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Financial Results of Japan's Banks for Fiscal 2012

Financial System and Bank Examination Department

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Summary

Net income for fiscal 2012 increased by around 30 percent at major banks and around 10 percent at regional banks relative to fiscal 2011, mainly because large gains on sales of bonds were recorded and tax-related expenses decreased.

However, net interest income on loans and securities holdings, which is the main profit source for banks, continued to decrease in the domestic business sector against the backdrop of a decline in the interest rate spreads. In this situation, operating profits from core business increased slightly at major banks due to increases in net non-interest income such as fees and commissions and net interest income in the international business sector, while regional banks, at which the weight of such income is low, experienced a decrease in operating profits from core business for the seventh consecutive year.

At major banks, credit costs arising from the disposal of nonperforming loans were more or less unchanged relative to fiscal 2011. At regional banks, credit costs rose reflecting an increase in special loan-loss provisions, but remained at a low level since the number and amount of corporate bankruptcies have recently been stable.

[1] Fiscal 2012 was the period from April 2012 to March 2013.

[2] In this paper, 11 major banks and 105 regional banks are counted. Figures are on a non-consolidated basis, unless otherwise noted.

Contents

I. Outline of Financial Results for Fiscal 2012

A. Net Income

Net income for fiscal 2012 was about 2.3 trillion yen at major banks, up by around 30 percent from fiscal 2011. Specifically, <u>operating profits from core business</u> increased slightly and <u>realized gains on bondholdings</u> increased, in a situation where <u>credit costs</u> were more or less unchanged (the left-hand sides of Charts 1 and 2).

Net income for fiscal 2012 at regional banks was about 0.8 trillion yen, up by around 10 percent from fiscal 2011. Specifically, <u>realized gains/losses on bondholdings and stockholdings</u> contributed to an increase in net income, although net income was depressed by a decrease in <u>operating profits from core business</u> and an increase in <u>credit costs</u> (the right-hand sides of Charts 1 and 2).

Tax-related expenses (income tax and income tax adjustments) declined, and this also contributed to an increase in net income for fiscal 2012 at major and regional banks (Chart 2; see Appendix 1).

Chart 1: Net income/losses

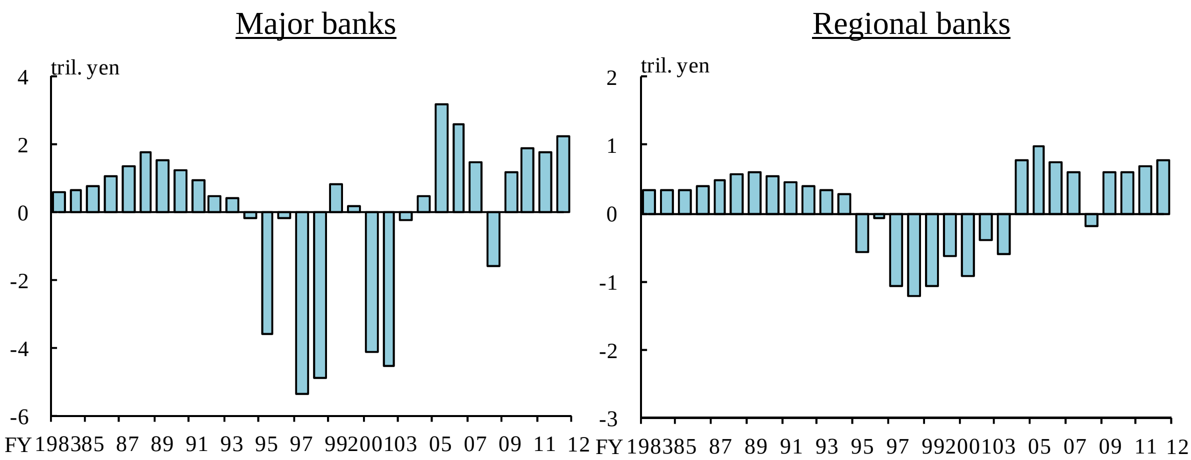
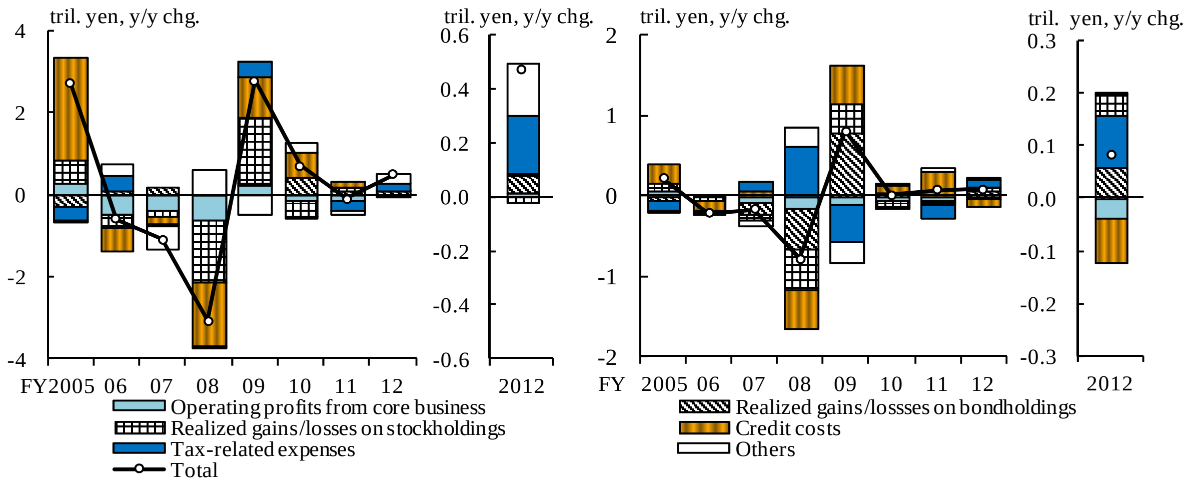


Chart 2: Factor decomposition of the change in net income/losses (change from a year earlier)[1]

Major banks Regional banks



Note: *1*. The factor decomposition for fiscal 2012 is shown in detail on the right-hand sides of the charts for major and regional banks.

B. Operating Profits from Core Business

Operating profits from core business increased slightly at major banks, as an increase in net non-interest income exceeded a decline in net interest income. On the contrary, regional banks experienced a decrease in operating profits from core business for the seventh consecutive year because a substantial decline in net interest income more than offset the effects of a decrease in general and administrative expenses and an increase in net non-interest income (Charts 3 and 4).

