

# **“On an Even Keel”: Hedging Exchange Rate Risk on the Branch Network Level**

“A word next as to our Exchange policy. There seems to be a mistaken idea that our sterling deposits are remitted to the East for investment there, and I may tell you, gentlemen, plainly and at once, that this is not the case. We have today some 4¾ millions of sterling deposits, which are exclusively employed for the purchase of outward mercantile bills, silver bullion, Mexican dollars or council bills for shipment to the East, pending the arrival of homeward bills purchased simultaneously by the Eastern branches, both operations being legitimate Banking transactions. It will be easily understood that by following this policy, large sterling deposits can be used without the price of silver affecting the position in the least, the money deposited having in reality never left London. The management has taken and will take particular care that *the bank keeps on an even keel with regard to both gold and silver*; beyond the comparatively trifling differences from day-to-day business, neither a rise nor a fall in the dollar exchange can injure or benefit us to any appreciable extent.”

Mr. Davies, Chairman of the Hongkong and Shanghai Banking Corporation in an address at the Ordinary Half-Yearly Meeting at the Hongkong City Hall, at noon, August 20 1892. Published in: *North China Herald*, September 2 1892, p. 344. Italics mine.

## 1. Introduction

In the preceding chapter, we reviewed the accounting specifics of the most representative type of bills exchange banks dealt with in the second half of the nineteenth century. We demonstrated that, in the case of an imaginary bank existing of two branches with a different metal as unit of account, the key to recouping funds incurred by branch X when sending on a bill to Y ( $X_y$ ) was to engage in a reverse transaction, with a bill flowing in the opposite direction (or  $Y_x$ , as it concerns a bill branch Y sent on to branch X). In a concrete example: a branch sold, for local currency, remittances to importers in order to recover the same amount in local currency it had spent on buying bills from exporters. The idea of an exchange bank's workflow can thus, in its most general and symbolic form, be expressed as:  $X_y \rightleftharpoons Y_x$ . We also saw that, ideally, operations were executed simultaneously or, in other words, at the same rate of the day, in order to avoid exchange rate risks and, by extension, in order to avoid situations in which the working capital of the branch was affected.<sup>1</sup>

Yet how do sets of such binary relationships translate on the branch network level? This question is a pertinent one. Most importantly, does the above relationship imply that *every* liability/asset incurred by X on Y should be matched a liability/asset of the same amount incurred by Y on X? Although this situation might seem logically implied, it is patently improbable in a real world scenario. As we know, the balance of trade between nations is typically in disequilibrium rather than in equilibrium. Is it therefore not to be expected that imbalances in interbranch assets and liabilities are offset by, say, triangular relationships? Clearly, this must be the case. But then, if so, how can this be organized? Concretely, which currencies are more likely to be used as

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<sup>1</sup> A similar description can be found in one of the contemporary accounting manuals, under the heading *kawase no deai* (為替の出合, 'exchange cover'): 富田 源太郎. 1894. 『外国為替の説明』. 東京: 富田源太郎. Pp. 76-83. The manual stresses that not covering his dealings, or running an exchange imbalance (in Japanese referred to as *kata-kawase* 片為替) would "amount to speculation, which was not in the true character of the exchange banker" (*tōkiteki no michi ni hairu ha ginkōsha no honshoku ni arazu* 投機的の道に入るは銀行者の本色に非ず).

the vehicle for offsetting others? Related to the latter, can currencies be clustered into a basket and treated as isomorph? How can branches protect against highly volatile exchange rates? Were bankers aware of hedging techniques? On the branch network level, can the network be organized into a core-periphery structure, with certain key branches put in charge of monitoring the portfolios of lower-tier ones? And put into an intra-bank comparative perspective, why were some banks apparently more successful in their hedging strategies than others?

## 2. From the fall of the Oriental Bank to HSBC losses

The above questions turned out to be topics of great contention in the 1880s, when the once mighty Oriental Bank Corporation had been forced into liquidation.<sup>2</sup> A few years later the debate gained even more traction, when the until then profitable Hongkong and Shanghai Banking Corporation suffered unexpected losses “by advancing against sugar in Manila”, as Mr. Provand explained to the parliamentary commission of the preceding chapter.<sup>3</sup> It was this event indeed that triggered, among others, the parliamentary hearings that provided the greater deal of evidence for the former chapter.

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<sup>2</sup> For a very solid and probably definitive account of the reasons behind the *Oriental Bank Corporation*’s demise, see: Suzuki, Toshio. 2012. “The Rise and Decline of the Oriental Bank Corporation, 1842–84.” In *The Origins of International Banking in Asia*, edited by Shizuya Nishimura, Toshio Suzuki, and Ranald C. Michie, 86–106. Oxford University Press. <http://www.oxfordscholarship.com/view/10.1093/acprof:oso/9780199646326.001.0001/acprof-9780199646326-chapter-4>. The paper is all the more remarkable given that the bank’s archives were destroyed at the time of its bankruptcy. For obvious reasons, however, contemporary journalistic evidence remains: “The Failure Of The Oriental Bank Corporation”. *The Economist* (London, England), Saturday, May 10, 1884; pg. 567; Issue 2124; “The Liquidation Of The Oriental Bank”. *The Economist* (London, England), Saturday, December 6, 1884; pg. 1480; Issue 2154.

<sup>3</sup> Again, according to Mr. Provand in 1887. *Report of the Royal Commission Appointed to Inquire into the Recent Changes in the Relative Values of the Precious Metals; with Minutes of Evidence and Appendices*. 1887–1888. London: Eyre and Spottiswoode. P. 166.

Yet the debate had many facets. Not in the least, it concerned the activities of the mighty British exchange banks in Asia. More specifically, people came to focus on the question of how to turn exchange banking into a profitable business in the long-run, or, in other words, unaffected by volatility in the gold price of silver. That the latter had become problematic after 1876 does not need any repetition here. In a remarkable opinion piece from 1882, *The Economist* hinted to the urgency of reconsidering the complexities of the silver problem on the micro-level in the following manner:

“Why have the Anglo-Indian banks fared so badly in 1881? To find any really satisfying answer to the above question is a matter of difficulty. By all the laws of legitimate banking, the profits of the Indian banks should have increased last year, not diminished. [...] There was a much increased demand for money, thus enabling banks to employ their resources more completely, and at higher rates, than in 1880. Further than this, the export trade of India grew rapidly, and means of remittance to pay for Indian produce were in considerable request. At the same time, far from the banks holding diminished funds, their deposits were increased, and so were their notes in circulation; they discounted more bills, advanced more money, and under almost every head their business operations gave unmistakable signs of expansion. Neither can there be said to have been any losses due to the depreciation of silver. [...]. Yet, with it all, they have lost ground in profits, in dividends, and in market values.”<sup>4</sup>

As we argued in the former chapter, the *Economist* blamed only part of these outcomes on flawed managerial decisions; it also identified reduced usance of bills as a culprit behind the numbers.

Yet more important for the following discussion is that the authors appeared unhampered by macroeconomic concerns, and felt free to delve into aspects of managerial decisions. They thereby transcended the ideological cleavages that were so typical of much discussions of the time. They did, for instance, explicitly and emphatically deny any condemnation of bimetallist premises that may have played a

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<sup>4</sup> ‘Why Have The Anglo-Indian Banks Fared So Badly In 1881?’. *The Economist* (London, England), Saturday, April 22, 1882; Pp. 468-469; Issue 2017.

role in the judgment of the Anglo-Indian bank managers (“they are probably beyond the reach of argument”, as the article states). What matters, so the authors argued, are the interests of the banks’ shareholders and depositors; and the managers’ decisions should be judged only in terms of the latter. Something that stood out, however, was the fact that the few profitable banks operated on terms that were quite different from all other ones:

“[...] one point strikes us with regard to the [profitable banks]. The Bank of Bengal makes up its accounts in rupees; the Hongkong and Shanghai Corporation in Mexican dollars. What reason is there why the Anglo-Indian banks should not render their accounts in the currency of the country where their business lies? [...] As far as capital is concerned, we hold that a bank should always consult its customers’ convenience first; but as regards the deposits, where at present so large an element of risk lies, there is everything to be said in favour of a change of form. Rupee securities are becoming more and more popular over here, and there is room for a converted Anglo-Indian bank, which instead of taking deposits in sterling would take them in rupees.”<sup>5</sup>

The logic behind the argument is clear: have the London branches exchange banks opt to acquire their liabilities (deposits) in the silver currencies of the Eastern countries, so that, when the export bills –which were purchased with those deposits– fell due months later in Asia at the rate of the day, there would be no exchange risk to incur. Put differently: if liabilities acquired by the London branch had the same unit of account as the remittances the Eastern branches sold to the Eastern importers, the banks could neutralize the vices of the “present system”, which “throws all risk on the bank, which should not incur it”.<sup>6</sup>

The idea is simple enough. Yet, as it turns out, the managing of exchange risk was at the time, just as it is today, not so easily understood. On second sight, the proposal

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<sup>5</sup> ‘Why Have The Anglo-Indian Banks Fared So Badly In 1881?’. *The Economist* (London, England), Saturday, April 22, 1882; P. 469; Issue 2017.

