyo as an Innovation Powerhouse

The third reason for Tokyo's relative advantage is that Tokyo is transforming itself into an innovation hub. To begin with, Tokyo has a large urban economy and population almost tantamount to a mid-sized open economy. Being home to the headquarters of numerous global companies, Tokyo is quickly evolving as an innovation powerhouse that provides companies with cutting-edge technologies to meet key challenges such as decarbonization.

As a matter of fact, the chart on Chart 9 shows that the number of patents obtained by Japanese firms in hard to abate sectors like the auto and shipping industries stands out among the developed economies. Likewise, Japan has over 18,000 patents related to renewable energy including geothermal and solar, as well as new energy sources like hydrogen and ammonia. These numbers suggest the potential of Japanese firms in meeting climate challenges.

Meanwhile, universities have become an increasingly important part of the innovation hub. From universities concentrated in Tokyo, more graduates like never before are choosing to be entrepreneurs. The best and brightest these days tend to head for startups rather than listed companies or civil service, which once were their favorite destinations.



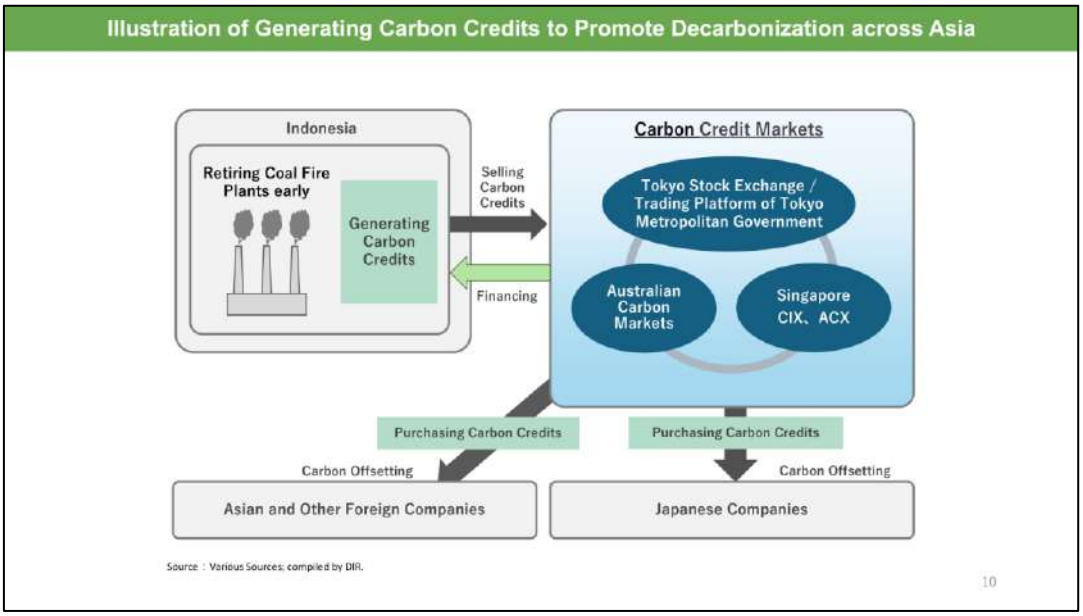
<Chart 9: Tokyo's capacity as a green innovation powerhouse >

3: The Business Model of Tokyo Financial Center

Against the backdrop of the improving macroeconomy and the relative advantages that I have mentioned, Tokyo is back on the global financial stage. Today, I want to introduce Tokyo's ongoing three initiatives that overlap with the current ABAC exercises.

