BOJ Reports & Research Papers

Financial System Report Annex Series

FSR – A
Financial System Report – Annex

Financial Results of Japan's Banks for Fiscal 2017

FINANCIAL SYSTEM AND BANK EXAMINATION DEPARTMENT
BANK OF JAPAN
SEPTEMBER 2018

The total of major banks, regional banks, and *shinkin* banks covered in this *Report* is as follows (as at March 31, 2018).

Major banks comprise the following 10 banks: Mizuho Bank; The Bank of Tokyo-Mitsubishi UFJ (renamed as MUFG Bank); Sumitomo Mitsui Banking Corporation; Resona Bank; Saitama Resona Bank; Mitsubishi UFJ Trust and Banking Corporation; Mizuho Trust and Banking Company; Sumitomo Mitsui Trust Bank; Shinsei Bank; and Aozora Bank. Regional banks comprise the 64 member banks of the Regional Banks Association of Japan (Regional banks I) and the 41 member banks of the Second Association of Regional Banks (Regional banks II). *Shinkin* banks are the 253 *shinkin* banks that hold current accounts at the Bank of Japan.

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Background

The Bank of Japan issues the *Financial System Report* semi-annually with the objectives of assessing the stability of Japan's financial system from a macroprudential perspective and enhancing communication with concerned parties with respect to financial stability issues. The *Report* provides a regular and comprehensive assessment of the financial system.

The *Financial System Report Annex Series* supplements the *Financial System Report* by providing more detailed analysis and insight into a selected topic on an ad hoc basis. This paper covers the financial results of Japan's banks for fiscal 2017.

Abstract

The characteristics of the financial results of Japan's banks for fiscal 2017 are summarized in the three paragraphs below.

First, net income increased for major banks, while that for regional banks and *shinkin* banks showed a smaller decline than in the previous year. For all types of banks, factors such as the shrinking domestic lending margins and the increased losses on sales of U.S. Treasuries pushed down net income. On the other hand, net income was pushed up mainly by low credit costs and the increased gains from sales of stocks.

Second, pre-provision net revenue (PPNR) (excluding trading income), which show core profitability, were more or less unchanged from the previous year for regional banks, while they continued to decrease for major banks and *shinkin* banks. All types of banks saw a decline in net interest income through the shrinking domestic lending margins. Regional banks and *shinkin* banks, both of which are highly dependent on net interest income, have demonstrated increasing heterogeneity in core profitability among financial institutions.

Third, financial institutions have maintained their financial soundness on the whole. The amount of capital continued to increase mainly at major banks, due to the accumulation of retained earnings.

Contents

I. Outline of Financial Results of Japan's Banks for Fiscal 2017[1]

A. Profits and Losses

Net income for fiscal 2017 at major financial groups was about 2.8 trillion yen, increasing by 6.6 percent from the previous year. The main factors were (1) the improvement in credit costs backed by the reversals of loan-loss provisions for domestic exposures to some large companies and favorable economic conditions, and (2) the widening of the extent to which realized gains exceeded losses on stockholdings, due mainly to sales of strategic stockholdings. These factors more than offset a continued decline in net interest income through the shrinking domestic lending margins.

Meanwhile, net income for fiscal 2017 at major banks (on a non-consolidated basis) was about 2.1 trillion yen, an increase of 6.1 percent from the previous year. Compared to that of major financial groups, the decline in net interest income exerted stronger downward pressure on net income. For details regarding the comparison between the consolidated and non-consolidated financial results of major banks, see Box 1.

I-A-1: Main profit and loss items at major financial groups and banks

100mil.yen,%

	Major Financial Groups			Major Banks (non-consolidated)		
	FY2017	y/y chg.	y/y % chg.	FY2017	y/y chg.	y/y % chg.
Net interest income	48,306	-1,852	-3.7	34,324	-3,563	-9.4
Net non-interest income	54,784	+846	+1.6	24,106	-416	-1.7
General and administrative expenses	-68,901	-648	+0.9	-37,322	+145	-0.4
PPNR (excluding trading income)	——	——	——	21,108	-3,835	-15.4
Realized gains/losses on bondholdings	-94	-1,277	——	-122	-1,114	——
Realized gains/losses on stockholdings	5,596	+727	+14.9	6,119	+1,017	+19.9
Credit costs	53	+4,044	——	2,939	+4,542	——
(Credit cost ratio)	——	——	——	(-10bp)	(-15bp)	——
Others	-881	+1,127	-56.1	-3,067	+805	-20.8
Net income before income taxes	38,862	+2,967	+8.3	26,977	+1,415	+5.5
Tax-related expenses	-8,468	-639	+8.2	-6,056	-215	+3.7
Net income	27,853	+1,713	+6.6	20,922	+1,200	+6.1

Note: 1. Regarding credit costs, negative numbers represent a rise in costs while positive numbers represent an increase in reversals.
2. Some items for which there exist no data based on financial groups are calculated using banks' data on a non-consolidated basis.
3. PPNR stands for pre-provision net revenue.
Source: Published accounts of each financial group; BOJ.

[1] Figures provided in Chapters I and II are calculated on a non-consolidated basis unless otherwise noted.

Net income for fiscal 2017 at regional banks was about 0.9 trillion yen, a 2.4 percent decline from the previous year. While net interest income was on a declining trend due to the shrinking domestic lending margins, the decline in net income was mainly attributed to larger realized losses on bondholdings incurred by the losses on sales of U.S. Treasuries. On the other hand, the level of net income was supported by the reduction in general and administrative expenses as well as the increase in the amount to which realized gains exceeded losses on stockholdings.

Net income at *shinkin* banks was about 0.3 trillion yen, a decrease of 4.6 percent from the previous year. This was attributed to a decline in net interest income due to the shrinking lending margins and a decrease in the amount to which realized gains exceeded losses on bondholdings.

I-A-2: Main profit and loss items at regional banks and *shinkin* banks

100mil.yen,%

	Regional banks (non-consolidated)			*Shinkin* banks		
	FY2017	y/y chg.	y/y % chg.	FY2017	y/y chg.	y/y % chg.
Net interest income	37,359	-73	-0.2	15,444	-137	-0.9
Net non-interest income	5,362	-80	-1.5	645	-95	-12.8
General and administrative expenses	-29,792	+353	-1.2	-13,180	+180	-1.3
PPNR (excluding trading income)	12,929	+200	+1.6	2,909	-52	-1.7
Realized gains/losses on bondholdings	-1,186	-820	+223.8	422	-378	-47.3
Realized gains/losses on stockholdings	2,601	+506	+24.1	539	+201	+59.4
Credit costs	-1,050	-521	+98.5	-210	+10	-4.7
(Credit cost ratio)	(4bp)	(+2bp)	+91.2	(3bp)	(-0bp)	-7.0
Others	-168	+434	-72.1	-148	+88	-37.4
Net income before income taxes	13,125	-201	-1.5	3,512	-130	-3.6
Tax-related expenses	-3,702	-31	+0.8	-872	+1	-0.2
Net income	9,423	-233	-2.4	2,640	-129	-4.6

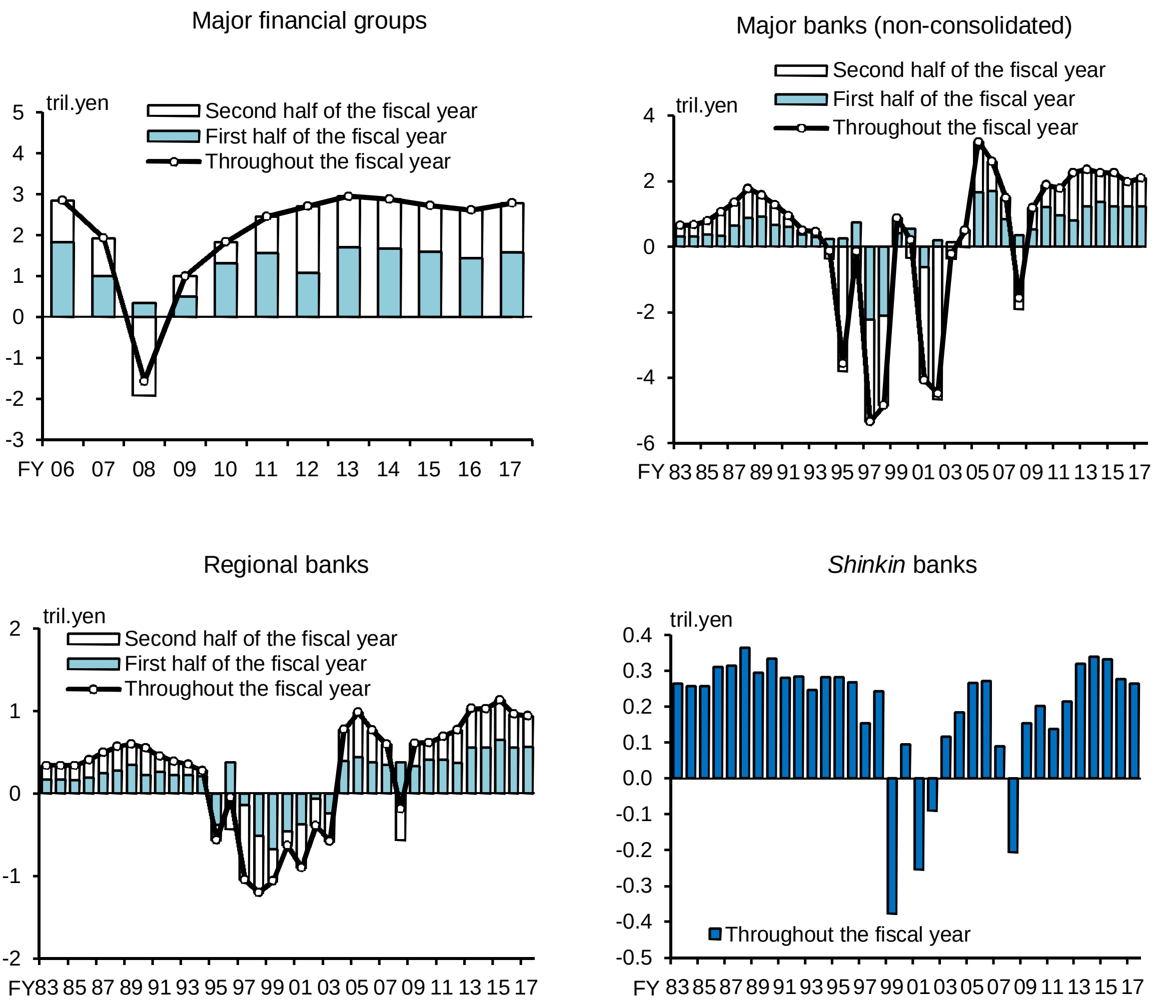
Note: Regarding credit costs, negative numbers represent a rise in costs while positive numbers represent an increase in reversals.

Source: BOJ.

B. Profit Levels from a Long-Term Perspective

Net income for fiscal 2017 for major banks increased for the first time in four years on a consolidated basis and two years on a non-consolidated basis. Net income for regional banks and *shinkin* banks declined, but to a lesser extent. From a longer-term perspective, the net income levels for all types of banks, which were maintained at around the average of the past several years, bear comparison with those before the failure of Lehman Brothers and even before the bursting of Japan's bubble economy in the early 1990s.

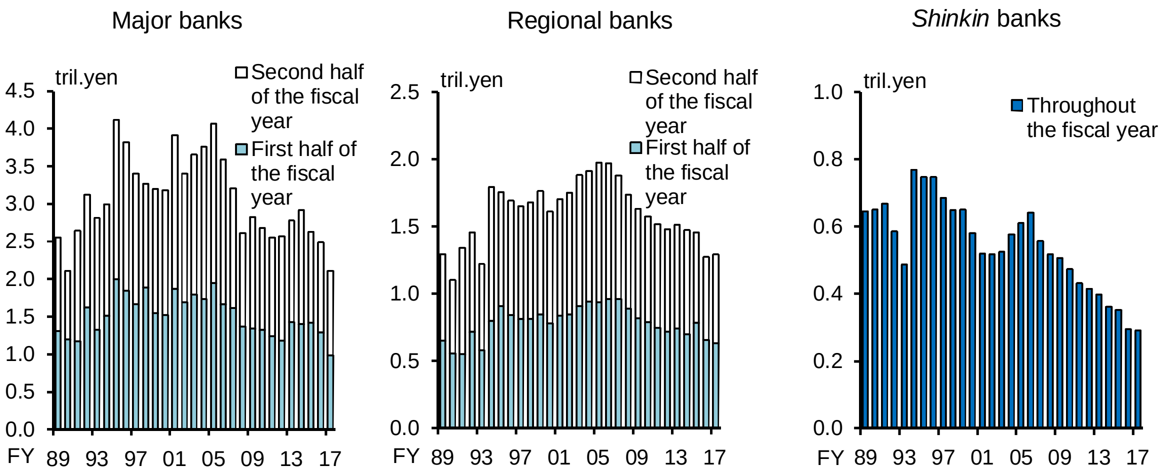
I-B-1: Net income



Source: BOJ.

With regard to the movements of core profitability, pre-provision net revenue (PPNR) (excluding trading income) at major banks for fiscal 2017 marked a larger decline of 15.4 percent, decreasing for the third consecutive year, mainly because of a decline in domestic net interest income. At regional banks, PPNR (excluding trading income) showed a slight increase of 1.6 percent from the previous year, due in part to the reduction in general and administrative expenses. At *shinkin* banks, such profits continued to decline, although they marked a smaller decline of 1.7 percent from the previous year. Meanwhile, regional banks and *shinkin* banks have demonstrated increasing heterogeneity in core profitability among financial institutions. See Box 2 for further details.

I-B-2: PPNR (excluding trading income)



Source: BOJ.

C. Balance Sheets

Looking at developments in balance sheets for fiscal 2017 at major banks, total assets increased by 24.5 trillion yen as cash and due from banks, including current account balances at the Bank of Japan, and securities increased. On the liability side, the main increases were in deposits in the domestic business sector and other liabilities, including market funding such as repos and call money.

I-C-1: Main balance sheet items of major banks

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	End-Mar. 2018	y/y chg.	Change from end-Sep. 2017		End-Mar. 2018	y/y chg.	Change from end-Sep. 2017
Loans and bills discounted	304.1	-2.9	-2.1	Deposits + NCD	503.2	+12.7	+6.7
Domestic business sector	210.6	-0.6	+2.8	Domestic business sector	404.8	+12.3	+10.5
International business sector	93.6	-2.3	-4.9	International business sector	98.4	+0.4	-3.8
Securities	130.3	+4.8	+5.2	Loans from BOJ	26.0	-1.3	-2.1
JGBs	50.7	+1.3	+5.8	Due to trust accounts	15.8	+1.6	+2.3
Stocks	17.8	+0.7	-0.0	Other liabilities	130.4	+10.2	+2.6
Foreign securities	43.7	+0.4	-2.7	Total liabilities	675.4	+23.2	+9.5
Cash and due from banks	188.3	+19.5	+7.1	Total net assets	34.3	+1.3	+0.2
Other assets	87.0	+3.1	-0.6	Retained earnings	12.3	+1.0	+0.4
Total assets	709.7	+24.5	+9.7	Net unrealized gains/losses on securities	6.2	+0.5	-0.1

Source: BOJ.

Regarding total assets at regional banks, they increased by 10.6 trillion yen as loans as well as cash and due from banks, including current account balances at the Bank of Japan, increased while securities decreased. On the liability side, the main increase was in deposits.

I-C-2: Main balance sheet items of regional banks

tril.yen

	End-Mar. 2018	y/y chg.	Change from end-Sep. 2017		End-Mar. 2018	y/y chg.	Change from end-Sep. 2017
Loans and bills discounted	253.4	+9.5	+5.5	Deposits + NCD	340.6	+8.1	+4.8
Securities	85.6	-6.1	-4.1	Current deposits	178.4	+11.6	+8.2
JGBs	24.9	-5.5	-2.6	Other liabilities	33.5	+1.5	+1.7
Cash and due from banks	45.8	+5.9	+4.8	Total liabilities	374.1	+9.6	+6.4
Other assets	11.8	+1.4	+0.3	Total net assets	22.5	+1.0	+0.1
Total assets	396.6	+10.6	+6.6	Net unrealized gains/losses on securities	3.9	+0.3	-0.1

Source: BOJ.

With regard to *shinkin* banks, total assets increased by 3.5 trillion yen as loans as well as cash and due from banks increased. On the liability side, the main increase was in deposits.