<sup>6</sup> ‘Why Have The Anglo-Indian Banks Fared So Badly In 1881?’. *The Economist* (London, England), Saturday, April 22, 1882; P. 469; Issue 2017.

was not only impractical, but even oxymoronic. Given that the depositors' base of the exchange banks' London branches was mostly composed of British importers (who wanted to remit silver currencies but had their accounts otherwise in British pounds) and British exporters (who wanted to receive remittances in British pounds), rupee or other silver denominated deposits in London would imply a transfer from the bank to the depositors, *who had turned to the bank for insuring against exchange risk in the first place*. Clearly, such cannot have been the objective.

More subtle but equally important, the above reasoning implies that the *only* way to eliminate exchange risk was by means of adopting a uniform unit of account because, so the *Economist* concluded, "we may be very sure we shall never find the gold and silver mixing amicably in [the exchange banks'] accounts".<sup>7</sup> Moreover, the reason that the *Economist* proposed rupee securities in London (and not: gold-denominated securities in Asia) has to be seen against the overall liquidity condition of London vis-à-vis the money markets in Asia. As the former was the financial center of the world, it was *de facto* the place where the exchange banks held the lion's share of their capital. Consequently, the reasoning went, the only place where a change of unit of account could practically be implemented was in the gold centers; the periphery was too liquidity poor.

### 3. Hedging Exchange Risk: From Unit of Account to the 'Even Keel'

The reason I highlight the premises of the above proposal is not so much because they were correct (as we will see, they were in many ways mistaken) but because they were so widely held at the time, even among those intimately involved in the import- and export trade with East-Asia. We find, for instance, a similar argument in the testimony of Mr. Provand before the parliamentary commission in 1887 (cf. *supra*):

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<sup>7</sup> 'Why Have The Anglo-Indian Banks Fared So Badly In 1881?'. *The Economist* (London, England), Saturday, April 22, 1882; P. 470; Issue 2017.

“[...] does not the fact that [the exchange banks] make small profits, although they charge large interest, show that there is a good deal of risk in their transactions?’ –Yes. ‘And is not the very heavy charge for interest due to the existence of this risk?’ –It is. ‘Quite as much as to the question of exchange or fall in silver?’ –*It is the exchange which is the risk, and if there had been no fall in silver there would have been no question of exchange.* [...] Every decline in silver since 1873 has caused the banks severe loss. Their capital is in sterling and also their chief deposits. These were sent to the East when exchange was high and stand in the banks’ books at nearly 2s. per rupee. But since the decline in silver they have written down this value, which has cost them several several hundred thousand pounds, and much of their profits have gone in doing this. [...] The Hong Kong and Shanghai Bank’s capital is in silver, because it is a local bank out there, and its profits have chiefly derived from local business. [...] I believe it would be infinitely better today if silver and gold were tied together again as they were before 1873.”<sup>8</sup>

Note the fundamental similarities with the aforementioned reasoning: 1) exchange rate risk is a question of the unit of account, and 2) the only ways to absolve silver risk is a) by fixing the values of gold and silver,<sup>9</sup> or, as in the case of HSBC, b) by adopting the unit of account of the liquidity poor Eastern countries and focusing on local business in East-Asia.

Yet was the unit of account the only key to managing exchange rate risk? In a rare series of heated exchanges in the *North China Herald* of 1886, we find this notion fundamentally challenged, notably by whom we can very safely assume to have been managers at the Hong Kong and Shanghai Bank. Their timing for throwing light on their exchange strategy is important. This was the first time that the bank had run considerably losses, as said before because of managerial mistakes in Manila, but also because of the unfortunate decision to have laid down funds for an exceptionally bad tea

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<sup>8</sup> *Report of the Royal Commission Appointed to Inquire into the Recent Changes in the Relative Values of the Precious Metals; with Minutes of Evidence and Appendices.* 1887–1888. London: Eyre and Spottiswoode. Pp. 166-167. Italics mine.

<sup>9</sup> Clearly, the *Economist* did not espouse this option in view of its strong antagonism with respect to bimetallism.

harvest in China. This, together with another episode in the silver drama,<sup>10</sup> and the fall of the Oriental Bank only two years earlier,<sup>11</sup> had shaken confidence in the business of the exchange banks. Now, managers of the HSBC too had come under fire. The critique voiced in the *North China Herald* by a certain C.S. Taylor<sup>12</sup> was particularly damaging, as it, echoing the above-described common understanding of trade with East-Asia, questioned the fate of the bank's sterling deposits in London:

“My [...] question has reference to the \$69,664,853 of Deposits. How is this amount made up? How much is there in sterling, and at what rate of exchange is this sterling converted into [Hong Kong] dollars? [I assume] that the London sterling deposits are converted into dollars each half year at the ruling rate of exchange. [...] Taking this as my basis, and looking at the accounts as presented at the half yearly meeting of shareholders, I find that [based on the manager's statement that about one third of the deposits is in sterling] the Bank must have written off, since the 30th June last year, for loss on sterling deposits no less a sum than \$2,840,553 and since the 30th June 1880 \$3,905,063 as the following figures show: —

		Sterling		Sterling
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<sup>10</sup> The silver price had fallen from 32:4d to 35:0½d, or 8.8% (!) in the first six months of 1886. For evidence of the full episode, see the *North China Herald* (several issues).

<sup>11</sup> For a very thorough discussion, see: Suzuki, Toshio. 2012. “The Rise and Decline of the Oriental Bank Corporation, 1842–84.” In *The Origins of International Banking in Asia*, edited by Shizuya Nishimura, Toshio Suzuki, and Ranald C. Michie, 86–106. Oxford University Press. <http://www.oxfordscholarship.com/view/10.1093/acprof:oso/9780199646326.001.0001/acprof-9780199646326-chapter-4>. For a more descriptive story, see: McGuire, John. 2004. “The Rise and Fall of the Oriental Bank in the Nineteenth Century: A Product of the Transformations That Occurred in the World Economy or the Result of Its Own Mismanagement.” In *Asia Examined: Proceedings of 15th Biennial Conference of the Asian Studies Association of Australia*. Canberra: Asian Studies Association of Australia (ASAA) & Research School of Pacific and Asian Studies (RSPAS), The Australian National University.

<sup>12</sup> According to several directories of foreigners in China at the time, C.S. Taylor seems to have been a clerk with the Chinese Marine Customs Administration. See, for example: *The Directory & Chronicle for China, Japan, Corea, Indo-China, Straits Settlements, Malay States, Siam, Netherlands India, Borneo, the Philippines, &c: With Which Are Incorporated “The China Directory” and “The Hong Kong List for the Far East”* ... 1892. Hongkong daily Press office. P. 116. The Jardine Mason Archives at Cambridge University contain a letter, dated 6 September 1886, from presumably the same C.S. Taylor in their ‘Letters from Shanghai’: ref. MS JM/B22/3.



	Deposits	1/3rd.	Exchange	Deposits
June '80	\$21,000,000	\$ 7,000,000	3/9¾	£1,334,000
June '81	\$30,000,000	\$10,000,000	3/8⅝	£1,859,000
June '82	\$35,000,000	\$12,000,000	3/9⅜	£2,268,000
June '88 [sic.]	\$46,000,000	\$15,000,000	3/7½	£2,718,000
June '84	\$46,000,000	\$15,000,000	3/8½	£2,781,000
June '85	\$53,000,000	\$18,000,000	3/6¼	£3,168,000
June '86	\$69,000,000	\$23,000,000	3/6½	£3,496,000

[...] The question is simply whether the Bank has or has not written down its sterling deposits, to the present actual rate of exchange, for if it has not, the Reserve Fund [which the Bank reported to stand at \$4,5 million at the time] exists only on paper [...].”<sup>13</sup>

A reply from the HSBC managers was swift and condemning. Their reaction in the same issue, and signed with L.S.D (a pun on ‘*librae, solidi, denarii*’, the old expression for the pre-decimal British pound?), rejected the letter as an “ungracious charge” which “goes out of his way to question a very straightforward statement”. L.S.D continued: “Mr. Taylor ought to know that the principle of banking is to *turn over money*, and *not bury it in the East*, as he appears to think it is done. The London Deposits may come out to the East half-a-dozen times in the course of the year, and be returned at a profit or a loss as the case may be, which shows itself at the end of every half-year.”<sup>14</sup>

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<sup>13</sup> *North China Herald*, September 10 1886, Pp. 287-288. Square brackets mine. Mr. Taylor calculated the losses (and gains) on changes in the exchange rate as follows: “During the year 1880-1 you write down £ 1,344,000 from 3/9¾ exchange to 3/8⅝ exchange; loss £33,000 or \$182,478. During the year 1881-2 you write up £1,859,000 from 3/8⅝ exchange to 3/9⅜ exchange; gain £31,000 or \$163,966. During the year 1882-3 you write down £2,268,000 from 3/9⅜ exchange to 3/7½ exchange; loss £106,000 or \$584,827. During the year 1883-4 you write up £2,718,000 from 3/7½ exchange to 3/8½ exchange; gain £63,000 or \$339,774. During the year 1884-5 you write down £2,781,000 from 3/8½ exchange to 3/6¼ exchange; loss £141,000 or \$800,945. During the year 1885-6 you write down £3,168,000 from 3/6¼ exchange to 3/6½ exchange; loss £432,800 or \$2,840,553.” Ibidem.

<sup>14</sup> *North China Herald*, September 10 1886, P. 288.