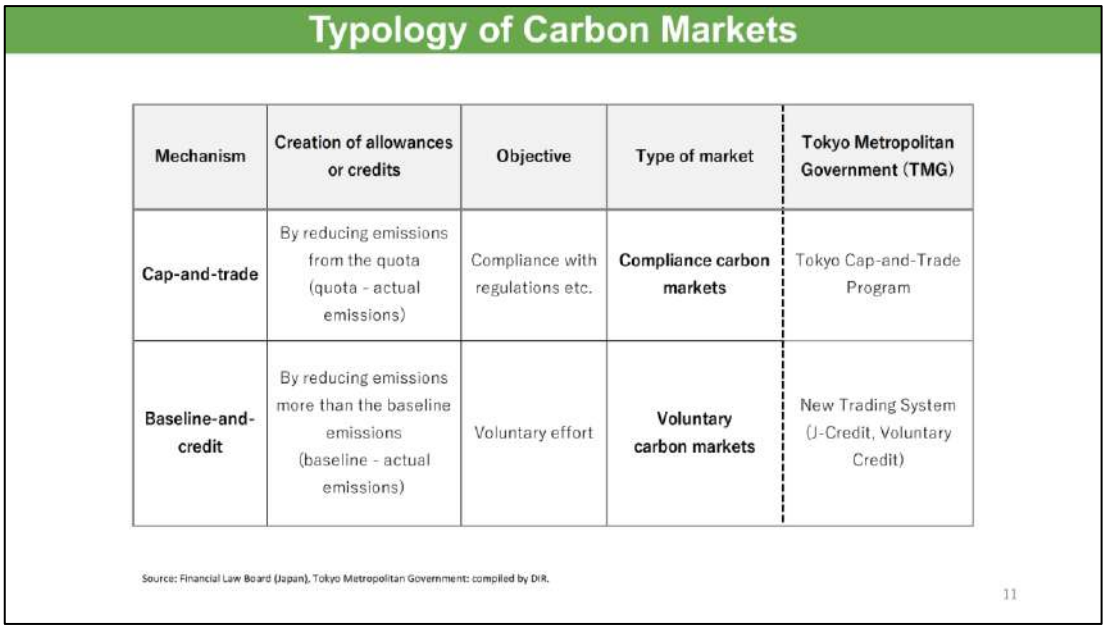
3-1: Creating Interoperable Voluntary Carbon Markets with High-Integrity

First, Tokyo wants to be an integral part of network of interoperable carbon markets in the Asia Pacific region. The concept design chart on Chart 10 illustrates what we envisage. It shows, as an example, a case in which an Indonesian electric power company reduced carbon emission by early retirement of a coal-fired power plant. A part of the reduced emission can be sold as carbon credits to domestic as well as overseas markets like Tokyo, Singapore, or elsewhere in the region. Business companies in the region can purchase carbon credits to partially offset their carbon emissions. Thus the economies across the region can collectively become green quicker than otherwise.



<Chart 10: Illustration of Generating Carbon Credits to Promote Decarbonization across Asia>