I-C-3: Main balance sheet items of *shinkin* banks

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	End-Mar. 2018	y/y chg.		End-Mar. 2018	y/y chg.
Loans and bills discounted	70.7	+1.8	Deposits + NCD	140.4	+3.1
Securities	42.4	-0.0	Current deposits	51.3	+3.2
JGBs	7.7	-0.9	Other liabilities	4.4	+0.2
Cash and due from banks	37.7	+1.5	Total liabilities	144.8	+3.4
Other assets	3.0	+0.2	Total net assets	8.9	+0.1
Total assets	153.7	+3.5	Net unrealized gains/losses on securities	0.7	-0.1

Source: BOJ.

II. Financial Results of Japan's Major Banks and Regional Banks for Fiscal 2017

This chapter analyzes banks' core profitability (net interest income, net non-interest income, and general and administrative expenses), credit costs and non-performing loans, as well as capital adequacy ratios. The financial results of *shinkin* banks are analyzed in Chapter III.

A. Core Profitability

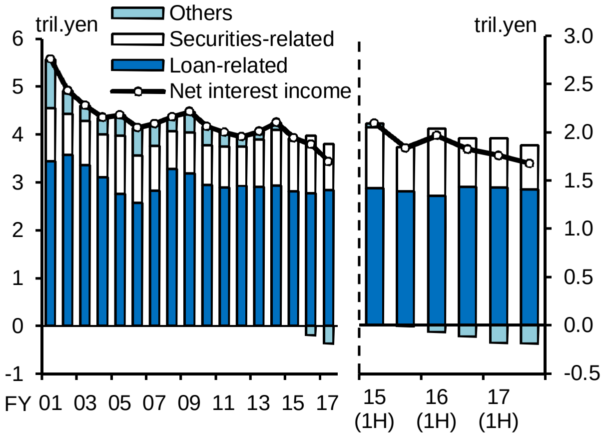
1. Net Interest Income

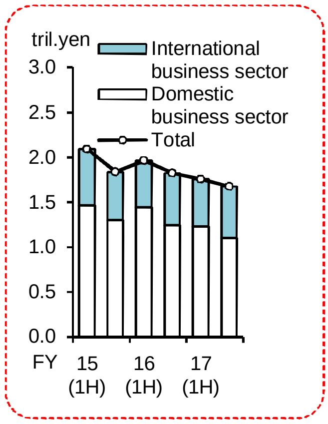
Net interest income at major banks for fiscal 2017 decreased by 9.4 percent from the previous year. Net interest income in the international business sector was more or less unchanged from the previous year, marking 0.3 percent growth, while such income in the domestic business sector decreased by 13.4 percent from the previous year as interest rates on loans and yields on Japanese government bonds (JGBs) continued to decline.

Net interest income at regional banks for fiscal 2017 was more or less unchanged from the previous year, marking 0.2 percent decline. Loan-related income continued to decrease due to narrowing interest rate spreads on loans, while securities-related income increased owing to the rise in stock yields and the increasing share of investment trusts with wide profit margins.

II-A-1: Net interest income

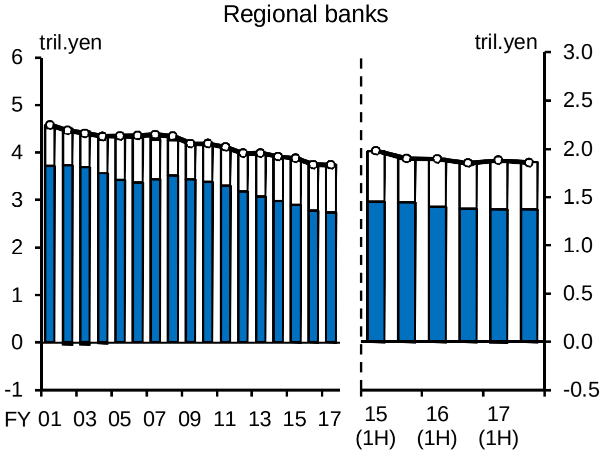
Major banks





Categorized by domestic and international business sector

Regional banks



Note: Loan-related = (average loans outstanding) * (interest rate spreads on loans).
Securities-related = (average outstanding securities holdings) * (interest rate spreads on securities).
Source: BOJ.

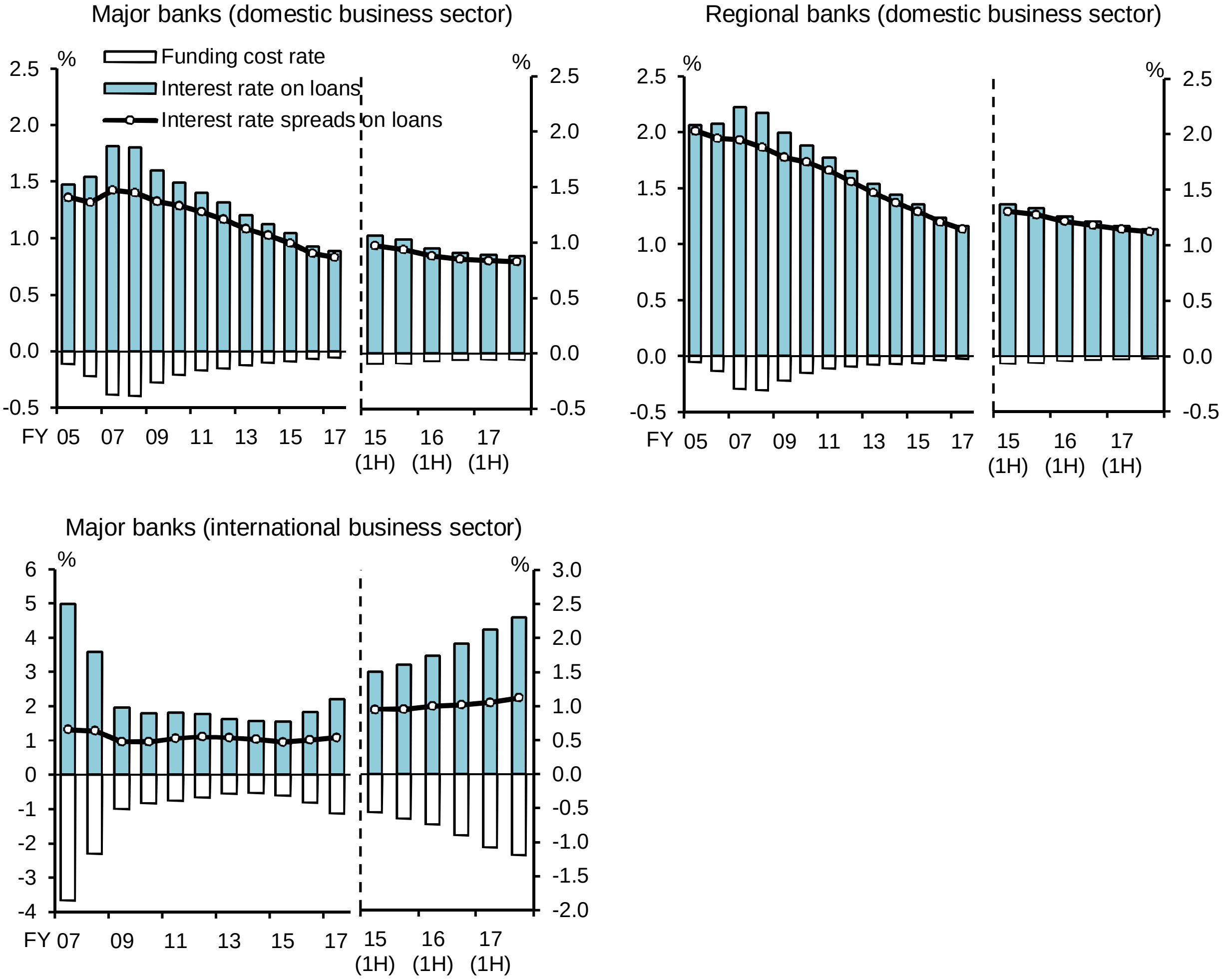
2. Interest Rate Spreads on Loans and Loans Outstanding

(1) Interest Rate Spreads on Loans

Interest rate spreads on loans in the domestic business sector continued to narrow at both major banks and regional banks as the decline in interest rates on loans exceeded the decline in funding rates under the prolonged low interest rate environment.

Interest rate spreads on loans in the international business sector at major banks were more or less unchanged as both interest rates on loans and funding increased, reflecting policy rate hikes in the United States.

II-A-2: Interest rate spreads on loans

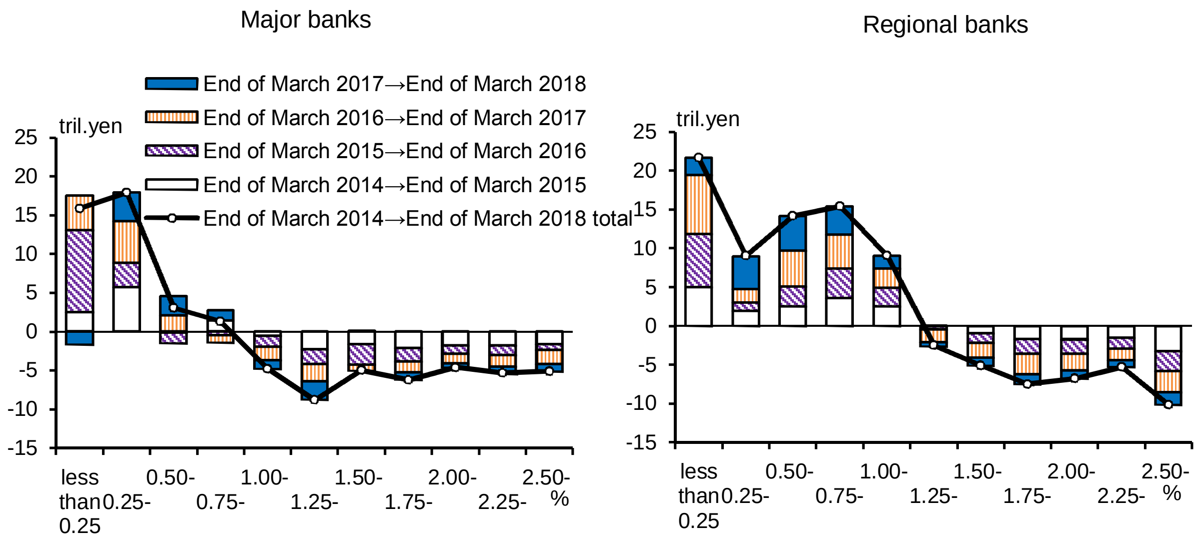


Note: 1. In calculating the interest rate spreads, interest expenses on interest rate swaps are deducted from funding costs.
2. Semiannual data are annualized.
Source: BOJ.

(2) Loans Outstanding by Lending Rate

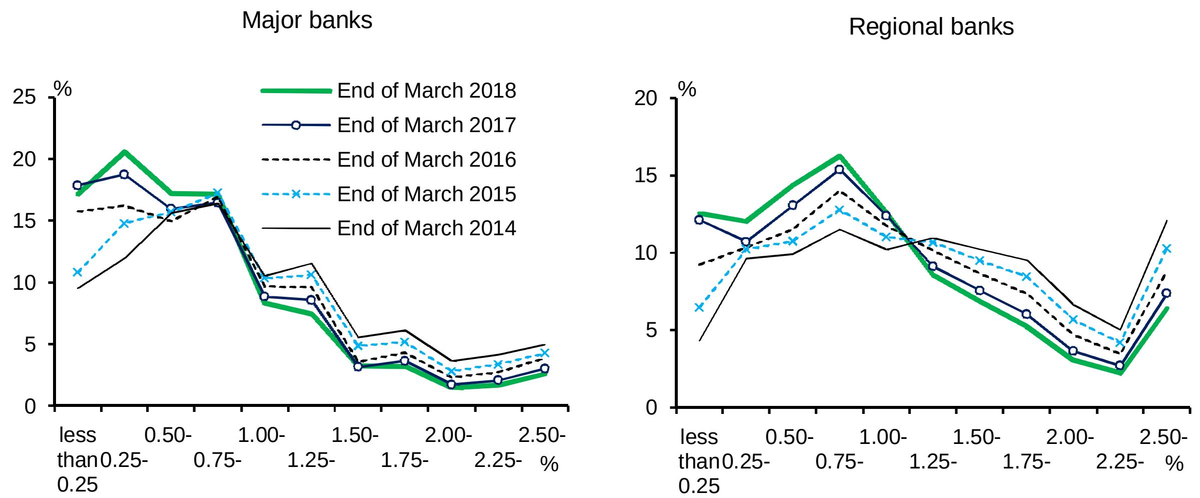
Looking at developments in loans outstanding by lending rate (yen loans in domestic branches) at both major banks and regional banks, those with low lending rates continued to increase.

II-A-3: Changes in loans outstanding by lending rate (from the end of March 2014 to the end of March 2018)



Note: The data are for yen loans outstanding in domestic branches (excluding loans to the financial sector) based on the amount outstanding at month-end.
Source: BOJ.

II-A-4: Changes in proportion of loans outstanding by lending rate (from the end of March 2014 to the end of March 2018)

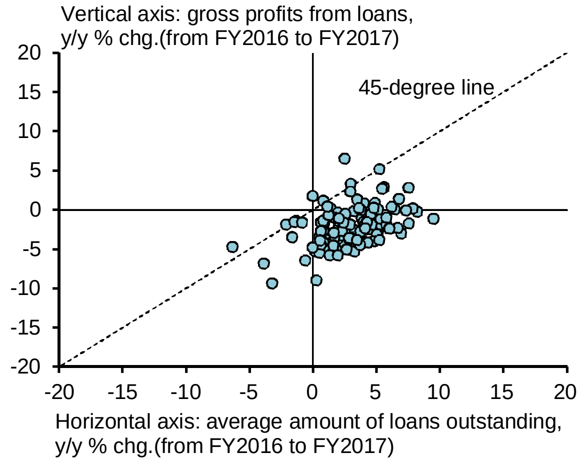


Note: The data are for yen loans outstanding in domestic branches (excluding loans to the financial sector) based on the amount outstanding at month-end.
Source: BOJ.

(3) Factors behind Changes in Profits from Lending Activities

Looking at the changes in profits from domestic lending activities (= loans outstanding * interest rate spreads on loans) over the last year, most banks faced a decrease, although their loans outstanding increased. This suggests that a narrowing of interest rate spreads on loans is continuing to push down profits.

II-A-5: Relationship between changes in loans outstanding and profits from loans (major and regional banks, domestic business sector)



Note: 1. The data for loans outstanding do not include foreign currency-denominated impact loans.

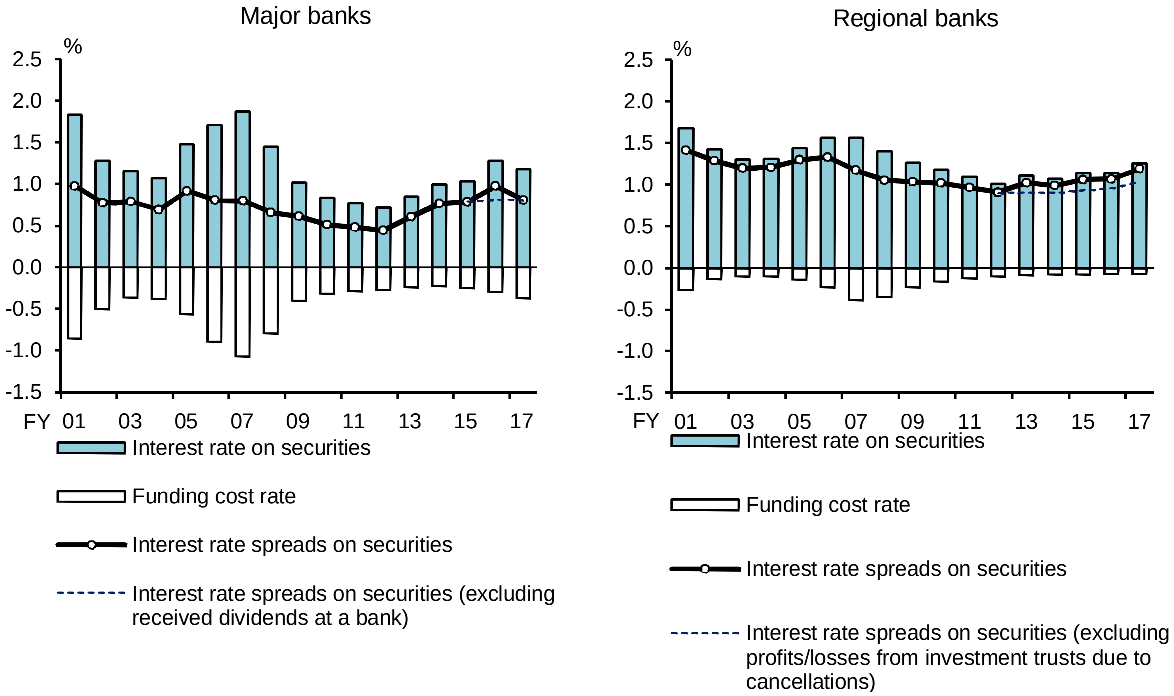
2. Gross profits from loans = (average amount of loans outstanding) * (interest rate spreads on loans).