Chart 3: Operating profits from core business

Major banks Regional banks

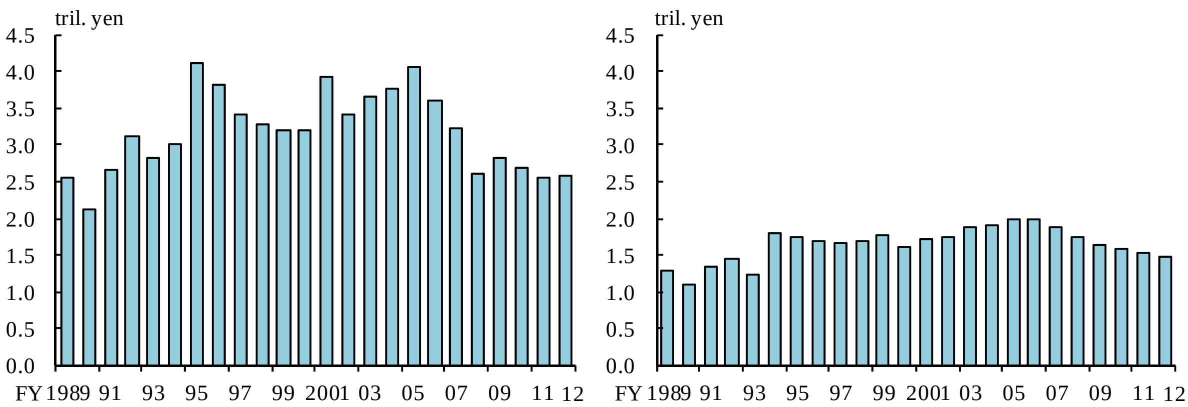
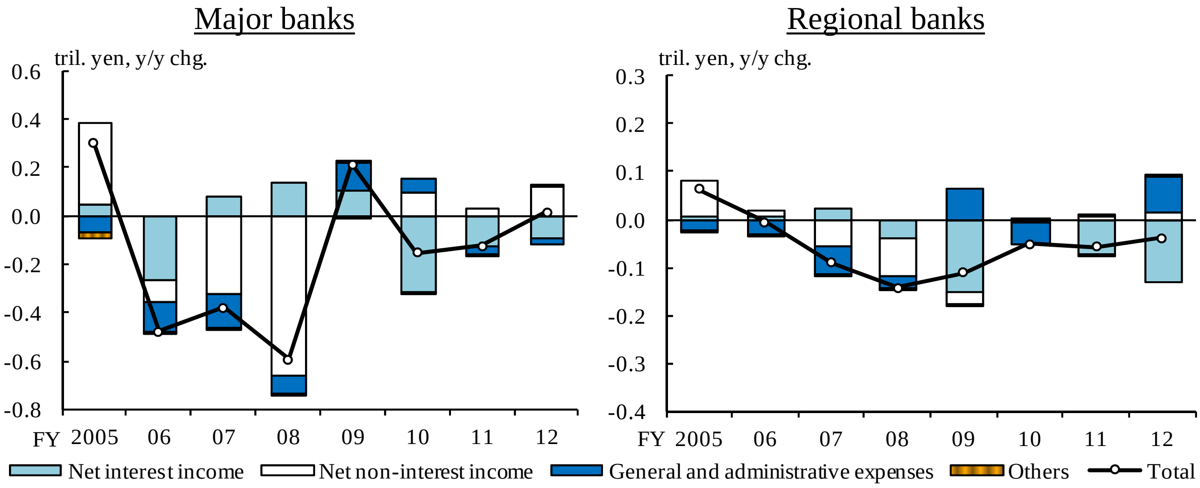


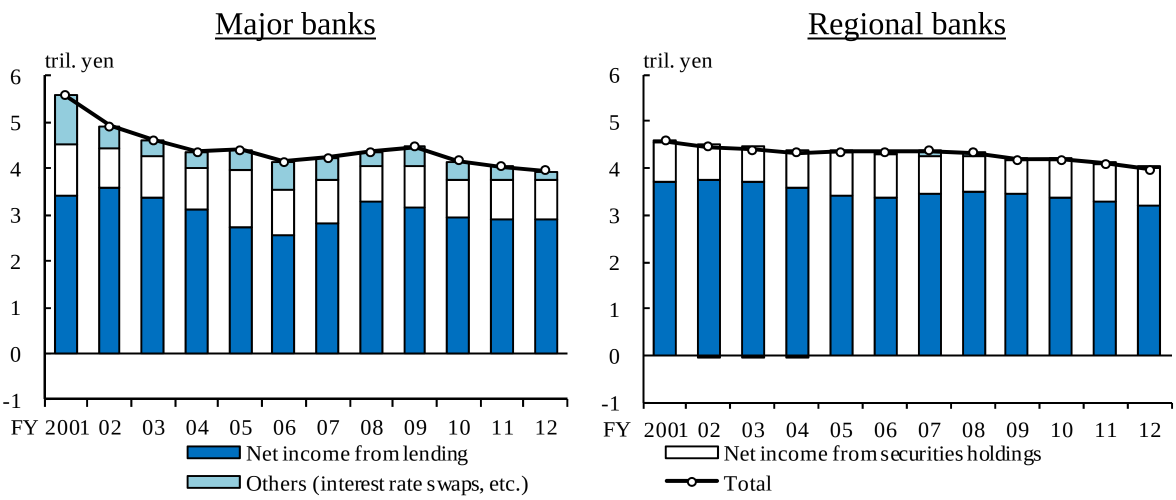
Chart 4: Factor decomposition of the change in operating profits from core business (change from a year earlier)



1. Net interest income

Net interest income as a whole decreased at major banks: income from lending started to increase slightly, while income from securities holdings and others (interest rate swaps, etc.) decreased. At regional banks, net interest income remained on a downtrend, mainly due to a decrease in income from lending (Chart 5).

Chart 5: Net interest income[1]



Note: *1*. Net income from lending = Interest rate spreads on loans × average outstanding amount of loans
Net income from securities holdings
= Interest rate spreads on securities × average outstanding amount of securities holdings

The decomposition of <u>net interest income</u> into factors in terms of amount outstanding and spreads in the domestic and international business sectors, respectively, shows that <u>net interest income</u> of the domestic business sector declined, due to decreases in spreads on loans and securities, at major and regional banks. On the other hand, <u>net interest income</u> of the international business sector at major banks increased mainly because of increases in the amounts outstanding of loans and securities (Charts 6 and 7).

Chart 6: Net interest income of the domestic business sector

<u>Major banks</u> <u>Regional banks</u>

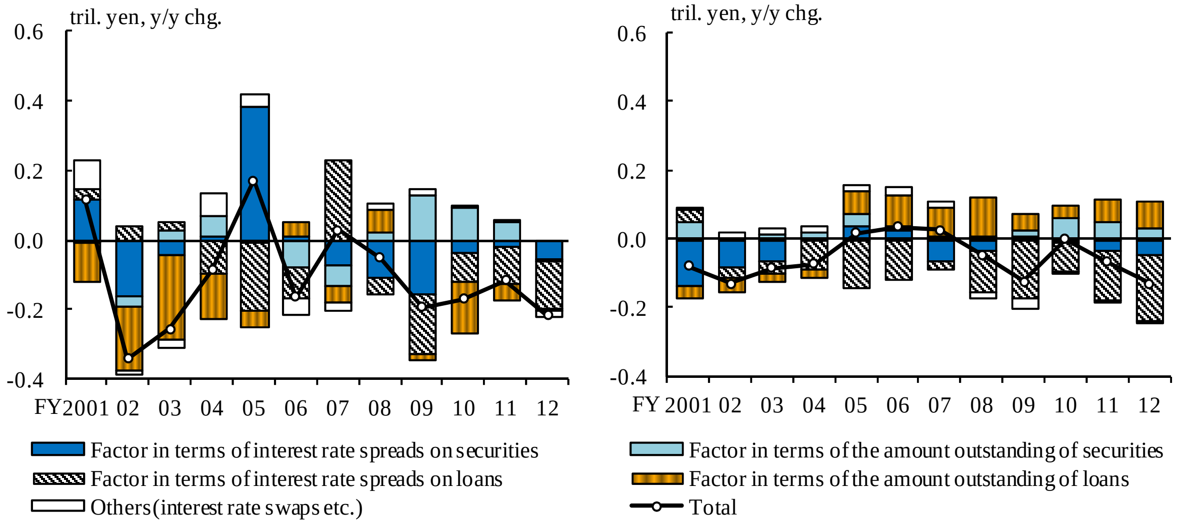
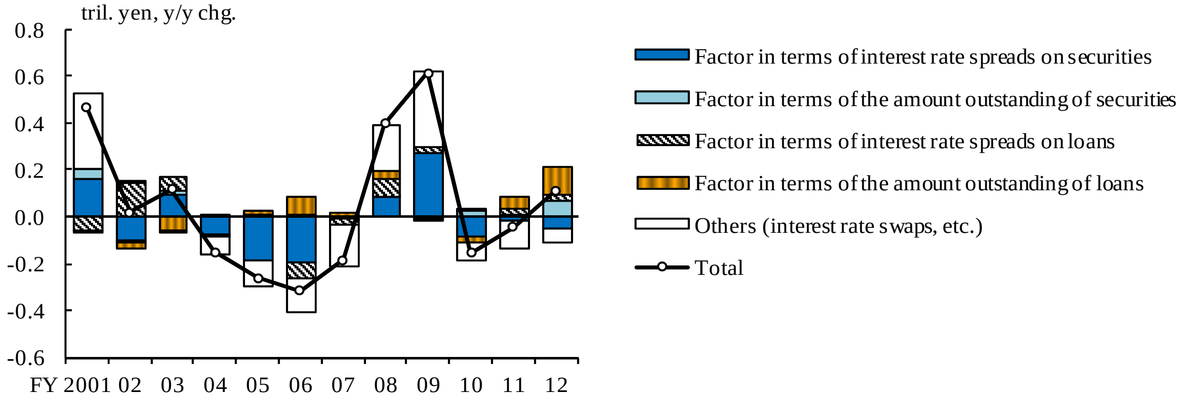


