BOJ Reports & Research Papers

Financial System Report Annex Series

FSR - A
Financial System Report - Annex

Financial Results of Japan's Banks for Fiscal 2015

FINANCIAL SYSTEM AND BANK EXAMINATION DEPARTMENT
BANK OF JAPAN
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The total of 10 major banks, 105 regional banks, and 256 *shinkin* banks covered in this *Report* is as follows (as of March 31, 2016).

The 10 major banks comprise Mizuho Bank, The Bank of Tokyo-Mitsubishi UFJ, 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. The 105 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). The 256 *shinkin* banks are the *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 the communication of financial stability issues with concerned parties. 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 2015.

Abstract

The characteristics of the financial results of Japan's banks for fiscal 2015 are summarized as follows.

First, net income remained at high levels for all types of banks: major banks, regional banks, and *shinkin* banks. Although net interest income and net non-interest income decreased, realized gains from sales of securities such as domestic and foreign bonds, ETFs, equity investment trusts, and strategic stockholdings, and institutional factors including the deposit insurance premium rate cut contributed to a rise in profits.

Second, operating profits from core business, which show core profitability, decreased for all types of banks. Factors behind this included a reduction in interest rate spreads on domestic loans, a decline in fees and commissions associated with sales of financial instruments such as investment trusts, and a decrease in major banks' net interest income from the international business sector, mainly due to a rise in foreign currency funding costs.

Third, financial institutions have maintained their financial soundness. Credit costs still remained low at major banks, albeit with a slight increase, mainly in overseas exposure to the commodity sector, and continued to decline at regional banks. In addition, the amount of capital increased, mainly at major banks, due to the accumulation of retained earnings.

Contents

III. Financial Results of Japan's *Shinkin* Banks for Fiscal 2015

A. Core Profitability

1. Net Interest Income

2. Interest Rate Spreads on Loans and Loans Outstanding

3. Interest Rate Spreads on Securities

4. Net Non-Interest Income

5. General and Administrative Expenses

Box 4: Developments in core profitability of regional financial institutions

B. Realized and Unrealized Gains/Losses on Securities Holdings

1. Realized Gains/Losses on Securities Holdings

2. Unrealized Gains/Losses on Securities Holdings

C. Credit Costs and Non-Performing Loans

1. Credit Costs

2. Non-Performing Loans

3. Loan-Loss Provisions

D. Capital Adequacy Ratio

I. Outline of Financial Results of Japan's Banks for Fiscal 2015[1]

A. Profits and Losses

Net income for fiscal 2015 at major banks was about 2.3 trillion yen, almost flat from the previous year's level (up by 0.4 percent). Although operating profits from core business declined, mainly due to a decrease in net interest income, and credit costs increased (a rise in costs following the increase in reversals in the previous year), a rise in realized gains on securities holdings and other factors contributed to pushing up net income.

Net income for fiscal 2015 at regional banks was about 1.1 trillion yen, up by around 10 percent from the previous year. Although operating profits from core business declined slightly, a lift in realized gains on stockholdings contributed to pushing up net income.

Net income for fiscal 2015 at *shinkin* banks was about 0.3 trillion yen, down by around 2 percent from the previous year. Although credit costs declined, a reduction in operating profits from core business, mainly due to a decrease in net interest income, as well as a reduction in realized gains on bondholdings contributed to the decline in net income.

As for major banks and regional banks, in addition to the deposit insurance premium rate cut, which pushed down general and administrative expenses, a decline in tax-related expenses that was mainly due to the corporate tax rate cut contributed to pushing up net income levels.

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

I-A-1: Main profit and loss items

100 mil.yen

	Major banks		Regional banks		*Shinkin* banks	
	FY 2015	y/y chg.	FY2015	y/y chg.	FY2015	y/y chg.
Net interest income	39,285	▲ 3,183	38,762	▲ 359	16,154	▲ 438
Net non-interest income	23,724	▲ 168	6,001	▲ 208	819	▲ 41
General and administrative expenses	36,707	▲ 464	30,189	▲ 400	13,448	▲ 381
Operating profits from core business	26,302	▲ 2,882	14,574	▲ 167	3,525	▲ 98
Realized gains/losses on bondholdings	4,259	＋ 993	704	▲ 148	839	▲ 280
Realized gains/losses on stockholdings	3,127	＋ 433	1,586	＋ 434	626	＋ 45
Credit costs (Credit cost ratio)	1,419 (5bp)	＋ 1,947 (+7bp)	486 (2bp)	▲ 15 (▲0bp)	488 (7bp)	▲ 192 (▲3bp)
Others	▲ 976	＋ 1,696	175	＋ 300	▲ 136	＋ 3
Net income before income taxes	31,293	▲ 1,708	16,554	＋ 433	4,366	▲ 138
Tax-related expenses	8,750	▲ 1,792	5,226	▲ 617	1,041	▲ 74
Net income **<y/y % chg.>**	22,543	＋ 85 <+0.4%>	11,327	＋ 1,050 <+10.2%>	3,325	▲ 64 <▲1.9%>

Note: *1.* Regarding credit costs, positive numbers represent a rise in costs while negative numbers represent an increase in reversals.

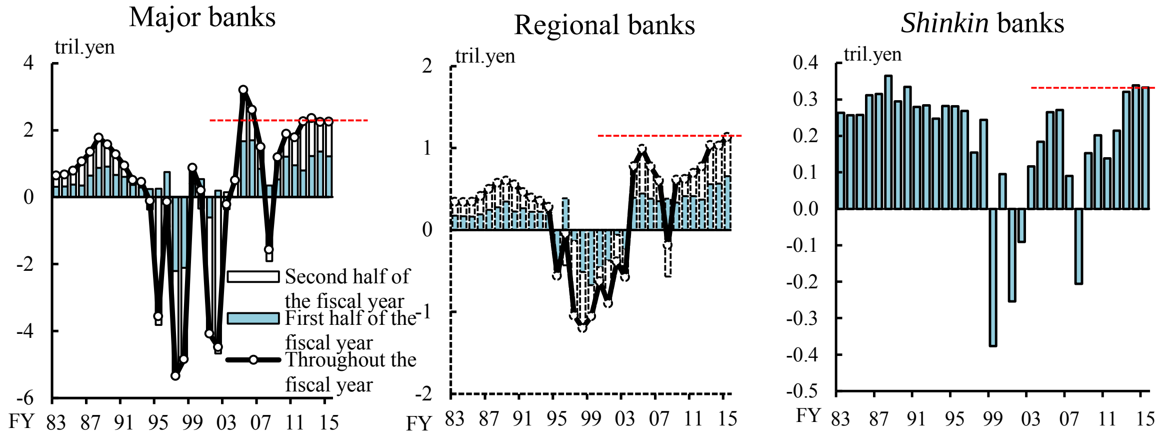
B. Profit Levels from a Long-Term Perspective

Net income for fiscal 2015 was maintained at high levels for all types of banks. It was the 5th highest figure recorded at major banks, the highest at regional banks, and the 4th highest at *shinkin* banks since fiscal 1983.[2]

In the meantime, with regard to major banks, operating profits from core business, which show core profitability, declined in fiscal 2015 for the first time in four years. Factors behind this included a continued decline in domestic net interest income and a decline in net interest income from the international business sector, which had continued to expand. With regard to regional banks and *shinkin* banks, operating profits from core business continued to follow a declining trend. Looking at developments on a half-year basis, they declined in the second half of fiscal 2015 at both major banks and regional banks after showing solid growth in the first half of fiscal 2015.

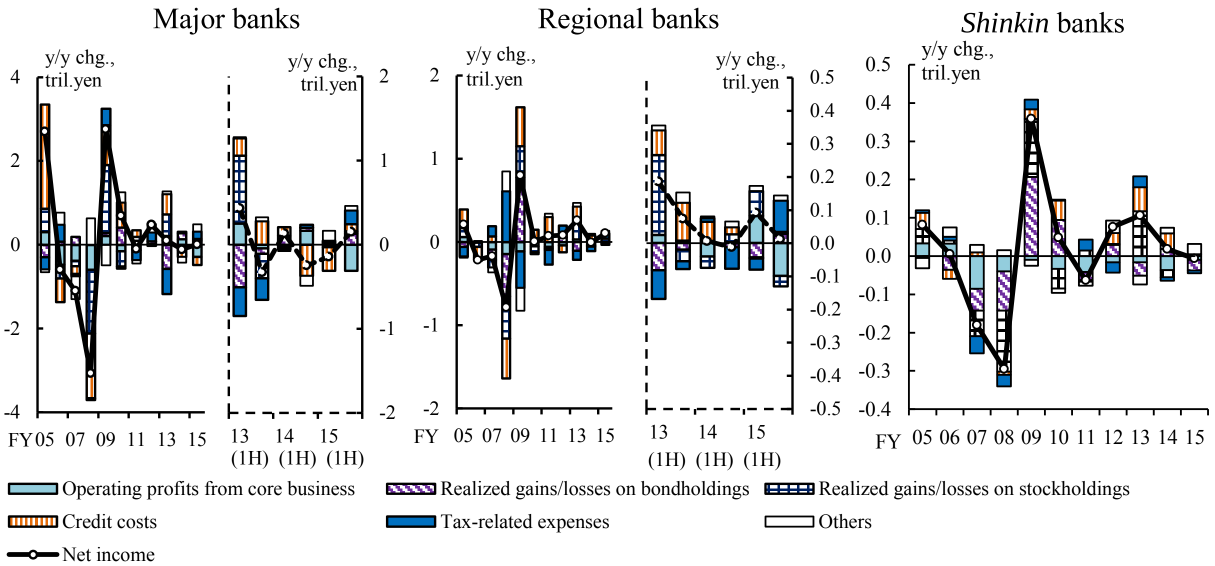
2 In this paper, financial statement items are analyzed using time series data (the longest times series data begin from fiscal 1983).

I-B-1: Net income/losses

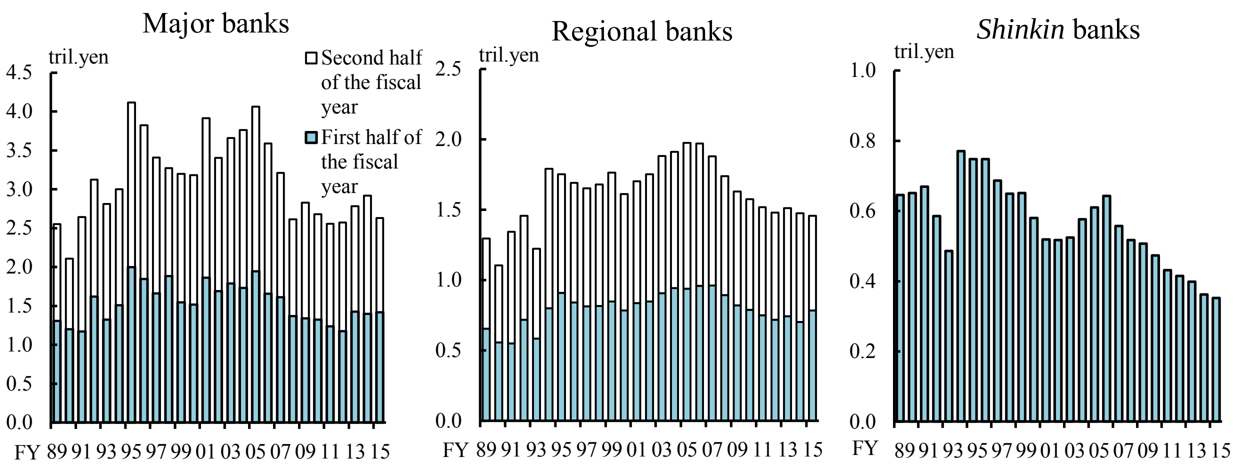


Note: *1.* Dotted lines show the net income level for fiscal 2015.

I-B-2: Factor decomposition of change in net income/losses (change from a year earlier)



I-B-3: Operating profits from core business



C. Balance Sheets

Looking at developments in balance sheets for fiscal 2015 among major banks, while securities, mainly consisting of Japanese government bonds (JGBs), and stocks decreased on the asset side, cash and due from banks including current account balances at the Bank of Japan and loans in the international business sector increased. On the liability side, while borrowing from the Bank of Japan and market funding such as repos decreased, deposits increased.

Turning to developments in the second half of fiscal 2015, the increase in loans in the international business sector became more gradual on the asset side relative to the first half of fiscal 2015. On the other hand, securities other than JGBs, mainly foreign securities, increased. On the liability side, the rate of increase in domestic business sector deposits rose.

I-C-1: Main balance sheet items

Major banks

tril.yen

	End of FY2016	y/y chg.	Change from Sep. 2015		End of FY2016	y/y chg.	Change from Sep. 2015
Loans and bills discounted	302.4	+6.7	+2.8	Deposits + NCD	464.2	+17.8	+11.6
Domestic business sector	209.9	+1.5	+1.8	Domestic business sector	369.5	+14.5	+11.4
International business Sector	92.4	+5.3	+1.0	International business Sector	94.7	+3.3	+0.2
Securities	144.0	▲ 13.2	▲ 1.7	Loans from BoJ	21.6	▲ 1.9	▲ 2.2
JGBs	61.7	▲ 14.9	▲ 7.3	Other liabilities	151.5	+3.2	+1.4
Cash and due from banks	142.4	+22.2	+5.6	Total liabilities	637.2	+19.1	+10.9
Other assets	82.1	+3.2	+5.2	Total net assets	33.6	▲ 0.2	+1.1
Total assets	670.9	+18.9	+11.9	Net unrealized gains/losses on securities	5.7	▲ 1.4	+0.1

With regard to regional banks, while loans increased, securities (mainly JGBs) decreased. In the second half of fiscal 2015, however, securities excluding JGBs -- mainly investment trusts and foreign securities -- increased relative to the first half of fiscal 2015.

Regional banks

tril.yen

	End of FY2016	y/y chg.	Change from Sep. 2015		End of FY2016	y/y chg.	Change from Sep. 2015
Loans and bills discounted	235.0	+8.1	+5.2	Deposits	313.1	+6.1	+6.2
Securities	95.8	▲ 3.7	+1.0	NCD	11.4	▲ 0.2	▲ 1.9
JGBs	36.1	▲ 4.5	▲ 1.3	Other liabilities	24.3	+0.5	+0.4
Cash and due from banks	29.4	+2.5	▲ 1.0	Total liabilities	348.9	+6.3	+4.8
Other assets	9.8	▲ 0.3	+0.1	Total net assets	21.1	+0.3	+0.5
Total assets	370.0	+6.6	+5.3	Net unrealized gains/losses on securities	3.8	▲ 0.5	+0.3

With regard to *shinkin* banks, both loans and securities increased slightly.

Shinkin banks

tril.yen

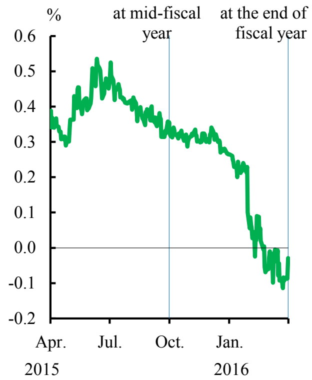
	End of FY2016	y/y chg.		End of FY2016	y/y chg.
Loans and bills discounted	67.0	+ 1.5	Deposits	134.0	+ 2.8
Securities	43.0	+ 0.9	NCD	0.1	+ 0.0
JGBs	9.3	▲ 0.6	Other liabilities	3.7	+ 0.5
Cash and due from banks	33.9	+ 1.3	Total liabilities	137.8	+ 3.3
Other assets	2.8	+ 0.1	Total net assets	8.9	+ 0.5
Total assets	146.7	+ 3.8	Net unrealized gains/losses on securities	1.1	+ 0.2

I-C-2: Developments in financial markets during fiscal 2015

Nikkei 225

Foreign exchange rates

Long-term interest rates



Source: Bloomberg.