Source: BOJ.

3. Interest Rate Spreads on Securities

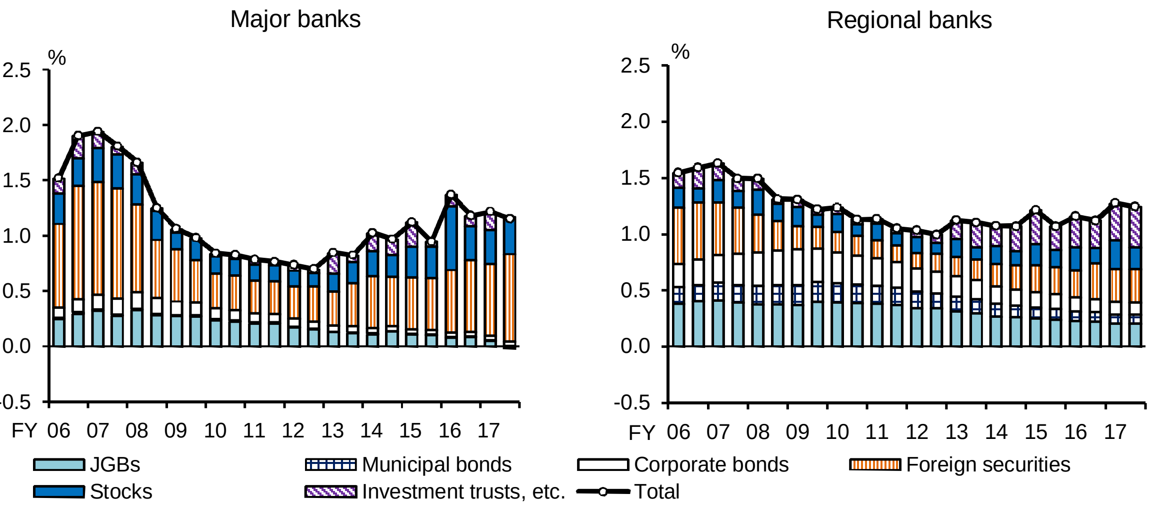
Interest rate spreads on securities were more or less unchanged at major banks as stock yields rose on the back of favorable corporate results, while JGB yields declined. Such spreads on securities at regional banks increased for the third consecutive year owing to the rise in stock yields and the increasing share of investment trusts with wide profit margins.

II-A-6: Interest rate spreads on securities



Note: In calculating the interest rate spreads, interest expenses on interest rate swaps are deducted from funding costs.
Source: BOJ.

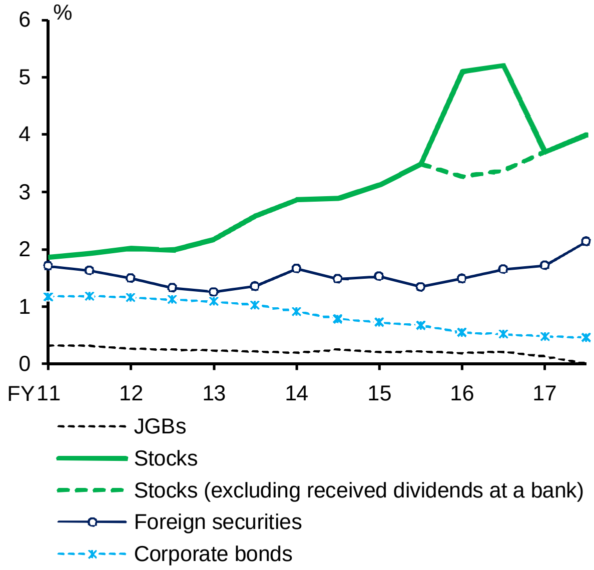
II-A-7: Factor decomposition of change in interest rates on securities by product type

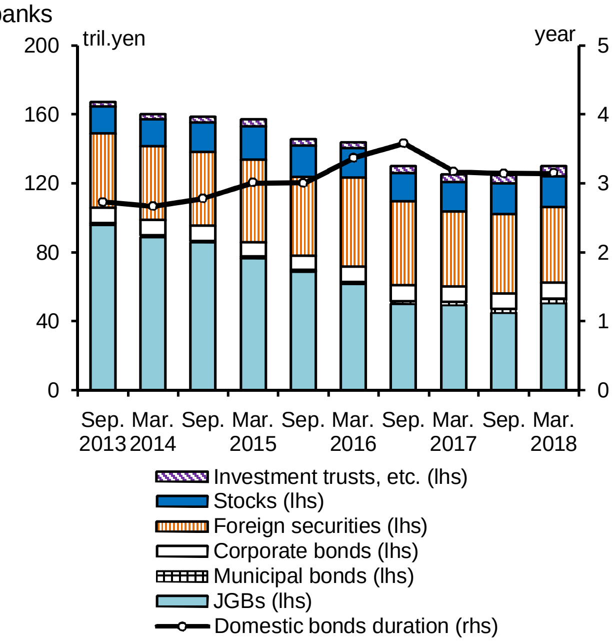


Note: 1. The data are calculated on a half-year basis.
2. Some banks are excluded due to a lack of time-series data.
3. The rise in stock yields in the first half of fiscal 2016 reflects received dividends from subsidiary at a bank.
Source: BOJ.

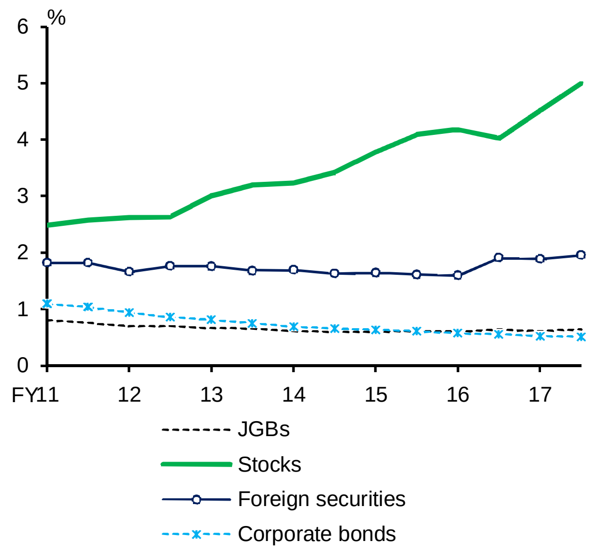
II-A-8: Interest rates on securities holdings and amounts outstanding by product type (at month-end)

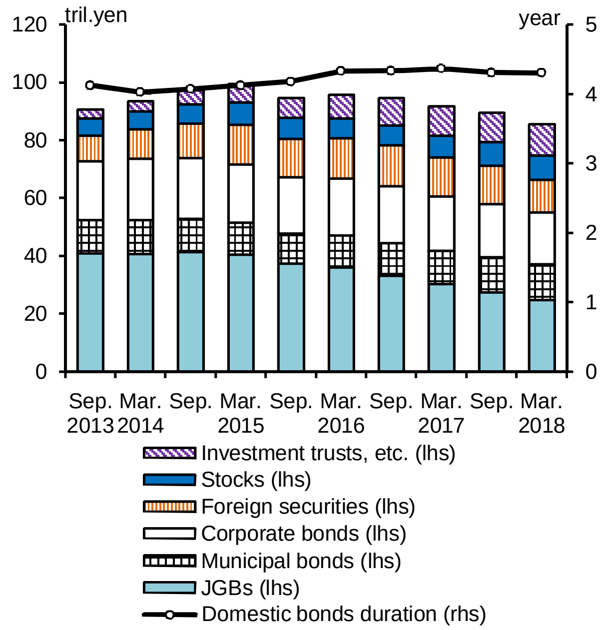
Major banks





Regional banks



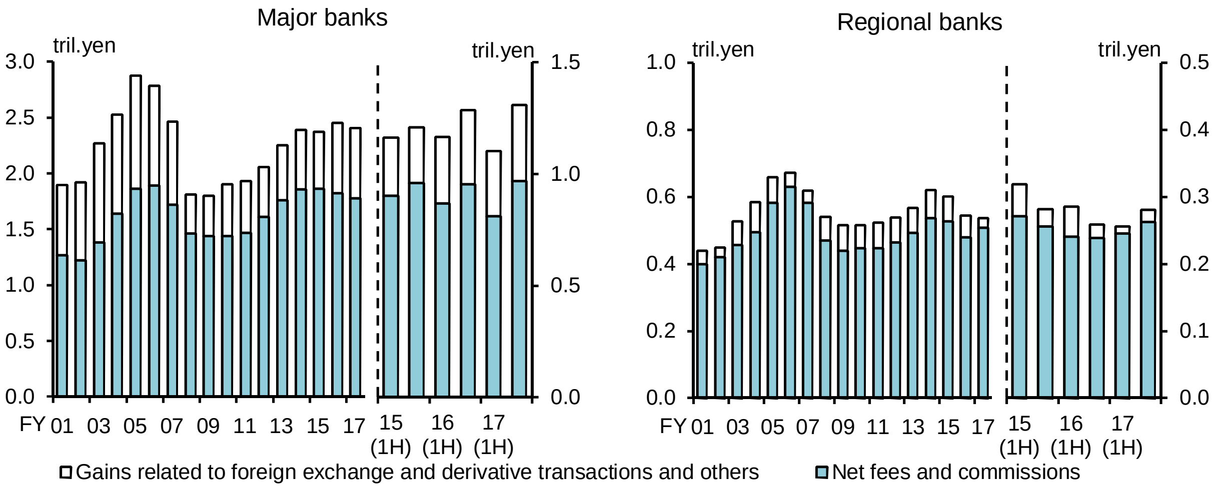


Note: 1. The data are calculated on a half-year basis.
2. The rate is annualized. In calculating interest rates, some banks are excluded due to a lack of time-series data.
3. Stock yields are calculated using a 2-quarter moving average to mitigate fluctuations in each quarter's dividends.
Source: BOJ.

4. Net Non-Interest Income

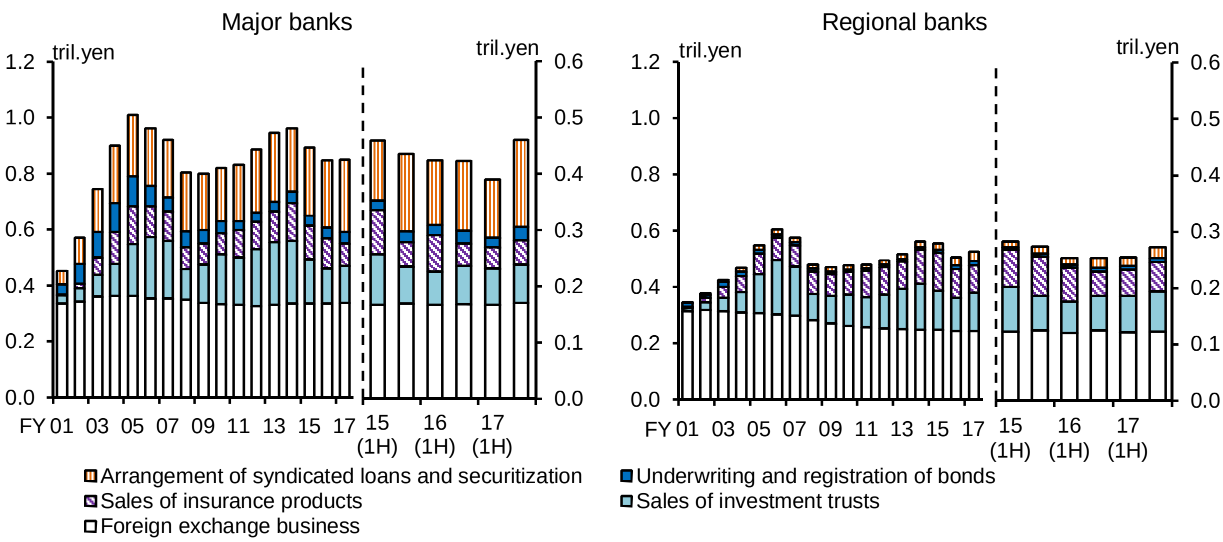
Net non-interest income decreased by 1.7 percent over the previous year at major banks mainly because income from fees and commissions in the international business sector declined, particularly for those associated with deposits and lending. Net non-interest income at regional banks decreased by 1.5 percent from the previous year, mainly due to a decline in fees and commissions related to foreign exchange and derivative transactions. At both major and regional banks, fees and commissions for insurance products continued to decrease, although those associated with domestic deposits and lending, such as the arrangement of syndicated loans as well as securitization, increased and fees and commissions associated with sales of investment trusts also started to increase.

II-A-9: Net non-interest income



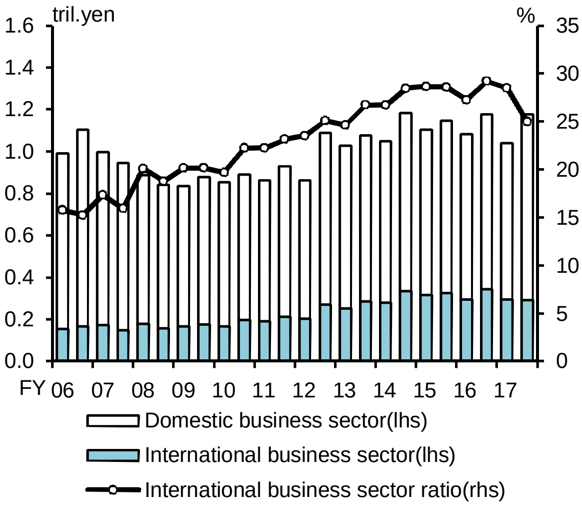
Source: BOJ.

II-A-10: Income from fees and commissions (domestic business sector)



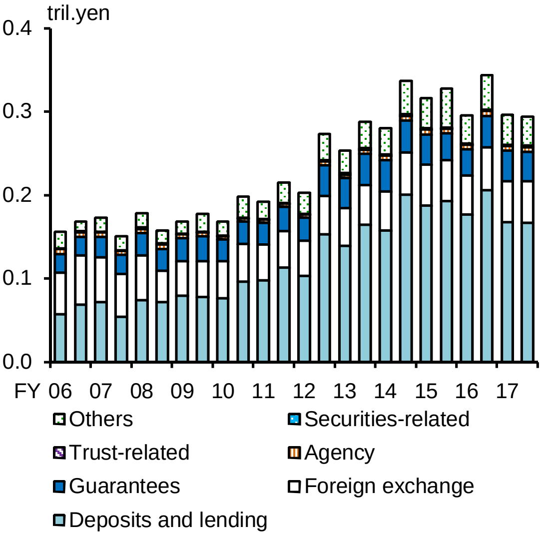
Note: Among items of income from fees and commissions, the 5 items listed above are counted.
Source: BOJ.

II-A-11: Income from fees and commissions at major banks (by domestic and international business sector)



Note: The data are calculated on a half-year basis.
Source: BOJ.

II-A-12: Income from fees and commissions in the international business sector at major banks

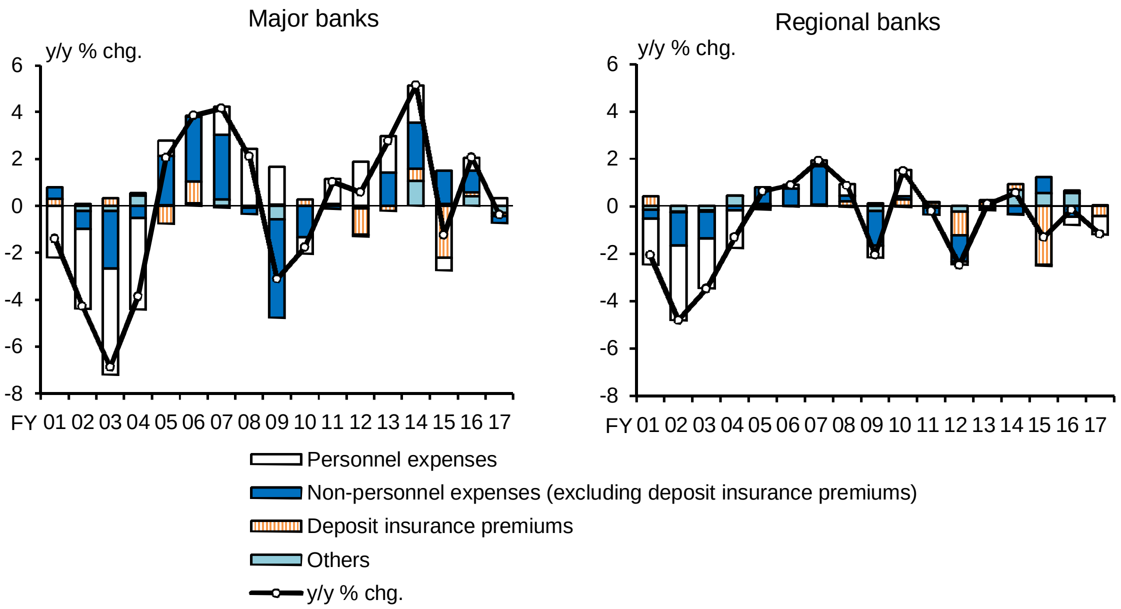


Note: 1. The data are calculated on a half-year basis.
2. The figures are categorized based on each bank's internal definition. "Deposits and lending" includes income from fees and commissions related to the arrangement of syndicated loans, commitment lines, securitization, and M&A transactions.
Source: BOJ.