What this ‘straightforward statement’ meant was addressed in yet another contribution. It upset all of the assumptions listed above, and sought out the unit-of-account argument in articular:

“Those who did not take the trouble to study the half-yearly reports of the Bank, and ascertain from them how the funds were distributed, who took it for granted that all its deposits must necessarily be employed in loans and discounts in the East, had a notion [...] that when the London deposits came to be paid off, there would be a considerable loss, unless silver recovered its value of two or three years ago, in the meantime. [...]”<sup>15</sup>

This was simply not the case, its authors stressed. The unit of account did *not* play any role of significance in the bank’s dealings; neither a fall not a rise in the silver price would affect the bank’s capital. As I will explore later in greater detail, what did matter,

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<sup>15</sup> *North China Herald*, September 10 1886, P. 273-274. Note as well that the authors of the piece charged the unit of account argument to be also intellectually dishonest, i.e. a way by means of which the bimetallists sought to influence British policy making towards some kind of bimetallic compromise: “it always seemed that those who held the opinion that a liability for the depreciation existed, considering it a contingency which would disappear, when the relative values of gold and silver came to be adjusted. It was not looked upon as bad debts and business losses are looked upon, as required to be provided for at once. [...] Probably this was mainly owing to the unreality of the opinion, even in the minds of those who held it; to their considering the possibility of loss not sufficiently imminent, or as something that a turn of the wheel might remove, when the American Government or the Indian Government did something, —or bi-metallism was universally adopted,— which should send the price of silver up again.” Ibidem.

and in which respect HSBC differed from its competitors, was the *even keel*<sup>16</sup> (*kingin kinkōsaku* 金銀均衡策), i.e. a *management strategy* whereby:

1. the uses of funds in one particular metal (silver/gold) were kept within the boundaries of the sources of funds in that metal (silver respectively gold); or, in other words, a ‘moving’ of funds between the gold and silver regions was ruled out; and...
2. ...the exchange rate of every transaction was ‘locked in’:
  - a. On the branch level, managers were supposed to avoid, as much as possible an uncovered exchange position (*kata-kawase* 片為替). Ideally, the banker’s positions were offsetting: the buy positions were, in that case, equal to the sell positions.
  - b. On the *branch network level*, the amounts of bills bought and bills sold were *at all times kept identical*, in other words, the position was *squared*. The relative appreciation/depreciation of aggregated assets and liabilities at the silver branches would thus be offset by the depreciation/appreciation of assets and liabilities held by the gold branches, to the same degree. The bank thus significantly reduced exchange rate risk. At no point would the bank *as a whole* tilt towards one metal (hence the ‘even keel’).
  - c. Although this may seem obvious now, the difference was made through an innovation in communication technology. Because of telegraphy, branches could at all time inform each other about how much was due by whom to whom, and

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<sup>16</sup> From the title of the first volume of Frank King’s official history of HSBC, the reader might get the impression that the ‘even keel’ was the accepted terminology among contemporaries. This is, however, not the case. In one of his recent publications, Suzuki Toshio stresses that the word is nowhere to be found in the bank’s surviving archives. On the other hand, the relatively regular occurrence of “even keel” in the online databases of the *Economist*, and the *North China Herald*, more specifically in the context of money and finance demonstrates that it functioned as a generic term for all matters related to maintaining a form of balance (typically: ‘keeping one’s finances on an even keel’). It follows therefore that one should be careful not to make too much of a term that, at least for the contemporary observer, did not carry the meaning of a specific hedging strategy. King, Frank H. H. 1987. *The Hongkong Bank in Late Imperial China, 1864-1902: On an Even Keel*. The History of the Hongkong and Shanghai Banking Corporation v.1. Cambridge [Cambridgeshire] ; New York: Cambridge University Press. 鈴木俊夫. 2014. 「東洋銀行 1842–1884年」 In 国際銀行とアジア 1870～1913, by 西村閑也, 鈴木俊夫, and 赤川元彰, 433–538. 東京: 慶応大学出版会. P. 530, fn. 325.

use that information vis-à-vis their customers (for instance by lowering the discount rate at a time foreign exchange was plenty).

3. Concretely, short-hedging happened by means of different, yet related operations:
  - a. Typically, the proceeds of the bills falling due (bills for collection (B/C)) at a branch (or a cluster of branches on the same metal) at a certain date formed the funds out of which bankers of that branch (/branches) paid out their obligations (bills for payment (B/P)) for the same date.
  - b. *At the same time*, the banker of this branch (/branches) sold remittances (mostly telegraphic transfers) in order to remit to the branch (/branches) on the other metal to the same amount it had received B/P in (a).
  - c. And again *at the same time*, the proceeds of the sales of the remittances (+ any surplus or shortage of B/C in (a)) were used to buy export bills that would fall due several months later at a branch (/ a cluster of branches) on the other metal.
  - d. The latter branches were informed by telegraph of the amount of bills for collection, so they could in turn plan to balance amounts of bills sold and bought at the same future date.
4. Bankers at branches saw to it that more or less identical amounts of assets and liabilities were *swapped* between silver and gold branches. They tried to set them off *simultaneously*, in other words, at the rate of the same day. Branches thus avoided a situation in which their working capital was affected.<sup>17 18</sup>

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<sup>17</sup> 北林雅志. 1992. 「イギリス植民地銀行の対銀価下落政策：香港上海銀行の Even Keel Policy を中心に」 経営史学 26 (4): 42–70, iii. doi:[10.5029/bhsj.26.42](https://doi.org/10.5029/bhsj.26.42). Esp. pp. 52ff. Stuart Muirhead's mention of 'simultaneous transactions' within CMBILC seems to hint at a comparable mechanism: Muirhead, Stuart. 1996. *Crisis Banking in the East: The History of the Chartered Mercantile Bank of India, London, and China, 1853-93*. Aldershot, Hants, England : Brookfield, Vt., USA: Scolar Press ; Ashgate Pub. Co. P. 200; p. 218.

<sup>18</sup> According to Frank King, it was the “matching of sources with sterling uses of funds by sterling sources of funds –and similarly in silver– was to be known as ‘keeping on an even keel’”, but this is mistaken, as it only pays attention to what above is outlined as point 1 of the strategy. Furthermore, as is also indicated in contemporary journalistic sources, uses of funds in a certain metal were not ‘matched’ by sources of funds in the same metal; the latter had to exceed the former, in order to retain a safe margin. We will discuss this aspect of the strategy below. King, Frank H. H., and Frank H. H. King. 1987. *The Hongkong Bank in Late Imperial China, 1864-1902: On an Even Keel*. The History of the Hongkong and Shanghai Banking Corporation v.1. Cambridge [Cambridgeshire] ; New York: Cambridge University Press. P. 277.

Although the discussion in the *North China Herald* mostly focus on point 2b of the above (and then only on the branches in Asia), it suffices to understand the banker's point of view:

“The accounts of the Bank to the 30th of June show very clearly that none of its gold deposits can have been used in Loans and Discounts in the East. The Capital and the Reserves are about balanced by the Cash held, and a large part of this asset is necessarily in gold. The Deposits amount to 69 millions of dollars, and if the local advances, 37 millions, are deducted therefrom, there is a balance of 32 millions of dollars, which is employed in the exchange business of the bank, and for which it is altogether insufficient. *These 32 millions of dollars are represented in the Bills Receivable, which are the remittances made to London*, and it will be seen that in addition to the 23 millions of dollars, or one third of the deposits, which the General Manager of the Bank stated was about the amount of sterling deposits, there are some nine millions of silver deposits employed in exchange. And as one of our correspondents correctly showed, a great part of these funds are kept in London in order to provide for the telegraphic transfers which the Bank sells every day, and in which the bulk of merchants' remittances are now made. Against these sales of transfers the bank purchases mercantile paper at four and six months' sight, and this course of business necessitates the keeping of a very large amount of funds in London.”<sup>19</sup>

Let us briefly review this. First of all, the deposits referred to can be broken down schematically as follows:

Table 1: Breakdown of deposits for Jan. 1 1886 - June 30 1886

Deposits total: \$69 million		
	gold deposits: \$23 million	silver deposits: \$46 million
employed for advances in East-Asia:	0	\$37 million
employed for exchange (bills bought and telegraphic	\$23 million	\$9 million

<sup>19</sup> *North China Herald*, September 10 1886, P. 274.

transfers)		
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Obviously, these numbers in the half-yearly reports are a mere snapshot of a banking business characterized by a constant turnover. What was missing from Mr. Taylor's argument, is the fact that the liabilities (bills payable and the sales of telegraphic transfers) and assets (bills receivable and proceeds of telegraphic transfers sold) can constantly be kept in a very *liquid* state. Chains of exchange operations in which the proceeds from bills collected at a branch in a certain metal (credit) were shorted, i.e. by immediately buying export bills that will fall due at branches in the other metal make it possible to run a large business with limited capital.<sup>20</sup> This is the meaning of L.S.D.'s point that "London Deposits may come out to the East half-a-dozen times in the course of the year" (cf. *supra*). The one thing that made matters more complicated were 1) the differences in usance (for export bills: 4 months for bills on New York, 6 months for bills on Lyon; for import bills: 2 months)<sup>21</sup> among types of bills, 2) seasonal fluctuations in demand for the latter and 3) the type of underlying contract. However, these could be flattened out relatively easy depending on the skills and foresight of the bank's accountants. The use of 'forward contracts', which became more and more common after 1890, clearly facilitated the banker's business.<sup>22</sup> They enabled a very accurate assessment of outstanding assets and liabilities at all time.