II. Financial Results of Japan's Major Banks and Regional Banks for Fiscal 2015

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

A. Core Profitability

1. Net Interest Income

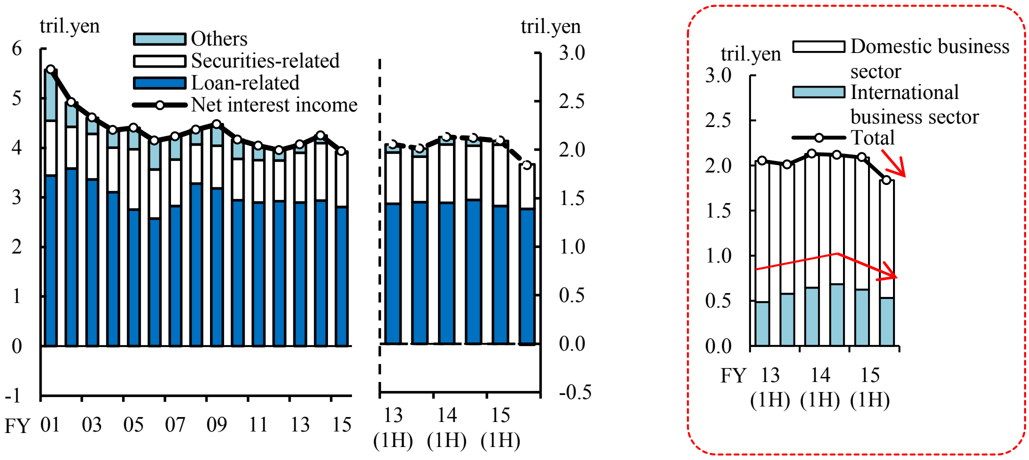
Net interest income at major banks for fiscal 2015 decreased as a whole for the first time in three years: it continued to decline in the domestic business sector and fell in the international business sector for the first time in four years. In addition to a continued decline in interest rate spreads on loans, a reduction in spreads on securities in the second half of fiscal 2015, mainly because of lower profits from investment trusts due to cancellations, affected the decline in net interest income.

In the international business sector, net interest income began to fall slightly in the first half of fiscal 2015 and declined further in the second half of fiscal 2015. This reflected a decline in interest rate spreads on both loans and securities, mainly due to an increase in foreign currency funding costs.

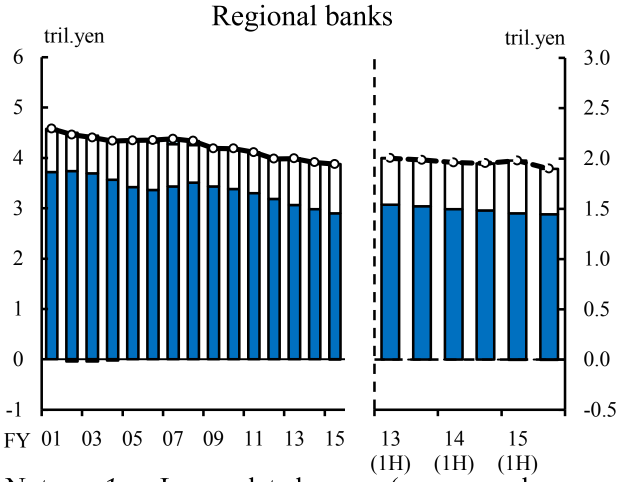
On the other hand, the rate of decrease in net interest income at regional banks for fiscal 2015 slowed slightly due to an improvement in interest rate spreads on securities (increases in profits from investment trusts due to cancellations and in stock dividends), although the impact of reduced interest rate spreads on loans has been greater than the effect of higher loans outstanding.

II-A-1: Net interest income

Major banks

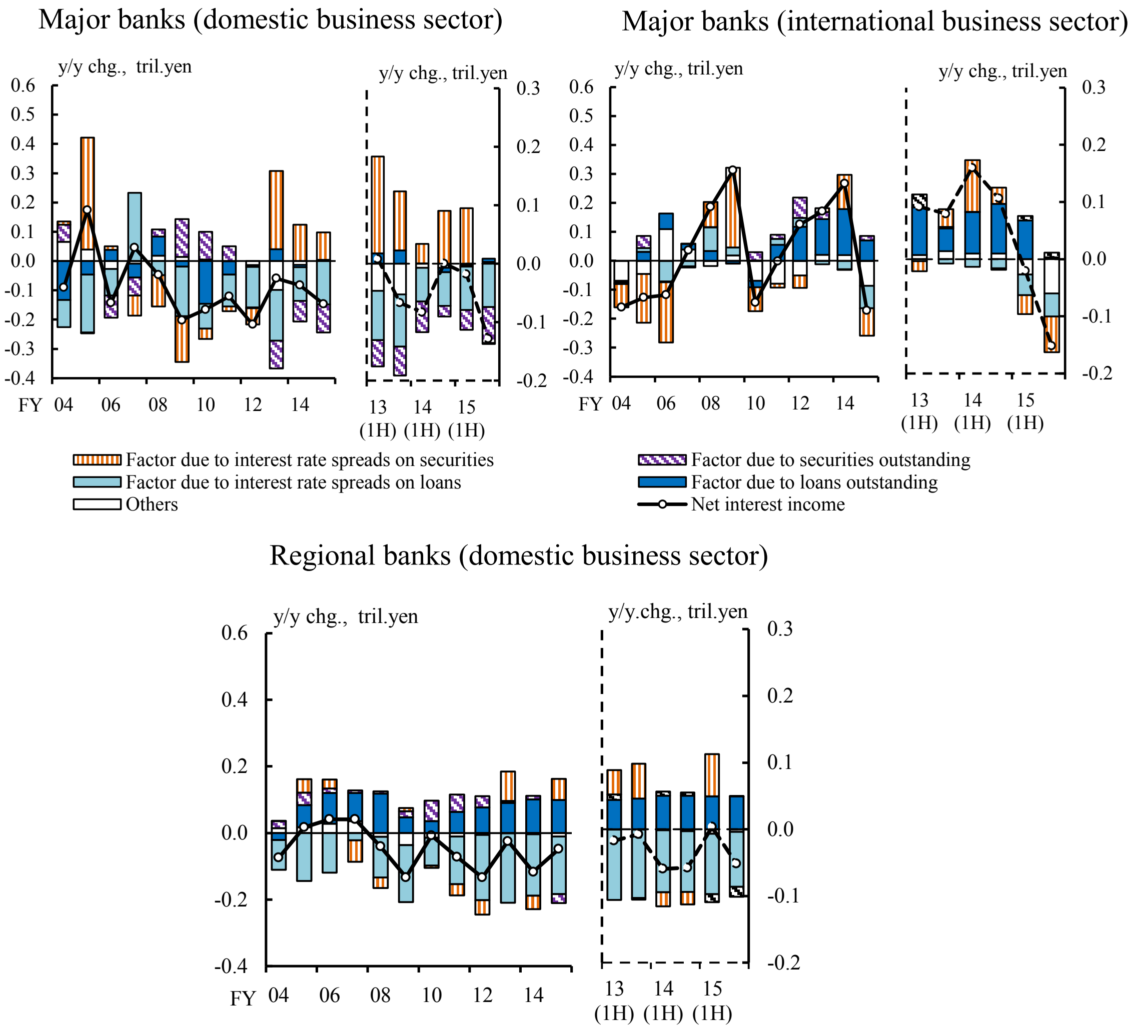


Regional banks



Note: *1.* Loan-related = (average loans outstanding) * (interest rate spreads on loans). Securities-related = (average outstanding securities holdings) * (interest rate spreads on securities).

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

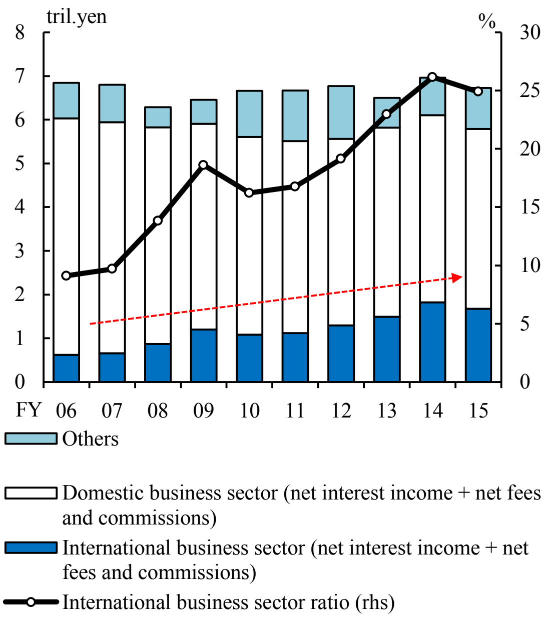


Box 1: Developments in major banks' foreign net interest income

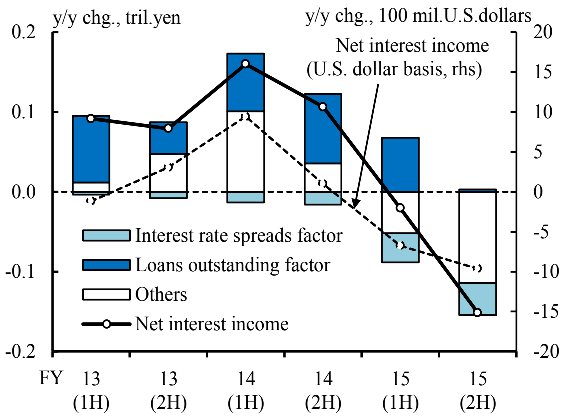
The international business sector has been a driver of profit growth at major banks in recent years, but net interest income in this sector declined from the previous year for the first time in four years in fiscal 2015 (while the effect of calculations due to appreciation of the Japanese yen had some impact, net interest income also declined when measured in U.S. dollars).

Factors behind the fall in net interest income included (i) a reduction in interest rate spreads, mainly due to a rise in U.S. dollar funding premiums and the hike in U.S. short-term interest rates; (ii) a change in one major bank's securities investment stance; and (iii) a slowdown in the rate at which loans outstanding increased on a Japanese yen basis.

B1-1: Developments in major banks' gross profits



B1-2: Change in major banks' foreign net interest income (change from a year earlier)



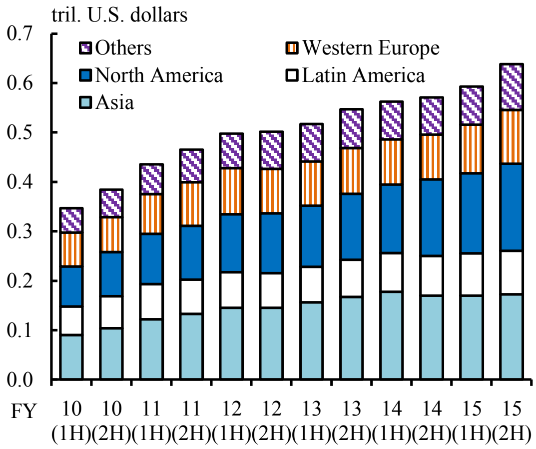
Notes:
1. The data are calculated on a half-year basis.
2. Figures are converted to Japanese yen using exchange rates as of the end of each fiscal year.

B1-3: Major banks' foreign interest rate spreads

		FY14	FY15	y/y chg.
Interest rate spreads on loans		103bps	95bps	▲ 8bps
	Interest rate on loans	157bps	156bps	▲ 1bps
	Funding cost rate	▲ 54bps	▲ 61bps	▲ 6bps
Interest rate spreads on securities		103bps	82bps	▲ 20bps
	Interest rate on securities	157bps	143bps	▲ 14bps
	Funding cost rate	▲ 54bps	▲ 61bps	▲ 6bps

Notes:
1. The funding cost rate is shown by using negative numbers. For the sake of convenience, the same figures are used for both loans and securities.
2. In calculating the funding cost rate, interest expenses on interest rate swaps are deducted from costs.

B1-4: Foreign loans outstanding among three mega-banks



Notes:
1. The data are calculated on a half-year basis.
2. Figures are converted to Japanese yen using exchange rates as of the end of each fiscal year.
3. The data are calculated on a borrowers' location basis.

Source: Financial results disclosed by individual banks.

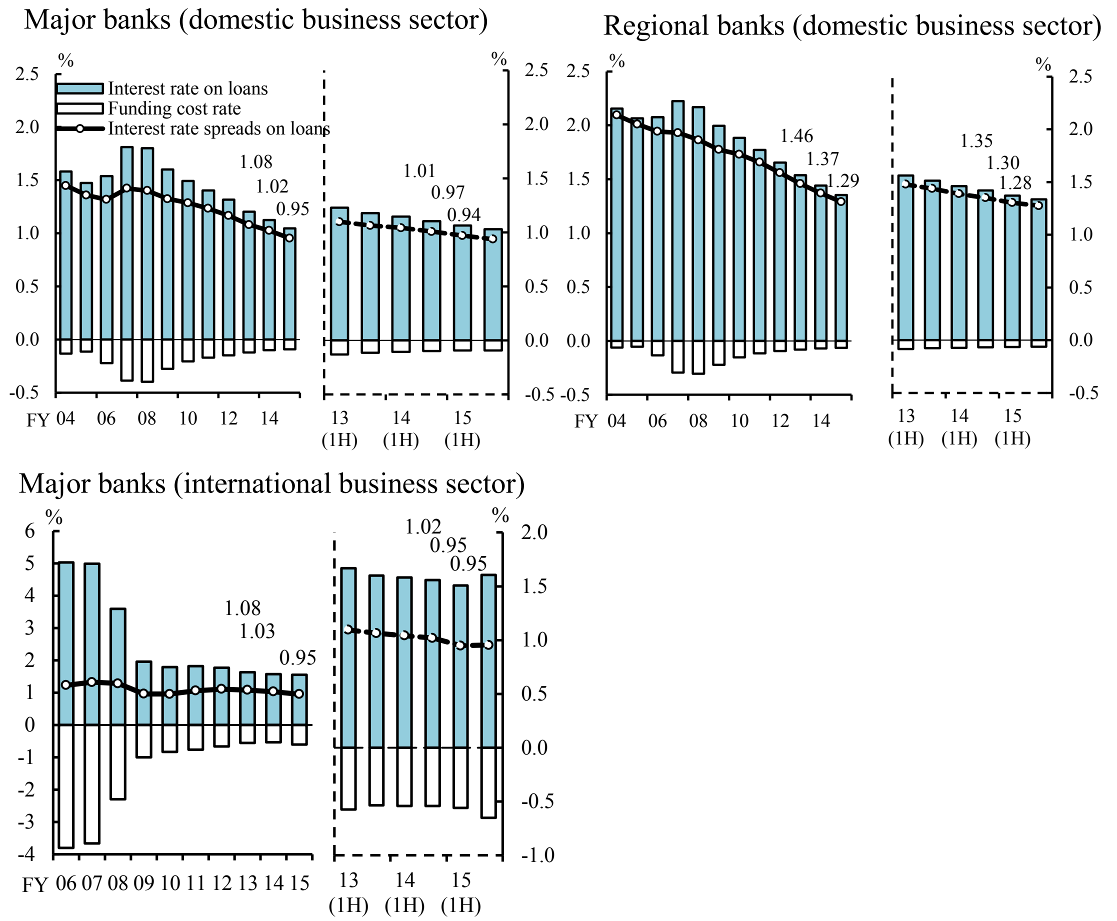
2. Interest Rate Spreads on Loans and Loans Outstanding

(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 due to a decline in lending interest rates.

Interest rate spreads on loans in the international business sector at major banks also narrowed, mainly because foreign currency funding costs rose and remained high.

II-A-3: Interest rate spreads on loans



Note: *1.* In calculating the funding cost rate, interest expenses on interest rate swaps are deducted from costs.