Chart 7: Net interest income of the international business sector (major banks)

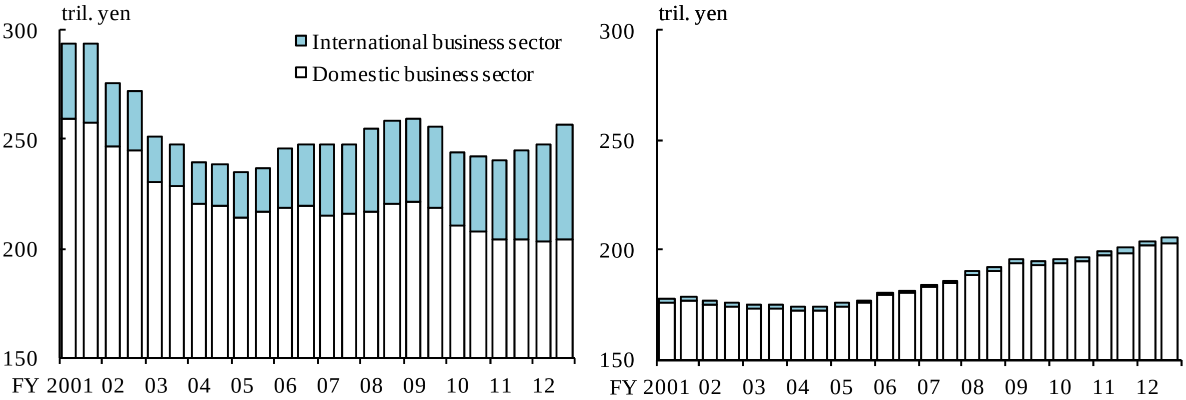


a. Net interest income (loans)

The loans outstanding (average amount outstanding) as a whole increased at major banks: the loans outstanding in the domestic business sector declined slightly, while those in the international business sector continued to rise. At regional banks, the loans outstanding remained on an uptrend, particularly in the domestic business sector (Chart 8).

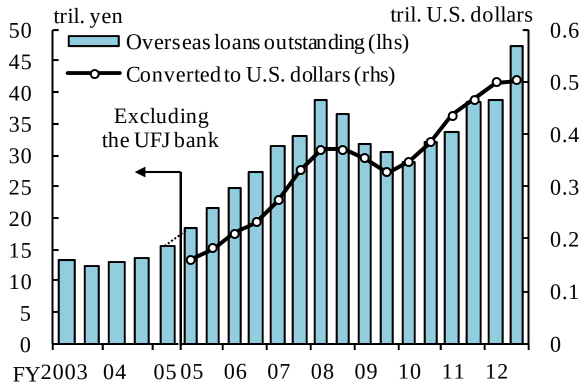
Chart 8: Average amounts outstanding of loans

Major banks Regional banks



The amount outstanding of overseas loans continued to increase at three major financial groups as a whole (Chart 9).

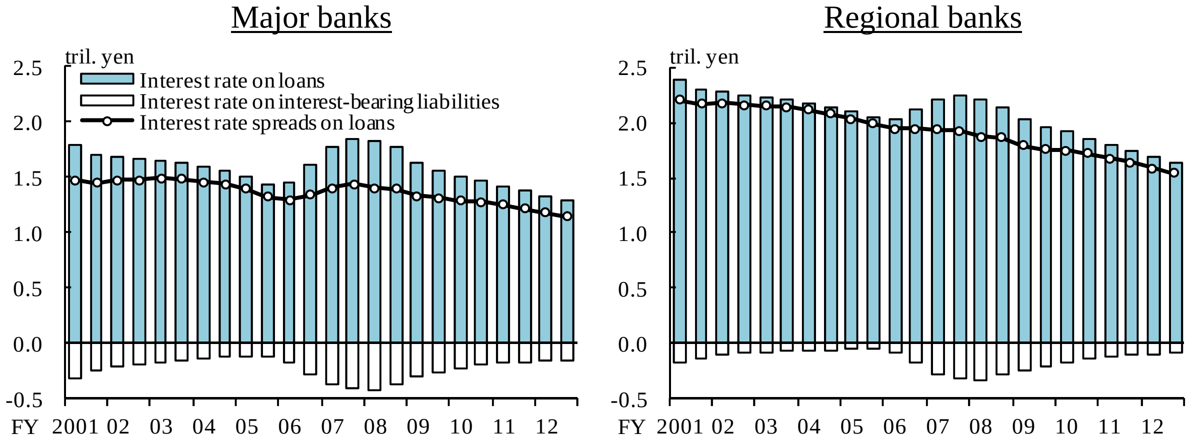
Chart 9: Overseas loans outstanding (end of the semiannual period)[1]



Note: *1*. The three major financial groups (Mizuho Financial Group, Mitsubishi UFJ Financial Group, and Sumitomo Mitsui Financial Group) are counted on a non-consolidated basis.

Interest rate spreads on loans in the domestic business sector diminished at major and regional banks, as the loan interest rate remained on a downtrend (Chart 10).

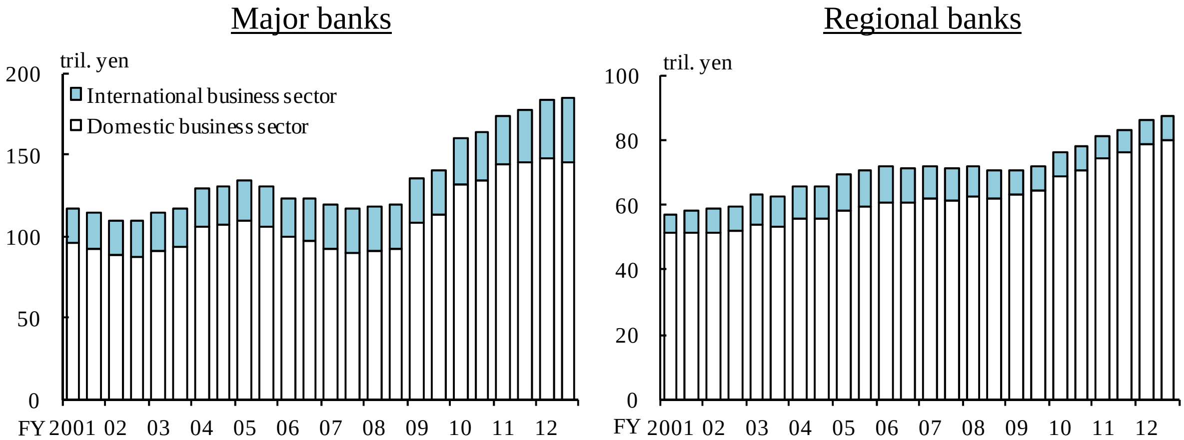
Chart 10: Interest rate spreads on loans (domestic business sector)



b. Net interest income (securities)

Securities holdings (average amount outstanding) as a whole continued to increase at major banks: securities holdings in the domestic business sector declined marginally, whereas those in the international business sector increased. At regional banks, securities holdings continued to increase mainly due to the rise in the domestic business sector (Chart 11).