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<sup>20</sup> In the jargon of exchange banking, these operations are therefore also referred to as 'simultaneous transactions'. Stuart Muirhead briefly touches upon these transactions in his discussion of the Chartered Mercantile Bank. In his view, "head office were not particularly in favour of continually carrying out 'simultaneous transactions' because the profit was so small." Muirhead, Stuart. 1996. *Crisis Banking in the East: The History of the Chartered Mercantile Bank of India, London, and China, 1853-93*. Aldershot, Hants, England : Brookfield, Vt., USA: Scolar Press ; Ashgate Pub. Co. P. 218.

Regardless of the fact whether this factually was a concern uttered by head office personnel at the time, this is nevertheless mistaken as it confuses the branch level with the branch network level. As is clear from our discussion of YSB, interbranch differences in exchange positions could be very wide, yet were then flattened out on the network level.

<sup>21</sup> See: 石井寛治. 1999. 『近代日本金融史序説』. 東京大学出版会. P. 244-245.

<sup>22</sup> Engel, Alexander. 2015. "Buying Time: Futures Trading and Telegraphy in Nineteenth-Century Global Commodity Markets." *Journal of Global History* 10 (2): 284–306. doi:[10.1017/S1740022815000078](https://doi.org/10.1017/S1740022815000078).

The reader will notice that in such operations the risk on exchange fluctuations is transferred from the exporters and importers to the banker, and the margin of profit which the latter has made on the rates will be increased or diminished in proportion to the rise or fall in the exchange.<sup>23</sup> Also, the fact that these operations were valued at different rates did not need to affect the bank's working capital. Because "the exchange is adjusted once a week by mail, or daily by wire",<sup>24</sup> all outstanding exchange transactions "are valued at the rate of exchange actually ruling, and at which they could be closed, at the end of the half-year. This enables a just estimate of the profit and loss account to be made, and the lapse of a few days or weeks makes the estimates certainties."<sup>25</sup>

The rate at which the banker sold foreign exchange was, at all times, a relative matter. In itself, it was not an indicator of a banker's profits or losses. Instead, the rate itself was no more than the product of the rate *at which bankers were able to cover their drawing operations* (i.e. the gold price of silver in London, both spot and forward).<sup>26</sup> Taking into account the aforementioned fact that the bank worked towards a situation in which the London based sterling deposits were at all times replenished by sterling remittances from silver-using regions in Asia ("heavy remittances are constantly on the way to London, making the position there impregnable")<sup>27</sup>, it is clear that the

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<sup>23</sup> After: Spalding, William Frederick. 1915. *Foreign Exchange and Foreign Bills in Theory and in Practice*. 2d impression. London, New York [etc.]: Sir Isaac Pitman & Sons, Ltd. P. 144. His discussion is based on a lesser known discussion by Charles Addiss, once HSBC banker: Schiltz, Michael. 2016. "The Daily Exchange Quotations' - An Address Delivered by C.S. Addiss before the Foreign Y.M.C.A at Shanghai on Feb. 4th, 1903. Courtesy of the Tōyō Bunko 東洋文庫, [Http://www.toyo-bunko.or.jp/](http://www.toyo-bunko.or.jp/)." [https://figshare.com/articles/The\\_Daily\\_Exchange\\_Quotations\\_-\\_An\\_Address\\_Delivered\\_by\\_C\\_S\\_Addiss\\_before\\_the\\_Foreign\\_Y\\_M\\_C\\_A\\_at\\_Shanghai\\_on\\_Feb\\_4th\\_1903\\_Courtesy\\_of\\_the\\_Toyo\\_Bunko\\_http\\_www\\_toyo-bunko\\_or\\_jp\\_/3799305](https://figshare.com/articles/The_Daily_Exchange_Quotations_-_An_Address_Delivered_by_C_S_Addiss_before_the_Foreign_Y_M_C_A_at_Shanghai_on_Feb_4th_1903_Courtesy_of_the_Toyo_Bunko_http_www_toyo-bunko_or_jp_/3799305).

<sup>24</sup> *North China Herald*, September 10 1886, P. 288.

<sup>25</sup> *North China Herald*, September 10 1886, P. 274.

<sup>26</sup> "The rate of exchange, it may be noted, although subject to the variations in the gold price of silver bullion, does not always respond to these changes, yet, broadly speaking, the gold price of silver is taken to form the limit above which, after adding importing charges, exchange cannot rise, and below which, after deducting export charges, it cannot fall." Spalding, William Frederick. 1915. *Foreign Exchange and Foreign Bills in Theory and in Practice*. 2d impression. London, New York [etc.]: Sir Isaac Pitman & Sons, Ltd. P. 137.

<sup>27</sup> *North China Herald*, September 2 1892, P. 344.

Hong Kong and Shanghai Banking Corporation was running a safe business indeed. What remained of the exchange risk were the ‘comparatively trifling differences of the day-to-day business’ referred to in the epitaph to this chapter.

HSBC’s strategy worked. Whereas its competitors struggled, or went out of business altogether, the company thrived, as can be concluded from its share price during the period under discussion (graph 1). In terms of trade volume too, its record was impressive. Several authors estimate that, in the early 1880s, the Bank was responsible for financing half of all trade to and from Hong Kong; the Chartered Bank accounted for some 25 percent, whereas the other exchange banks competed for the remaining quarter.<sup>28</sup>

Graph 1:



Notes:

- 1) Data were taken half-yearly, i.e. for the months January and July.

<sup>28</sup> Mackenzie, Compton. 1954. *Realms of Silver; One Hundred Years of Banking in the East*. London: Routledge & K. Paul. P. 75; 石井寛治. 1999. 近代日本金融史序説. 東京大学出版会. P. 58.



- 2) Source: *The Economist*, 'Bankers' Price Current' (until 1880) / 'Stock Markets Price Current' (from 1880), multiple issues

#### 4. The Even Keel: Stock versus Flow data

Unfortunately not further developed in the otherwise excellent discussion by Kitabayashi,<sup>29</sup> the Hong Kong and Shanghai Bank's management principles (largely copied by YSB in the 1890s and later) were of such nature to necessitate a distinction between *stock data* on the one hand, and *flow data* on the other. In this context, Mr. Buchanan (another shareholder of the Hong Kong and Shanghai Bank) reminds us once more that trade from and to England was financed by means of different types of contract: "since the extension of the telegraph to China the methods of finance has changed. While shipments from China are generally drawn against 4 months' sight, the proceeds of imports are usually remitted by electronic transfer."<sup>30</sup> This explains the *discrepancies* that emerge in the *stock data* when comparing the amounts of bills receivable and bills payable, as he illustrated by means of the following table:<sup>31</sup>

Table 2: *Statement of Bills Receivable and Payable (in millions and thousands of Hong Kong dollars)*

Date of Account	Bills Receivable	Bills Payable	Date of Account	Bills Receivable	Bills Payable
30 June '73	\$24,7	\$29,4	30 June '80	\$17,8	\$14,9
31 Dec. '73	26,9	26,1	31 Dec. '80	28,2	14,6
30 June '74	18,7	22,5	30 June '81	17,9	8,7
31 Dec. '74	21,7	17,8	31 Dec. '81	30,1	15,3
30 June '75	15,5	17,8	30 June '82	26,5	18,5
31 Dec. '75	18,1	15,7	31 Dec. '82	35,5	17,9

<sup>29</sup> 北林雅志. 1992. 「イギリス植民地銀行の対銀価下落政策：香港上海銀行の Even Keel Policy を中心に」 経営史学 26 (4): 42–70,iii. doi:[10.5029/bhsj.26.42](https://doi.org/10.5029/bhsj.26.42).

<sup>30</sup> *North China Herald*, September 10 1886, P. 288.

<sup>31</sup> *North China Herald*, September 10 1886, P. 288.

30 June '76	19,6	18,7	30 June '83	30,4	8,8
31 Dec. '76	28,9	24,4	31 Dec. '83	36,9	16,0
30 June '77	25,4	20,1	30 June '84	27,9	12,7
31 Dec. '77	34,0	24,0	31 Dec. '84	34,3	15,6
30 June '78	30,9	28,3	30 June '85	33,8	14,1
31 Dec. '78	28,2	22,3	31 Dec. '85	46,5	20,7
30 June '79	25,7	27,9	30 June '86	44,9	14,2
31 Dec. '79	27,2	20,8			

Note hereby once more the implications of the changes in the methods of financing of which Mr. Buchanan spoke, and which we explored earlier. Whereas, in the early seventies, bills receivable (i.e. gold denominated remittances from China to London) and (silver denominated long-term) bills payable are more or less in balance, the late seventies show a tendency for a slightly higher amount of the former *vis-à-vis* the latter. This discrepancy can largely be explained by the fact that inland bills for international trade could be renewed, whereas currency drafts, which went out of the country, could not (cf. *supra*); a longer usance naturally caused the amounts of outstanding bills receivable to be higher. Yet later, i.e. around 1880, with the growing popularity of telegraphic transfers for remittances to Great-Britain, amounts of bills receivable became consistently and markedly higher than bills payable: as these were transmitted immediately, they showed up on the banker's books much faster than bills payable, which took weeks or months to arrive.