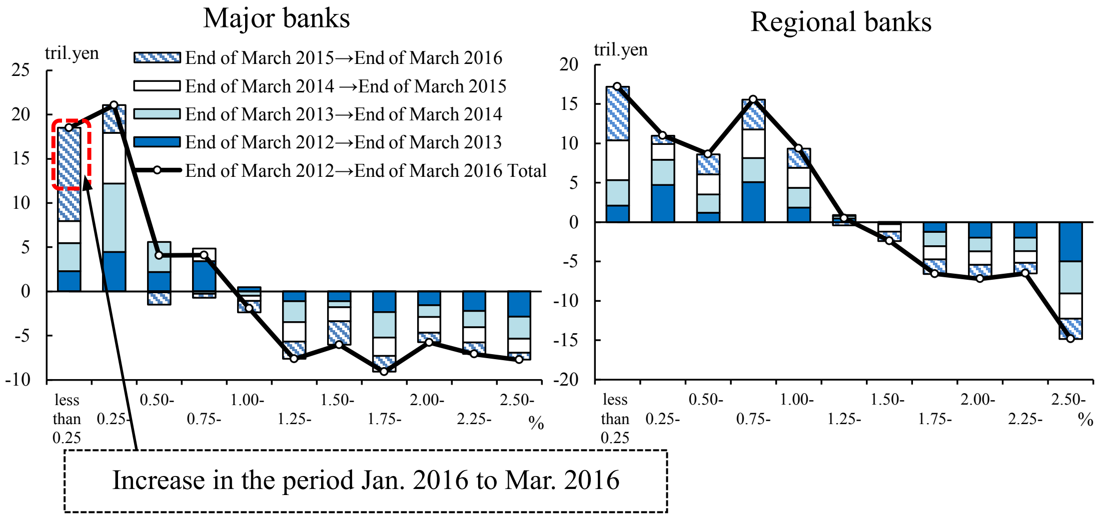
(2) Loans Outstanding by Lending Rate

Looking at developments in loans outstanding by lending rate (yen loans in the domestic business sector), those with lending rates below 1 percent have continued to increase.

In particular, loans outstanding with lending rates below 0.25 percent increased significantly in fiscal 2015, and this trend strengthened in the fourth quarter of fiscal

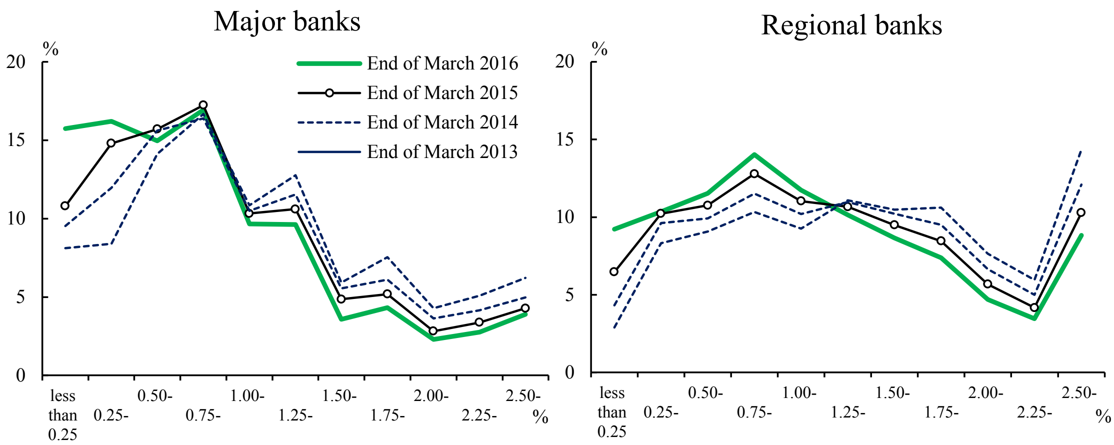
2015. As the Bank of Japan introduced "Quantitative and Qualitative Monetary Easing with a Negative Interest Rate," interest rates on spread lending -- which are linked to market interest rates such as TIBOR -- declined. Housing loan applications, mainly used for refinancing, increased. In addition, the accumulation of loans to government agencies led to an increase in the amount of loans outstanding with low interest rates.

II-A-4: Changes in loans outstanding by lending rate
(from the end of March 2012 to the end of March 2016)



Note: *1.* The data are for yen loans outstanding in the domestic business sector (excluding loans to the financial sector) based on the amount outstanding at month-end.

II-A-5: Changes in proportion of loans outstanding by lending rate
(from the end of March 2013 to the end of March 2016)

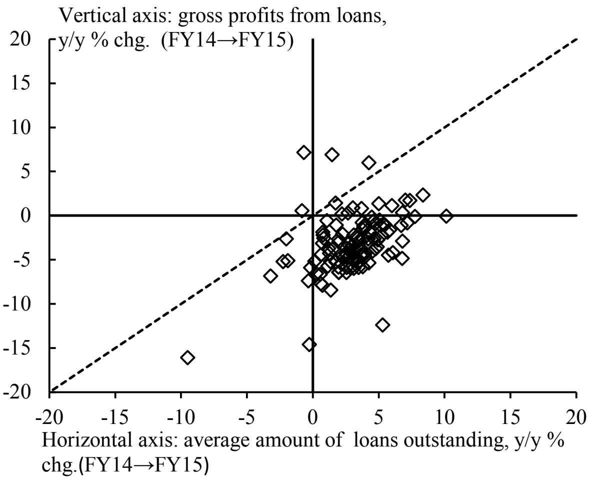


Note: *1.* The data are for yen loans outstanding in the domestic business sector (excluding loans to the financial sector) based on the amount outstanding at month-end.

(3) Factors behind Changes in Profits from Lending Activities

Many banks faced a decrease in profits from lending activities (gross profits = loans outstanding * interest rate spreads on loans) over the last year, although their loans outstanding increased. As the chart below shows, although the year-on-year change in loans outstanding was positive, many dots, representing major and regional banks, sit below the 45-degree line. This indicates that a reduction in interest rate spreads on loans has continued to have a large impact on profits.

II-A-6: Relationship between changes in loans outstanding and gross profits from loans (major and regional banks, domestic business sector)



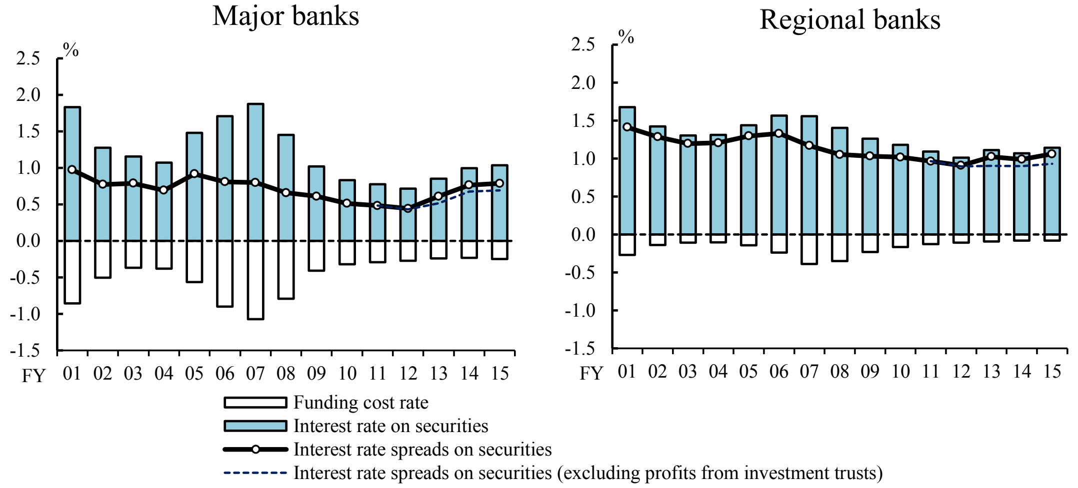
Notes:
1. The data include all loans outstanding in the domestic business sector.
2. Gross profits from loans = (average amount of loans outstanding) * (interest rate spreads on loans).

3. Interest Rate Spreads on Securities

Interest rate spreads on securities rose at major banks for the third consecutive year and at regional banks for the first time in two years. An increase in profits from stockholdings (higher dividends from ETFs and profits from investment trusts due to cancellations) contributed to the rise in spreads at both major and regional banks.

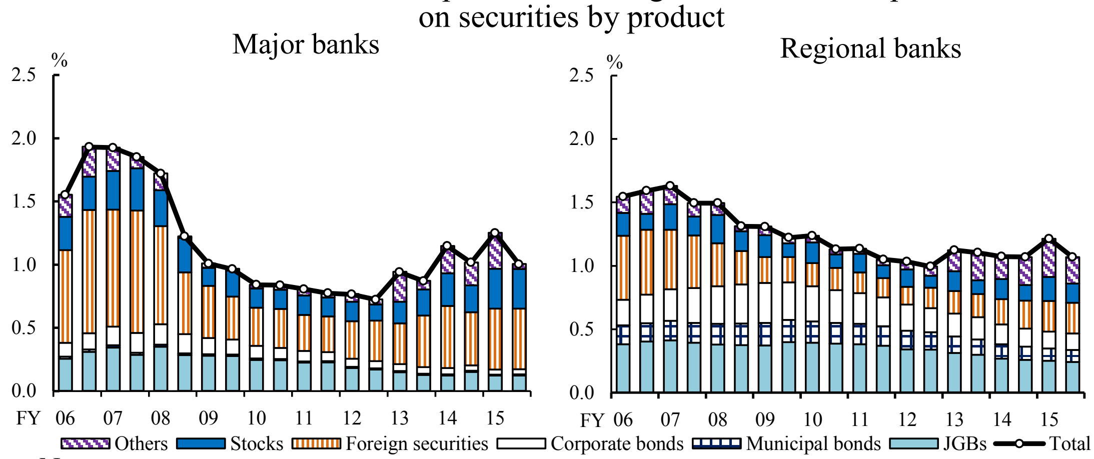
However, a large amount of profits from investment trusts due to cancellations (realized gains) was recorded as net interest income. Excluding this factor, interest rate spreads on securities remained more or less unchanged. While yields on JGBs, which account for a large part of securities holdings, continued to decline, the drop in interest rate spreads moderated due to JGB duration extension and an increase in outstanding amounts of foreign securities and investment trusts.

II-A-7: Interest rate spreads on securities



Note: *1.* In calculating the funding cost rate, interest expenses on interest rate swaps are deducted from costs.

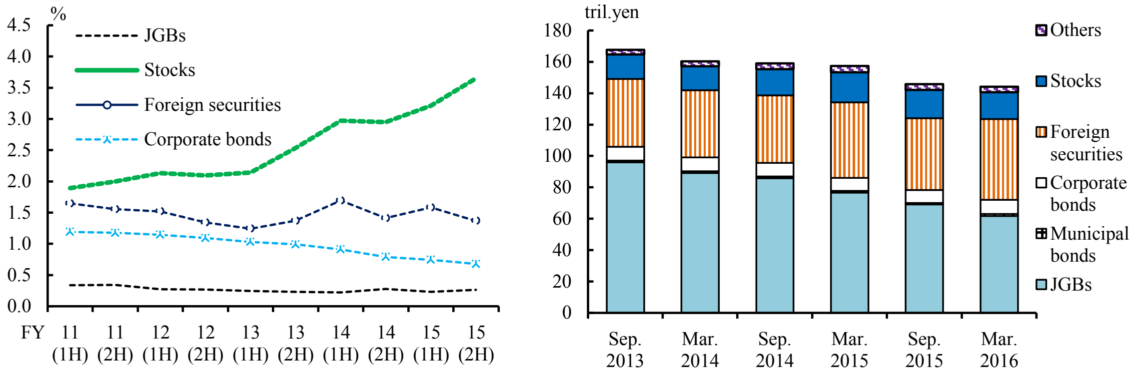
II-A-8: Factor decomposition of change in interest rate spreads on securities by product



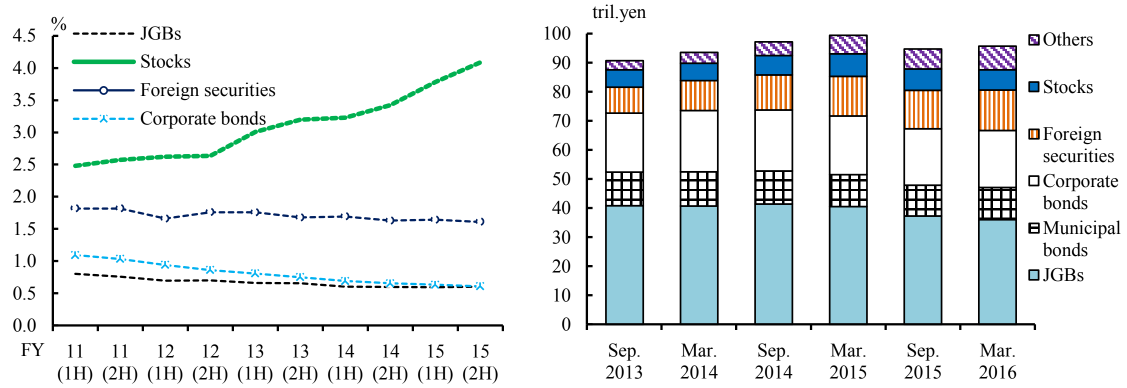
Notes:
1. The data are calculated on a half-year basis.
2. Some banks are excluded due to a lack of time-series data. The data on equity investment trusts are included in "others".

II-A-9: Interest rate spreads on securities holdings and amounts outstanding by product

Major banks



Regional banks



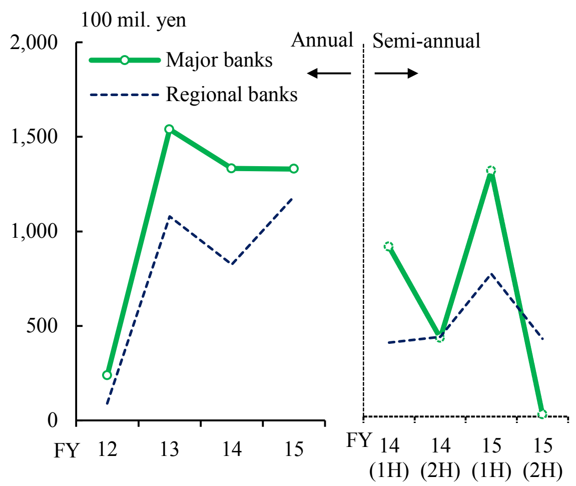
Note: *1*. In calculating interest rates, some banks are excluded due to a lack of time-series data. Interest rate spreads on stocks (annualized) are calculated by using the 2-quarter moving average to mitigate fluctuations in each quarter's dividends.

Box 2: Impact of profits from investment trusts due to cancellations on net interest income

Similar to interest and dividends, which mainly flow from bonds and stocks, profits from investment trusts due to cancellations are counted as "interest and dividends on securities," a component of net interest income (on the other hand, profits and losses from sales of listed ETFs are counted as "realized gains/losses on stockholdings").

Looking at developments in fiscal 2015, as both major banks and regional banks took profit-taking stances by selling mainly in a rising stock market, they recorded high levels of profits from investment trusts due to cancellations in the first half of the year (almost the same as total fiscal 2014 levels at major banks and about 90 percent of total fiscal 2014 levels at regional banks). In the second half of 2015, regional banks continued to adopt a profit-taking stance by selling. On the other hand, major banks sold some of their investment trusts which carried unrealized losses as they had already secured high profits in this market segment, and as a result, profits from investment trusts due to cancellations were limited as a whole.