5. General and Administrative Expenses

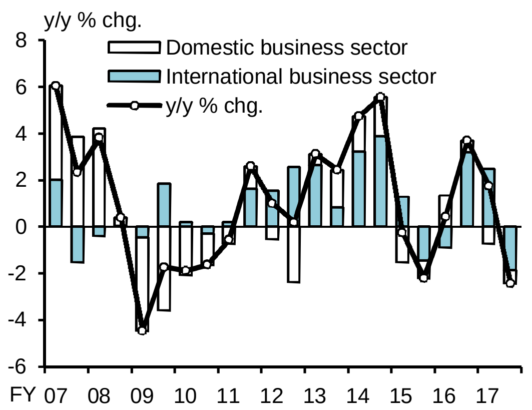
General and administrative expenses decreased slightly at major banks, mainly reflecting the promotion of measures to reduce such expenses. At regional banks, general and administrative expenses decreased due to a decline in personnel expenses. Meanwhile, overhead cost ratios (= overhead costs / gross operating profits) remained on an upward trend at both major and regional banks, mainly due to the decrease in gross operating profits.

II-A-13: Factor decomposition of change in general and administrative expenses



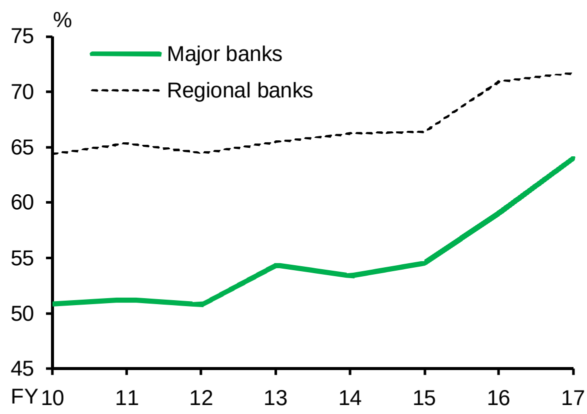
Source: BOJ.

II-A-14: Factor decomposition of change in general and administrative expenses by sector at major banks



Source: BOJ.

II-A-15: Overhead cost ratios



Note: Overhead cost ratios = overhead costs / gross operating profits.

Source: BOJ.

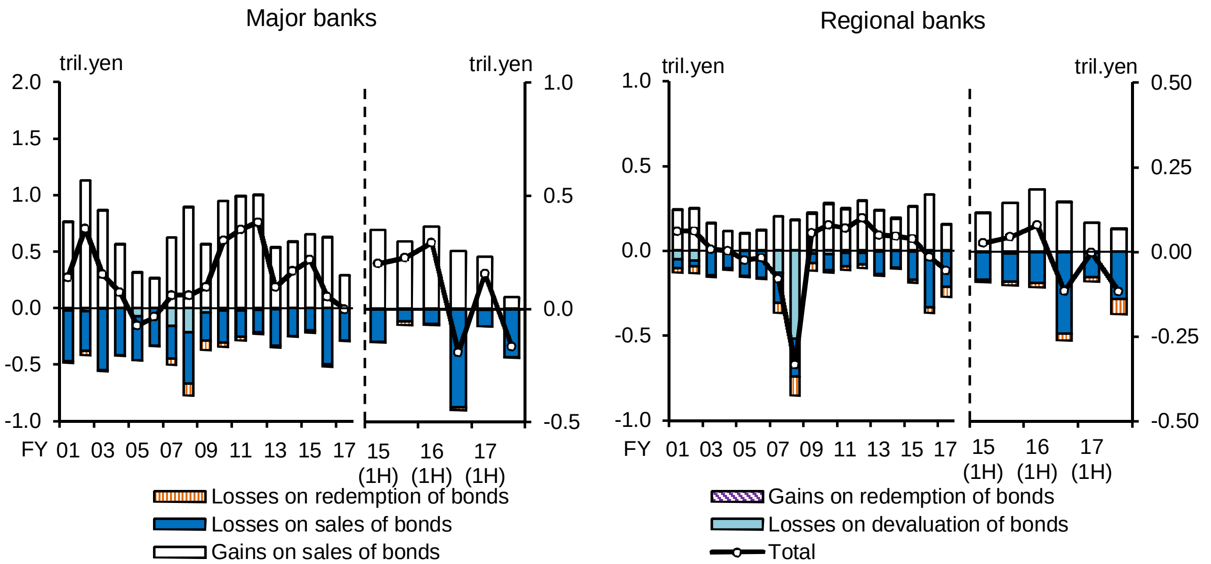
B. Realized and Unrealized Gains/Losses on Securities Holdings

1. Realized Gains/Losses on Securities Holdings

Realized gains/losses on bondholdings turned slightly negative at major banks, and at regional banks, the extent to which such losses exceeded gains expanded. At both major and regional banks, further losses continued to be realized from sales of U.S. Treasuries due to the rise in U.S. long-term interest rates.

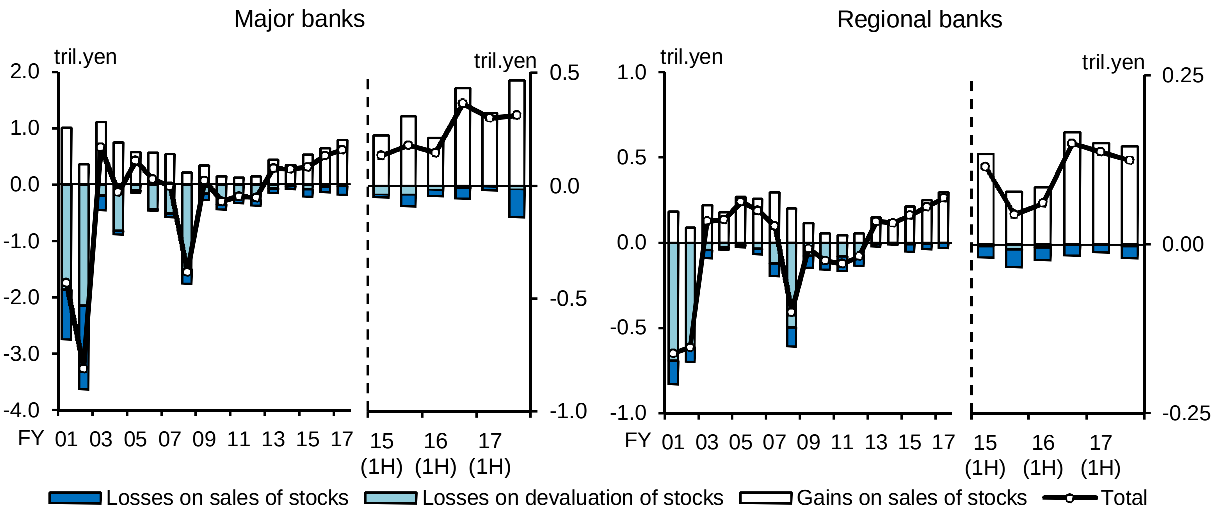
As for realized gains/losses on stockholdings, the extent to which gains exceeded losses continued to increase at both major banks and regional banks. Reductions in strategic holdings and sales of ETFs to realize gains continued to proceed as stock prices rose.

II-B-1: Realized gains/losses on bondholdings



Source: BOJ.

II-B-2: Realized gains/losses on stockholdings



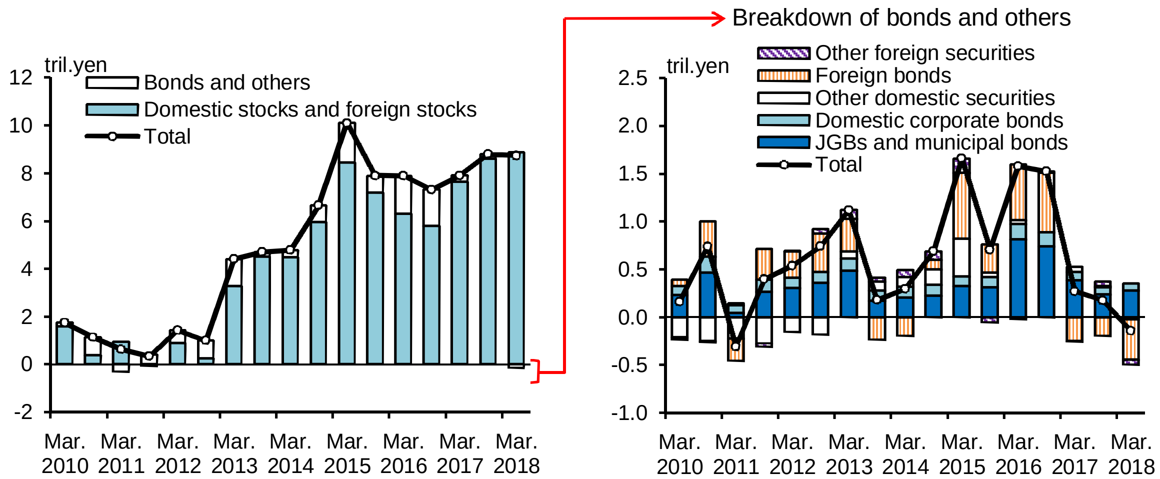
Source: BOJ.

2. Unrealized Gains/Losses on Securities Holdings

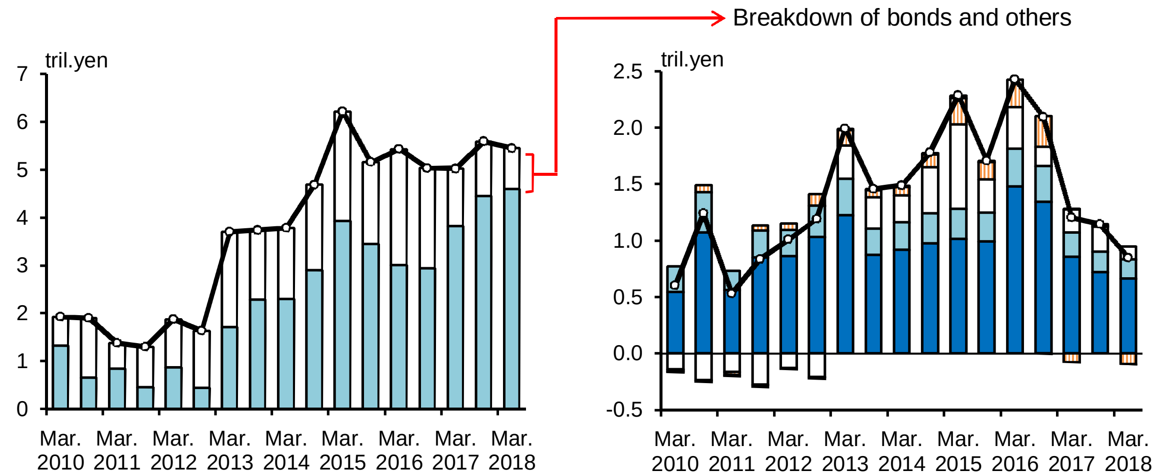
Looking at unrealized gains/losses on available-for-sale securities holdings as of the end of March 2018, the extent to which unrealized gains exceeded losses has remained high, at about 9 trillion yen at major banks and about 5 trillion yen at regional banks. Looking more closely at the breakdown, unrealized gains/losses on holdings of "bonds and others" turned slightly negative at major banks as the extent to which unrealized losses on foreign bondholdings exceeded gains increased due to the rise in long-term U.S. interest rates. On the other hand, the extent to which unrealized gains in stockholdings exceeded losses continued to increase due to the rise in stock prices countering the effect of reducing strategic shareholdings. At regional banks, the extent to which unrealized gains in holdings of "bonds and others" exceeded losses decreased due to smaller unrealized gains in domestic bondholdings resulting from their reduction, as well as increased unrealized losses on foreign bondholdings. On the other hand, the extent to which unrealized gains in stockholdings exceeded losses continued to expand.

II-B-3: Unrealized gains/losses on available-for-sale securities holdings

Major banks



Regional banks



Note: 1. The breakdown of bonds and others at both major and regional banks is shown on the right. "Other domestic securities" and "other foreign securities" include investment trusts and funds.
2. The data are as of month-end and calculated on a half-year basis.

Source: BOJ.

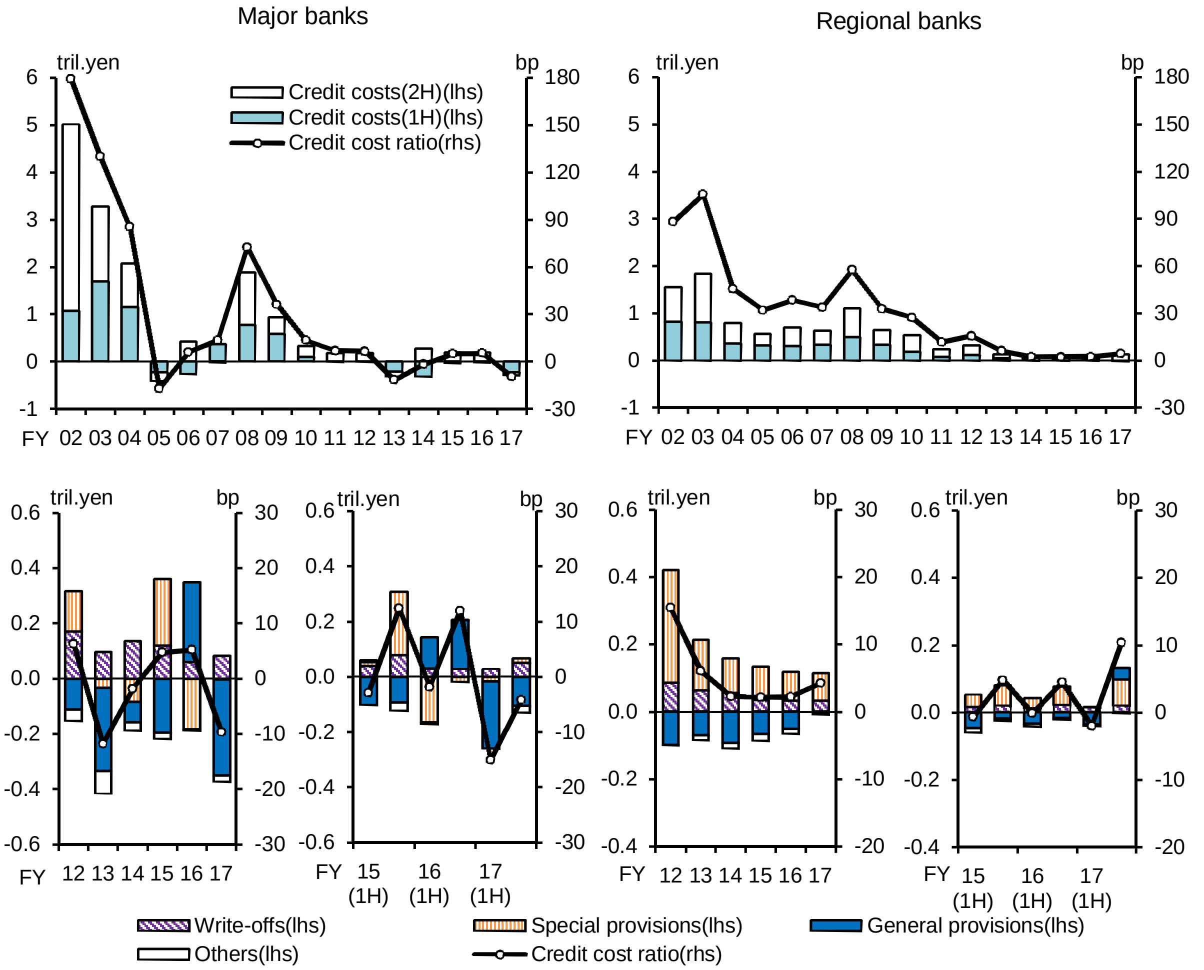
C. Credit Costs and Non-Performing Loans

1. Credit Costs

Looking at credit costs, major banks recorded credit costs in reversals as there were reversals of loan-loss provisions for domestic exposures to some large companies and loan-loss provision ratios declined on the back of favorable economic conditions. Credit costs at regional banks also remained at a low level.