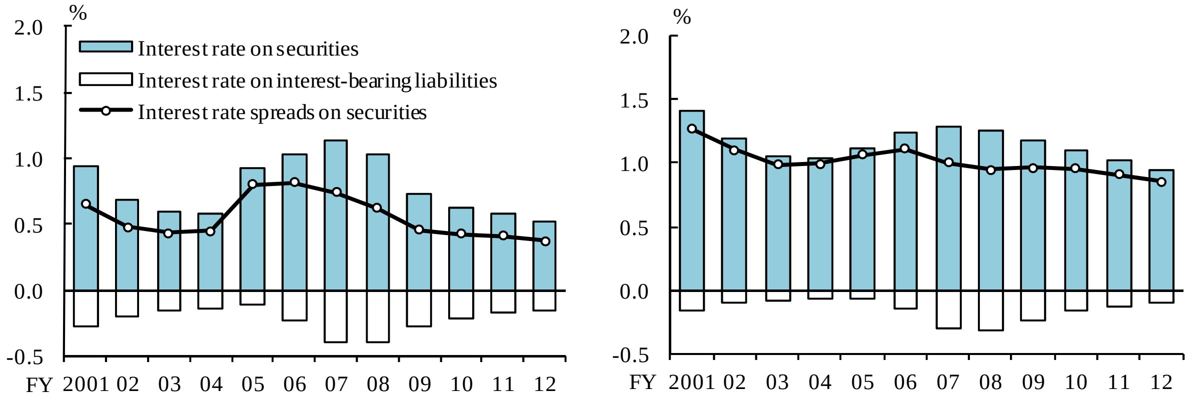
Chart 11: Average amounts outstanding of securities holdings



Spreads on securities in the domestic business sector decreased gradually at major and regional banks, as the yields on securities declined (Chart 12).

Chart 12: Interest rate spreads on securities in the domestic business sector

Major banks Regional banks

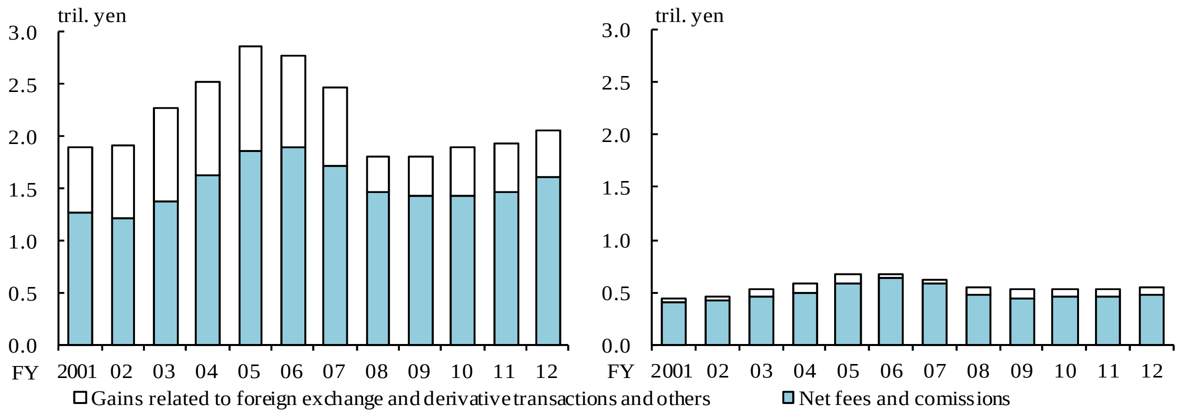


2. Net non-interest income

Net non-interest income increased at major and regional banks since net fees and commissions rose (Chart 13).

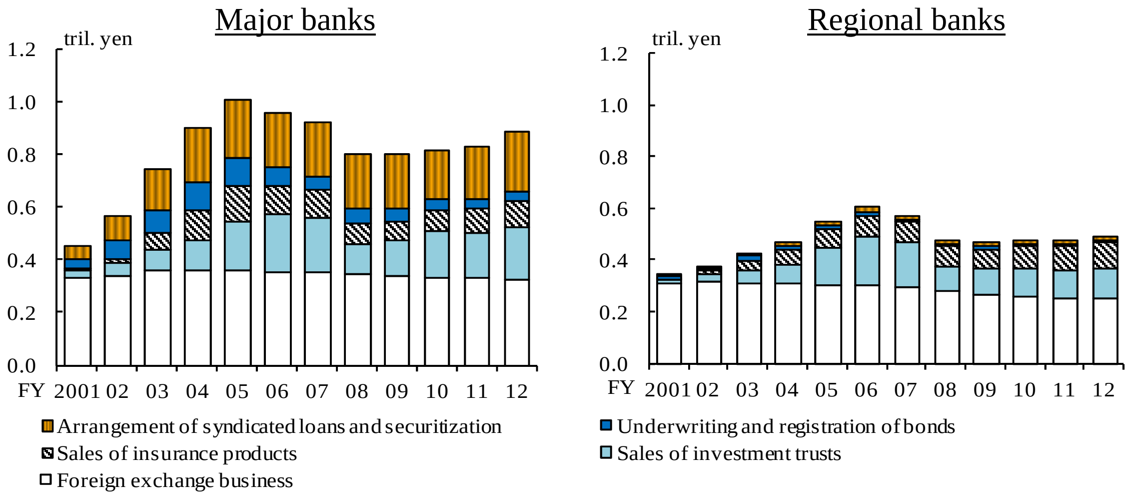
Chart 13: Non-interest income

Major banks Regional banks



The breakdown of income from fees and commissions (the domestic business sector) shows that fees and commissions for sales of investment trusts and for syndicated loans increased at major banks, and at regional banks those for sales of investment trusts increased (Chart 14).[3]

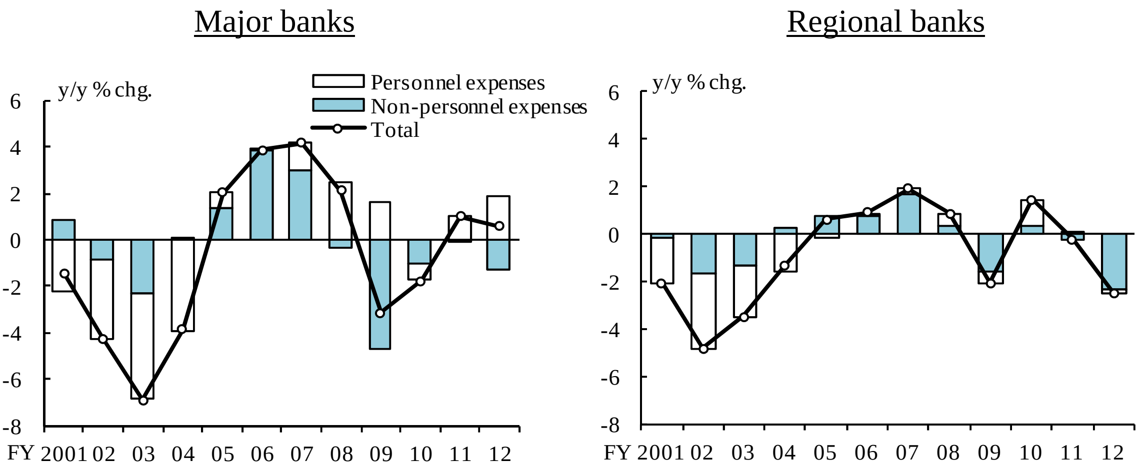
Chart 14: Income from fees and commissions in the domestic business sector



3. General and administrative expenses

General and administrative expenses increased as a whole at major banks due to a rise in personnel expenses, while non-personnel expenses decreased. At regional banks, general and administrative expenses decreased, particularly non-personnel expenses (Chart 15). The decrease in non-personnel expenses at major and regional banks was mainly caused by the decline in the deposit insurance premium.