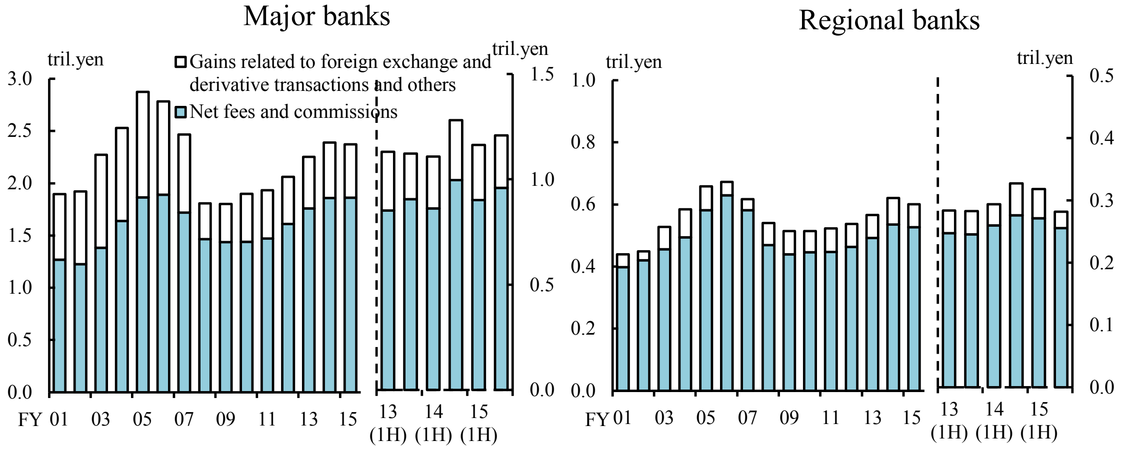
B2-1: Profits from investment trusts due to cancellations included in net interest income



4. Net Non-Interest Income

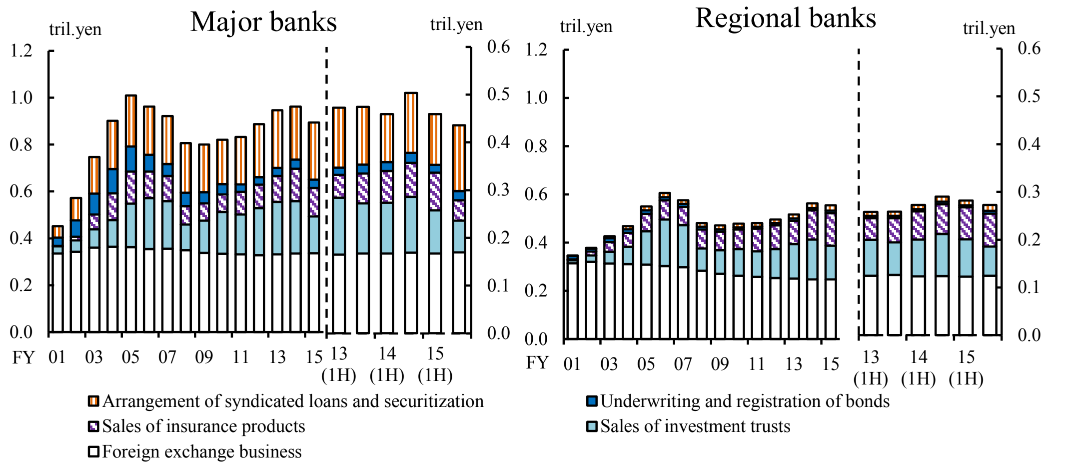
Net non-interest income decreased for the first time in six years at major banks and in five years at regional banks. Looking at the breakdown, net fees and commissions, which had continued to increase, were more or less flat.

II-A-10: Net non-interest income



Looking at the breakdown of income from fees and commissions in the domestic business sector, fees and commissions for sales of investment trusts and insurance products decreased at major banks. At regional banks, although fees and commissions for sales of insurance products remained solid, those for sales of investment trusts fell like they did at major banks. The pace of sales of investment trusts slowed, particularly in the second half of fiscal 2015, due to a fall in stock prices and a rise in volatility.

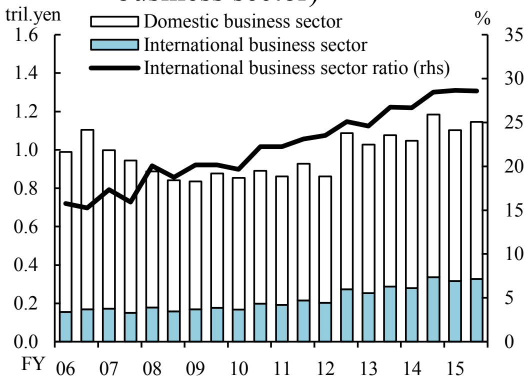
II-A-11: Income from fees and commissions (domestic business sector)



Note: *1.* Among items of income from fees and commissions, the 5 items listed above are counted.

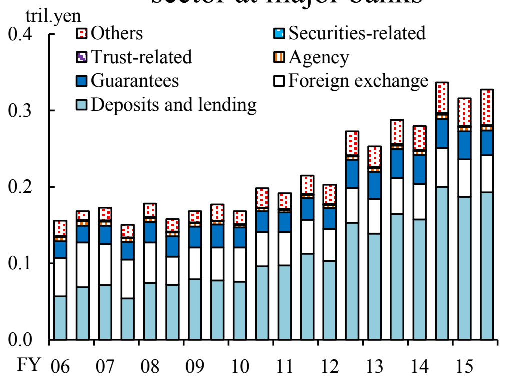
Income from fees and commissions in the international business sector at major banks continued to increase, albeit with some fluctuations, mainly due to a lift in fees and commissions associated with deposits and lending, such as the arrangement of syndicated loans and M&A transactions, although calculation effects due to appreciation of the Japanese yen had some impact in fiscal 2015.

II-A-12: Income from fees and commissions at major banks (by domestic and international business sector)



Note: *1.* The data are calculated on a half-year basis.

II-A-13: Income from fees and commissions in the international business sector at major banks



Notes:

1. The data are calculated on a half-year basis.

2. Though 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.

B. Realized and Unrealized Gains/Losses on Securities Holdings

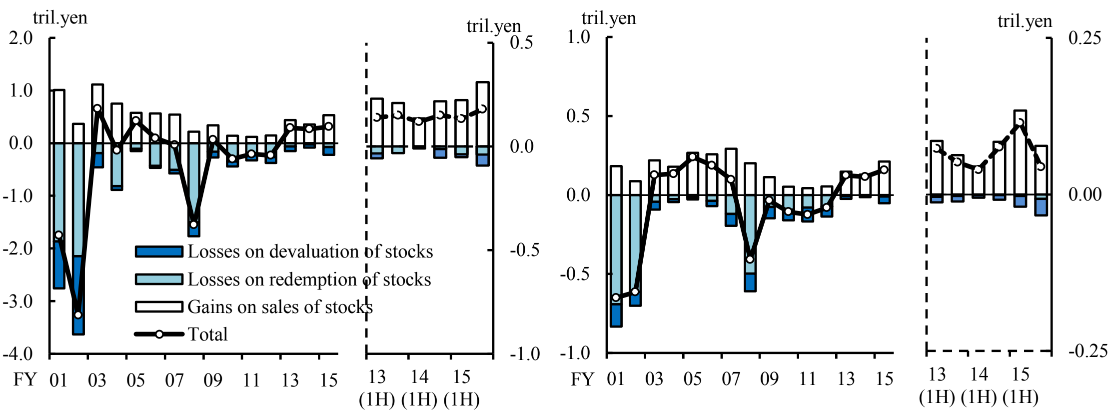
1. Realized Gains/Losses on Securities Holdings

Looking at realized gains/losses on stockholdings, the extent to which gains exceeded losses rose from the previous year at both major and regional banks. Profit-taking ETF sales and a reduction in strategic stockholdings led to an increase in realized gains. In the meantime, some major banks recorded impairment losses on their stockholdings.

As for realized gains/losses on bondholdings, the extent to which gains exceeded losses at major banks increased from the previous year as a result of tactical trading activities based on interest rate developments. At regional banks, however, the extent to which gains exceeded losses fell slightly, partly because of their cautious stance on bond sales due to concerns regarding reinvestment.

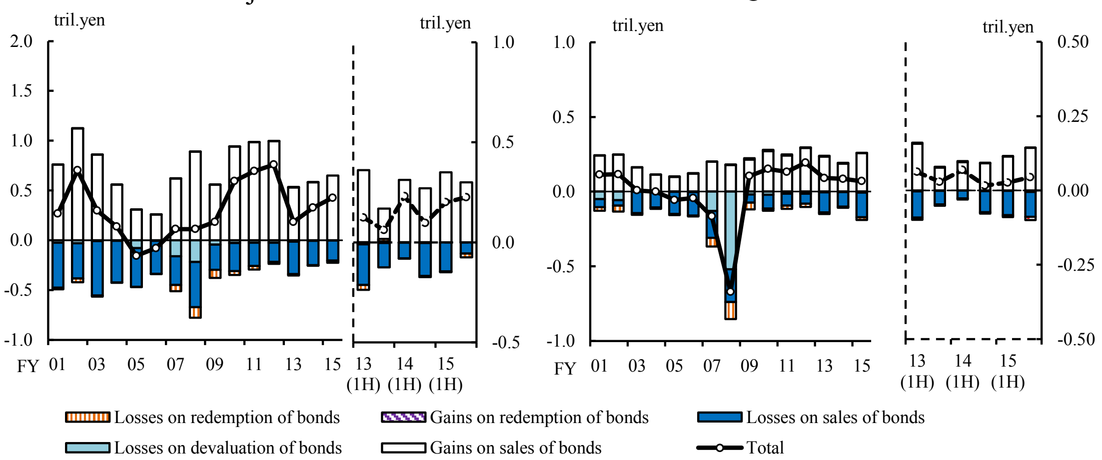
II-B-1: Realized gains/losses on stockholdings

Major banks Regional banks



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

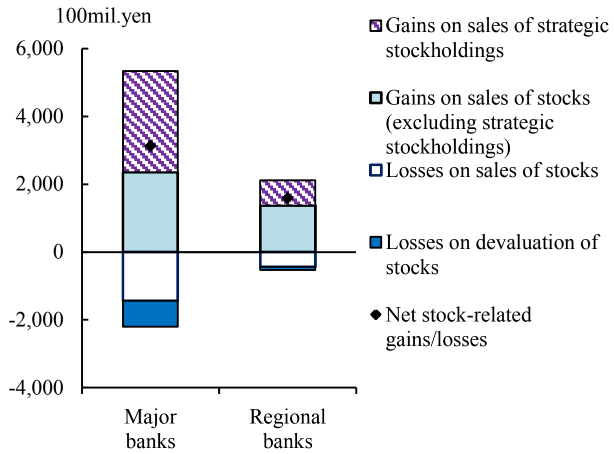
Major banks Regional banks



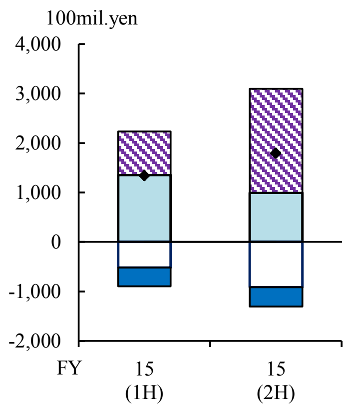
Box 3: Developments in realized gains from sales of strategic stockholdings

Sales of strategic stockholdings overall contributed greatly to pushing up realized gains on securities holdings in fiscal 2015. Looking at realized gains from sales of strategic stockholdings on a half-year basis, it appears that major banks in particular accelerated their sales -- albeit at an uneven pace across banks -- in the second half of fiscal 2015 after disclosing plans to reduce their strategic stockholdings at first half 2015 earnings announcements.

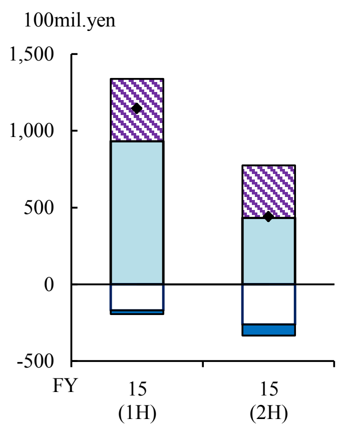
B3-1: Realized gains/losses on stockholdings in fiscal 2015



Major banks



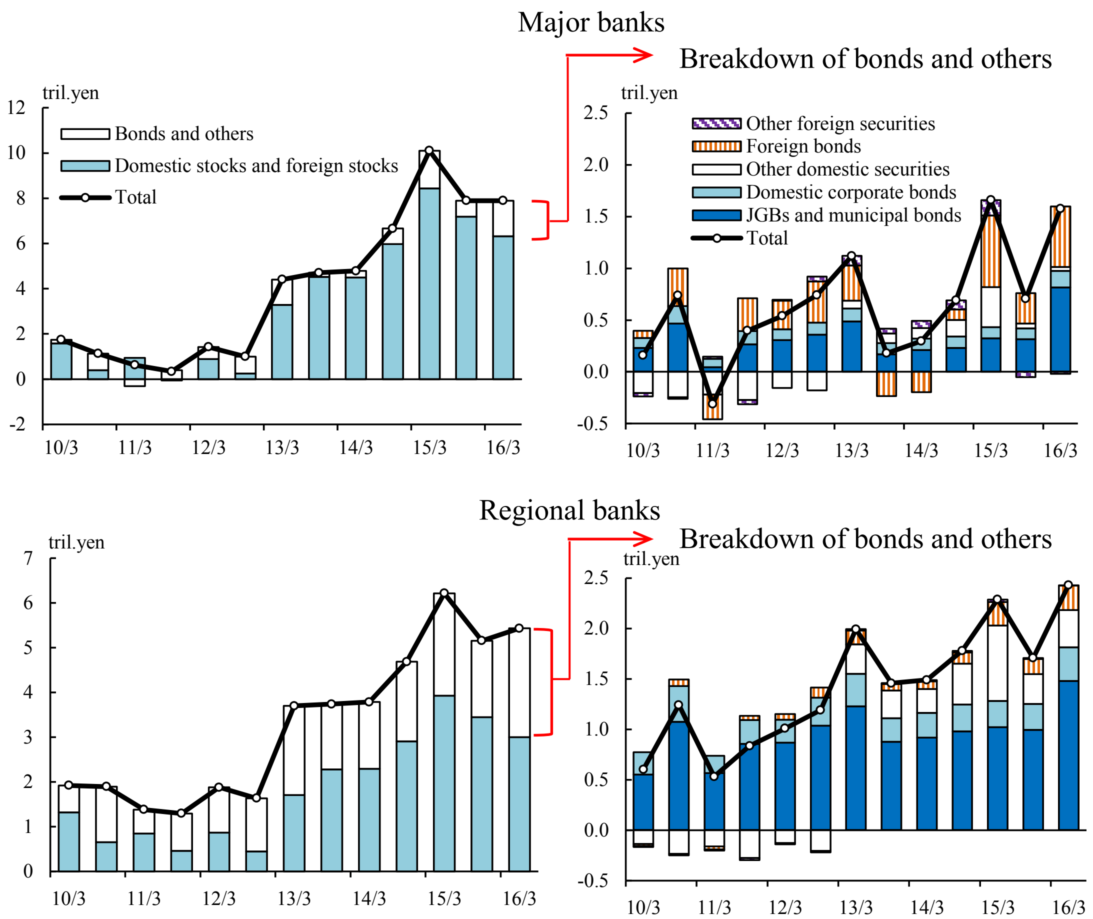
Regional banks



2. Unrealized Gains/Losses on Securities Holdings

Looking at unrealized gains/losses on available-for-sale securities holdings as of the end of March 2016, the extent to which gains exceeded losses fell from the previous year at both major banks and regional banks. From a long-term perspective, however, the level of unrealized gains has remained high. Looking at the breakdown, unrealized gains on stockholdings declined, mainly due to the fall in stock prices. Unrealized gains on bondholdings, however, increased significantly due to the rapid decline in interest rates.