The credit cost ratio (= credit costs / total loans outstanding) was minus 10 basis points (reversals) at major banks and 4 basis points at regional banks.

II-C-1: Credit costs and credit cost ratios

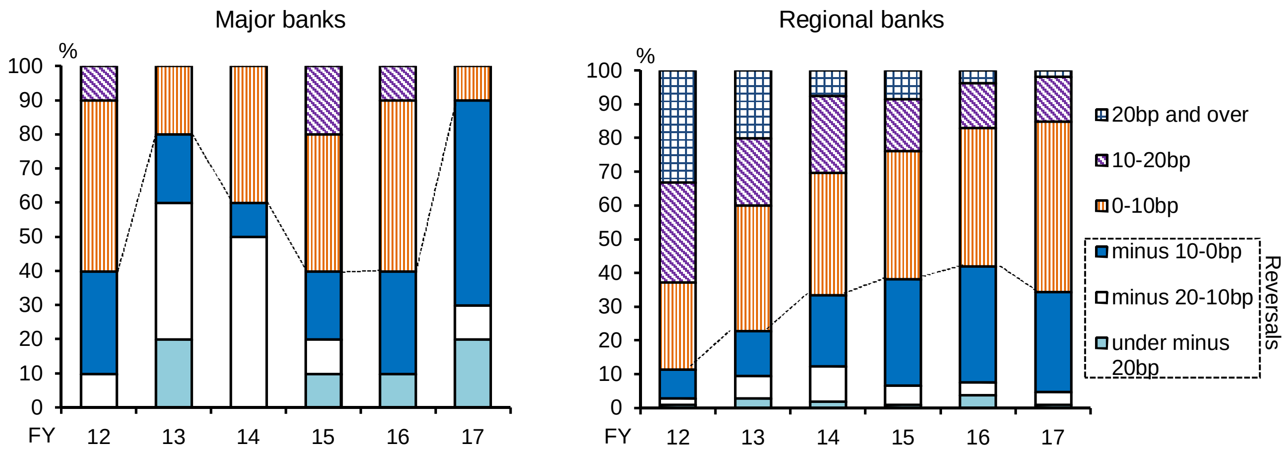


Note: 1. The lower charts show the breakdown of credit costs at major banks and regional banks, respectively.
2. Figures calculated on a half-year basis are annualized.

Source: BOJ.

The distribution of credit cost ratios among banks showed that, at major banks, the share of those with credit costs reversed increased significantly, accounting for 90 percent of the total, and the number of banks with credit costs greater than 10 basis points became zero. For regional banks, the share of those with credit costs greater than 10 basis points continued to decrease, while there was a pause in the rise in the share of banks with credit costs reversed.

II-C-2: Credit cost ratio distribution



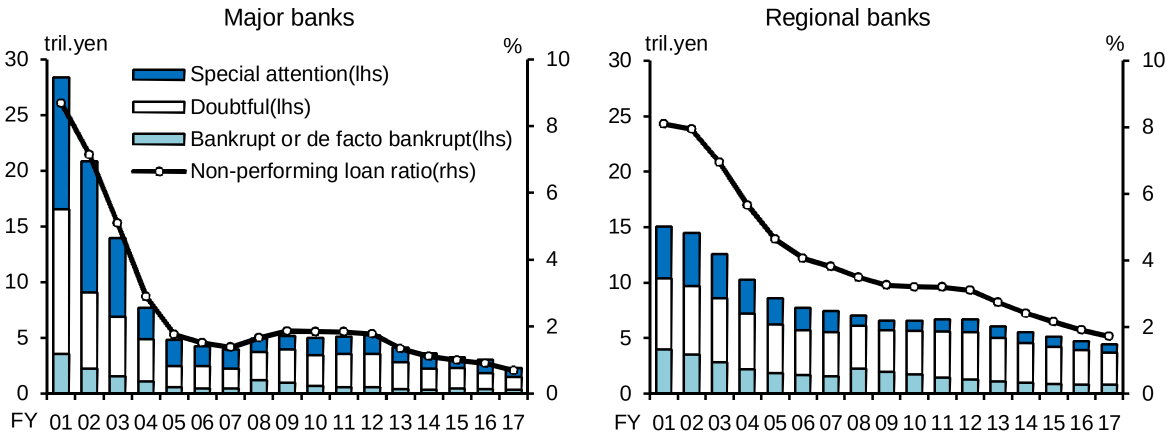
Note: Proportion of the number of banks by credit cost ratio.
Source: BOJ.

2. Non-Performing Loans

Non-performing loan (NPL) ratios continued to follow a moderate declining trend at both major banks and regional banks, and reached their lowest levels since fiscal 2001, when the relevant data were first recorded. Meanwhile, the NPL ratios for overseas loans at the three major banks remained at low levels.

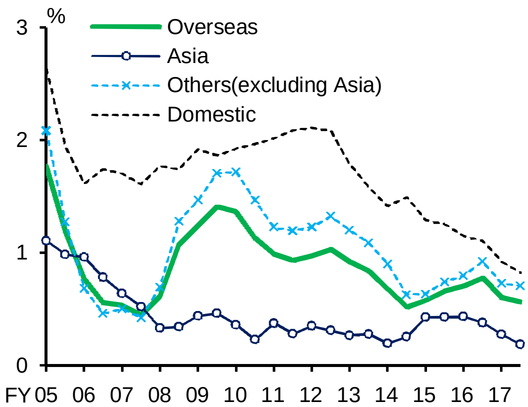
Looking at the proportion of loans outstanding by borrower classification, the ratio of normal loans at both major banks and regional banks continued to trend upward.

II-C-3: Non-performing loans outstanding and non-performing loan ratios



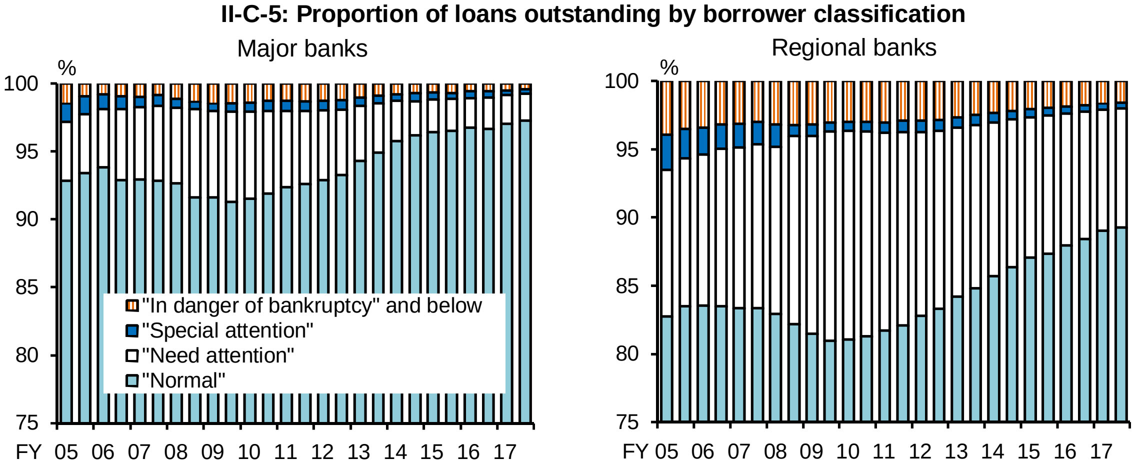
Source: BOJ.

II-C-4: Non-performing overseas loan ratios (three major banks)



Note: The data are calculated on a half-year basis.
Source: Published accounts of each bank.

II-C-5: Proportion of loans outstanding by borrower classification



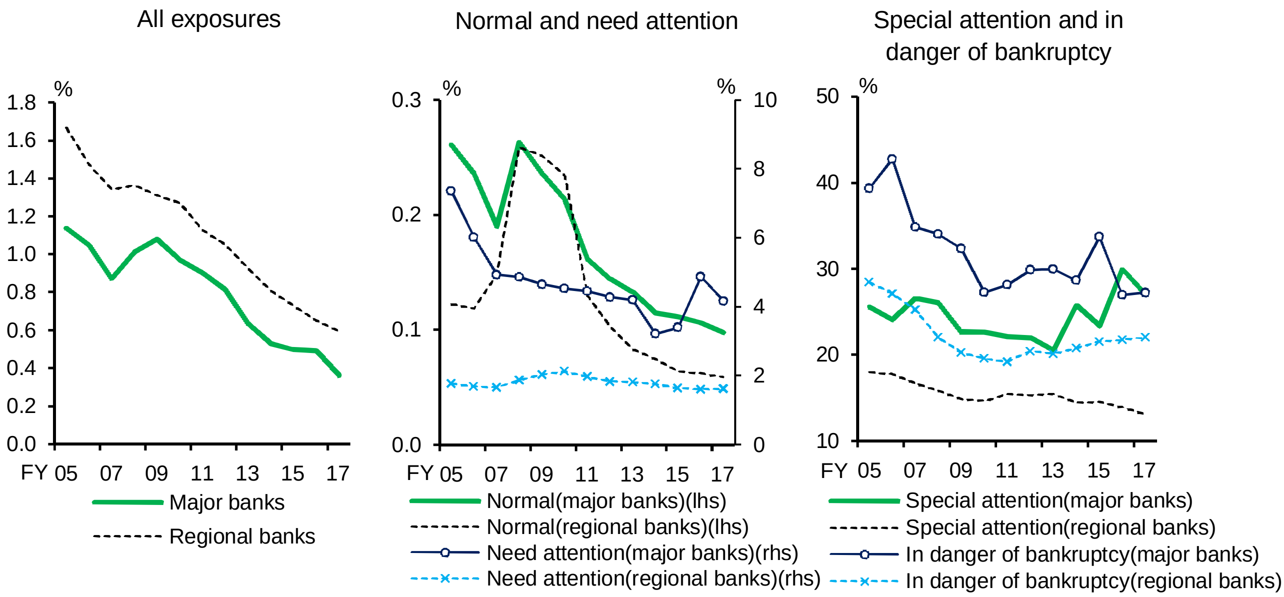
Note: The data are calculated on a write-off basis and on a half-year basis.
Source: BOJ.

3. Loan-Loss Provisions

(1) Loan-Loss Provision Ratios

The average loan-loss provision ratio for all exposures at major banks decreased somewhat significantly from the previous year due to the decline in loan-loss provisions for domestic exposures to some large companies. Such ratio at regional banks continued to decrease due to a larger proportion of normal loans with a low loan-loss provision ratio.

II-C-6: Loan-loss provision ratios

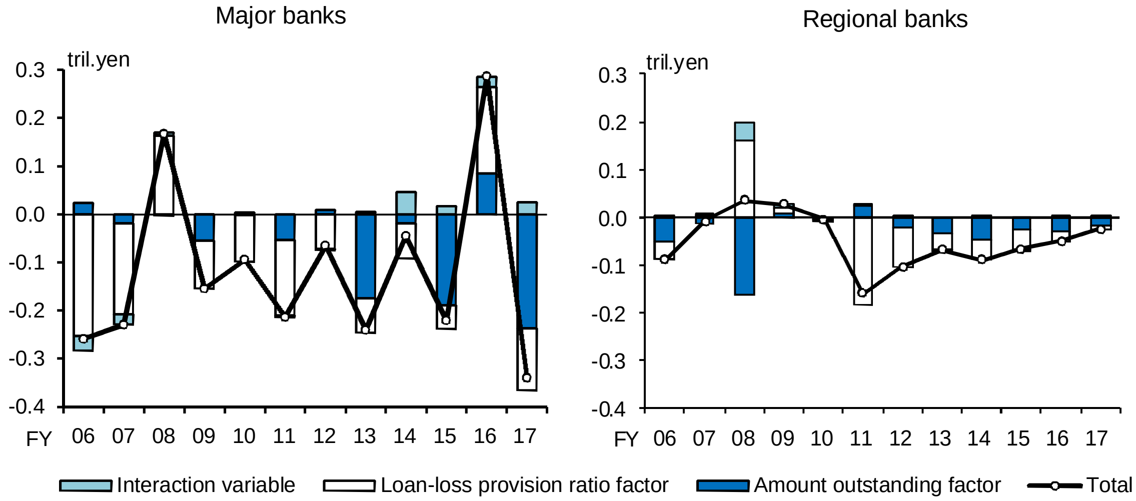


Note: 1. The data include loans to which the discounted cash flow method is applied.
2. The loan-loss provision ratio is calculated as loan-loss provisions divided by the total amount of claims (not the uncovered amount of claims).
Source: BOJ.

(2) Outstanding Amount of Loan-Loss Provisions

Looking at the outstanding amount of loan-loss provisions, general provisions declined and special provisions also continued to decrease at major banks due to the decline in loan-loss provisions for domestic exposures to some large companies and the reduction in the loans outstanding to these companies. Both general provisions and special provisions continued to follow a moderate declining trend at regional banks.

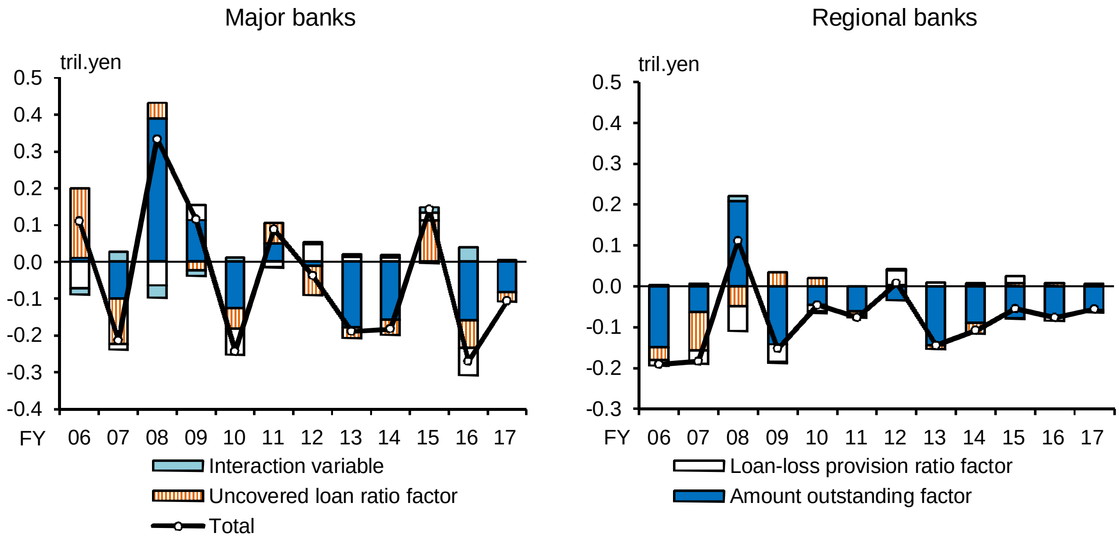
II-C-7: Factor decomposition of change in outstanding amount of general loan-loss provisions



Note: Each factor represents the sum of the amount calculated by borrower classification.

Source: BOJ.

II-C-8: Factor decomposition of change in outstanding amount of special loan-loss provisions



Note: Each factor represents the sum of the amount calculated by borrower classification.