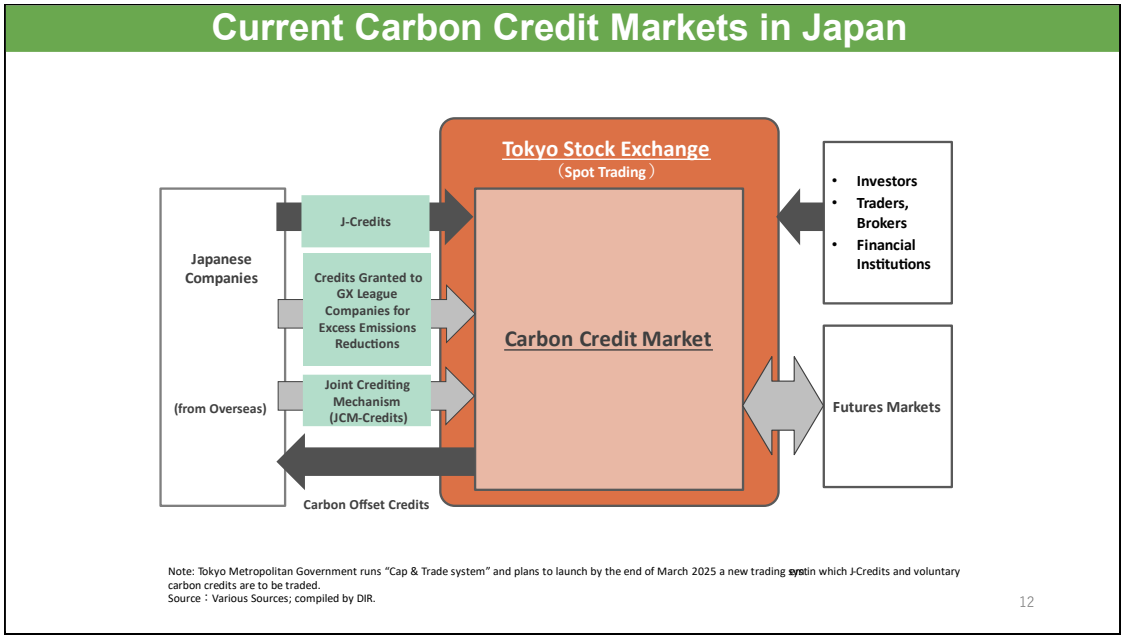
But we know this is easier said than done. In reality, as the table on Chart 11 shows, compliance and voluntary carbon credit systems coexist in a fragmented state. The “Cap and Trade” system is a typical compliance system regulated by the government, where a business firm is allotted an emission quota. If the firm’s actual emission exceeds the quota, the excess emission must be offset by purchasing carbon credits from a firm that has overachieved emission reduction and thus has an unused quota for sale. We understand the EU’s Emissions Trading System is a typical cap and trade system. There are a few similar emission trading systems in the Asia Pacific region but are not interoperable among jurisdictions.



<Chart11: Typology of Carbon Markets>

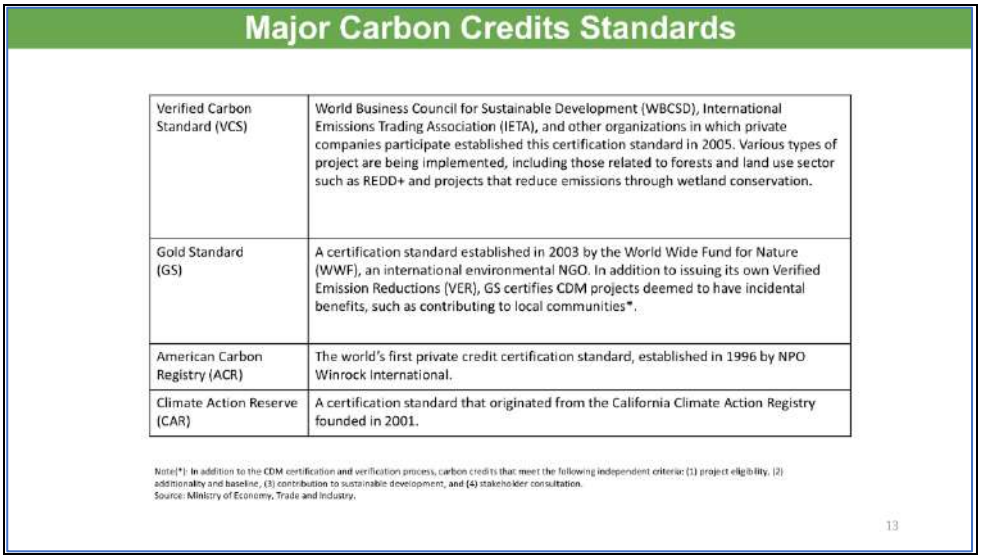
Meanwhile, most voluntary carbon credits that are outside the governments' direct control belong to the "Baseline Credit" system. Under this system, a firm that succeeded in reducing carbon emissions beyond a pre-determined target or baseline, can sell the over-achieved portion as carbon credits to those firms that are in need of carbon offsetting. The Tokyo Metropolitan Government (TMG) operates a compliance market and plans to introduce a new baseline carbon market this fiscal year.