Chart 15: Factor decomposition of the change in general and administrative expenses



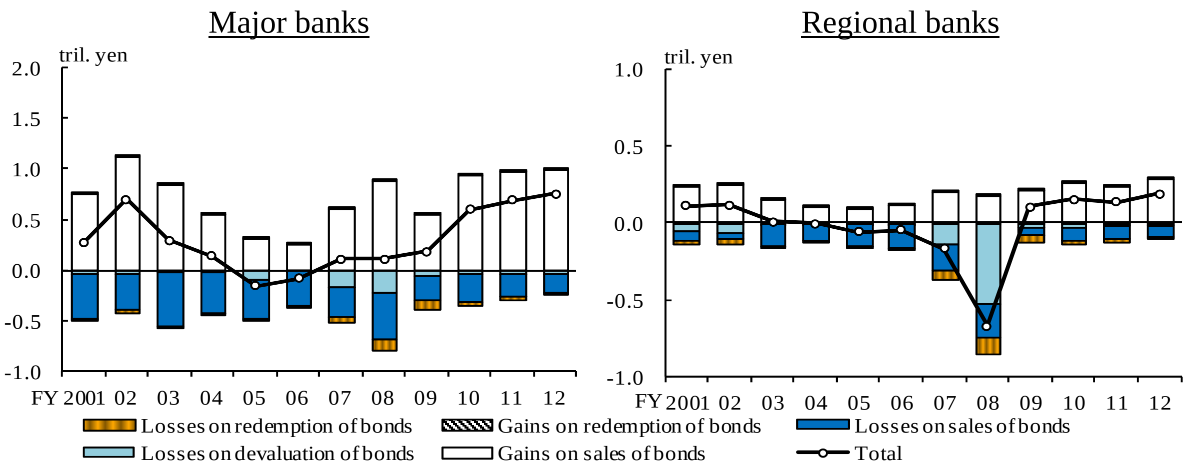
[3] Fees and commissions for sales of investment trusts increased particularly in the second half of fiscal 2012, when stock prices rose substantially.

C. Securities

1. Realized gains/losses on securities holdings

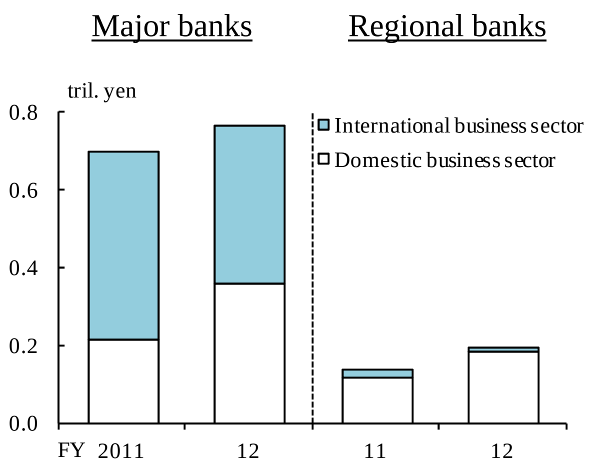
Among realized gains/losses on securities holdings, realized gains on bondholdings of both major and regional banks increased, and the levels remained high (Chart 16).

Chart 16: Realized gains/losses on bondholdings



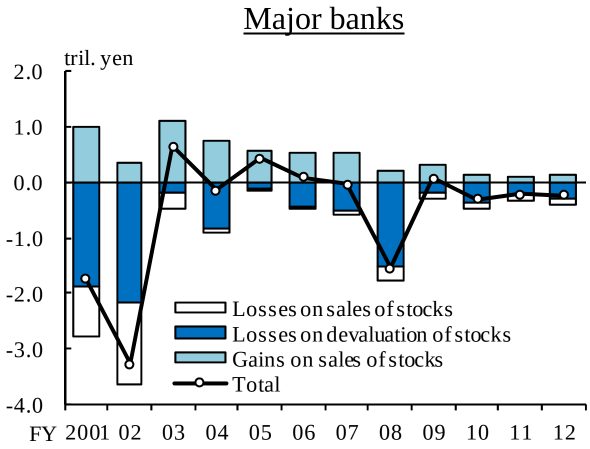
By sector, the domestic business sector boosted realized gains on bondholdings both at major and regional banks (Chart 17).

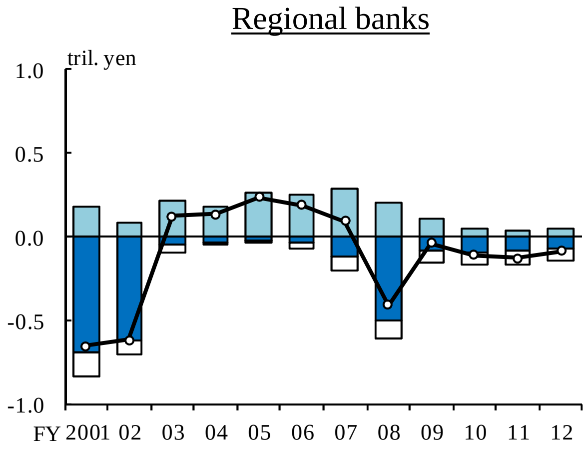
Chart 17: Composition of realized gains/losses on bondholdings of major and regional banks



As for realized gains/losses on stockholdings, both major and regional banks continued to record losses due to losses on devaluation of stocks (losses from impairment of stocks) (Chart 18).

Chart 18: Realized gains/losses on stockholdings



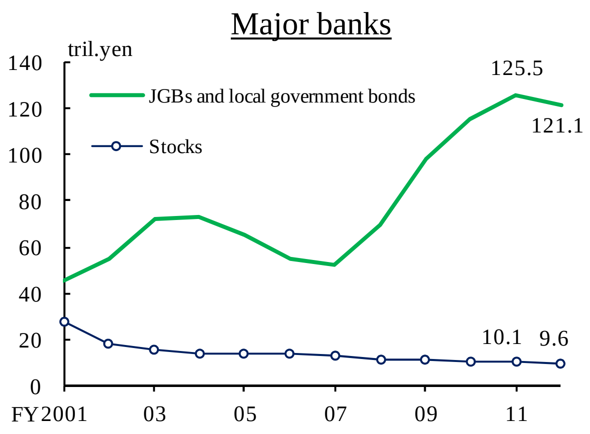


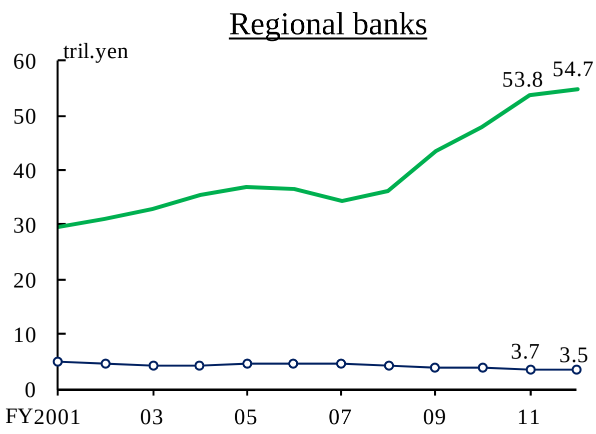
2. Amount outstanding of securities holdings

Regarding the amount outstanding of securities holdings at the end of March 2013, the amount of stockholdings continued to decrease, and the amount of holdings of Japanese government bonds (JGBs) and municipal bonds started to decline at major banks. At regional banks, the amount of stockholdings decreased, while that of holdings of JGBs and municipal bonds increased somewhat (Chart 19).

As for changes in the amount outstanding of securities holdings by type of security, the year-on-year rate of change in JGB holdings turned negative at major banks. At regional banks, the positive contribution from JGB holdings decreased, while the growth in holdings of other securities (public corporation bonds and others) increased (Chart 20).