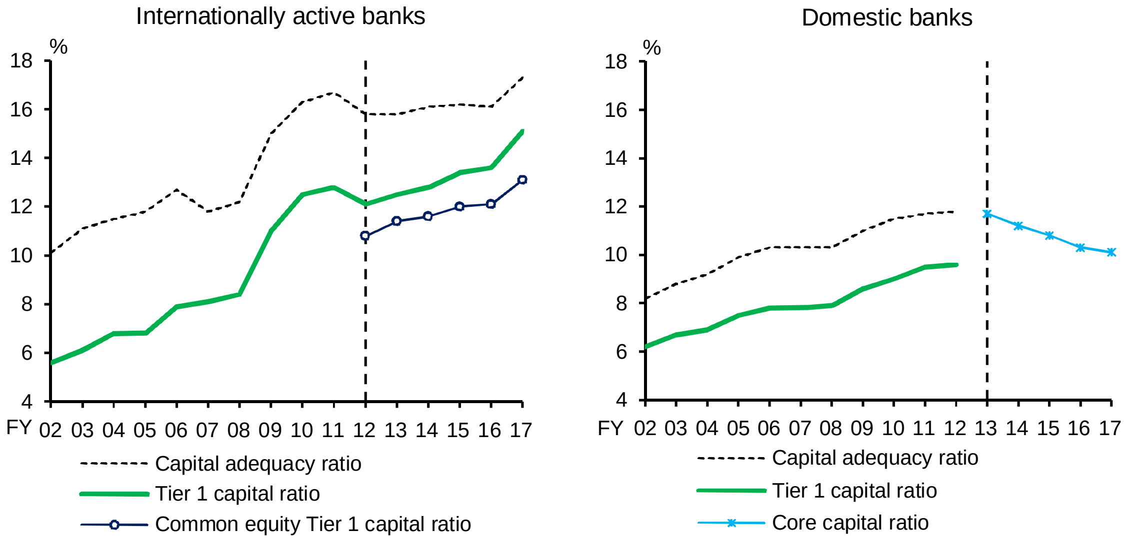
Source: BOJ.

D. Capital Adequacy Ratio

Turning to the capital adequacy ratio (on a consolidated basis), the common equity Tier 1 capital ratio (CET1 capital ratio) of internationally active banks rose further as retained earnings continued to be accumulated while risk-weighted assets decreased slightly. The capital adequacy ratio continued to rise due in part to the issuance of capital instruments that are reflected as capital base under the Basel III framework, such as additional Tier 1 perpetual subordinated bonds (AT1).

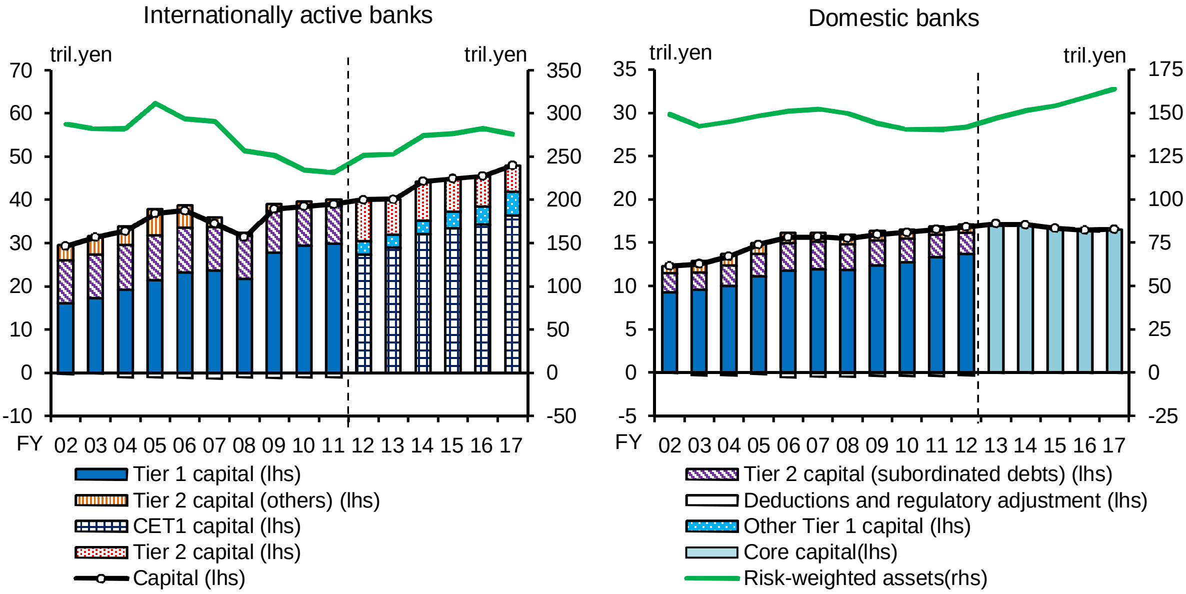
At domestic banks, the capital adequacy ratio declined slightly, as risk-weighted assets increased while the arrangements for these banks to phase in the Basel III requirements continued to be gradually removed (the proportion of instruments that can be included in capital was reduced).

II-D-1: Capital adequacy ratio



Source: BOJ.

II-D-2: Capital components and risk-weighted assets



Note: Since fiscal 2013, the numerator of the capital adequacy ratio at domestic banks is referred as "core capital" in order to distinguish the definition of "capital" in the current Financial Services Agency public notice from that in the former public notice (the same applies to Chart III-D-2).
Source: BOJ.

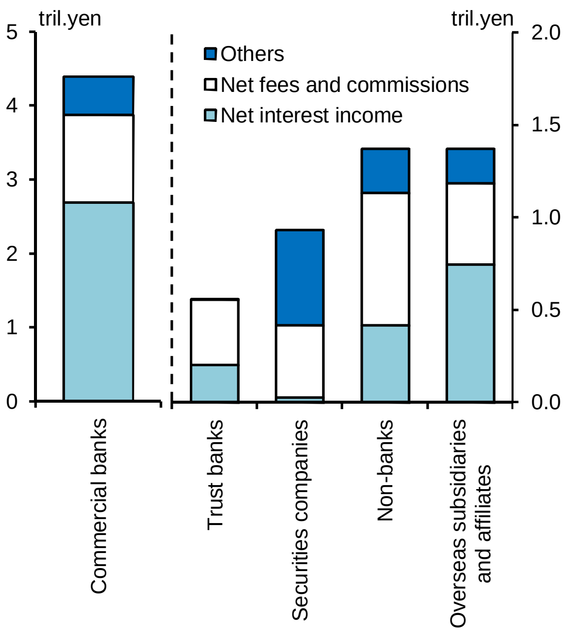
Box 1: Comparison between the consolidated and non-consolidated financial results of major banks

Looking at financial results at major financial groups, profits from group companies other than commercial banks made a large contribution, while the core profitability of commercial banks on a non-consolidated basis decreased.

In this regard, the gross operating profits of the three major financial groups by type of group company showed that profits were pushed up mainly by overseas subsidiaries and affiliates, non-banks, securities companies, and trust banks.

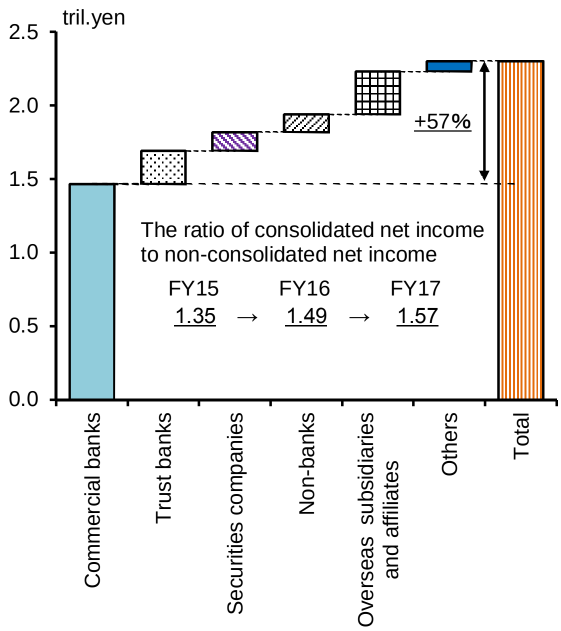
The ratio of consolidated net income to non-consolidated net income (= consolidated basis / non-consolidated basis) in financial results has continued to trend upward in recent years, marking 1.57 times for fiscal 2017.

B1-1: Gross operating profits of the three major financial groups for fiscal 2017



Source: BOJ.

B1-2: Breakdown of net income of the three major financial groups for fiscal 2017



Source: BOJ.

III. Financial Results of Japan's *Shinkin* Banks for Fiscal 2017

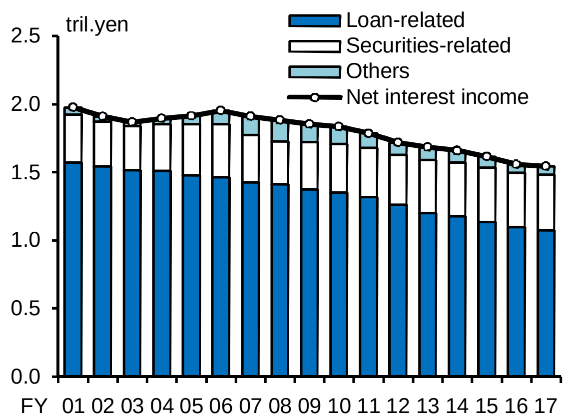
This chapter analyzes *shinkin* banks' core profitability (net interest income, net non-interest income, and general and administrative expenses), their credit costs and non-performing loans, as well as capital adequacy ratio.

A. Core Profitability

1. Net Interest Income

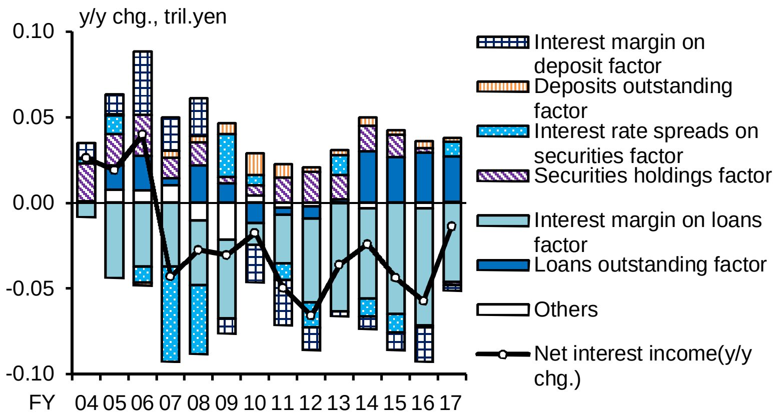
Net interest income continued to decrease as the impact of narrowing interest rate spreads on loans was larger than that of an increase in loans outstanding.

III-A-1: Net interest income



Note: 1. "Others" includes interest income on deposits at the *Shinkin* Central Bank and at the Bank of Japan.
2. Loan-related = (average loans outstanding) * (interest rate spreads on loans).
Securities-related = (average outstanding securities holdings) * (interest rate spreads on securities).
Source: BOJ.

III-A-2: Factor decomposition of change in net interest income (change from a year earlier)



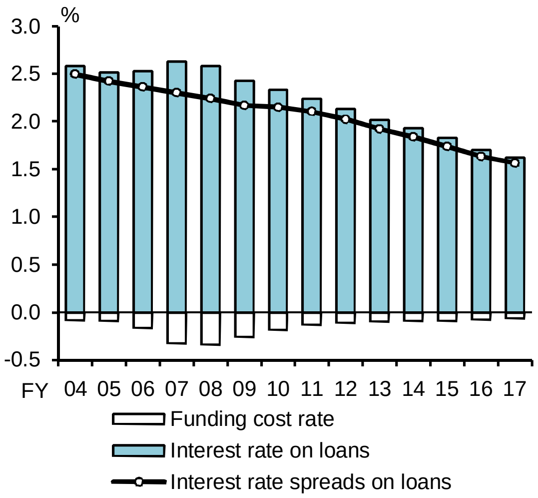
Source: BOJ.

2. Interest Rate Spreads on Loans and Loans Outstanding

(1) Interest Rate Spreads on Loans

Interest rate spreads on loans continued to narrow due to a decline in lending rates. The distribution of interest rate spreads for individual *shinkin* banks also continued to shrink on the whole.

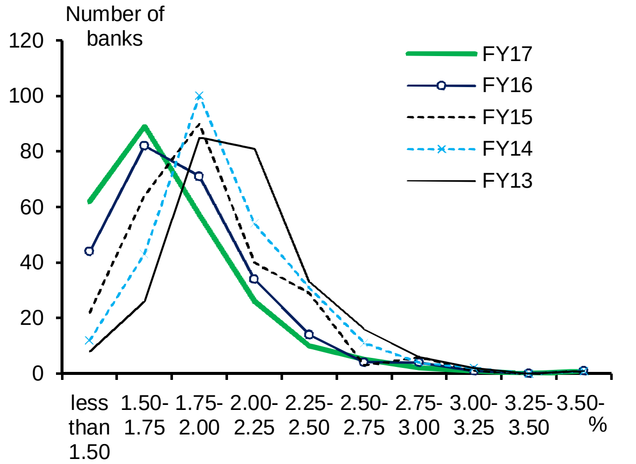
III-A-3: Interest rate spreads on loans



Note: In calculating the interest rate spreads, interest expenses on interest rate swaps are deducted from funding costs.

Source: BOJ.

III-A-4: Distribution of interest rate spreads on loans



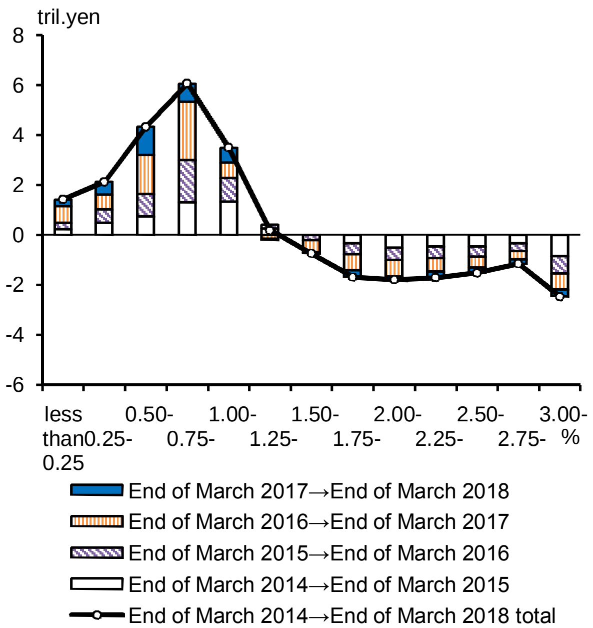
Note: In calculating the interest rate spreads, interest expenses on interest rate swaps are deducted from funding costs.

Source: BOJ.

(2) Loans Outstanding by Lending Rate

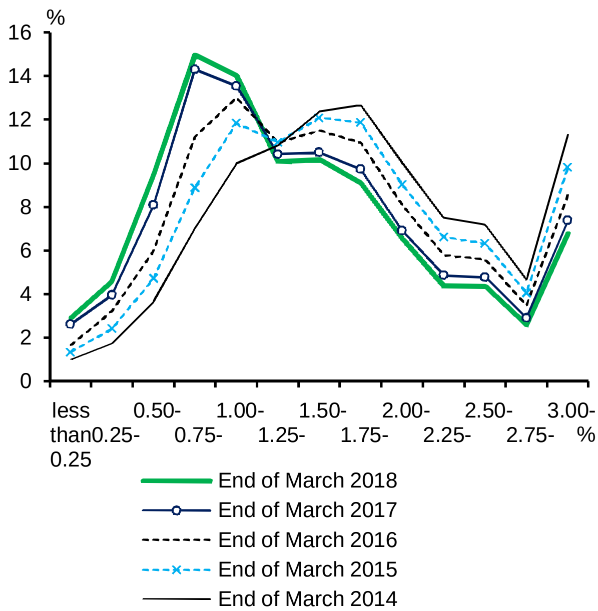
Looking at developments in loans outstanding, those with low lending rates continued to increase.

III-A-5: Changes in loans outstanding by lending rate (from the end of March 2014 to the end of March 2018)



Source: BOJ.

III-A-6: Changes in proportion of loans outstanding by lending rate (from the end of March 2014 to the end of March 2018)

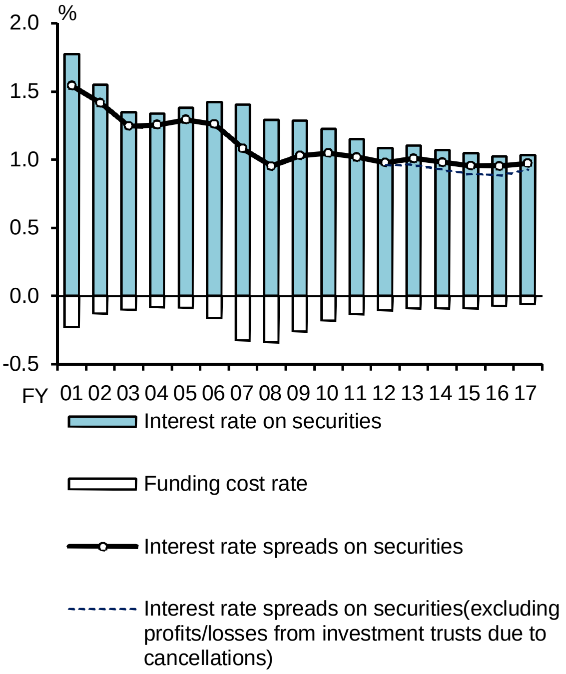


Source: BOJ.