The chart on Chart 12 shows where we are in Japan. Besides TMC, the Tokyo Stock Exchange (TSE) has launched a project that leads to a fully operational carbon credit market by 2026. Instruments traded or to be traded include J-Credit, GX League, and JCM, which are derived from Japanese sources and thus are not traded cross-border except on a limited basis for JCMs. Typology-wise, they all belong to the Baseline Credit system, because although they are managed by the government, they are neither compulsory nor regulated. The next step we envisage in the future, as shown on the right-hand side of the slide, is to widen the range of market participants to deepen market liquidity and develop a futures market to enhance efficiency.



<Chart 12: Current Carbon Credit Markets in Japan>

In the recent ABAC discussions, we have become aware of the growing interest in voluntary carbon markets (VCM) in the APEC economies. We learned Singapore, Thailand and Indonesia initiated domestic VCM trading. China, in the meantime, resumed VCM trading on its domestic platform. As the table on Chart 13 displays, there are several voluntary carbon credit systems in operation. However, although we believe in the potential of the VCM to support significant decarbonization, they are currently fragmented and to the best of our knowledge, cross-border trades remain limited to date.

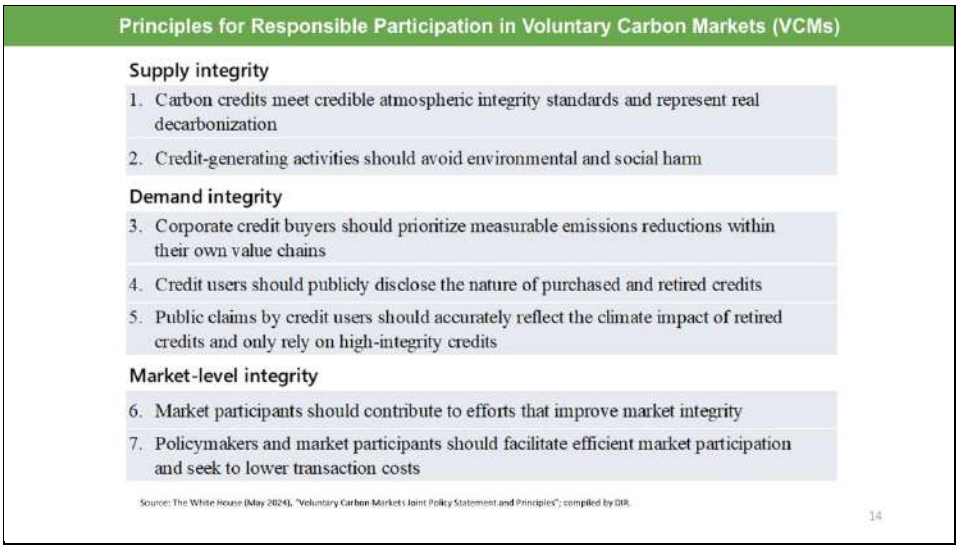


<Chart 13: Major Carbon Credits Standards>

Some key challenges must be addressed for the VCMs to become interoperable and thus become effective in contributing to the region's energy transition. Legal status of VCMs, which differ among jurisdictions and are sometimes opaque, must be clarified. Processes for issuance, registration, transfer and retirement of VCMs need to be standardized. An interoperable registry that eliminates the risk of double counting must also be put in place.

The good news is that there is growing momentum toward developing high-integrity VCMs. For example, the IOSCO published in December last year "Voluntary Carbon Markets Consultation Report" that proposed good practices on 21 points. More recently in May, the US Administration released "Principles for Responsible Participation in Voluntary Carbon Markets".

The principles comprise seven points as shown on Chart 14. While I think these are relevant and useful guiding principles, incentive mechanisms must also be put in place. Allowing carbon offsets to be reflected in public disclosure may serve this purpose.