And yet, as Mr. Buchanan also pointed out, “[i]n the end, Bills Receivable and Bills Payable balance each other.”<sup>32</sup> This is a very important remark, and it is therefore deplorable that nobody has ever attempted to explore its meaning quantitatively. Yet, as we will see in a minute, it is arguably for this reason that YSB, which, as said, emulated HSBC's exchange management strategy in the early 1890s, chose to include an elaborate section of *flow data* in its Mid-term Reports. After all, they make it possible to measure

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<sup>32</sup> *North China Herald*, September 10 1886, P. 288.

something fundamentally different. Whereas stock data report *total* amounts of assets resp. liabilities acquired and incurred at the point for which the balance is struck, flow data allow us to study *how assets and liabilities have been distributed among branches* (or branch clusters) *over an interval of time* (in the case of YSB, a semester). In other words, they offer insight in the *net* transfer of assets and liabilities, and, by extension, are a means of judging whether, on the branch network level, a net transfer of say, funds from the gold branches to the silver branches has been offset by a commensurate flow in the other direction. Although we cannot illustrate this for HSBC, for want of the relevant flow data,<sup>33</sup> that YSB was indeed on an ‘even keel’<sup>34</sup> after 1893 can be shown as follows:

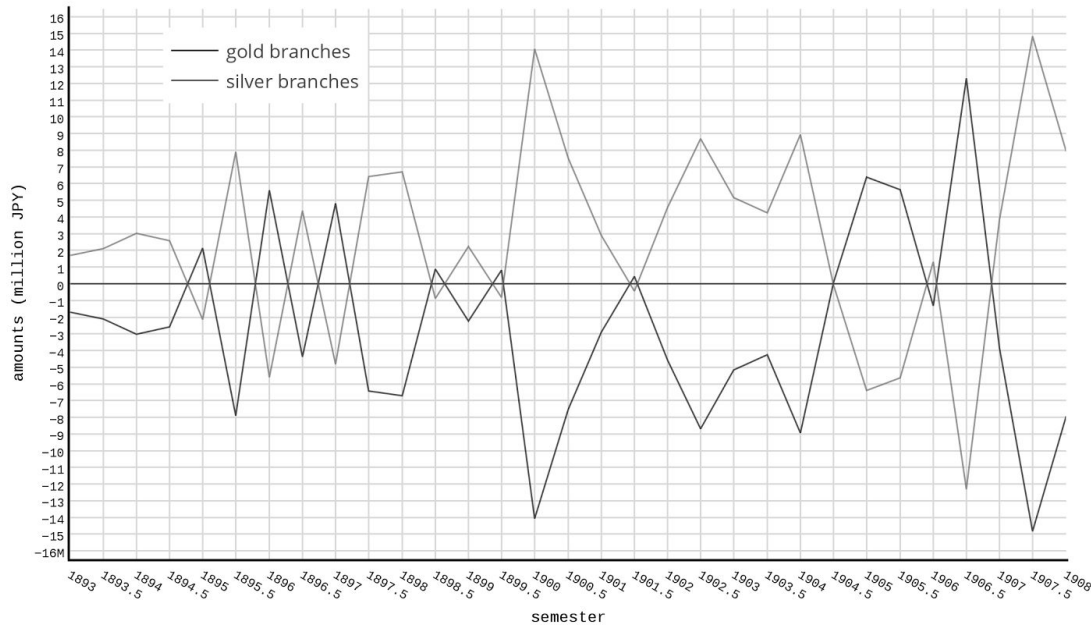
Graph 2: YSB on an ‘even keel’, 1893-1908

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<sup>33</sup> The absence of flow data notwithstanding, there have been some creditable efforts at reconstructing the flow of funds using the contemporary *Inspector’s Reports*, the *General Ledger Balances*, etc. See: Shizuya Nishimura, “The Flow of Funds within the Hongkong and Shanghai Banking Corporation in 1913,” in Olive Checkland, Shizuya Nishimura and Norio Tamaki (eds), *Pacific Banking, 1859-1959: East Meets West* (New York: St. Martin’s Press, 1994); 西村閑也. “香港上海銀行、1870-1913.” 金融構造研究 no. 29 (May 2007): 23–31; 西村閑也. 1993. “香港上海銀行の行内資金循環, 1913 年.” 経営志林 30 (1): 1–26. <http://ci.nii.ac.jp/naid/110000062908>; for an analysis of the period after 1913, see: 安富歩. “香港上海銀行の資金構造, 1913年～1941年.” アジア経済 44, no. 10 (October 2003): 27–54.

<sup>34</sup> As is well known, the notion gained currency through Frank King’s tetralogy on the history of the Hongkong and Shanghai Banking Corporation: it even figured on the title page of Vol. 1. Yet, the tetralogy has important drawbacks; notwithstanding the importance of the even keel strategy, its meaning was never quantitatively addressed. King, Frank H. H., and Frank H. H. King. 1987. *The Hongkong Bank in Late Imperial China, 1864-1902: On an Even Keel*. The History of the Hongkong and Shanghai Banking Corporation v.1. Cambridge [Cambridgeshire] ; New York: Cambridge University Press.

The Yokohama Specie Bank on an Even Keel, 1893-1908



A few remarks are in order here. Importantly, the graph should not be interpreted in a tautological manner, as if it were to mean that ‘what is sent by silver(/gold) branches is received by gold(/silver) branches’. What we see represented above are, in the strictest sense of the word, origin-destination data, or, in other words, amounts being transferred from one type of branches to another type of branches, irrespective of the fact that these amounts are positive or negative ones. Concretely, the graph describes that, at any time, *an aggregate positive transfer* (a surplus of ‘bills bought’ over ‘bills sold’) *from branches on one of two metals is countered by a nominally equal, aggregate negative transfer* (a surplus of ‘bills sold’ over ‘bills bought’) *from branches that have the other metal as unit of account*.

If considered as such –and this is indeed the intention behind considerations about the making of the database–, then similarities to what we have seen above about HSBC’s exchange risk hedging are too obvious to ignore: the aggregated flows of funds

sent by the silver respectively gold branches are almost perfect mirror images of each other (factually, very minor differences do exist, but they are to be explained by issues of rounding and the exclusion of yet other, more exotic, types of bills).<sup>35</sup>

## 5. An 'Asymmetric' Even Keel? - the role of silver deposits

It is equally important to try and understand the fact, that, for the larger part of the period under discussion, the net transfer of the silver to the gold branches is positive, and, vice versa, the transfer of from the gold to the silver branches is negative. In chapter 1, we explained in the rather sterile vocabulary of contemporary accounting practice that this must mean that the amount of bills bought by silver branches (for exports to gold standard countries) plus the amount bills sold on them (i.e. sold by gold branches to exporters in order to pay for imports from silver countries), on the one hand, outdid the amount of bills silver branches sold plus bills bought on them, on the other (cf. *supra*). If considered in the monetary geographical terms that inform this book, however, it will be clear that such discussion tends to underestimate the pivotal role of banking practice in East-Asia's silver periphery.

Several people, among whom the aforementioned L.S.D., have, partially erroneously, be led to stress that the focus of managers' attention was, in the end, with preserving the value of the bank's gold assets and liabilities. The Hong Kong and Shanghai Bank was, so he said, "operating on a gold basis",<sup>36</sup> as the amount of its gold denominated assets (bills receivable) was much larger than its silver-denominated

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<sup>35</sup> Discrepancies are most pronounced for the semesters December 1896 and June 1897. A look at the respective Mid-term reports reveals the existence of categories of bills that are not listed in other Mid-term reports, and that, for reasons of formatting of the matrices in the database, could not be included. More specifically, the reports mention –admittedly very limited– amounts of 'gold coin bills sent' (*kinka sōkin tegata* 金貨送金手形) from the London office to the Yokohama Head office. Determining the specific nature of these bills –is there perhaps a relationship with the repatriation of gold bullion in the context of the remittance of the Chinese indemnity after the Sino-Japanese War?– must be left for future research.

<sup>36</sup> *North China Herald*, September 10 1886, P. 28.

liabilities (bills payable). There is something to be said for that, but it is, at the same time, certainly not the whole story. Although strictly speaking not untrue, I tend to believe that this claim should be studied as a contemporary effort to reassure the doubtful London investor: for, if considered more carefully, it would have been more adequate to point out that *this very operating on a gold basis was, in itself, wholly dependent on the maintenance of large silver deposits in Asia*. Factually, L.S.D did so much as admit this when referring to the “large amounts of Bills Receivable”.<sup>37</sup> After all, the latter could only be sold to Asian importers *with money (deposits) at the Asian branches*. Similarly, these deposits formed the funds out of which the bank could buy bills which were to fall due in London or any other gold branch.

Understanding this was the catch to a successful hedging strategy, and it probably explains why HSBC managers were, in the strict sense, exchange operators aware of the problems that manifested themselves in daily trading routine.<sup>38</sup> Seen through their eyes, liquidity in particular lifted banking operations in the periphery, especially the soliciting of deposits, to a higher, asymmetric, level of importance. David McLean, manager of HSBC’s Shanghai office from 1865 to 1873, understood the centerpiece of HSBC’s hedging practice perfectly, and therefore vehemently resisted every plan to expand the bank’s capital base, which could only be done with capital raised in the city of London: “Our great success *depends upon the Eastern people being interested in the Bank*, besides if more than one-half were on this register the London shareholders might some day, for some reason or other, attempt to get the HO [Head Office] transferred to London, which in my opinion would not be for the good of the concern.”<sup>39 40</sup>

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<sup>37</sup> Ibidem.