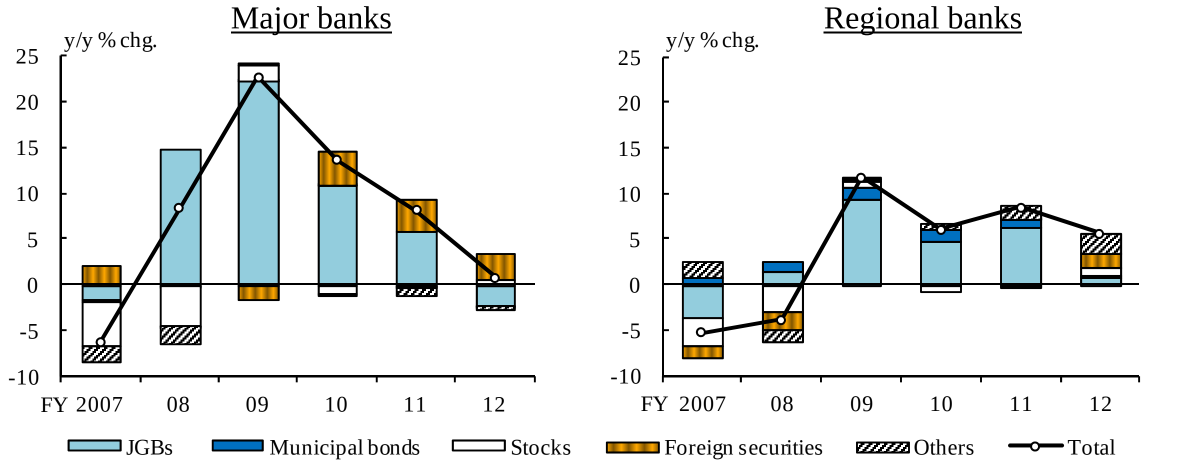
Chart 19: Outstanding amount of securities holdings (end of fiscal year)[1]





Note: *1*. "Stocks" indicates acquisition costs on a consolidated basis.

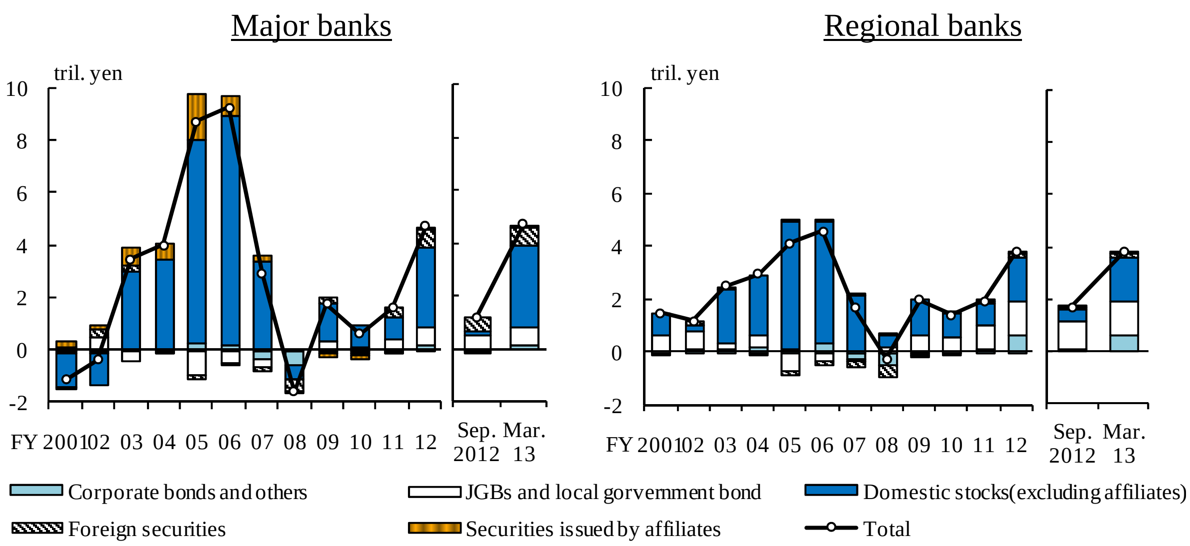
Chart 20: Change in the outstanding amount of securities holdings
by type of security (change from a year earlier)



3. Unrealized gains/losses on securities holdings

Regarding unrealized gains/losses on securities holdings as of the end of March 2013, the extent to which gains exceeded losses expanded significantly year on year at major and regional banks, mainly due to the improved balance in unrealized gains/losses on holdings of domestic stocks in the second half of fiscal 2012 (Chart 21).

Chart 21: Unrealized gains/losses on securities holdings



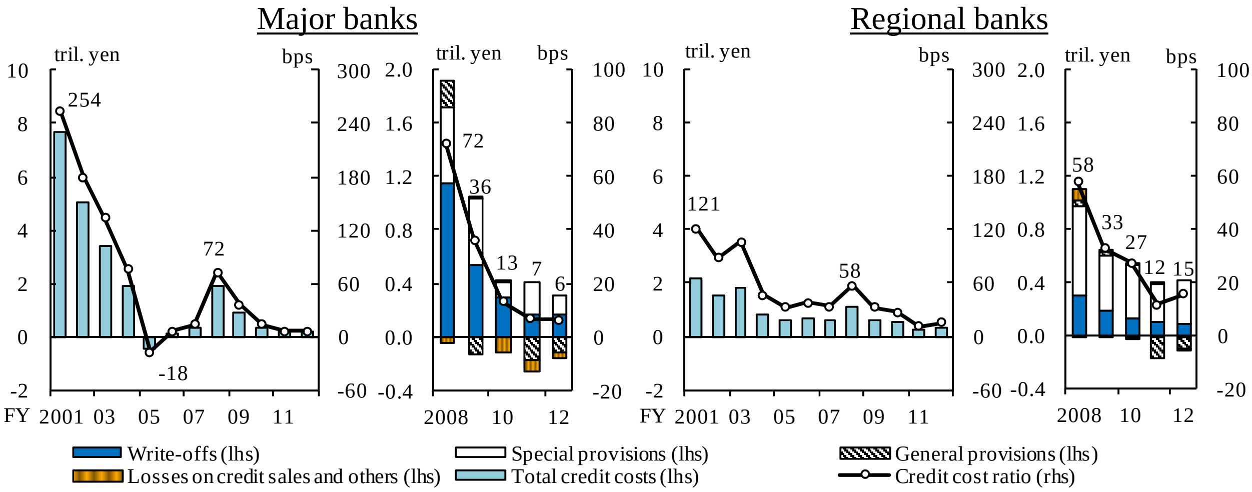
D. Credit Costs and Nonperforming Loans

1. Credit costs

Credit costs and credit cost ratios were more or less unchanged at major banks, while they increased at regional banks for the first time in 4 years (Chart 22).

With regard to factors behind the changes in credit costs, credit costs were more or less unchanged as a whole at major banks, as special loan-loss provisions decreased while reversals of general loan-loss provisions decreased (Chart 22). On the other hand, credit costs increased as a whole at regional banks because special loan-loss provisions increased reflecting an increase in the provisions in line with the downgrading of borrower firms and the change in the method for loan-loss provisioning intended to raise the loan-loss provision ratio, in addition to the decrease in reversals of general loan-loss provisions (Chart 22).

Chart 22: Credit costs and credit cost ratio[1,2]

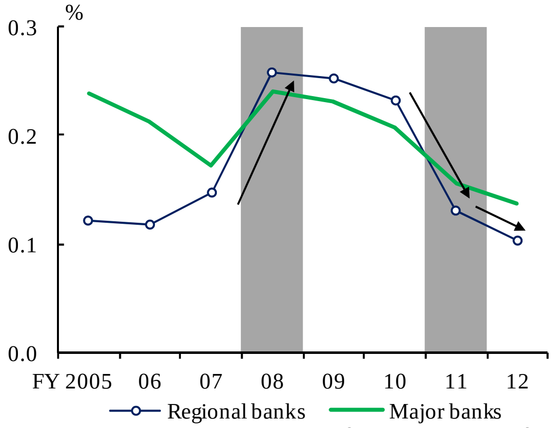


Notes: *1*. Figures in the charts indicate the credit cost ratio.
2. The factor decomposition from fiscal 2008 to fiscal 2012 is shown in detail on the right-hand sides of the charts for major and regional banks.