<Chart 14: Principles for Responsible Participation in Voluntary Carbon Markets (VCMs)>

ABAC proposes this year to launch a pathfinder pilot project to develop a network of interoperable voluntary carbon markets. Any interested member economy is welcome to join the pilot project. The intention is to identify potential challenges and develop solutions so that the VCMs meet the above-mentioned key principles and serve the region's decarbonization needs efficiently. The Tokyo Government is developing its own trading platform for carbon credits including overseas VCMs.

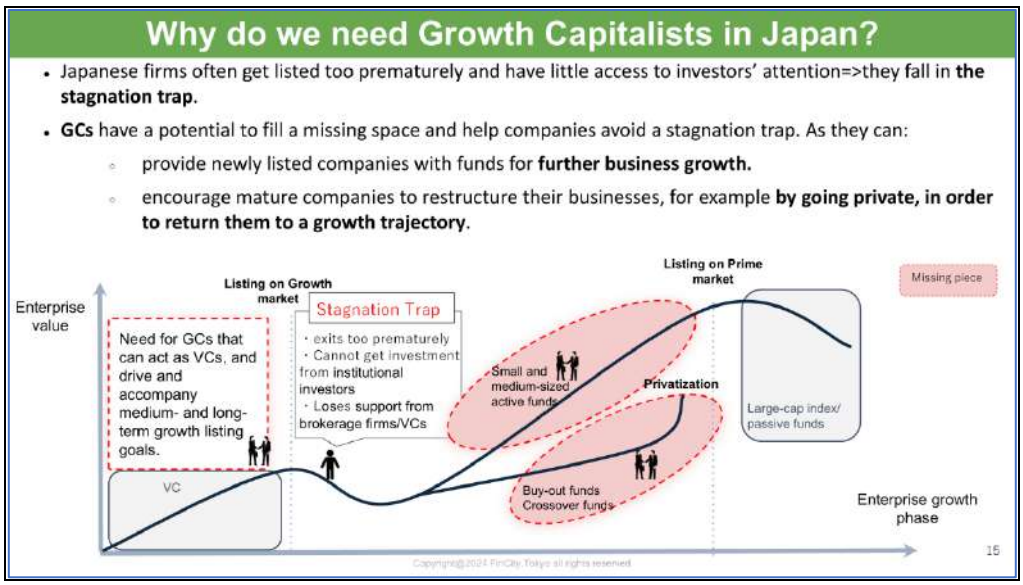
3-2 : Mobilizing Pension Funds for Growth

Tokyo's second initiative is to mobilize pension funds for growth. Like many economies in the region, Japan's economy is bank-centric, with banks providing the main intermediary function. The investment chain as an alternative funding channel has not fully functioned thus far. For this reason, the Government launched an initiative to enable more long-term capital to be invested in risk assets with potential for growth and higher returns over time.

A well-functioning investment chain requires enhanced roles played by both asset owners and asset managers. In the area of asset management, a new breed of asset managers called "Emerging Asset Managers" are expected to function as intermediators of capital for growth, or Growth Capitalists (GCs). An emerging manager typically refers to an independent and active asset manager

who has high investment skill in generating higher returns (or alpha), but with relatively small size in terms of assets under management and a short track record.

In Japan, as indicated in the lower left corner of the chart on Chart 15**,** it is often the case that venture capitalists (VCs) focus on short-term listing goals and only invest in companies between the founding stage and IPOs. Once they are gone the post-IPO companies are left unattended with small market capitalization, deprived of growth opportunities after the IPOs, even with potential. Growth Capitalists, as circled in the red dotted lines, are expected to fill the gap by providing support for companies after their IPOs to make sure they remain on a sustained growth path. Alternatively, they could privatize the listed companies again to revert to a missed growth trajectory.



<Chart 15: Why do we need Growth Capitalists in Japan?>

Against this background, the government decided to promote new entry by domestic and foreign emerging asset managers through the so-called "Emerging Manager Program (EMP)", which typically requires large asset owners and institutional investors to allocate a portion of their funds to emerging asset managers.

