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# Forty years of World Bank bonds in Japan

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2011 MARKS THE 40TH ANNIVERSARY OF THE FIRST PUBLIC BOND ISSUE BY THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (THE 'WORLD BANK') IN JAPAN. THAT ISSUE, A JPY11BN BOND LAUNCHED IN JUNE 1971, REPRESENTED AN IMPORTANT STEP IN THE EVOLUTION OF THE WORLD BANK'S RELATIONSHIP WITH JAPAN. JAPAN BECAME A MEMBER OF THE WORLD BANK IN 1952, AND THROUGHOUT THE 1950S AND 1960S, AS JAPAN RELIED ON CAPITAL INFLOWS TO REBUILD FROM THE DEVASTATION OF WORLD WAR II, THE WORLD BANK PROVIDED MORE THAN US\$850M OF LOANS TO THE COUNTRY. IN ALL, THE WORLD BANK MADE MORE THAN 30 LOANS TO JAPAN DURING THAT TIME, FUNDING IMPORTANT ECONOMIC DEVELOPMENT PROJECTS THROUGHOUT THE COUNTRY.

The World Bank's lending to Japan focused on three distinct areas that were critical to the country's programme to rapidly rebuild its economy: (i) power generation; (ii) heavy industrial production; and (iii) transportation. The World Bank's first loan, in 1953, helped Japan rebuild its basic electrical power capacity by financing electric power generation projects carried out by Kansai Electric, Kyushu Electric and Chubu Electric. Later, the World Bank financed six more power projects, five of which involved hydro-electricity, including the construction of the Kurobe No. 4 Dam and the Arimine Dam.

To assist in the reconstruction of Japan's heavy industrial capacity, World Bank loans provided financing for companies such as Kawasaki Steel, Mitsubishi Shipbuilding and the Toyota Motor Company. In the transportation sector, World Bank loans aided in the construction of the national highway system, including the Meishin and Tomei expressways, as well as the development of the first bullet train (*shinkansen*) line.

Japan grew at a very fast pace in the 1960s and became an industrialised nation with high employment, a high standard of living and a high savings rate. The World Bank's final loan to Japan was signed in 1966 and, by 1971, Japan completed the transition from being a borrower from the World Bank to being a source of



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funding for the institution. Since the World Bank’s inaugural bond issue in the country, Japan has become one of the most important markets in the world for World Bank bonds. Over the last 40 years, approximately US\$150bn of World Bank bonds have been bought by Japanese institutional and individual investors.

## The changing menu of World Bank debt products for Japanese investors

While the Japanese capital market has remained a consistent source of demand for World Bank debt products during the past 40 years, the types of products the World Bank has offered to Japanese investors have evolved over time. This evolution has been driven by shifting investor preference for different structures, currencies and forms of debt products, as well as by changes in market regulation and capital market innovations. The World Bank has always been quick to respond to these changes and, in the process, has been a leader in introducing new products to the Japanese capital market.

When the World Bank issued its first public bond to Japanese investors in 1971, the Japanese yen was not yet an international currency, and the Japanese capital market was still in a nascent state. That bond was one of the first ‘samurai’ bonds ever issued – *samurai* bond being the name applied to a Japanese yen-denominated bond issued in the domestic Japanese market by a foreign issuer (see Exhibit 1).

The World Bank’s inaugural *samurai* bond helped develop this new market and paved the way for the first sovereign *samurai* issue (by Australia in 1972) and eventually for the first corporate *samurai* issue (by Sears in 1979).<sup>2</sup> The World Bank continued to be an active issuer of *samurai* bonds throughout most of the 1970s and the first half of the 1980s (and continues to issue *samurai* bonds on occasion today if this format is requested by investors).

During the same period, the World Bank also regularly borrowed from Japanese commercial and trust banks in the form of syndicated loans. A syndicated loan was the preferred form of World Bank debt product for many

Japanese banks during that time, primarily because of the constraints they faced on dealing in bonds and other securities.