3. Interest Rate Spreads on Securities

Interest rate spreads on securities were more or less unchanged on the whole. Although an increase in the amounts outstanding of investment trusts and foreign securities -- both of which generate relatively high yields -- contributed to an expansion of interest rate spreads, the decline in yields on domestic bonds, which account for a large portion of banks' portfolios, contributed to narrowing interest rate spreads.

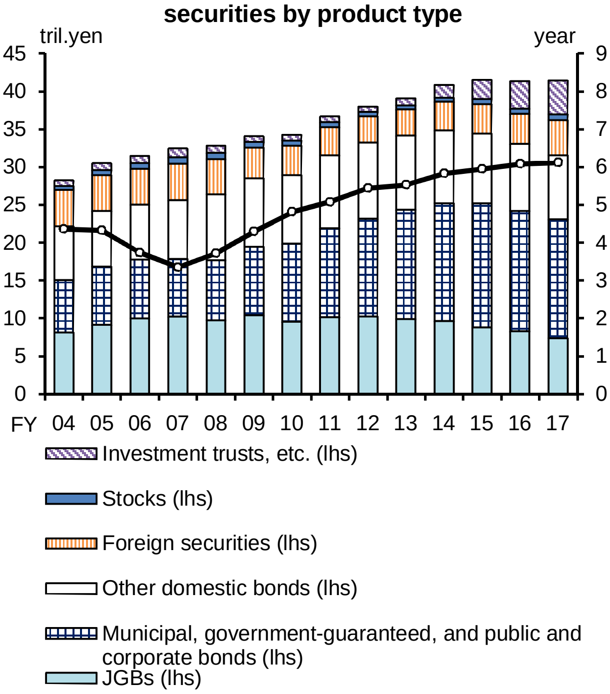
III-A-7: Interest rate spreads on securities



Note: In calculating the interest rate spreads, interest expenses on interest rate swaps are deducted from funding costs.

Source: BOJ.

III-A-8: Amounts outstanding and duration of securities by product type

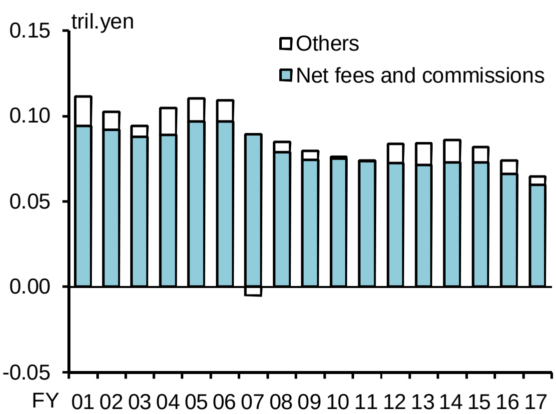


Source: BOJ.

4. Net Non-Interest Income

Net non-interest income decreased due to weakness in sales of investment trusts and insurance products.

III-A-9: Net non-interest income

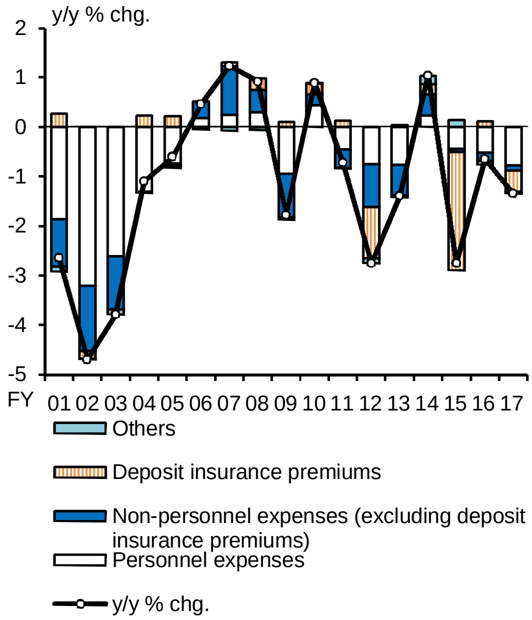


Source: BOJ.

5. General and Administrative Expenses

General and administrative expenses decreased, particularly with respect to personnel expenses.

III-A-10: Factor decomposition of change in general and administrative expenses



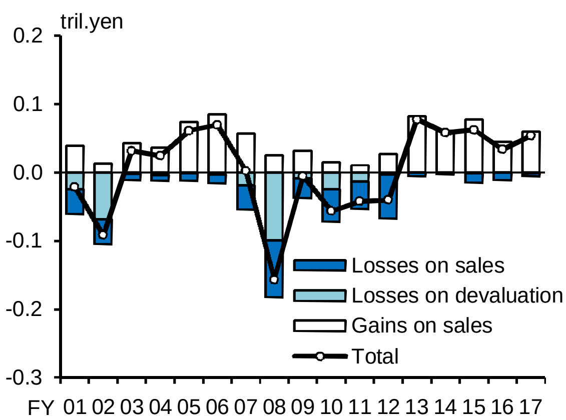
Source: BOJ.

B. Realized and Unrealized Gains/Losses on Securities Holdings

1. Realized Gains/Losses on Securities Holdings

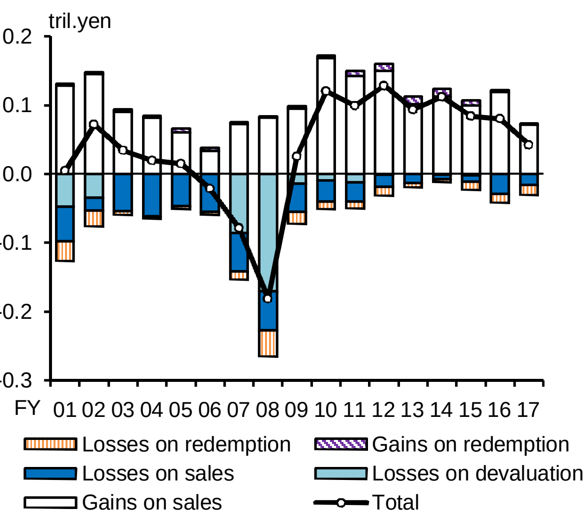
Looking at realized gains/losses on stockholdings, gains exceeded losses by a larger amount than in the previous year. For those on bondholdings, however, the extent to which gains exceeded losses was smaller than in the previous year.

III-B-1: Realized gains/losses on stockholdings



Source: BOJ.

III-B-2: Realized gains/losses on bondholdings

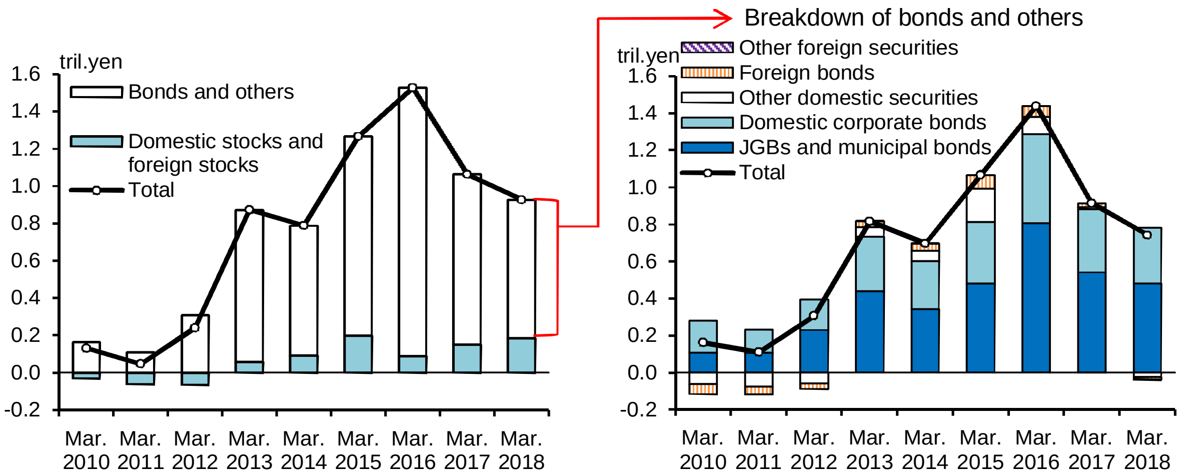


Source: BOJ.

2. Unrealized Gains/Losses on Securities Holdings

Looking at unrealized gains/losses on available-for-sale securities holdings as of the end of March 2018, the extent to which gains exceeded losses fell since that of bondholdings shrank, mainly due to a decrease in the outstanding amount of domestic bonds.

III-B-3: Unrealized gains/losses on available-for-sale securities holdings



Note: 1."Other domestic securities" and "other foreign securities" include investment trusts and funds.
2. The data are as of month-end.
Source: BOJ.

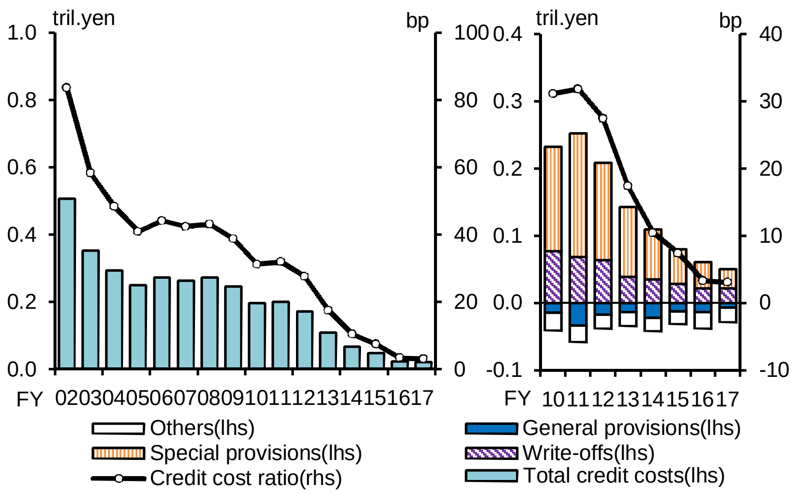
C. Credit Costs and Non-Performing Loans

1. Credit Costs

Credit costs continued to follow a declining trend and were the lowest since fiscal 2002, when the relevant data were first recorded.

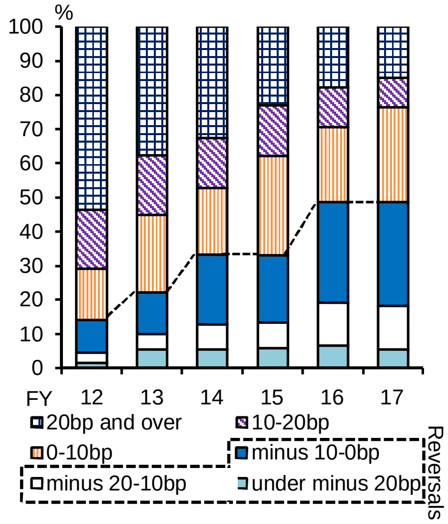
Looking at the distribution of credit cost ratios among *shinkin* banks, the share of banks with credit costs reversed was more or less unchanged, while the share of banks with credit costs greater than 10 basis points decreased.

III-C-1: Credit costs and credit cost ratio



Source: BOJ.

III-C-2: Distribution of credit cost ratios

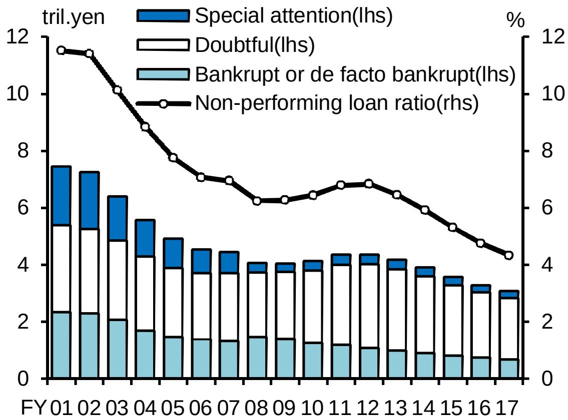


Note: Proportion of number of banks by credit cost ratio.
Source: BOJ.

2. Non-Performing Loans

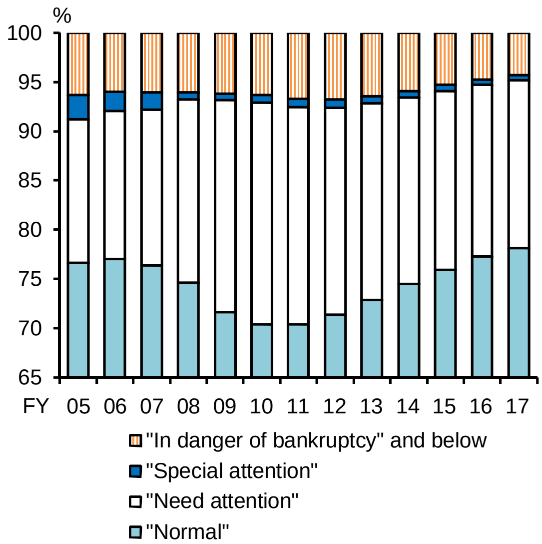
NPL ratios continued to decline moderately and reached their lowest point since fiscal 2001, when the relevant data were first recorded. The proportion of loans outstanding for normal loans continued to trend upward.

III-C-3: Non-performing loans outstanding and non-performing loan ratios



Source: BOJ.

III-C-4: Proportion of loans outstanding by borrower classification



Note: The data are calculated on a write-off basis.
Source: BOJ.

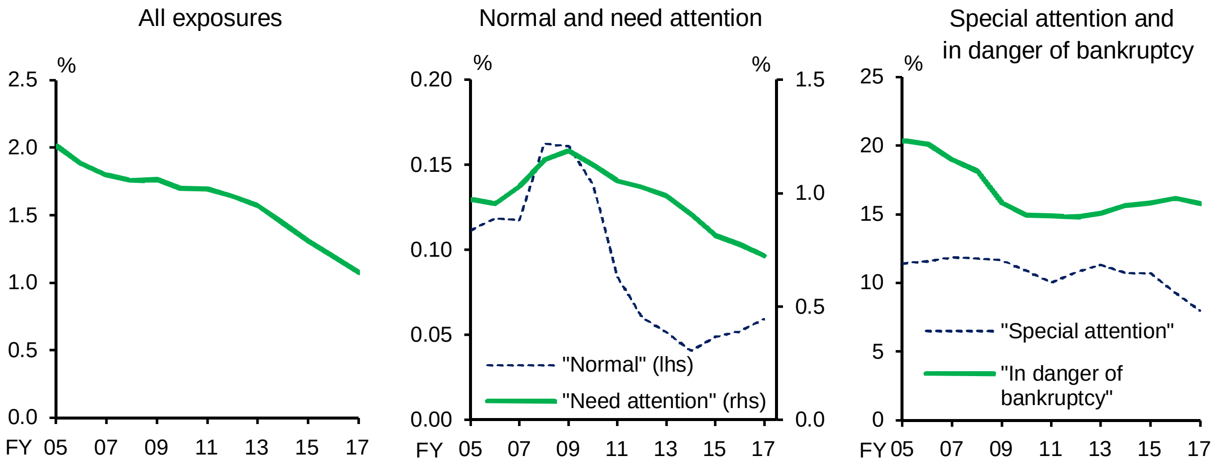
3. Loan-Loss Provisions

(1) Loan-Loss Provision Ratio

The average loan-loss provision ratio for all exposures continued to decline, mainly due to improved loan portfolio quality (an improvement in the proportion of loans outstanding by borrower classification).

Looking at loan-loss provisions by borrower classification, the loan-loss provision ratio was low in most of the borrower classifications. Factors behind this included the low number of corporate bankruptcies from a long-term perspective.

III-C-5: Loan-loss provision ratio

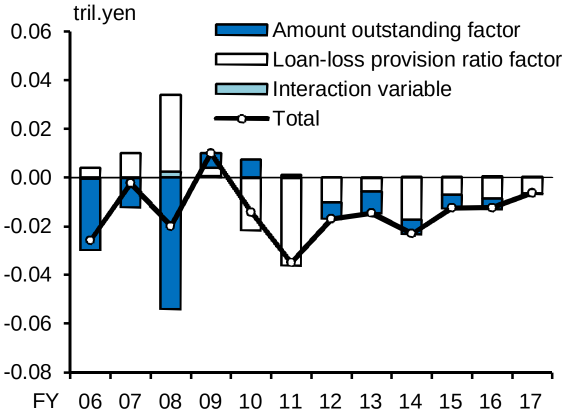


Note: 1. The data include loans to which the discounted cash flow method is applied.
2. The loan-loss provision ratio is calculated as loan-loss provisions divided by the total amount of claims (not the uncovered amount of claims).
Source: BOJ.