<sup>38</sup> Ibidem. Multiple references.

<sup>39</sup> David McLean in a letter to John Walter, 12 March 1886, ‘Private Letters’ V 253; David McLean Papers (MS 380401), Library, School of Oriental and African Studies, University of London; cited in: King, Frank H. H., and Frank H. H. King. 1987. *The Hongkong Bank in Late Imperial China, 1864-1902: On an Even Keel*. The History of the Hongkong and Shanghai Banking Corporation v.1. Cambridge [Cambridgeshire] ; New York: Cambridge University Press. P. 303. Italics and square brackets mine. The prospect of moving the Head Office to London had been an issue of contention almost since the bank’s establishment. Compare: ibidem, p. 98, 99ff: 275ff; pp. 342ff.; pp. 420ff.

For the Yokohama Specie Bank, liquidity in the silver regions similarly became a concern, first after the opening of the branch in Shanghai (1894), then when extending its network of branches and agencies in other towns in China and, yet later, in Manchuria (after 1905). [...]. Judging from the elaborate transcripts that survive in the bank's archives, the Meetings of the Managers of Asian Branches of YSB (*tōyō shitenchō kaigi* 東洋支店長會議) were, as late as 1908, organized especially in view of the problem of finding cover for the exchange dealings of the silver branches; put simply, demand for silver resources needed to finance the bank's 'legitimate' business exceeded the available supply. Having experimented with several management systems (cf. *infra*), the managers would eventually agree to appoint the Shanghai branch as the office in charge (*tōkatsuten* 統轄店) for offsetting imbalances in the silver branches' overall exchange position (*kawase-jiri* 為替尻): apparently, it was the only money market in East-Asia with the depth to accommodate the sometimes large daily imbalances.<sup>41</sup>

Even then, as is clear from graph 2, the bank struggled considerably to raise sufficient silver deposits. Although the graph is a little bit distortive in that its amounts of gold deposits also include the (very) high amounts of 'separate deposits' (*betsudan yokin* 別段預金) or 'escrow accounts'<sup>42</sup> at the Yokohama Headquarters and the London Branch (which in turn explains the much larger gap between the amount of deposits on the one hand and amounts of loans and bills at the gold branches), the difference between gold and silver branches is striking. What is more, deposits for the silver branches were at several times so low as to make breaches of HSBC's first rule (keeping

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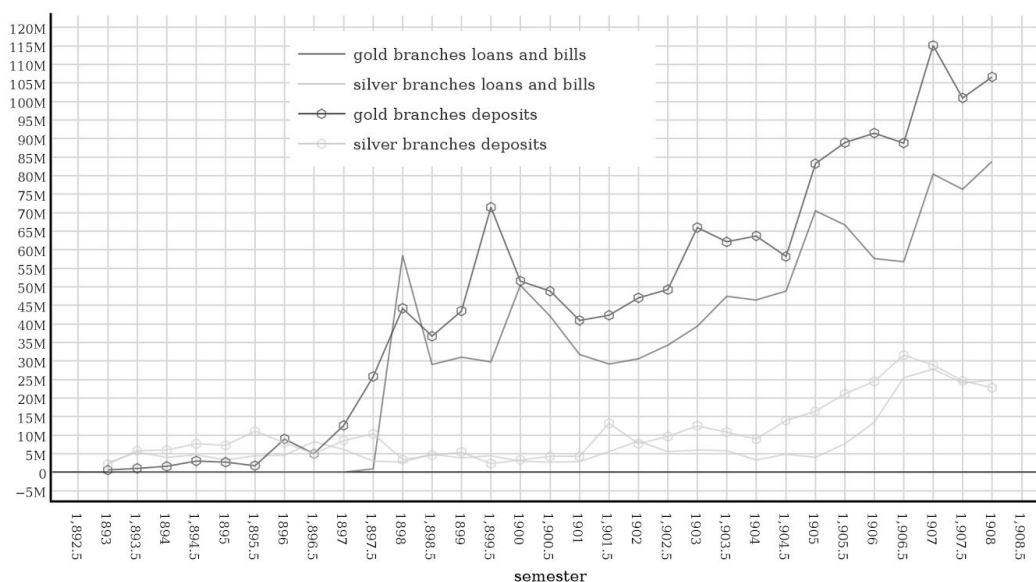
<sup>40</sup> Nishimura Shizuya reaches an identical conclusion in: Nishimura, Shizuya. 2012. "The Hongkong and Shanghai Banking Corporation, 1870–1913." In *The Origins of International Banking in Asia*, edited by Shizuya Nishimura, Toshio Suzuki, and Randal C. Michie, 112–21. Oxford University Press.  
<http://www.oxfordscholarship.com/view/10.1093/acprof:oso/9780199646326.001.0001/acprof-9780199646326-chapter-5>. Pp. 117–118.

<sup>41</sup> 横濱正金銀行. 19--. 東洋支店長會議録. [横濱正金銀行]. <http://ci.nii.ac.jp/ncid/BN04887997>. I used a copy in my personal collection. The transcripts for 1908 pay particular attention to the sometimes difficult relationship between the Shanghai and Kobe branches. Especially Chinese traders within the city of Kobe were supposed to be engaged in large speculative transactions.

<sup>42</sup> See, with regard to the origin of these accounts: 「大蔵省ノ部 正金銀行へ別段預入規則修正ノ件」. JACAR Ref. A07060571100.

the use of funds in one particular metal within the boundaries of the sources of funds in that metal) inevitable. In any case, as can be easily ascertained, the amount of loans and bills at the silver branches (especially around 1900) constantly flirts with the limits set by the amount of available deposits.<sup>43</sup> However, as we will see in a minute, the situation was more complex than that.

Graph 3: Gold respectively silver deposits versus gold respectively silver loans and bills



For HSBC, there was an interesting flip-side to this determination to check the bank's course of business by means of East-Asian business conditions (or in other words, the determination to keep silver denominated assets and liabilities separate from gold ones). Together with the relative ease of raising capital in London, it *ipso facto* had to lead to the rationing of deposits there. Again in McLean's words, and clearly hinting

<sup>43</sup> As the reader observes, there is one instant in which such 'breach' seems to be the case as well for the gold branches; it concerns the difficult transition period from the silver standard to the gold standard in the second half of 1897. It is therefore not immediately clear to me what causes this data mishap. Is it perhaps a mismatch caused by the change in denomination within the period? Or is something else at play?



to the ‘even keel’ strategy, “surplus on the water is no use to us”.<sup>44</sup> The half-yearly reports of HSBC, reprinted in the *North China Herald* and other Asian journalistic outlets of the day,<sup>45</sup> contain plenty of references. A report from 1888 had already hinted that the interest issue was related to the bank’s prudent management,<sup>46</sup> but, in 1892, then Chairman Davies put it more poignantly:

“Towards the end of 1891, it was considered that, by our constantly increasing deposits, we were getting more money than we could profitably employ, and the consequent loss of interest was a heavy drag on our earnings. It was, therefore, decided to attempt to lessen the amount of London deposits by reducing our rate of interest there from 4½% to 4%, and the result was quite satisfactory, deposits falling off in just the proportion we had expected and wished to see.”<sup>47</sup>

For YSB, I haste to add, similar devices were never so easily available. Being a Japanese bank with headquarters in Yokohama, YSB had to take into account credit conditions within Japan proper. The latter were, especially in the years after YSB’s establishment, rather averse to the prospect of competing with the other –mostly British– international banks. Saitō Hisahiko, relying on the reporting of the *Tokyo Nichi Nichi Shinbun*, points out that the annual interest YSB paid on fixed deposits

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<sup>44</sup> David McLean in a letter to J.J. Winton (Singapore), 22 August 1879, Private Letters II 225; David McLean Papers (MS 380401), Library, School of Oriental and African Studies, University of London; cited in: King, Frank H. H., and Frank H. H. King. 1987. *The Hongkong Bank in Late Imperial China, 1864-1902: On an Even Keel*. The History of the Hongkong and Shanghai Banking Corporation v.1. Cambridge [Cambridgeshire] ; New York: Cambridge University Press. P. 299. Admittedly, McLean used these words in the opposite context of superfluous remittances towards London, but the idea is clear.

<sup>45</sup> Several of these newspapers (e.g. *Straits Times* and *Singapore Journal of Commerce*) can be browsed/searched at NewspaperSG, an online resource for historical Singaporean and Malayan newspapers, maintained by the Singapore government. See: <http://eresources.nlb.gov.sg/newspapers/>.

<sup>46</sup> “[W]e are convinced that at 4 per cent., we shall get as much money in London as we can profitably employ. Even if our sterling deposits do diminish to some extent, it will not be an unmixed evil.” *North China Herald*, September 7 1888, P. 273.

<sup>47</sup> *North China Herald*, September 2 1892, P. 344; for yet other references to the London deposit issue, see: *North China Herald*, March 10 1893, P. 345; *North China Herald*, March 2 1894, P. 325; *North China Herald*, August 31 1894, P. 357. *North China Herald*, August 28 1896, P. 364.