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



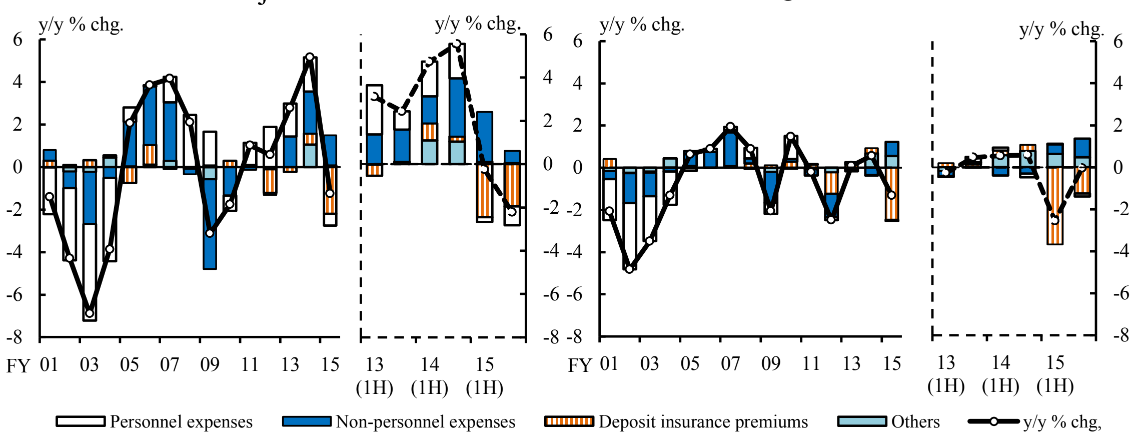
Notes:
1. The data are calculated on a half-year basis.
2. "Other domestic securities" and "other foreign securities" include investment trusts and funds.

C. General and Administrative Expenses

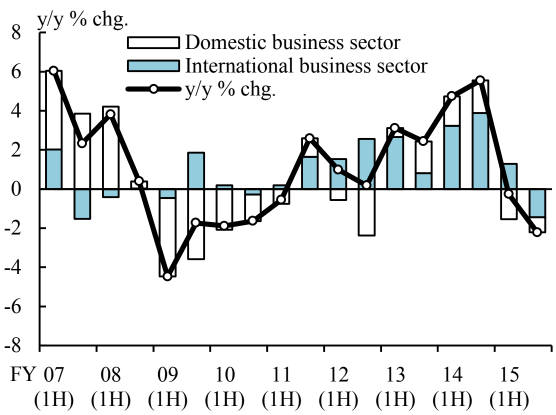
General and administrative expenses decreased as a whole at major banks for the first time in five years. Those in the domestic business sector fell due to the deposit insurance premium rate cut, and those in the international business sector, which had continued to rise, stopped increasing partly due to appreciation of the Japanese yen.

At regional banks, general and administrative expenses decreased significantly, mainly due to the deposit insurance premium rate cut.

II-C-1: Factor decomposition of change in general and administrative expenses



II-C-2: Factor decomposition of change in domestic and international business sectors at major banks



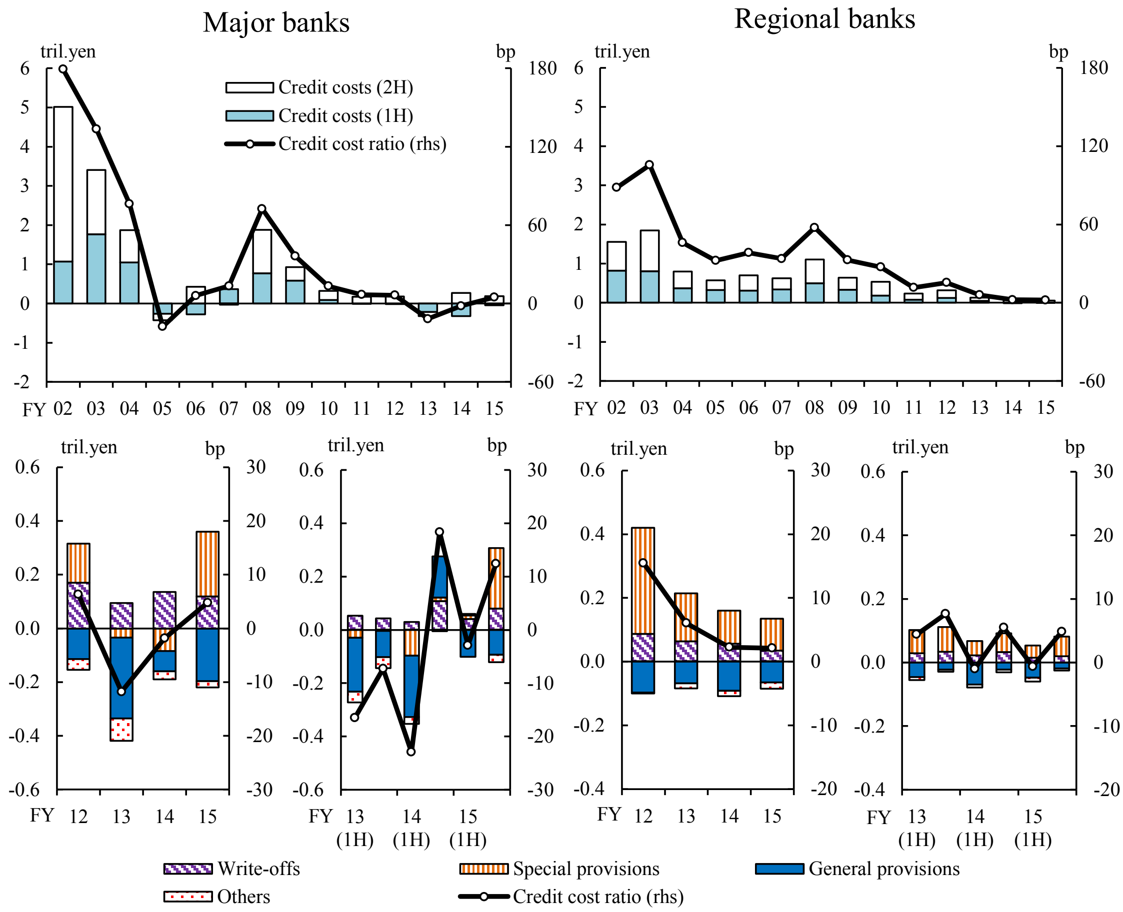
D. Credit Costs and Non-Performing Loans

1. Credit Costs

Credit costs began to increase (a rise in costs following the increase in reversals) at major banks for the first time in three years due to a rise in special loan-loss provisions in the second half of fiscal 2015 related to domestic exposure to some large companies and overseas exposure to the commodity sector. The level of credit costs has, however, remained low from a long-term perspective.

Regional banks continued to record credit costs, but at the lowest level since the relevant data first became available.

II-D-1: Credit costs and credit cost ratio



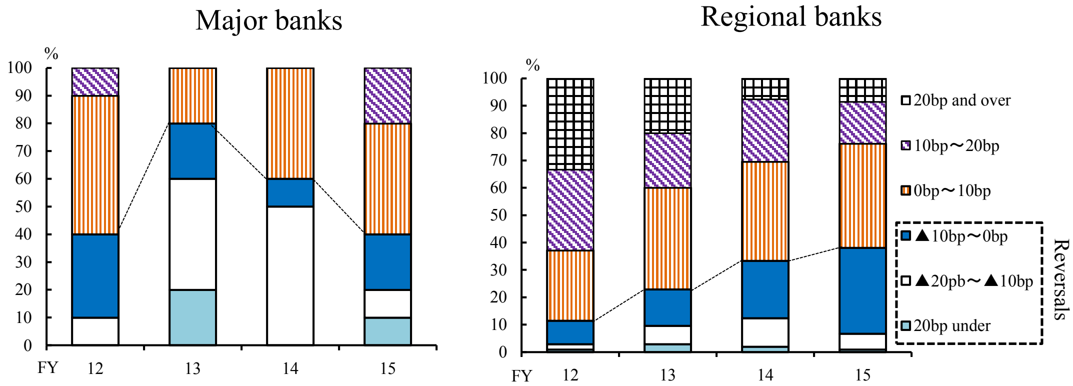
Note: 1. The lower charts show the breakdown of credit costs since fiscal 2012 at major banks and regional banks respectively. Figures calculated on a half-year basis are annualized.

The credit cost ratio (credit costs/total loans outstanding) was 5 basis points at major banks and 2 basis points at regional banks.

Looking at individual major banks, the number of banks with credit costs reversed declined for two years in a row.

By contrast, for regional banks, the number of banks with credit costs reversed continued to increase. In addition, banks with credit costs greater than 10 basis points accounted for only about 20 percent of all regional banks, and low credit costs have continued to support profits on the whole.

II-D-2: Credit cost ratio distribution



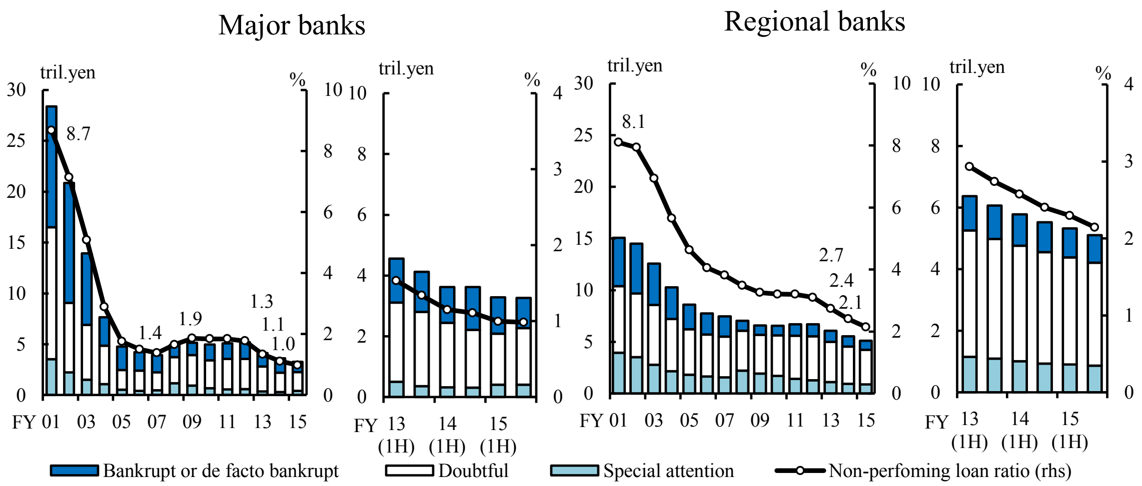
Note: *1*. Proportion of number of banks by credit cost ratio.

2. Non-Performing Loans

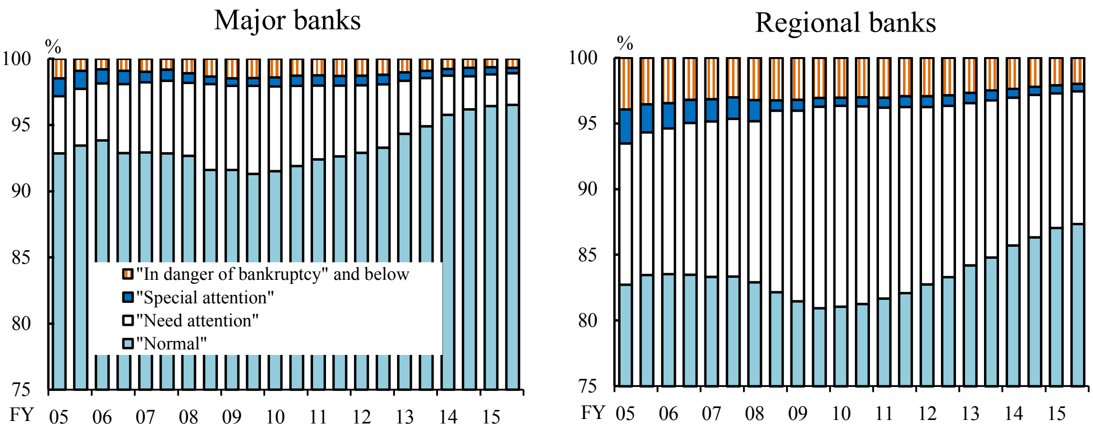
Non-performing loan (NPL) ratios continued to follow a moderately declining trend at both major banks and regional banks, and reached their lowest level since the relevant data were first recorded. At major banks, however, the pace of improvement in NPL ratios slowed down, with such ratios having already declined to as low as 1 percent.

In the meantime, looking at banks forming part of the three major financial groups, the NPL ratios for overseas exposures began increasing due to a rise in NPLs, mainly related to commodity-related exposures.

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

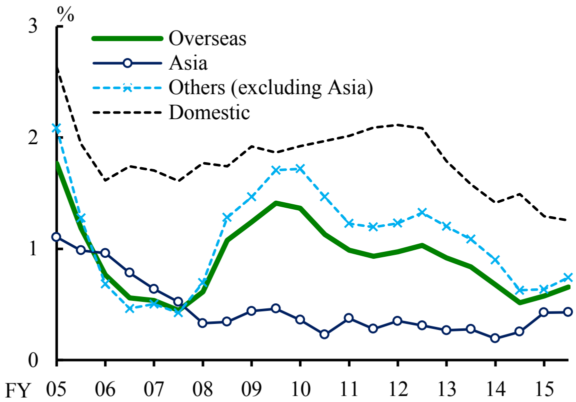


II-D-4: Proportion of loans outstanding by borrower classification



Notes:
1. The data are calculated on a half-year basis.
2. The data are calculated on a write-off basis.

II-D-5: Non-performing overseas loan ratios (three mega banks)



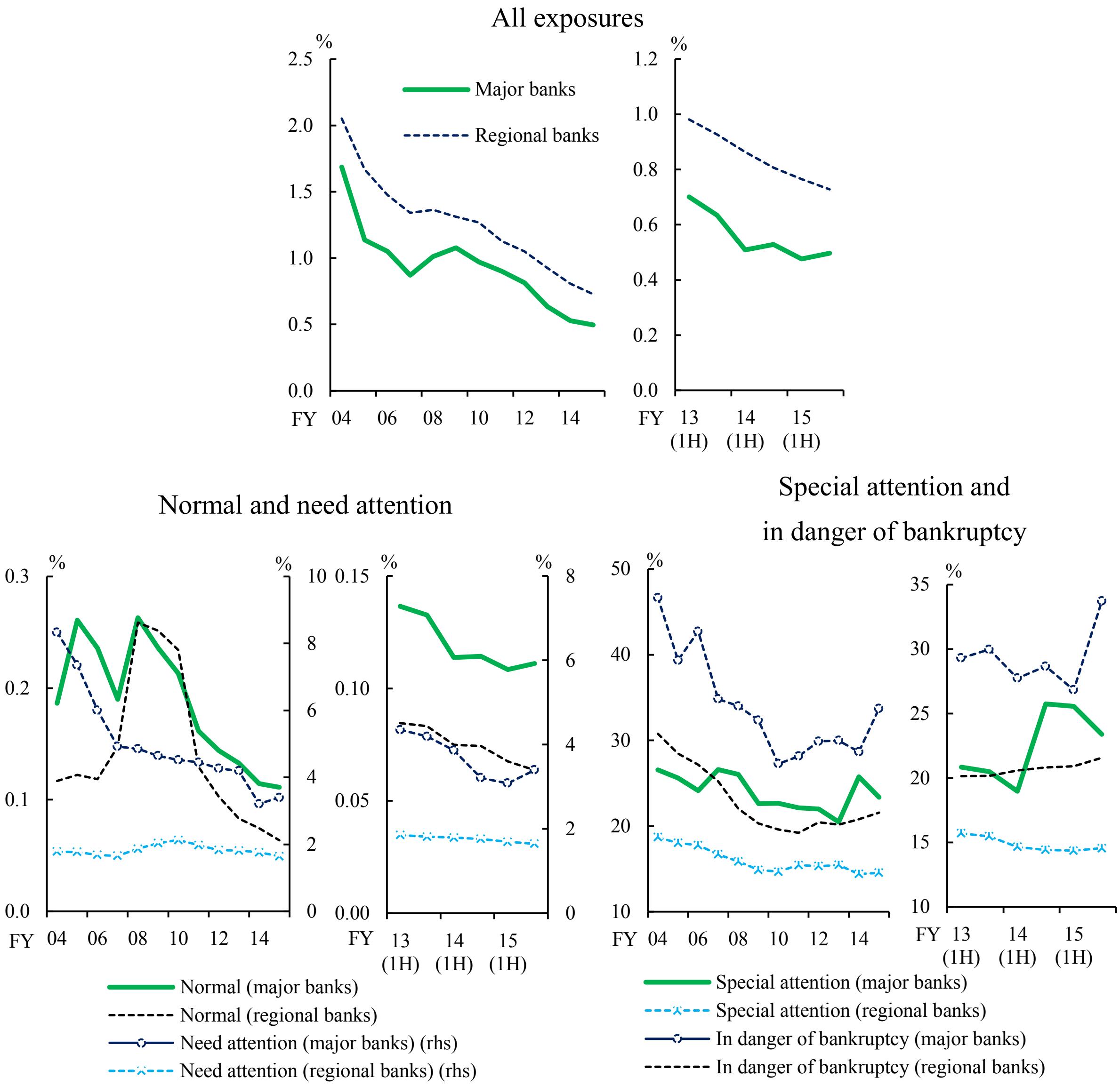
Note: 1. The data are calculated on a half-year basis.
Source: Financial results disclosed by individual banks.