(2) Outstanding Amount of Loan-Loss Provisions

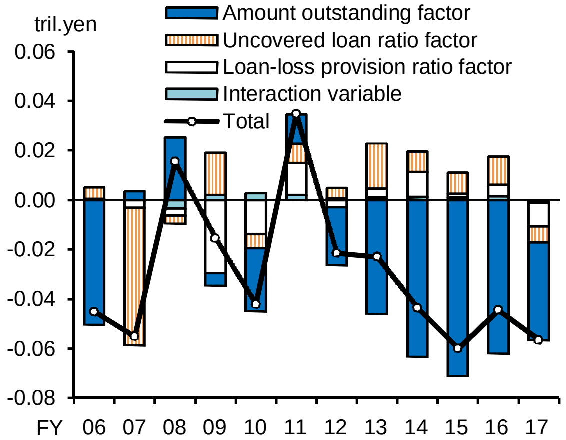
As for the outstanding amount of loan-loss provisions, general provisions decreased due to the decline in the loan-loss provision ratio for "need attention" loans. Special provisions also decreased due to declines both in the ratio of uncovered claims to all claims and the loan-loss provision ratio, in addition to the reduction in the outstanding amount of loans requiring special provisions.

III-C-6: Factor decomposition of change in the outstanding amount of general loan-loss provisions



Note: Each factor represents the sum of the amount calculated by borrower classification.
Source: BOJ.

III-C-7: Factor decomposition of change in the outstanding amount of special loan-loss provisions

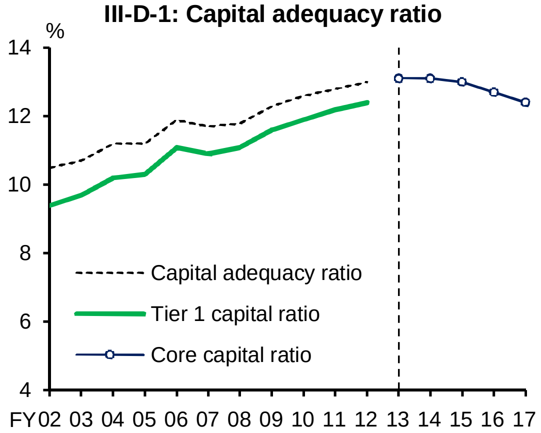


Note: Each factor represents the sum of the amount calculated by borrower classification.
Source: BOJ.

D. Capital Adequacy Ratio

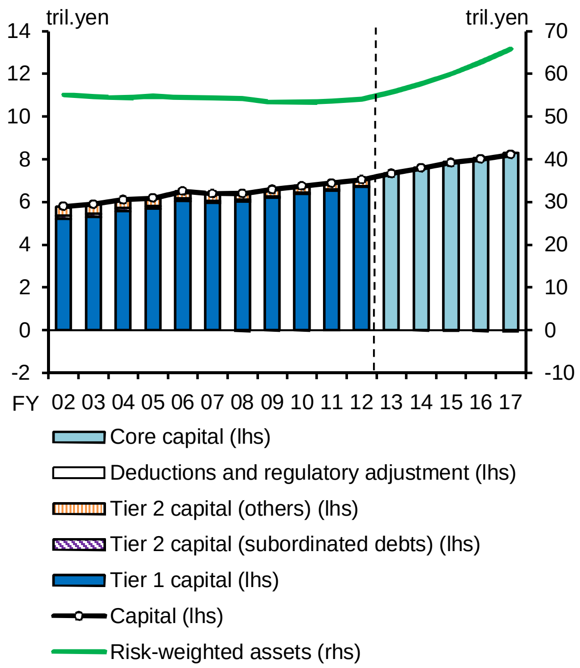
<u>The capital adequacy ratio</u> decreased slightly. While the amount of capital increased, mainly due to the accumulation of retained earnings, risk-weighted assets also increased.

III-D-1: Capital adequacy ratio



Source: BOJ.

III-D-2: Capital components and risk-weighted assets



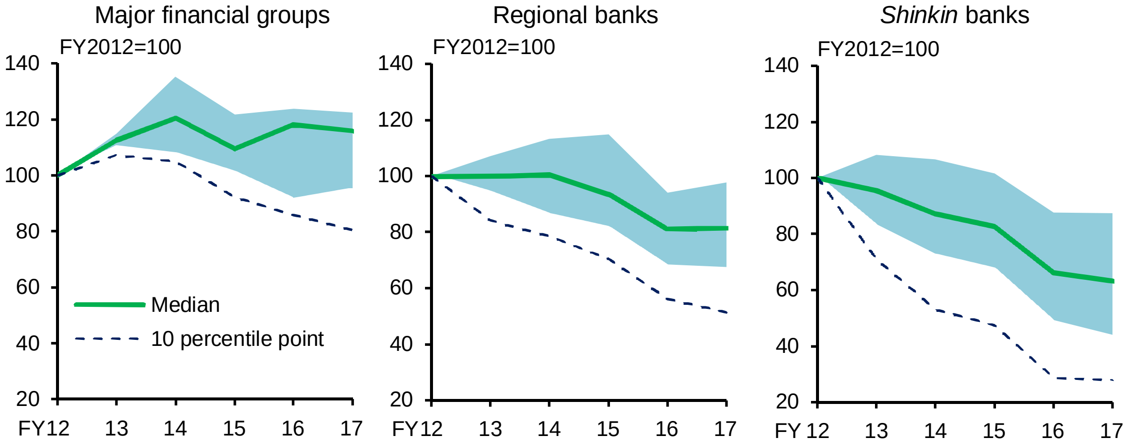
Source: BOJ.

Box 2: Heterogeneity in core profitability among regional financial institutions

Regional banks and *shinkin* banks, both of which are highly dependent on net interest income from deposits and lending in the domestic business sector, have demonstrated increasing heterogeneity in core profitability among financial institutions.

Looking at factors behind changes in PPNR (excluding trading income) according to the difference in core profitability, profits at banks with relatively low core profitability were diminished by the large negative contributions of lower lending rates and smaller interests on securities, despite the increase in loans outstanding.

B2-1: Heterogeneity in PPNR (excluding trading income)

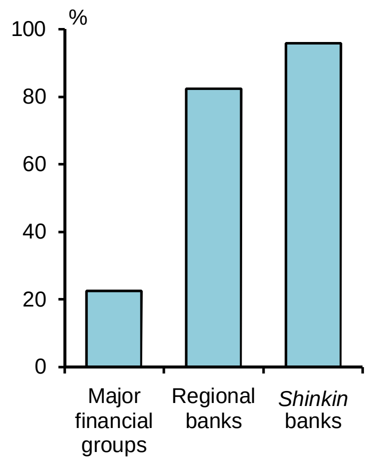


Note: 1. Shaded areas indicate the 25-75 percentile range.

2. PPNR (excluding trading income) at major financial groups = gross operating profits - general and administrative expenses + profits/losses on investments in affiliates - realized gains/losses on bondholdings on a non-consolidated basis.

Source: BOJ.

B2-2: Proportion of domestic net interest income in gross operating profits from core business

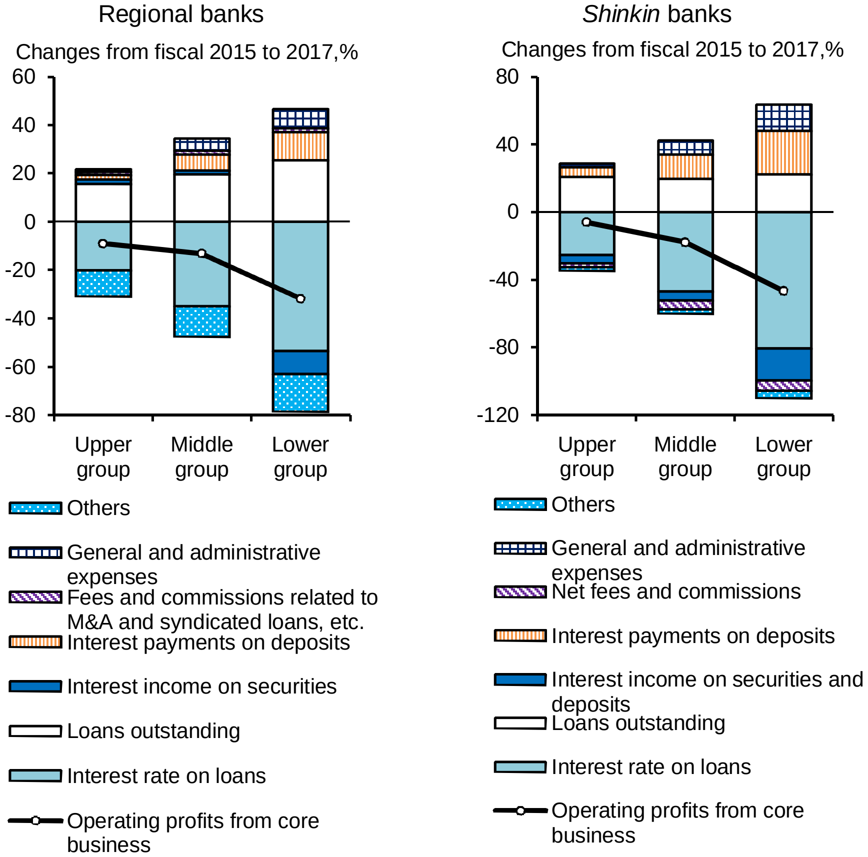


Note: 1. Gross operating profits from core business = gross operating profits - realized gains/losses on bondholdings.

2. Domestic net interest income at major financial groups is on a non-consolidated basis.

Source: BOJ.

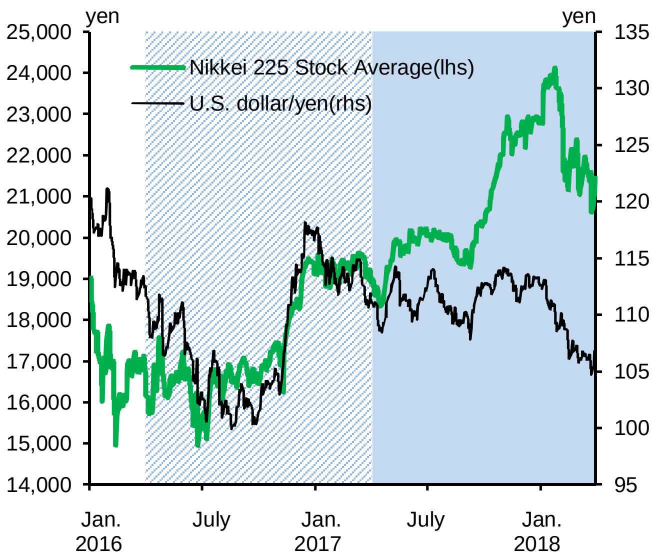
B2-3: Factors behind changes in PPNR (excluding trading income) by core profitability



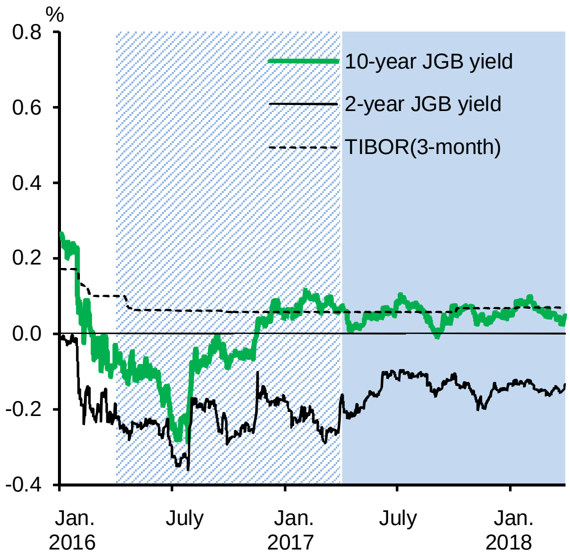
Note: Three groups (upper group, middle group, and lower group) are ordered from top to bottom based on trisection of ROA calculated using PPNR excluding trading income for fiscal 2017. PPNR (excluding trading income) exclude profits/losses from investment trusts due to cancellations.
Source: BOJ.

Reference: Developments in Financial Markets

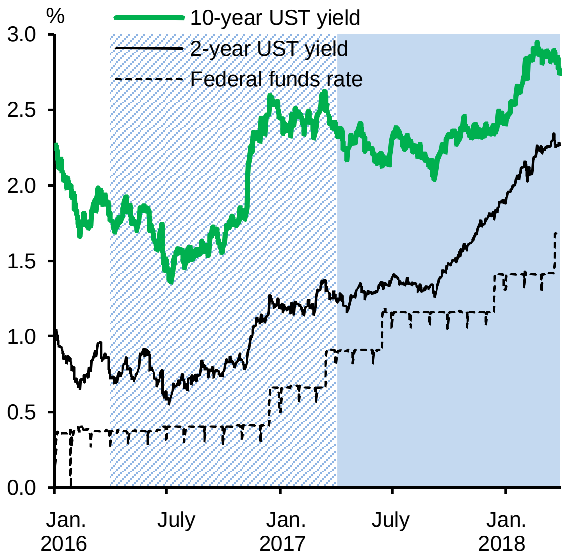
▽ Nikkei 225 Stock Average and foreign exchange rates



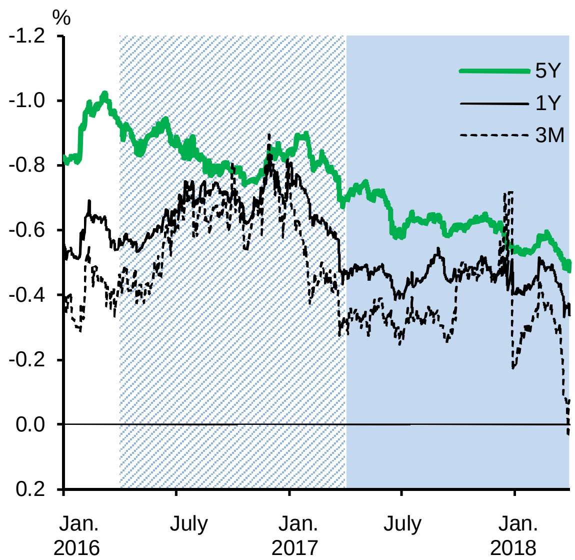
▽ JGB yields, etc.



▽ U.S. treasury yields, etc.



▽ U.S. dollar funding premiums



Note: 1. Latest data as at end-March 2018. U.S. dollar funding premiums indicate the additional interest costs on U.S. dollar LIBOR in financing U.S. dollar funds collateralized by yen funds. 3M dollar funding premiums, which are expressed in opposite signs, show U.S. dollar funding costs on U.S. dollar LIBOR spreads through currency and foreign exchange swaps. Both 1Y and 5Y dollar funding premiums are U.S. dollar/yen cross-currency basis swaps.

2. The lightly shaded areas show the data in fiscal 2016. The darker shaded areas show the data in fiscal 2017.

Source: Bloomberg.

Glossary

Financial statements of financial institutions

Net income = operating profits from core business + realized gains/losses on stockholdings + realized gains/losses on bondholdings – credit costs ± others (such as extraordinary gains/losses)

Operating profits from core business = pre-provision net revenue (PPNR) (excluding trading income) = net interest income + net non-interest income – general and administrative expenses

Net interest income = interest income – interest expenses

Net non-interest income = net fees and commissions + profits on specified transactions + other operating profits – realized gains/losses on bondholdings

Realized gains/losses on stockholdings = gains on sales of stocks – losses on sales of stocks – losses on devaluation of stocks

Realized gains/losses on bondholdings = gains on sales of bonds + gains on redemption of bonds – losses on sales of bonds – losses on redemption of bonds – losses on devaluation of bonds

Credit costs = loan-loss provisions + write-offs + losses on credit sales – recoveries of write-offs

Credit cost ratio = credit costs / total loans outstanding

Capital adequacy ratios of internationally active banks

Common equity Tier 1 (CET1) capital ratio = CET1 capital / risky assets

CET1 capital comprises common equities and retained earnings.

Risky assets are financial institutions' risk-weighted assets.

Tier 1 capital ratio = Tier 1 capital / risky assets

Tier 1 capital includes CET1 capital and equities such as preferred equities that meet certain conditions.

Total capital adequacy ratio = Total capital / risky assets

Total capital includes Tier 1 capital and subordinated bonds that meet certain conditions.

Capital adequacy ratios of domestic banks

Core capital ratio = core capital / risky assets

Core capital includes common equities and retained earnings as well as equities such as preferred equities that meet certain conditions.

Risky assets are financial institutions' risk-weighted assets.