(*teiki yokin* 定期預金, arguably the most important source for running an exchange business) in 1900 amounted to 6%. This was not only a major liability. If compared with the 3.3% interest YSB's foreign competitors in Yokohama paid, one understands that the bank had to rely on extensive government back-up, either in the form of direct subsidies and/or rediscounting facilities with the Bank of Japan, in order to play a role of significance in regaining Japanese control of import and export finance.<sup>48</sup> One is also not surprised that, because of the high interest paid on them, these deposits could not be used for purchasing low-yielding bills of exchange. Instead, they were only employed as funds for YSB's lending operations ('advances', *kashidashi* 貸出), which obviously yielded a higher profit.<sup>49</sup> Basing himself on a testimony in the *Transcripts of the Meetings of the Managers of Asian Branches*,<sup>50</sup> Ishii insists that YSB's comparatively low dependence on deposits (see: table 3 below) was also caused by the desire not to compete with other Japanese banks in this field, but I tend to believe that the former explanation carries more weight.<sup>51</sup>

Table 3: The Ratio of Deposits vis-à-vis the aggregate amount of capital (*shihonkin* 資本金) and reserve fund(s) (*tsumitatekin* 積立金) (deposits/(capital+reserve fund)).

Bank	Year			
	1890	1900	1911	1925
• YSB	0.57	1.99	2.89	2.95
• HSBC	6.52	6.85	6.38	6.51
• Chartered Bank	6.55	6.92	5.80	7.30
• International Banking Corporation			3.16	
• Russo-Chinese Bank (from 1910 onwards Russo-Asiatic Bank)			6.29	
• Deutsch-Asiatische			5.13	

<sup>48</sup> 齊藤寿彦. 1986. “日清戦争以後における横浜正金銀行の資金調達：準備的考察.” 金融経済 218: P. 71. <http://ci.nii.ac.jp/naid/110000174471>.

<sup>49</sup> 石井寛治. 1999. 近代日本金融史序説. 東京大学出版会. <http://ci.nii.ac.jp/ncid/BA41843751>. P. 244.

<sup>50</sup> 横浜正金銀行. 1908. 第壹東洋支店長会議録. [横浜正金銀行]. <http://ci.nii.ac.jp/ncid/BNo4887997>. P. 37ff.

<sup>51</sup> 石井寛治. 1999. 近代日本金融史序説. 東京大学出版会. <http://ci.nii.ac.jp/ncid/BA41843751>. P. 239.

Bank				
• Banque de l'Indochine			1.76	
• Nederlandsche Handel-maatschappij			2.07	
• Oriental Bank	5.47			

After: 石井寛治. 1999. 近代日本金融史序説. 東京大学出版会. P. 239;

Related to the above, YSB also lacked the prestige so typical of HSBC for most of its career. Kasuya Makoto reports that, as late as 1930, when YSB had arguably outgrown the problem of credibility that plagues nascent financial institutions, the bank had a middle class rating.<sup>52</sup> This situation must have certainly been worse at the beginning of the century. Interestingly, this very issue was brought up at the second meeting of the of the Managers of Asian Branches (May 1909), in the particular context of competition among the exchange banks. At the time, the manager of the Bombay Branch, Kodama Kenji 児玉謙次, put it as follows:

“[...] when I travelled through Shanghai and Hong Kong the other day, I happened to look at the rates of interest on deposits of [other] exchange banks, as these are listed in the English newspapers. I noticed that, in Hong Kong, the interest rate on time deposits of HSBC and the Chartered Bank is 4%, while [ours] is 5%; in Shanghai, the interest rate on time deposits of HSBC and the Chartered Bank is 4%, while [ours] is 5½%. Knowing that this [information] was out there in the open, I could not but feel pity [for the bank]; and I wondered whether this policy did not result in attracting unnecessary amounts of deposits [...].”<sup>53</sup>

<sup>52</sup> “YSB obtained ‘Prime-¼ up, while out of 159 banks, 101 banks obtained ‘Prime’, 9 banks had ‘prime-⅛ up’, 12 banks had ‘Prime-¼ up’, and 37 banks had a worse rating”. Kasuya, Makoto. 2012. “The Activities of Japanese Banks in Interwar Financial Centres: The Cases of the Yokohama Specie Bank’s Offices in London and New York.” In *The Origins of International Banking in Asia*, edited by Shizuya Nishimura, Toshio Suzuki, and Ranald C. Michie, 196–212. Oxford University Press.  
<http://www.oxfordscholarship.com/view/10.1093/acprof:oso/9780199646326.001.0001/acprof-9780199646326-chapter-10>. Pp. 215-216.

<sup>53</sup> 横濱正金銀行. 1909. 東洋支店長会議録. [横濱正金銀行].<http://ci.nii.ac.jp/ncid/BNo4887997>. 第二回第一巻 (2nd meeting Vol. 1), pp. 158-159.

Other Branch managers were quick to correct him. The higher rates of interest were not the cause of the bank's credit rating, they said, but rather a symptom of the latter. A concrete proposal from Suzuki Shimakichi<sup>54</sup> 鈴木島吉 (manager of the Shanghai branch) to cut rates in Shanghai to 5%, again in view of the bank's 'standing',<sup>55</sup> therefore fell on deaf ears. Chinese deposits were direly needed, so it was reasoned, and consequently, 'a lowering of rates is unnecessary' (*shina kakuten yokin risoku hikisage hitsuyō naki ya* 支那各店預金利息引下ノ必要ナキヤ), as one of the captions went.<sup>56</sup>

## 6. An intermittent conclusion: the microstructure of the 'even keel'

Concluding this chapter, one last remark is in order. In recent scholarship concerned with the question why countries opt for a certain monetary standard, in this case the gold standard, much has been made of the fact that the adoption of the gold standard is, for whatever reason, correlated with a growing trade volume with gold standard countries. For instance, in what seems to have become the obligatory reference, Ernesto López-Córdova and Christopher Meissner have reported "strong evidence that coordination on a similar commodity money regime is correlated with higher trade and some evidence that monetary unions are associated with large increases in trade [...] we find that gold standard countries trade up to 30 percent more with each other than with nations not on gold".<sup>57</sup> Around the same time, Estevadeordal et al. claimed that a large part of the change in trade volumes between 1870 and 1914 "can be explained by a

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<sup>54</sup> Suzuki Shimakichi would eventually go on to become president of the Industrial Bank of Japan (*nippon kōgyō ginkō* 日本興業銀行) (tenure: 1927-1930).

<sup>55</sup> The transcripts use the literal transcription *sutanjingu* (スタンディング), after the English original ('standing').

<sup>56</sup> 横濱正金銀行. 1909. 東洋支店長会議録. [横浜正金銀行].

<http://ci.nii.ac.jp/ncid/BNo4887997>. 第二回第一巻 (2nd meeting Vol. 1), pp. 274 ff.

<sup>57</sup> Ernesto López-Córdova, J., and Christopher M. Meissner. 2003. "Exchange-Rate Regimes and International Trade: Evidence from the Classical Gold Standard Era." *American Economic Review* 93 (1): 344–53. doi: [10.1257/000282803321455331](https://doi.org/10.1257/000282803321455331). P. 344.

“common currency” effect, related to the rise and fall of the gold standard”.<sup>58</sup> Absence of the common currency, as in the period after 1914 and later, after 1929, is in their view directly related to the fallback of worldwide trade volumes at the time. The payments frictions arising from the currency regime, they argue, must therefore be considered equally important to ‘conventional’ commercial policy frictions such as tariffs.<sup>59</sup>

This has led others to turn the argument inside out, and inquire whether such increase in the trade volume with countries on an identical standard may have been the motivation behind gold standard adoption in the first place. In the concrete case of Japan, Mitchener et al. have therefore turned to the vast legislative debates of the 1890s; in their view, “evidence of [these] debates suggests that policymakers believed gold standard adoption could impact borrowing costs, debt issuance, domestic investment, and trade”.<sup>60</sup> What is more, they say, history proved the gold proponents right. Using estimates from a gravity model of Japanese exports at the time, they find that gold standard adoption boosted the country’s trade volume even more than the adoption of the silver standard (which is obviously also a hard peg, and one it shared up to 1897 with the bulk of East-Asian countries).<sup>61</sup>

For reasons that cannot possibly be covered exhaustively here, the “common standard → increased (bilateral) trade” hypothesis does however suffer from grave

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<sup>58</sup> Estevadeordal, Antoni, Brian Frantz, and Alan M. Taylor. 2003. “The Rise and Fall of World Trade, 1870–1939.” *The Quarterly Journal of Economics* 118 (2): 359–407. doi: [10.1162/003355303321675419](https://doi.org/10.1162/003355303321675419). P. 362.

<sup>59</sup> Ibidem.

<sup>60</sup> Mitchener, Kris James, Masato Shizume, and Marc D. Weidenmier. 2010. “Why Did Countries Adopt the Gold Standard? Lessons from Japan.” *The Journal of Economic History* 70 (01): 27–56. doi:[10.1017/S0022050710000045](https://doi.org/10.1017/S0022050710000045). P.28.