Then, in 1985, following moves by the Japanese government to encourage greater internationalisation of the Japanese yen and liberalise the Japanese capital market, the World Bank became the first issuer of a ‘*shogun*’ bond (a foreign currency denominated bond issued in the domestic Japanese market). The bond, which was denominated in US dollars, marked the beginning of a long history of the World Bank introducing products to allow Japanese investors to diversify their currency exposure, which continues today. Two years later, the

### Samurai bond certificate from 1972 Exhibit 1



Source: World Bank

World Bank introduced its first '*daimyo*' bond (a yen-denominated bond that settles through European clearing systems). Five years later, in 1992, the World Bank issued the world's first Japanese yen-denominated global bond (a bond that settles through clearing systems in multiple geographical locations).<sup>3</sup>

Over the last two decades, the World Bank has also been one of the largest issuers of '*uridashi*' bonds to Japanese retail investors. The majority of '*uridashi*' bonds are simple fixed rate bonds that are denominated in foreign currencies. Having faced many years of extremely low domestic interest rates, Japanese investors are attracted to '*uridashi*' bonds denominated in foreign currencies that offer significantly higher rates of interest than they can achieve with Japanese yen investments. The currencies that predominate in this retail investor-driven market have changed over time as interest rates fluctuate and different countries or regions of the world gain or lose popularity with Japanese investors. At different times over the last two decades, US dollars, British pounds, Canadian dollars, euros, Australian dollars, New Zealand dollars, South African rand, and Brazilian reais have been popular currencies for World Bank '*uridashi*' bonds.

The World Bank has also been an active issuer of structured notes in Japan during the past two decades. Whereas '*uridashi*' bonds are largely sold to retail investors, structured notes are intended for institutional investors that have the requisite sophistication to understand the market risks embedded in the structures. The types of structures the World Bank has issued for Japanese investors have varied over time based on changing investor appetite. For example, when large numbers of institutional investors have been bullish on equity prices, equity-linked structured notes have been popular. Other World Bank structured notes have allowed investors to express their views on exchange rates, interest rates and the slope of the yield curve.

The most recent addition to the range of World Bank debt products that are available to Japanese investors are two open-ended investment trust funds that invest entirely in World Bank bonds. These funds are managed by Nikko Asset Management ('Nikko AM') and sold to Japanese

investors by more than 65 banks and securities firms all around Japan. The first of these funds was established in 2007 and is known as the World Supporter Fund. The fund invests in World Bank bonds denominated in, or linked to, a wide and well-diversified range of emerging market currencies, including Chilean pesos, South African rand, Turkish lira and Malaysian ringgits (Exhibit 2). The second fund, which was set up in 2010, invests in World Bank 'green bonds' (bonds for which the proceeds are used to support projects aimed at tackling the causes and consequences of climate change).

These examples illustrate that the range of debt products the World Bank has offered to Japanese investors during the past 40 years has evolved continuously. The products have included *samurai* bonds, syndicated loans, *shogun* bonds, *daimyo* bonds, global bonds, '*uridashi*' bonds, structured notes and investment trusts, and the currencies have shifted from solely Japanese yen in the 1970s, to a mix of Japanese yen and US dollars, to an enormous variety of currencies from A (Australian dollars) to Z (Zambian kwacha) in the current decade.

**Currency composition of the World Supporter Fund (as of August, 2011) Exhibit 2**



Source: World Bank

The common theme that runs through this four-decade long history is that the World Bank has continually created new and innovative financial products that respond to market developments and changing Japanese investor preferences. The World Bank has maintained a constant and deep presence in the Japanese capital market since its first *samurai* bond, working in partnership with over 100 Japanese banks and securities firms, from Hokkaido to Okinawa, whose hard work and innovative thinking have been invaluable to the success of the World Bank's borrowing programme in Japan.

## The new generation of World Bank debt products in Japan – 'green investments'

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Recently, 'socially responsible' or 'sustainable' investing (i.e., integrating social and environmental concerns into investment decisions) has become increasingly popular with Japanese investors. There has been a particularly strong demand for investment products that have a positive environmental impact and, in the fixed income market, the World Bank has been a leader in meeting this demand.

The World Bank issued its first environment focused bond in Japan in June 2008. The bond, which is denominated in US dollars, pays a coupon that is linked to: (i) the future performance of the market price for certified emission reductions of carbon issued under the Kyoto Protocol ('CERs'); and (ii) the actual volume of CERs generated by a hydropower plant located in the Guizhou Province in China. Known as the 'World Bank Co<sub>2</sub>L Bond' (or 'Cool Bond'), the issue was the first *uridashi* bond ever to be linked to CERs. Following on the success of that bond, in the same year the World Bank issued a second bond that had a similar structure, but was linked to a bio-energy project in Malaysia. These two bonds allowed Japanese investors to participate indirectly in the success of projects that aim to reduce greenhouse gas emissions in the Asian region.

The growing demand for environment friendly investment products in Japan also led the World Bank to issue its first

'green bond' to Japanese investors in 2010.<sup>4</sup> World Bank green bonds support projects in the World Bank's client countries that meet specific criteria for low carbon development, and therefore provide a perfect opportunity for Japanese investors to support climate change solutions through their investment decisions. Since the initial issue in Japan, green bonds have been bought by many types of Japanese investors, including institutional investors (in particular regional banks) that have highlighted their purchase of World Bank green bonds as part of their corporate social responsibility programmes.