In the meantime, Tokyo has been designated one of the four Special Zones by the government along with cities of Sapporo, Osaka, and Fukuoka. Tokyo intends to focus on inviting emerging asset managers to Tokyo by leveraging the deregulation enacted by the government that enables an emerging asset

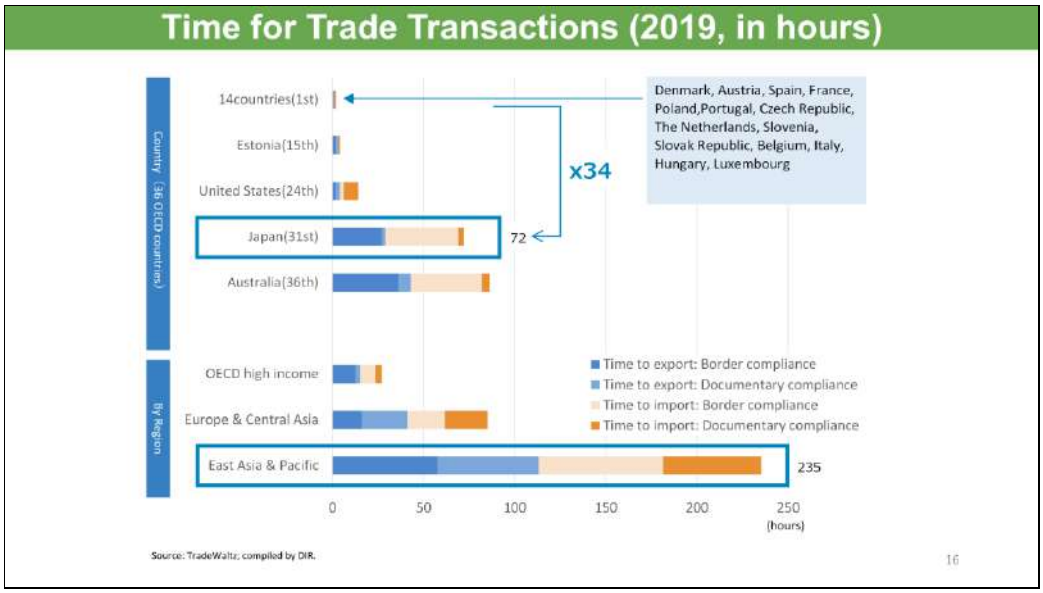
manager to outsource back-and-middle office operations to an outside firm.

We believe our experience has high relevance for those APEC economies that aim to mobilize pension funds for growth. ABAC has been exploring ways to develop investment chains in the region that effectively channel growth capital building upon the experiences of economies including Japan that have undergone reforms. This year ABAC proposes to launch what may be called the “Inclusive Long-Term Investment Pathfinder Initiative”.

This initiative aims to help member economies to introduce reforms enabling pension funds to expand investment in private markets and small- and mid-cap companies. It also intends to support economies in need of developing capacity to undertake these reforms in the future.