3. Loan-Loss Provisions

(1) Loan-Loss Provision Ratios

The average loan-loss provision ratio for all exposures at major banks had continued on a declining trend following an increase after the Lehman shock, but was more or less unchanged in fiscal 2015 from the previous year. While the pace of decline in the loan-loss provision ratio for normal loans -- which account for a large proportion of all loans -- moderated, loan-loss provisions for domestic exposures to some large companies and overseas exposures to the commodity sector increased. By contrast, at regional banks, the decline in the loan-loss provision ratio for normal loans (representing a fall in actual loan losses) has continued, and the average loan-loss provision ratio dropped further.

II-D-6: Loan-loss provision ratios

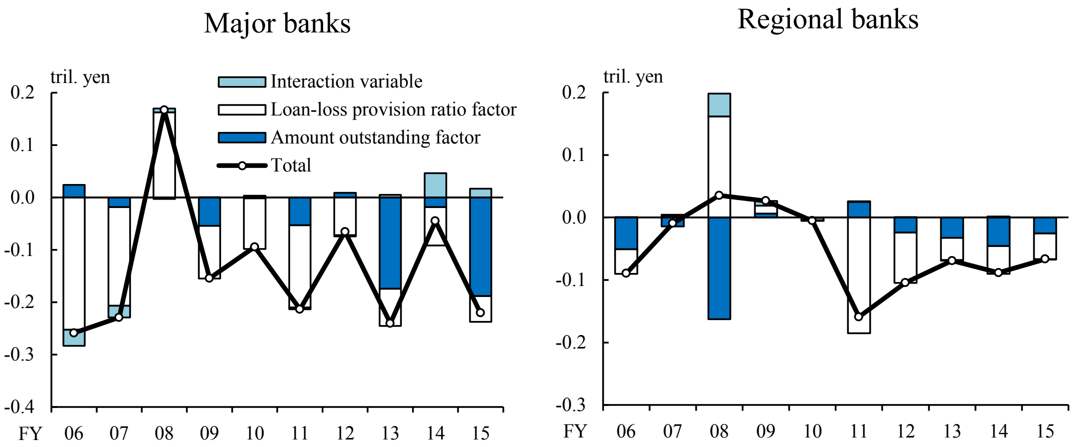


Notes:
1. The data include loans in which the discounted cash flow method is applied.
2. The loan-loss provision ratio is calculated as loan-loss provisions divided by the total amount of claims (not the uncovered amount of claims).

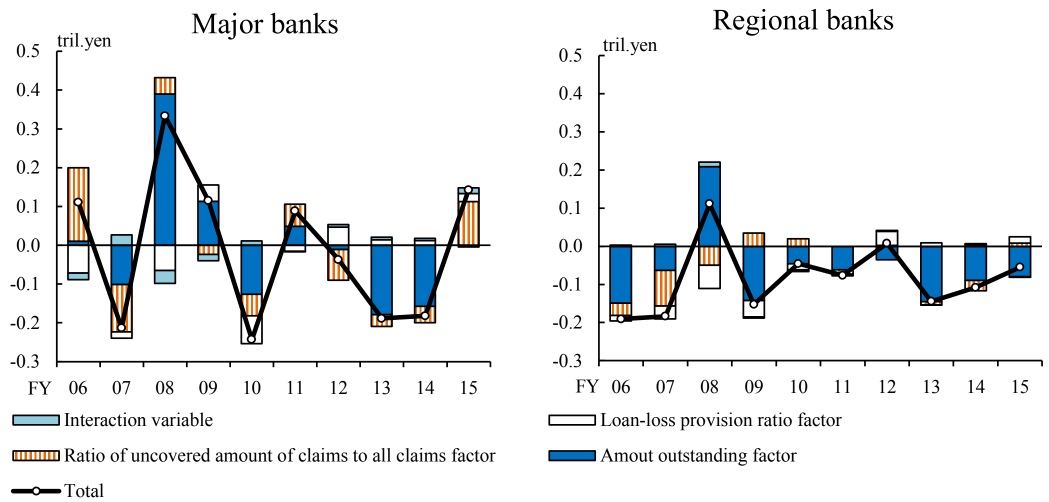
(2) Outstanding Amount of Loan-Loss Provisions

Looking at the outstanding amount of loan-loss provisions, general provisions continued to decrease at both major banks and regional banks. Special provisions began to increase at major banks for the first time in four years, mainly due to the downgrading of domestic exposures to some large companies and overseas exposures to the commodity sector, but they continued to follow a moderately declining trend at regional banks.

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



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



Note: *1*. Both Chart II-D-7 and Chart II-D-8 show the total factor decomposition for each factor: amount outstanding, loan-loss provision ratio, and interaction variable, which are calculated by borrower classification.

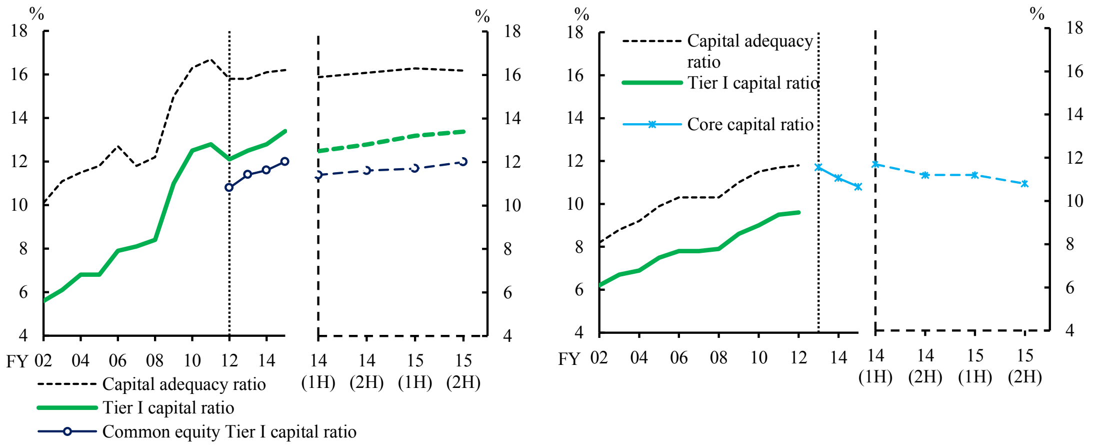
E. Capital Adequacy Ratio

Turning now to the capital adequacy ratio (on a consolidated basis), the common equity Tier I capital ratio (CET I ratio) of internationally active banks continued to increase. Risk-weighted assets (the denominator) rose at a more moderate rate, and the common equity Tier I capital (the numerator) increased.

At domestic banks, the capital adequacy ratio[3] declined slightly, mainly because risk-weighted assets increased. In addition, capital decreased because some banks repaid public funds and the arrangement for phasing in the Basel III requirements was gradually removed (the proportion of instruments that can be included in capital was reduced).

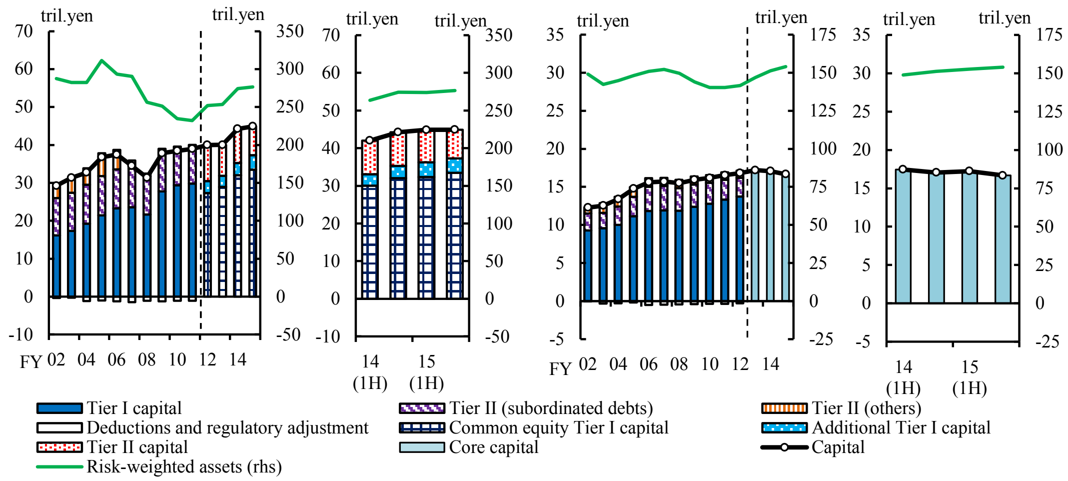
II-E-1: Capital adequacy ratio

Internationally active banks | Domestic banks



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

Internationally active banks | Domestic banks

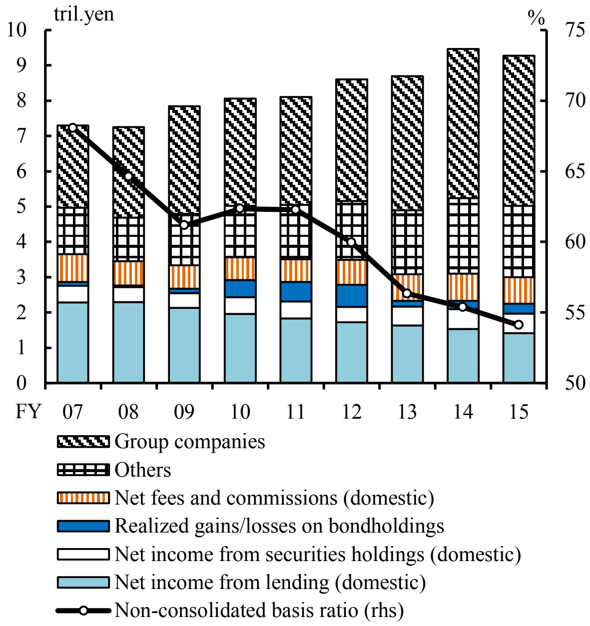


[3] In Chart II-E-1 and Chart II-E-2, the capital adequacy ratio is referred as the "core capital ratio" in order to distinguish the capital adequacy ratio definition in the current Financial Services Agency public notice from the capital adequacy ratio definition in the former public notice (the same applies to Chart III-D-1 and Chart III-D-2).

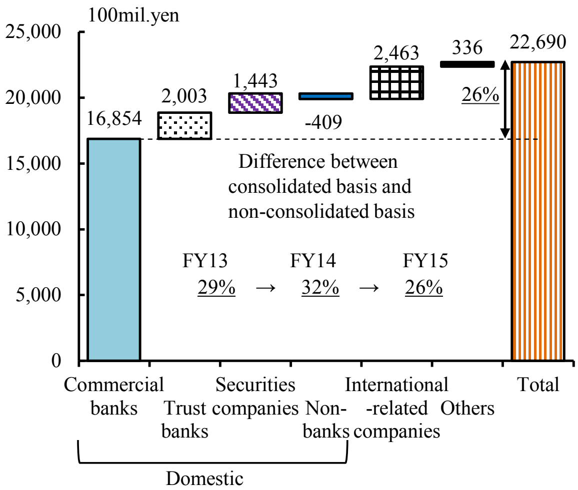
F. Major Banks' Financial Results on a Consolidated Basis

Looking at the financial results of major financial groups on a consolidated basis, the difference between net income on a consolidated basis and that calculated on a non-consolidated basis, which had continued to increase in recent years, stopped expanding in fiscal 2015, mainly due to losses in one major financial group's subsidiary. The difference between gross profits on a consolidated basis and that calculated on a non-consolidated basis, however, has continued to expand.

II-F-1: Breakdown of gross profits of three mega financial groups



II-F-2: Breakdown of net income of three mega financial groups



Notes:
1. Difference between consolidated basis and non-consolidated basis = (1- (non-consolidated domestic commercial banks' net income) / (consolidated groups' net income)) * 100.
2. The chart is based on financial results for fiscal 2015.

III. Financial Results of Japan's *Shinkin* Banks for Fiscal 2015

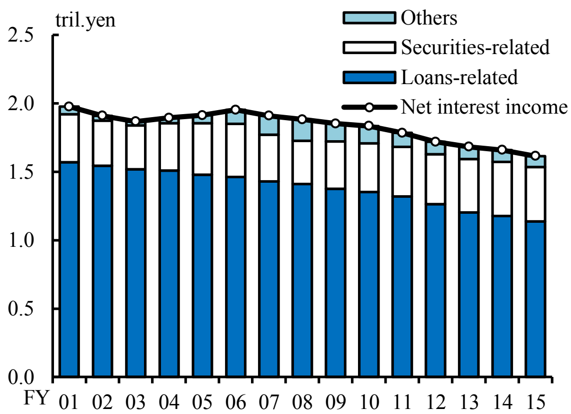
This chapter analyzes *shinkin* banks' core profitability (net interest income, net non-interest income, and general and administrative expenses), as well as their credit costs, non-performing loans, and capital adequacy ratio.

A. Core Profitability

1. Net Interest Income

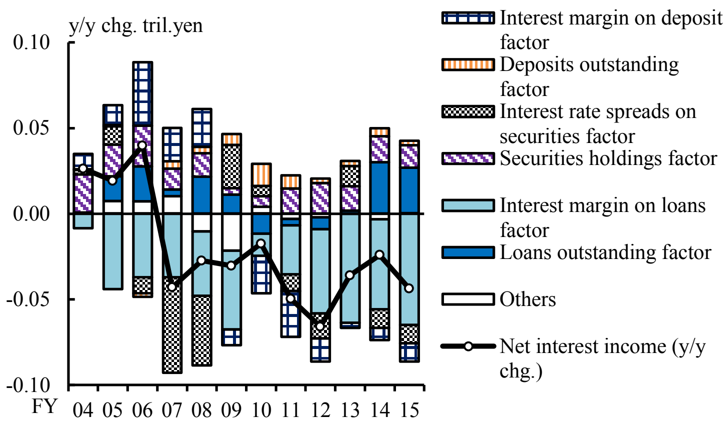
Net interest income has been on a declining trend due to the impact of reduced interest rate spreads on loans being larger than that of an increase in loans outstanding.

III-A-1: Net interest income



Notes:
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).