Behind the continued reversals of general loan-loss provisions lay the fact that the number and amount of corporate bankruptcies have recently been at low levels. Nevertheless, the pace of decline in the ratio of general loan-loss provisions for "normal" loans has moderated, and this partly contributed to the decrease in the reversals of general loan-loss provisions in fiscal 2012 (Charts 23 and 24).[4]

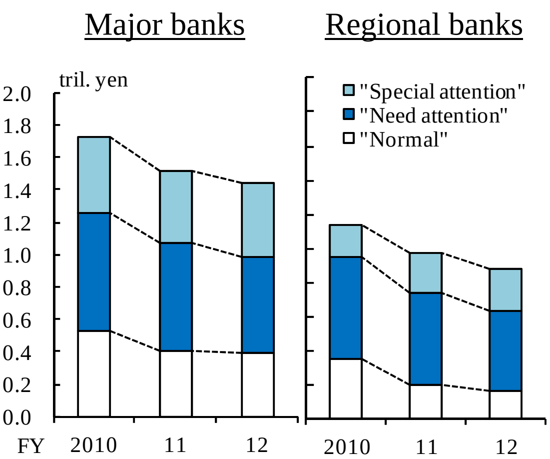
[4] When calculating general loan-loss provisions for "normal" loans, it is necessary to use the figures for actual loan losses at least for the past three calculation periods. It appears that the loan-loss provision ratio declined significantly in fiscal 2011 partly because many financial institutions began

Chart 23: Ratio of general loan-loss provisions for "normal" loans[1]



Note: *1*. Shaded areas indicate fiscal 2008 and fiscal 2011.

Chart 24: Amount outstanding of General loan-loss provision



The break-even credit cost ratio (the ratio at which credit costs and operating profits from core business match, namely, operating profits from core business / loans outstanding) continued to decline, and <u>the ratio of credit costs</u> that could be covered by the core profitability declined (Chart 25).

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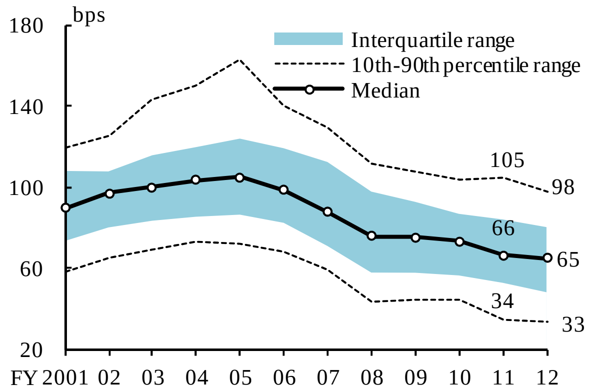
to exclude from the calculation period the figures for actual loan losses for fiscal 2008, when the ratio surged due to a sudden increase in loan losses following the Lehman shock.

Chart 25: Break-even credit cost ratio[1]

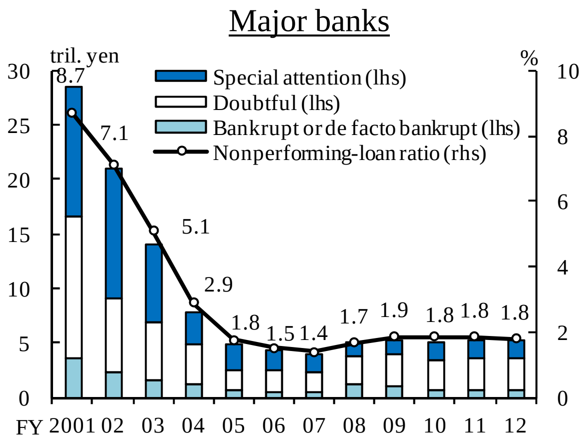


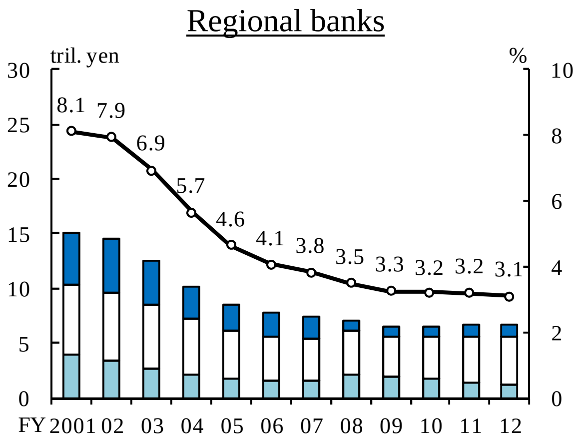
Note: *1.* Break-even credit cost ratios of major and regional banks are sorted in ascending order, and the 10th percentile point, 25th percentile point, 50th percentile point (median), 75th percentile point, and 90th percentile point are calculated.

2. Nonperforming loans

The ratios of nonperforming loans (NPLs) were more or less unchanged in fiscal 2012 relative to fiscal 2011: 1.8 percent at major banks and 3.1 percent at regional banks (Chart 26).

Chart 26: Amount outstanding and ratio of nonperforming loans

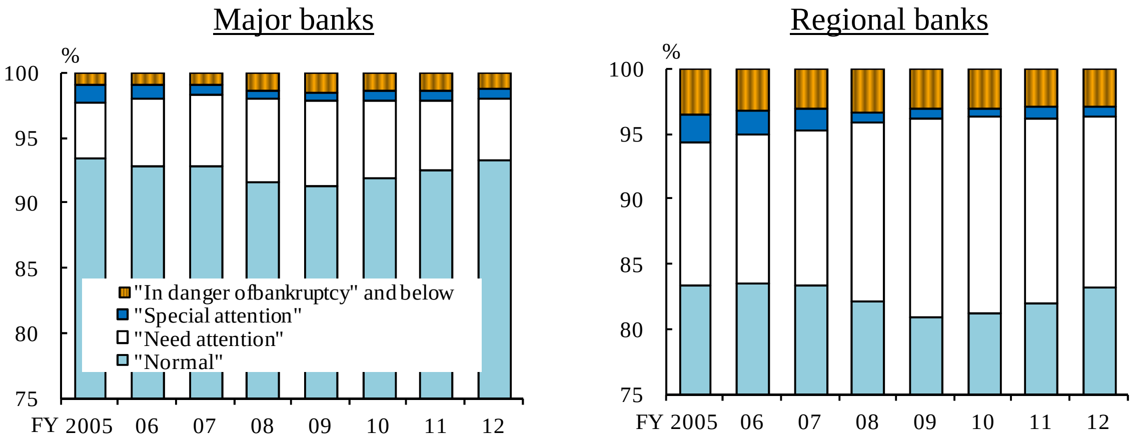




However, it should be noted that the amount of "special attention" loans extended to small and medium-sized firms might have been contained since fiscal 2008, with the relaxed requirements for restructured loans and other measures.[5]

As for loans outstanding by borrower classification, the proportions of "normal" loans have started to increase both at major and regional banks (Chart 27).

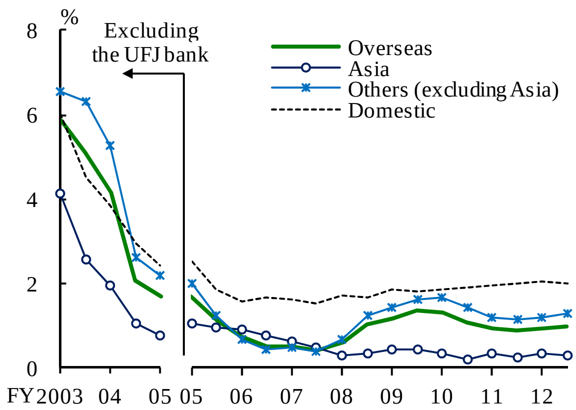
Chart 27: Loans outstanding by borrower classification[1]



Note: *1*. Figures are based on the results of self-assessments after write-offs in the banking book.

Regarding major banks, the NPL ratio in terms of overseas loans remained at low levels of about 1 percent at three large financial groups as a whole (Chart 28).