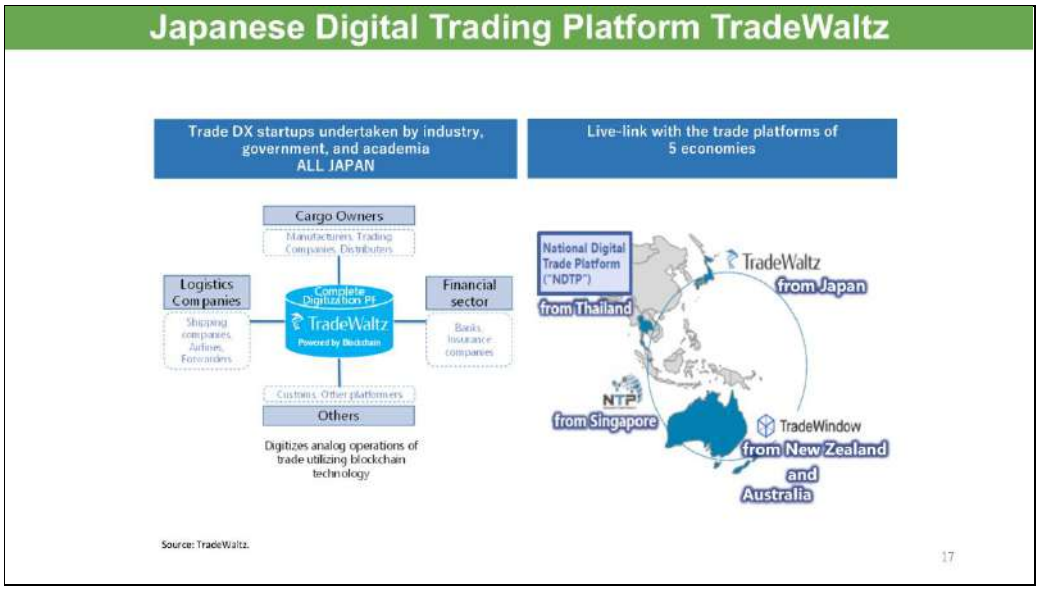
3-1: Digitalization of Trade

Tokyo’s third initiative is to improve efficiency of trade through DX. Indeed, there is a lot of room for improvement in the Asia Pacific. As you see in the chart on Chart 16, a much longer time is needed in Japan than our peers in cross-border trade procedures because some operations are run manually and on a paper-basis. Japan spends approximately 72 hours on processing, which is 34 times as long as the top 14 countries. The situation is even worse in other parts of Asia including the ASEAN, where 235 hours are wasted.



<Chart 16: Time for Trade Transactions (2019, in hours)>

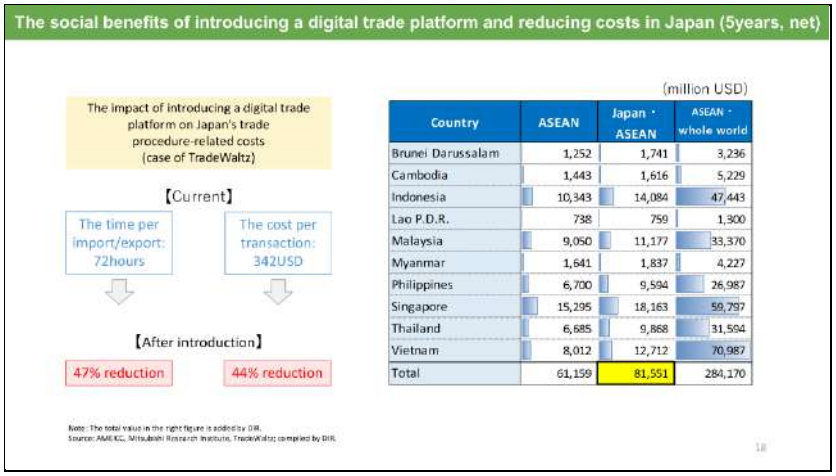
To improve the situation, we think standardization and full digitalization of documents as well as creation of a data platform are necessary. To serve this end, as shown on the left-hand side of the chart on Chart 17, a Japanese digital platform called “Trade Waltz” was launched and started operation in 2020. It enables full digitalization of trade documents as well as utilization of blockchain technology to ensure accurate and swift processing.