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

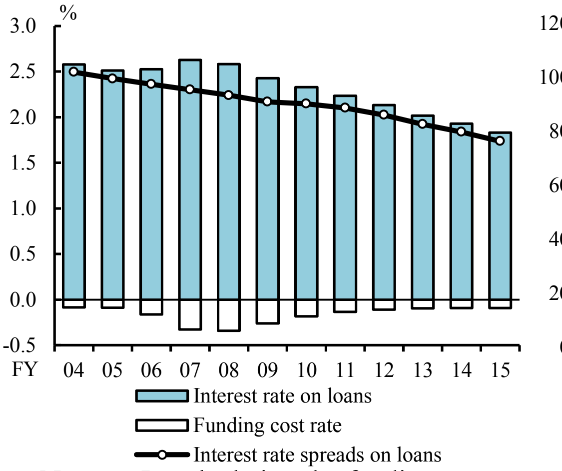


2. Interest Rate Spreads on Loans and Loans Outstanding

(1) Interest Rate Spreads on Loans

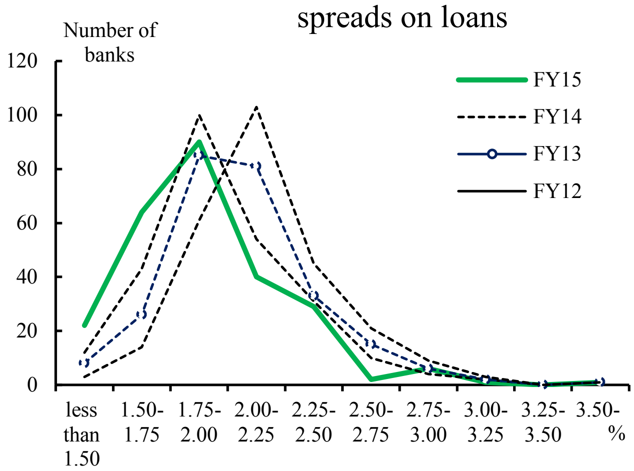
Interest rate spreads on loans have continued to narrow due to a decline in lending rates. The distribution of interest rate spreads also indicates that they have continued to shrink on the whole.

III-A-3: Interest rate spreads on loans



Note: *1*. In calculating the funding cost rate, interest expenses on interest rate swaps are deducted from costs.

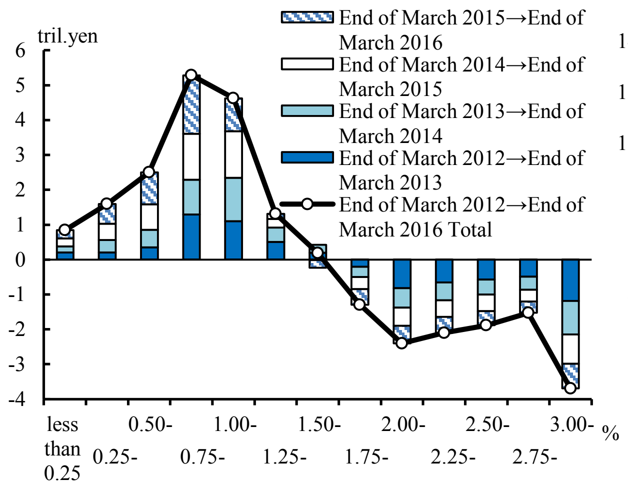
III-A-4: Distribution of interest rate spreads on loans



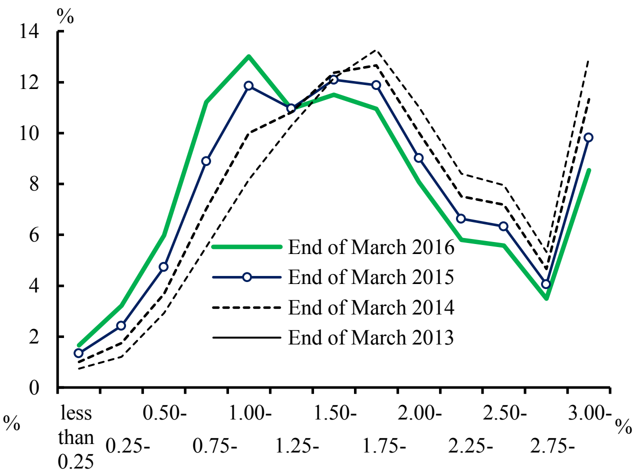
(2) Loans Outstanding by Lending Rate

Looking at developments in loans outstanding, those with lending rates below about 1 percent have continued to increase.

III-A-5: Changes in loans outstanding by lending rate (from the end of March 2012 to the end of March 2016)



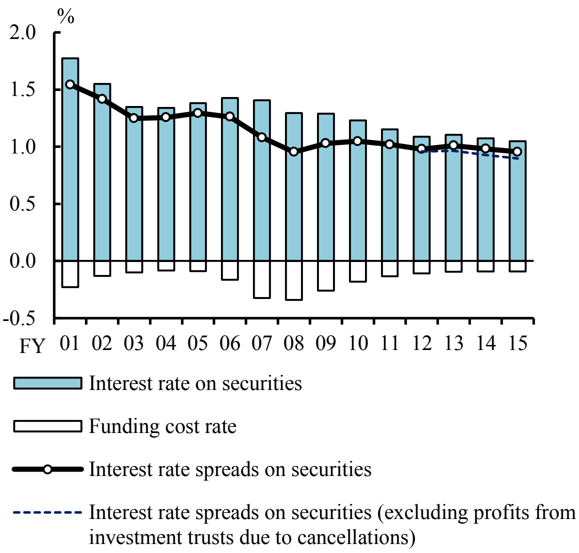
III-A-6: Changes in proportion of loans outstanding by lending rate (from the end of March 2013 to the end of March 2016)



3. Interest Rate Spreads on Securities

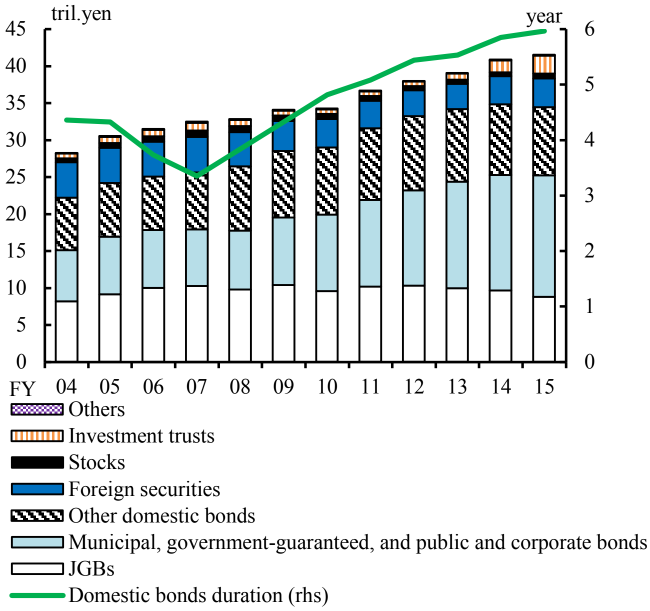
Interest rate spreads on securities narrowed slightly as a whole. Although an increase in outstanding investment trusts and extended domestic bond duration contributed to an expansion of interest rate spreads, the decline in yields of domestic bonds, which account for a large part of banks' portfolios, contributed to lowering interest rate spreads.

III-A-7: Interest rate spreads on securities



Note: *1.* Interest expenses on interest rate swaps are deducted from costs.

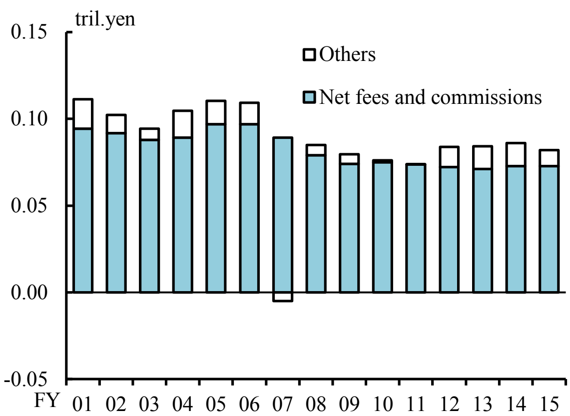
III-A-8: Amounts outstanding and duration of securities by product



4. Net Non-Interest Income

<u>Net non-interest income</u> decreased for the first time in four years.

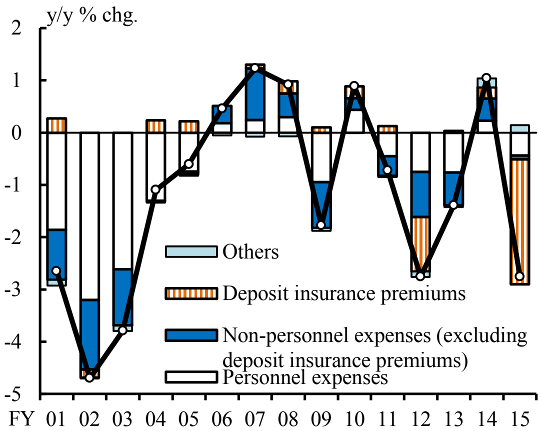
III-A-9: Net non-interest income



5. General and Administrative Expenses

As for general and administrative expenses, both personnel expenses and non-personnel expenses decreased. Looking at non-personnel expenses, the deposit insurance premium rate cut contributed to the decline.

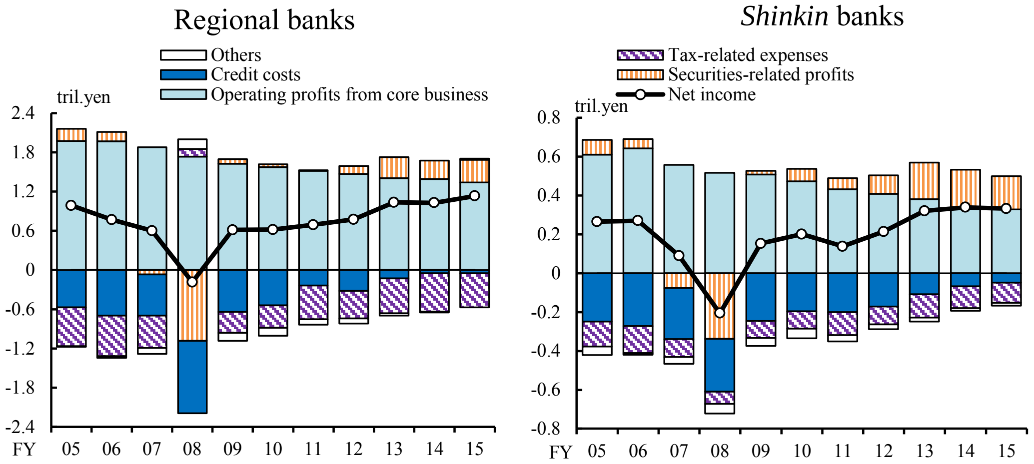
III-A-10: Factor decomposition of change in general and administrative expenses



Box 4: Developments in core profitability of regional financial institutions

Net income at regional banks and *shinkin* banks has continued to remain at historically high levels. The main factors behind this have been the decline in credit costs and the increase in realized gains on securities holdings, and the declining trend of operating profits from core business, which show core profitability, has not yet run its course, as indicated in the text.

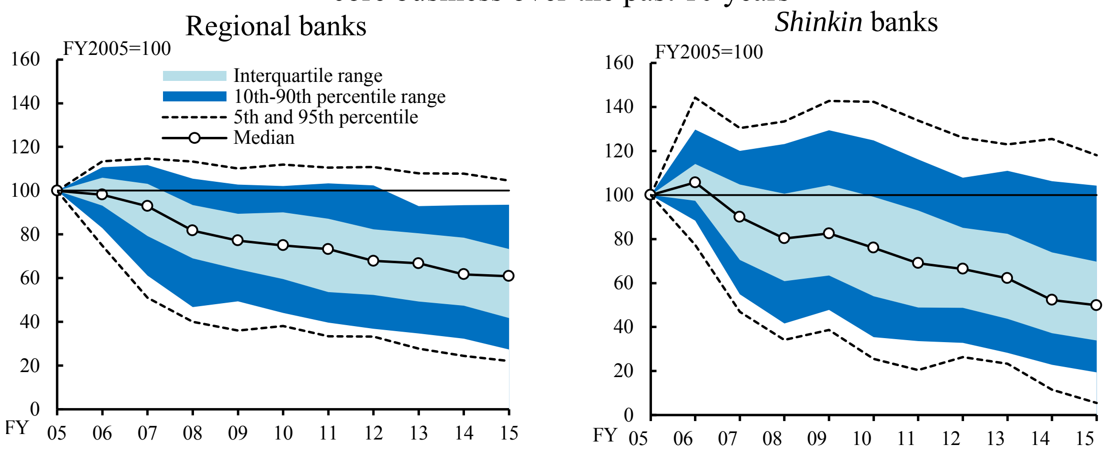
B4-1: Developments in net income and its breakdown



Note: *1.* Post-fiscal 2012 profits from investment trusts due to cancellations are included in securities-related profits, not in operating profits from core business.

Looking at the distribution of developments in the core profitability of individual financial institutions, the median has been on a declining trend. For the last 10 years, it has declined by 40 percent at regional banks and 50 percent at *shinkin* banks. There are some banks at which core profitability has declined by 70-90 percent during the same period.

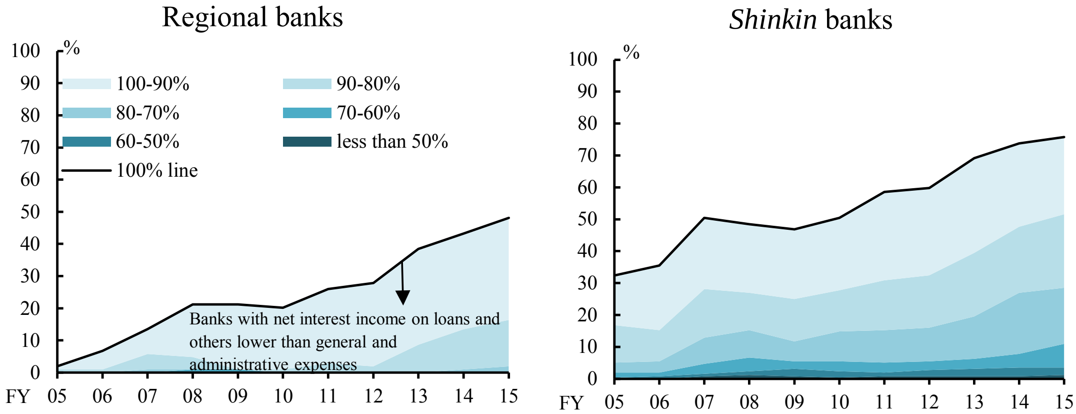
B4-2: Developments in distribution of operating profits from core business over the past 10 years



Note: *1.* Post-fiscal 2012 profits from investment trusts due to cancellations are excluded.

Under the circumstances, looking at the total of net interest income on loans and net fees and commissions (hereinafter, net interest income on loans and others), which are the main components of operating profits from core business, the share of financial institutions with net interest income on loans and others lower than general and administrative expenses has been rising. At the end of fiscal 2015, the share was slightly below 50 percent at regional banks and slightly below 80 percent at *shinkin* banks. In addition, the share of financial institutions with a low ratio of net interest income on loans and others to general and administrative expenses has been increasing for all types of regional financial institutions.