<sup>61</sup> Mitchener, Kris James, Masato Shizume, and Marc D. Weidenmier. 2010. “Why Did Countries Adopt the Gold Standard? Lessons from Japan.” *The Journal of Economic History* 70 (01): 27–56. doi:[10.1017/S0022050710000045](https://doi.org/10.1017/S0022050710000045). P. 29. For a related attempt at analysis, see: Mitchener, Kris James, and Hans-Joachim Voth. 2011. “Trading Silver for Gold: Nineteenth-Century Asian Exports and the Political Economy of Currency Unions.” In *Costs and Benefits of Economic Integration in Asia*, edited by Robert J. Barro and Jong-Wha Lee, 126–56. Oxford University Press.  
<http://www.oxfordscholarship.com/view/10.1093/acprof:oso/9780199753987.001.0001/acprof-9780199753987-chapter-005>.

oversimplifications, against which arguments existed long before their formulation. Some have pointed out the multicollinearity of trade and protectionism, thereby indicating that the direction of causality is not an obvious given.<sup>62</sup> Put simply, the desire to move one's country onto the gold standard may itself be borne out by an already increasing trade volume with gold standard countries, or the anticipation of the latter (the 'Lucas' critique').<sup>63</sup>

If put in the microeconomic context of exchange banking, as in this chapter, it is easy to see that the model needs a great deal of further specification. After all, given its cognitive bias towards the inevitable emergence of a *common* monetary (gold) standard (and because of the extreme difficulty of counterfactually quantifying the effects of the survival of bimetallism),<sup>64</sup> it cannot but treat the boost of Japanese banking and

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<sup>62</sup> Flandreau, Marc. 2000. "The Economics and Politics of Monetary Unions: A Reassessment of the Latin Monetary Union, 1865–71." *Financial History Review* 7 (01): 25–44; Flandreau, Marc, and Mathilde Maurel. 2005. "Monetary Union, Trade Integration, and Business Cycles in 19th Century Europe." *Open Economies Review* 16 (2): 135–52. doi:[10.1007/s11079-005-5872-4](https://doi.org/10.1007/s11079-005-5872-4).

<sup>63</sup> Lucas, Robert E. 1976. "Econometric Policy Evaluation: A Critique." In *Carnegie-Rochester Conference Series on Public Policy*, 1:19–46. Elsevier.  
<http://www.sciencedirect.com/science/article/pii/S0167223176800036>. Related: Kydland, Finn E., and Edward C. Prescott. 1977. "Rules Rather than Discretion: The Inconsistency of Optimal Plans." *Journal of Political Economy* 85 (3): 473–91.  
<http://www.jstor.org/stable/1830193>.

<sup>64</sup> This bias is reflected in the fallacy of expressing the monetary value of trade among countries on different standards in *nominal* gold (!) terms only, whereas the latter's value is obviously conditioned by the degree towards which gold was adopted as a standard worldwide (the problem of endogeneity). Vice versa, the same is true for silver. The authors take it as a given that silver was depreciating, thereby obscuring the fact that depreciation was, at least partially, a function of the historical process of the white metal's monetary marginalization. The fallacy may not be initially obvious, but it nevertheless crucially discounts the paper's conclusions. After all, it demonstrates that the authors' very benign treatment of imperialist policies ("imperial intervention may have been beneficial in overcoming entrenched interests of existing trading companies") is directly related to their choice to take the monetary standard of the world's center as the standard against which the silver standard periphery should be measured. Ironically, the very appropriateness of the latter was a hotly debated topic among policy makers (see, for a typical example in the context of 1890s' India, the reports of the Herschell Committee (1893) and others) and exchange bankers at the time, as we will see at the end of this chapter. For a discussion of the desirability (and difficulty) of relating *nominal* and *real* effective exchange rates for the late nineteenth century, more specifically for the case of Japan, see: Shimazaki, Masao, and Solomos Solomou. 2001. "Effective Exchange Rates in Japan 1879–1938." *Japan and the World Economy* 13 (2): 161–78.  
doi:[10.1016/S0922-1425\(01\)00052-4](https://doi.org/10.1016/S0922-1425(01)00052-4).

business activity in silver China and Manchuria after 1897 as anomalous.<sup>65</sup> Yet, in our empirical analysis the anomaly does not only disappear; it must even be treated as *prerequisite* to expanded trade with gold standard countries, and this especially in view of the share an exchange bank as the Yokohama Specie Bank had in the financing of Japan's foreign trade.

[illustration: the evolution of YSB share in Japan's foreign trade]

The empirics of exchange banking practice (and the typical attention for the 'flow-of-funds') thus naturally invites an extended focus on the latter's reflection, namely the corollary 'flow-of-goods' (*ryūtsū* 流通). This is the subject of the following chapter. Again, a host of primary and secondary sources in Japanese will be our guide.

Whether the inclusion of banking and corollary accounting practice factually invalidates the 'gold-standard-and-trade-hypothesis' is something that cannot be concluded here. It does, however, demonstrate the distinct advantages of integrating an understanding of the contracts and operations associated with trade finance in the historically circumscribed context of late 19th century Asia. Indeed, we argue that existing macro-economic analyses may need to be updated with micro-historical findings. In particular, we challenge economic historians to take the micro-structure of, among others, exchange banking, much further. Thus, they will not only answer Jacob Viner's call in the epitaph to the appendix of this book. It may also make it possible to address some of the paradoxes that appear in the existing macro-economic literature.

In the end, the empirical demonstration is that, at least for the Japanese case, the analysis must necessarily take into account the realities of a world that is multipolar (or, at least, bipolar). The preference for a certain monetary standard thus does not imply a

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<sup>65</sup> Factually, Mitchener et al. find that gold standard adoption also resulted in an increased trade volume with countries on a different monetary standard ("remarkably, even bilateral trading volumes between countries that had previously shared the silver standard increased significantly"), but explain it away ("while silver was good for trade, joining gold was much better"), in a typical example of confirmation bias. The technicalities of trade *finance* are not given any attention.

preference pro or contra trade partners on a certain monetary standard. Instead, decision is, ultimately, a *financial* one, i.e. one of *insurance against mismatch*, as I have argued elsewhere.<sup>66</sup> In terms of the ‘balance sheet approach’ towards monetary policy, *what matters is the denomination of one’s assets and liabilities, 1) both public and private, and 2) both domestic and external*. And whereas the negative policy implications of these matters are arguably distributed asymmetrically among so-called core and peripheral countries,<sup>67</sup> core countries are at their peril to ignore them. This was as true in the nineteenth century as it is today, as we see in –once HSBC Chairman (1876-1882)– Emanuel Raphael Belilios’ indictment of the Indian decision to close the mints (1894):

“Gentlemen, I’m sure that you will agree with me that the policy pursued has been foolish and irrational. The Indian government should have done in effect what the Court of Directors of this Bank has done —convert their profits into sterling and make the sum in sterling subject to payment of dividends in sterling less loss in exchange. The revenue of India should have been dealt with in the same manner as the profits of the working of

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<sup>66</sup> Schiltz, Michael. 2012. “Money on the Road to Empire: Japan’s Adoption of Gold Monometallism, 1873–971.” *The Economic History Review* 65 (3): 1147–68. doi:[10.1111/j.1468-0289.2011.00619.x](https://doi.org/10.1111/j.1468-0289.2011.00619.x). For a discussion in the context of sovereign debt, see: Bordo, Michael D., Christopher M. Meissner, and Marc D. Weidenmier. 2006. “Currency Mismatches, Default Risk, and Exchange Rate Depreciation: Evidence from the End of Bimetallism”. Working Paper 12299. National Bureau of Economic Research. <http://www.nber.org/papers/w12299>. For a discussion of the mismatch problem on the economy wide level, see: Galindo, Arturo, Ugo Panizza, and Fabio Schiantarelli. 2003. “Debt Composition and Balance Sheet Effects of Currency Depreciation: A Summary of the Micro Evidence.” *Emerging Markets Review* 4 (4): 330–39. doi:[10.1016/S1566-0141\(03\)00059-1](https://doi.org/10.1016/S1566-0141(03)00059-1). Other important publications on the specifically negative effects of depreciation on the balance sheets of emerging market economies are: Eichengreen, Barry, and Ricardo Hausmann, eds. 2005. *Other People’s Money: Debt Denomination and Financial Instability in Emerging Market Economies*. 1 edition. Chicago: University Of Chicago Press; Devereux, Michael B., Philip R. Lane, and Juanyi Xu. 2006. “Exchange Rates and Monetary Policy in Emerging Market Economies\*.” *The Economic Journal* 116 (511): 478–506. doi:[10.1111/j.1468-0297.2006.01089.x](https://doi.org/10.1111/j.1468-0297.2006.01089.x); Lane, Philip R., and Jay C. Shambaugh. 2010. “Financial Exchange Rates and International Currency Exposures.” *The American Economic Review* 100 (1): 518–40. <http://www.jstor.org/stable/27804939>.

<sup>67</sup> See, in this respect, the large literature on ‘sudden stops’, or the typical procyclicality of capital flows to and from peripheral countries. References are too numerous to be included here.



the Bank during the past 15 or 20 years. [...] It is gold that is appreciating, not silver that is depreciating, because it is a fact, [...], that today in Europe, a certain sum in gold buys more real estate than it did twenty years ago, whereas in the East a certain sum in silver buys as much produce and provisions as it did twenty years ago. If this enhancement in the value of gold, this appreciation, is allowed to go on unchecked, we shall probably find in a few years eighteen pence of gold buying one ounce of silver. If [England] hesitates too long —and a few months may prove most disastrously— she may find her manufactures shut out of these markets altogether.”<sup>68</sup>

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<sup>68</sup> *North China Herald*, August 31 1894, P. 357