<Chart 17: Japanese Digital Trading Platform TradeWaltz>

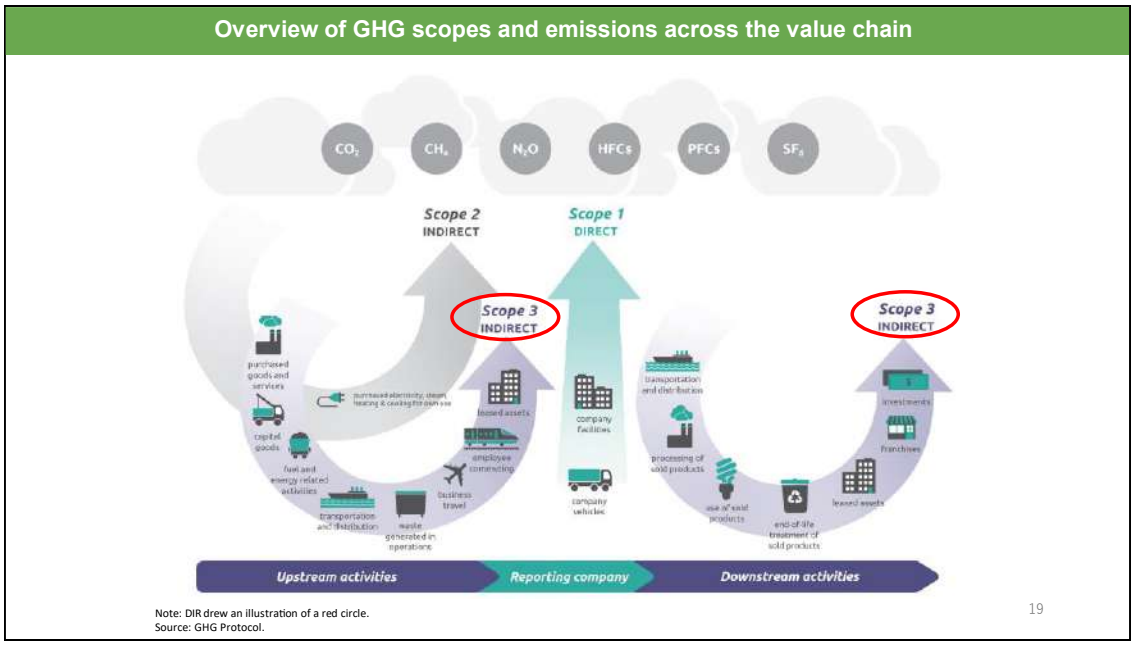
As a next step, ABAC Thailand leads the initiative on expanding the Digital Trade Connect Network. Under this initiative, Trade Waltz intends to connect with similar platforms operating in the Asia Pacific region, as shown on the right-hand side. We recommend more platforms from the region join the initiative, because the wider the network, the larger the positive effect.

As a matter of fact, the network effect in its fullest extent is estimated to result in a $81.5 billion cost reduction over the five-year time horizon associated with trade between Japan and the ASEAN economies, as indicated in the table on chart 18.



<Chart18: The social benefits of introducing a digital trade platform and reducing costs in Japan>

The network of digital trade platforms will bring other positive effects. For example, it may pave the way to what may be called deep-tier supply chain finance, where second-and third-tier SME suppliers joining the platform have better access to credit by utilizing the data stored in the platform such as the receivables as collateral against bank loans. Furthermore, if the network is expanded to encompass the entire supply chain of a company, capturing Scope 3 emissions may become possible. As the conceptual chart on Chart 19 shows, it might become easier to detect the hot spots with high emissions in the supply chain. By concentrating investments in the hot spots, the firm can effectively reduce overall carbon emissions.



<Chart 19: Overview of GHG scopes and emissions across the value chain>

We heard at the Opening Plenary, that the global economy continues to face the risk of fragmentation. What ABAC can do in this context is to collaborate closer in such areas of common interest as addressing climate change, maintaining free trade, and promoting investment for sustained growth.

I have no nostalgia for an Armada type of financial center that Tokyo once upon a time used to be. What is expected of Tokyo today is a new financial role to support the efforts of APEC economies to overcome common challenges. I am confident Tokyo is well-qualified to fulfill the mission. Let me conclude my speech by reiterating our commitment to being the Chief Navigator in our pathfinding voyage that we have embarked upon. Thank you very much for your attention.