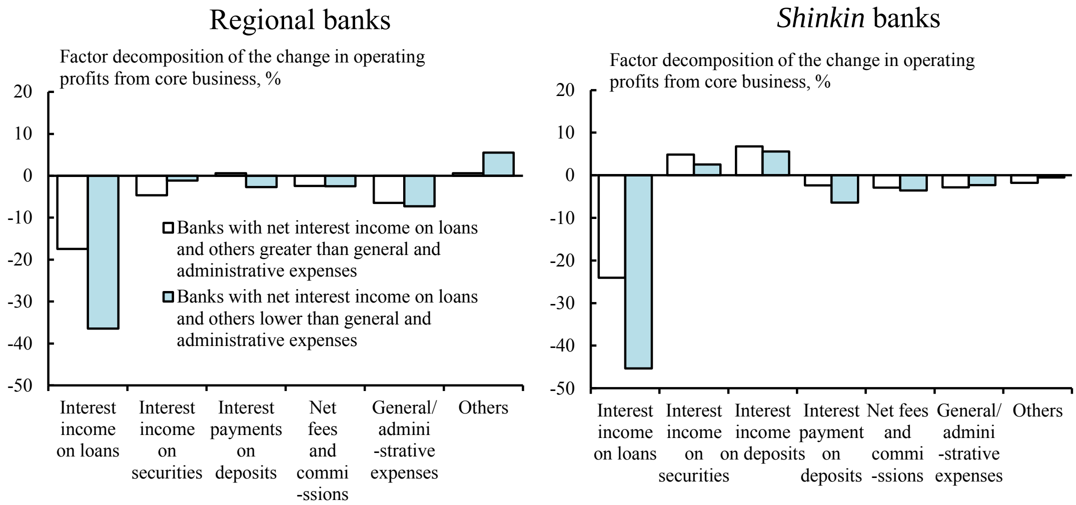
B4-3: Proportion of banks with net interest income on loans and others lower than general and administrative expenses and distribution of ratio to general and administrative expenses



Note: *1.* The charts show the ratio calculated as follows: (interest income on loans + interest income on deposits + net fees and commissions – interest payments on deposits)/general and administrative expenses.

Looking at factors behind changes in operating profits from core business for the last 10 years, the contribution of general and administration expenses has been small both for financial institutions with net interest income on loans and others lower than general and administrative expenses and for those with net interest income on loans and others exceeding general and administrative expenses. On the other hand, the contribution of interest income on loans has differed substantially.

B4-4: Factors behind change in operating profits from core business



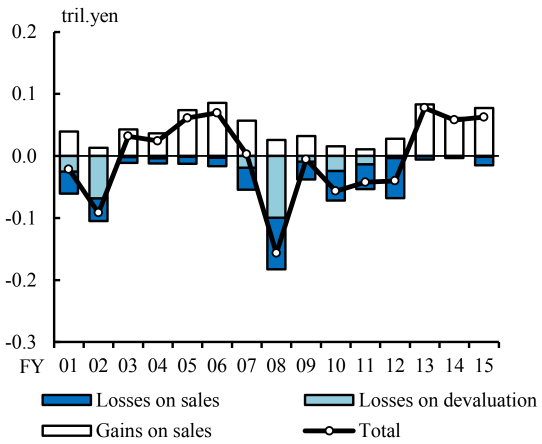
Note: *1*. Profits from investment trusts due to cancellations are excluded from interest income on securities. Deposit insurance premiums are also excluded from general and administrative expenses.

B. Realized and Unrealized Gains/Losses on Securities Holdings

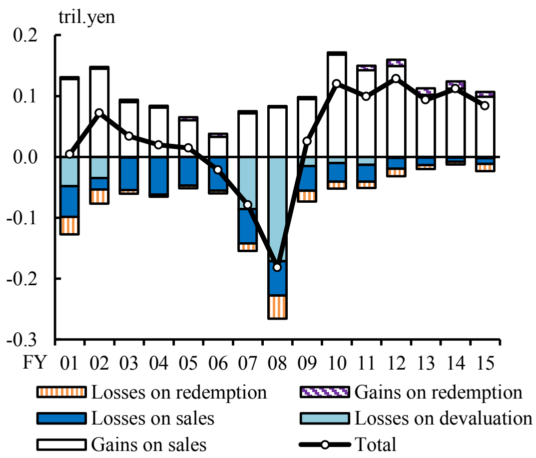
1. Realized Gains/Losses on Securities Holdings

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

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



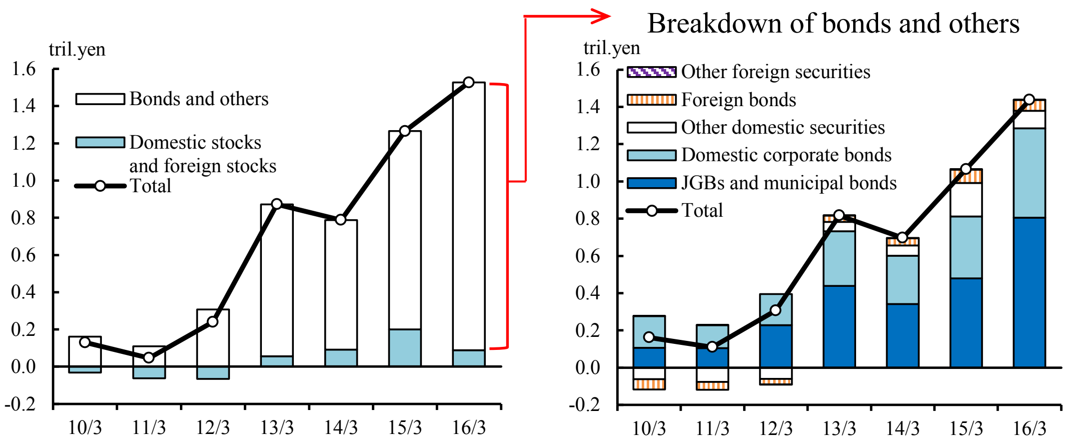
III-B-2: Realized gains/losses on bondholdings



2. Unrealized Gains/Losses on Securities Holdings

Looking at unrealized gains/losses on available-for-sale securities holdings as of the end of March 2016, gains exceeded losses by a significantly greater amount due to a decline in interest rates, mainly in JGBs and municipal 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.

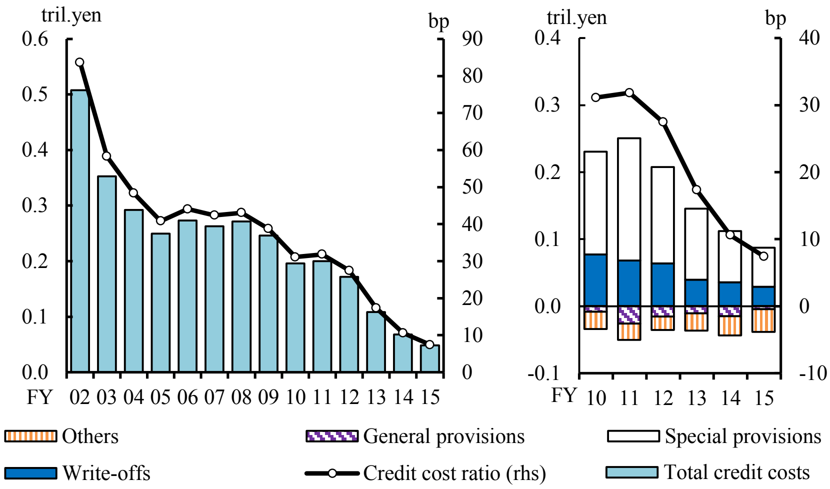
C. Credit Costs and Non-Performing Loans

1. Credit Costs

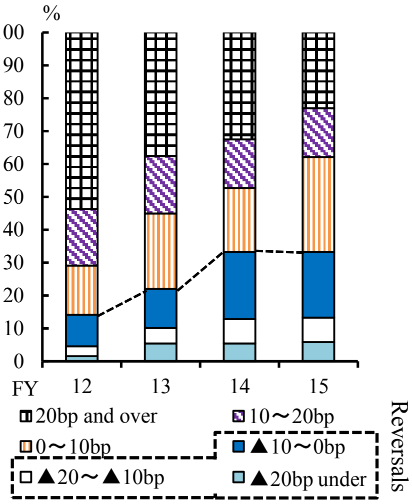
Credit costs were the lowest since the relevant data were first recorded.

Looking at individual *shinkin* banks, although the number of banks with credit costs that were reversed was more or less unchanged, the number of banks with a low credit cost ratio increased.

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



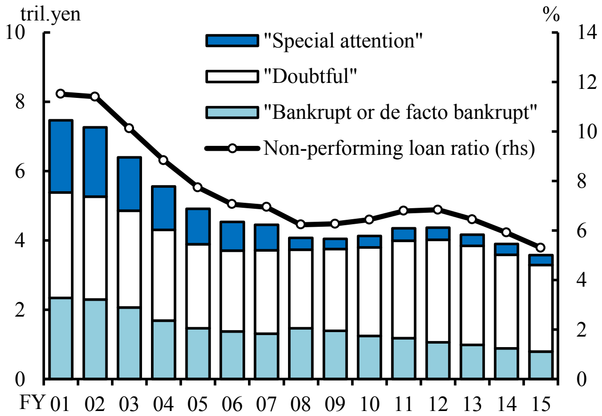
III-C-2: Distribution of credit cost ratios



2. Non-Performing Loans

Non-performing loan (NPL) ratios continued to decline moderately and reached their lowest point since the relevant data were first recorded.

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



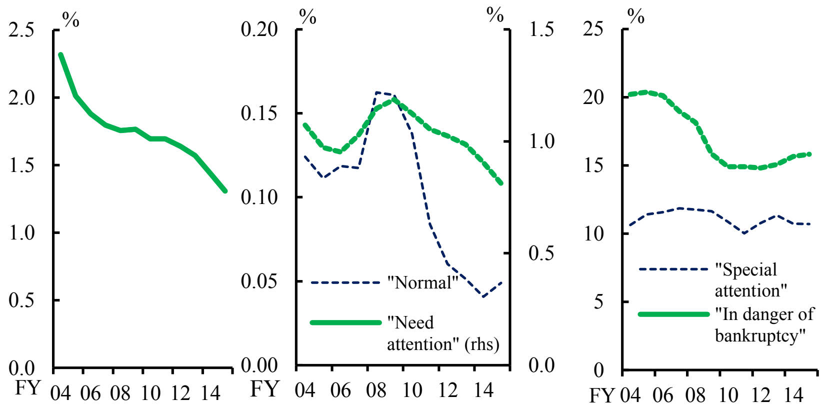
3. Loan-Loss Provisions

(1) Loan-Loss Provision Ratio

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

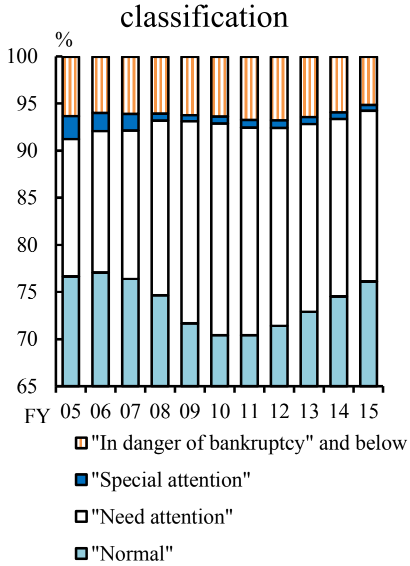
Looking at loan-loss provisions by borrower classification, the loan-loss provision ratio was low in all borrower classifications. Factors behind this included the low number of corporate bankruptcies from a long-term perspective.

III-C-4: Loan-loss provision ratio



Notes:
1. The data include loans in 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).

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

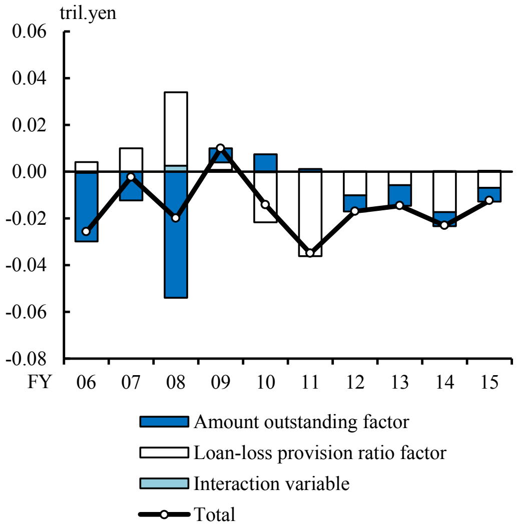


Note: 1. The data are calculated on a write-off basis.

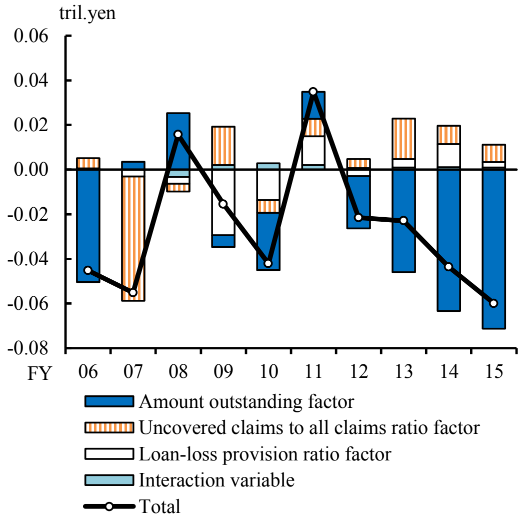
(2) Outstanding Amount of Loan-Loss Provisions

As for general provisions, both a decline in the loan-loss provision ratio and a decrease in the outstanding amount of “need attention” loans and “need special attention” loans contributed to the decline in loan-loss provisions. As for special provisions, both the ratio of uncovered claims to all claims and the loan-loss provision ratio rose slightly for two consecutive years. Nevertheless, special provisions decreased because of a decline 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



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

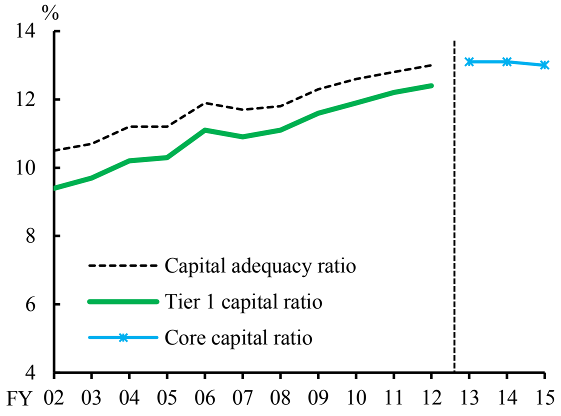


Note: *1*. Both Chart III-C-6 and Chart III-C-7 show the total factor decomposition for each factor: amount outstanding, loan-loss provision ratio, and the interaction variable, which are calculated by borrower classification.

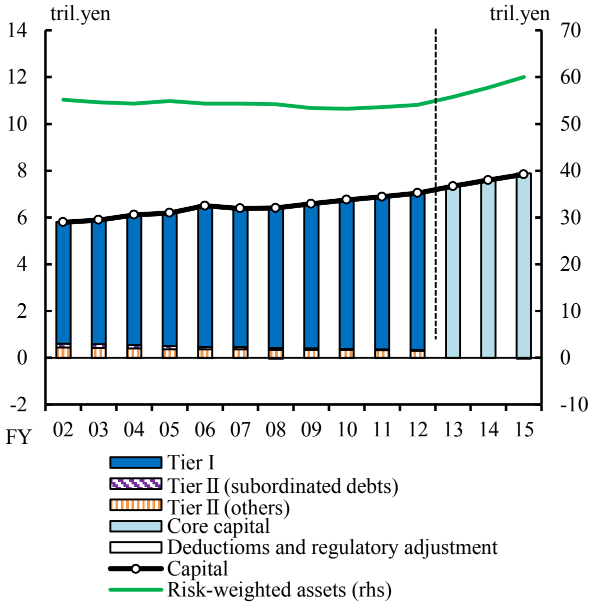
D. Capital Adequacy Ratio

<u>The capital adequacy ratio</u> was more or less unchanged. While the amount of capital increased, mainly due to the accumulation of retained earnings, risk-weighted assets increased.

III-D-1: Capital adequacy ratio



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



Appendix: 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 = 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 I (CET I) capital ratio = CET I capital / risky assets

CET I capital comprises common equities and retained earnings.

Risky assets are financial institutions' risk-weighted assets.

Tier I capital ratio = Tier I capital / risky assets

Tier I capital includes CET I capital and equities such as preferred equities that meet certain conditions.

Total capital adequacy ratio = total capital / risky assets

Total capital includes Tier I 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.