In addition, as described earlier, Nikko AM launched a World Bank Green Bond Fund in 2010. The fund is comprised of World Bank green bonds that are denominated in a variety of developed and developing market currencies, including Australian dollars, Mexican pesos and Norwegian kroner.

## Conclusion: the World Bank and Japan – a successful development partnership

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The relationship between the World Bank and the Japanese society is an example of an extremely successful development partnership. Over a 13-year period in the 1950s and 1960s, the World Bank provided loans to Japan that helped the country recover and rebuild from the damage caused by World War II.<sup>5</sup> The reconstruction of the Japanese economy was so successful that just a few years after Japan signed its last loan from the World Bank, Japan had become an important source of funding for the institution. In fact, within a few years of the first *samurai* issue, Japan was a net creditor of the World Bank, with the amount of outstanding World Bank debt held by Japanese institutions and individuals exceeding the outstanding balance of World Bank loans to the country.

In addition to becoming an important market for World Bank debt, Japan became an increasingly important development partner for the World Bank over the past four decades in other ways as well. In 1970, Japan went from being the seventh to the fifth largest shareholder in the

World Bank, and in 1984 it became the second largest shareholder, a position it still retains today.<sup>6</sup> Japan is also one of the largest donors to the International Development Association (IDA), the arm of the World Bank Group that helps the poorest countries, as well as to many funds administered by the World Bank, including the Global Environment Facility and the Global Fund for Aids, Tuberculosis and Malaria.

Given the high rate of savings in Japan and the growing desire of Japanese investors to purchase investment products that support sustainable development, Japan is likely to continue to be an important market for World Bank bonds in the years ahead. Through their investments in World Bank bonds, Japanese institutions and individuals help fund important projects in developing countries.

During the post-war years, Japan went from being a country plagued by hyperinflation and high unemployment to one with a strong and stable economy with a gross national product (GNP) that grew on average by over 10% per year and real industrial wages that quadrupled in a decade.<sup>7</sup> During the same period, educational levels improved significantly and life expectancy increased by almost 14 years. Similarly impressive results are being achieved now in many of the World Bank's largest borrowers, such as China, India and Brazil. Thus, by purchasing World Bank bonds, Japanese investors are funding results in developing countries that resemble those achieved by Japan as it rebuilt in the aftermath of World War II.

**Notes:**

- 1 The findings, interpretations and conclusions expressed herein are those of the authors and do not necessarily reflect the views of the World Bank or its affiliated organisations.
- 2 For more information on the development of the *samurai* bond market, see Fumiaki Nishi and Alexander Vergus, 2006. *Asian Bond Issues in Tokyo: History, Structure and Prospects*. In: *Asian Bond Markets: Issues and Prospects*. *BIS Papers No. 30* (November).
- 3 The World Bank created the global bond form in 1989. See Richard Jory, 204. *The World that Changed the Bond*. *IFR Magazine 20th Anniversary Special Report* (July).
- 4 The first World Bank green bond was issued in 2008 to Scandinavian investors.
- 5 It is estimated that for the period from 1959 to 1964, loans from the World Bank represented just under 20% of Japan's total external borrowing. However, the qualitative impact of the World Bank's lending during that time was even more important than the quantitative impact. New construction technologies were brought in as part of World Bank funded projects, and the World Bank also imposed conditions on the executing agencies and companies that led to greater financial efficiency in their operations. For more information about the relationship between the World Bank and Japan during this time, see Toyoo Gyohten, 1997. *Japan and the World Bank*. In: Kapur, Daves, Lewis, John P. and Webb, Richard eds., 1997. *The World Bank: Its First Half Century*. The Brookings Institution.
- 6 When Japan joined the World Bank in 1952, it was the ninth largest shareholder. Through subsequent capital increases, it became the eighth largest shareholder in 1959, the seventh largest in 1965, the fifth largest in 1970 and the second largest in 1984. As of June 30, 2011, Japan held 9.9% of the shares of the World Bank (with the value of its total capital subscription in excess of US\$19bn).
- 7 Real wages for Japanese manufacturing workers increased from 30.2 in 1947 to 114.5 in 1955 (based on a pre-war base of 100). See Hiroshi Harama, 1976. *Historical Changes in the Lifestyle of Industrial Workers*. In: Patrick, Hugh, ed., 1976. *Japanese Industrialization and its Social Consequences*. University of California Press.

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