Chart 28: Ratio of nonperforming overseas loans[1]



Note: *1*. The three major financial groups (Mizuho Financial Group, Mitsubishi UFJ Financial Group, and Sumitomo Mitsui Financial Group) are counted on a non-consolidated basis.

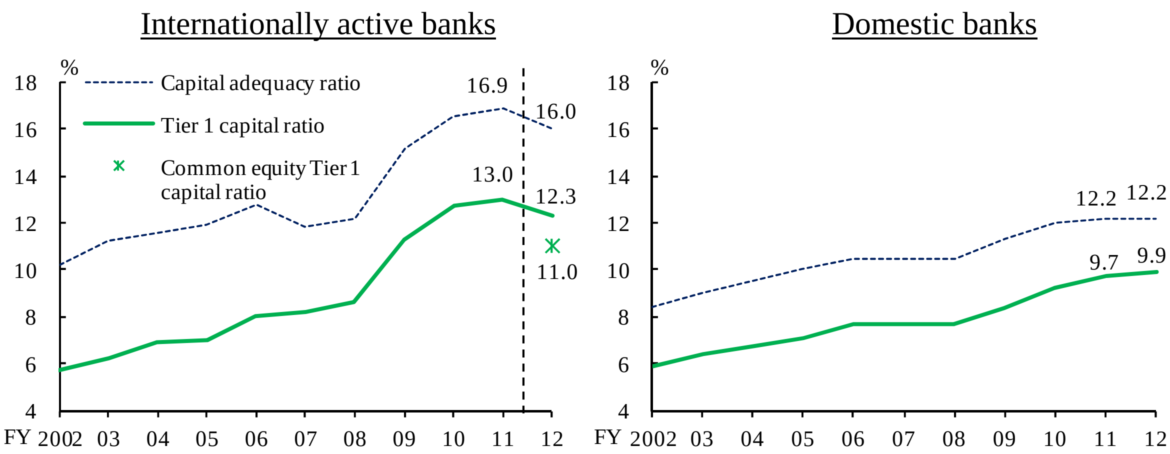
[5] See Chapter IV.C.1 in the April 2012 *Financial System Report* for the estimation of the effects on the NPL ratio based on certain assumptions on business conditions of firms with relaxed requirements for restructured loans, using the financial data on small and medium-sized firms.

E. Capital Adequacy Ratio

As for the capital adequacy ratio (on a consolidated basis) as of the end of March 2013, looking at the capital adequacy ratio (after taking into consideration the transitional arrangements) of internationally active banks, which have shifted to the Basel III requirements, the total capital adequacy ratio was 16.0 percent, the Tier I capital ratio was 12.3 percent, and the common equity Tier I capital ratio was 11.0 percent.[6] With regard to domestic banks (on a Basel II requirement basis), the capital adequacy ratio was 12.2 percent and the Tier I capital ratio was 9.9 percent (Chart 29).

At internationally active banks, the fact that risk-weighted assets (the denominator) increased, partly reflecting the enhanced coverage of credit risk due to the transition to the Basel III requirements, contributed to the decline in the capital adequacy ratio (Chart 30).

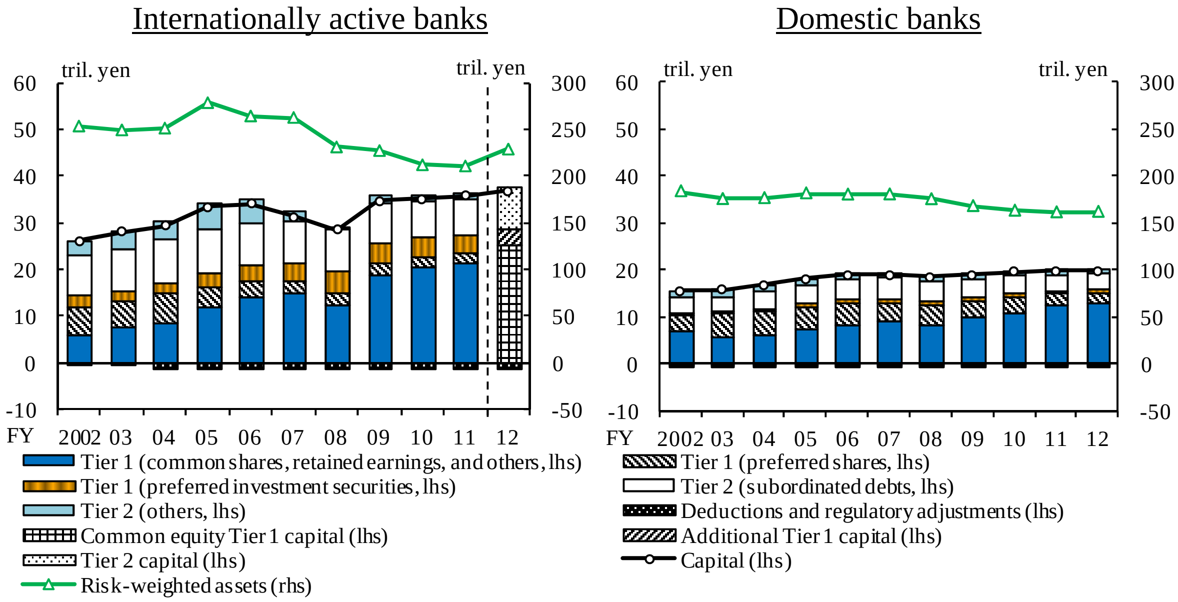
Chart 29: Capital adequacy ratio[1,2]



Notes: *1*. Internationally active banks and domestic banks are classified as of end-March 2013.
2. Figures are based on the Basel II requirements (those of internationally active banks in fiscal 2012 are based on the Basel III requirements).

[6] Under the Basel III requirements, conditions for inclusion/deduction of some items to/from capital have become stringent, but the requirements, in principle, will be phased in gradually in line with the transitional arrangements.

Chart 30: Capital components and risk-weighted assets[1]



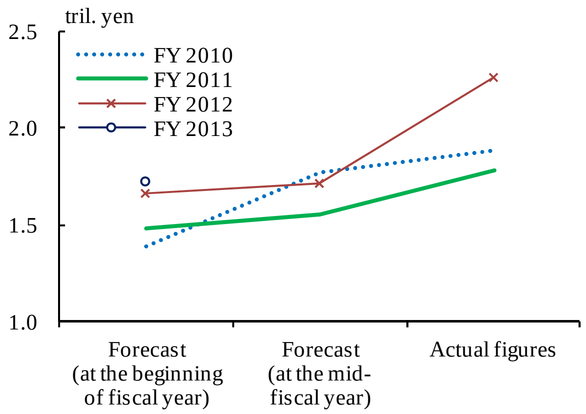
Note: *1.* See the footnotes to Chart 29.

II. Outlook for Financial Results for Fiscal 2013

A. Major Banks

Net income for fiscal 2013 is expected to decline by more than 20 percent relative to the actual figures for fiscal 2012 (Chart 31). Looking at the data from fiscal 2010 to fiscal 2012, the actual figures exceeded the forecasts made at the beginning of each fiscal year.

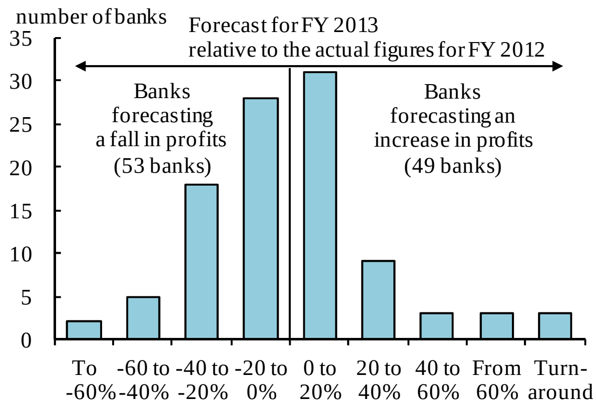
Chart 31: Comparison between banks' forecast and actual figures for major banks' net income

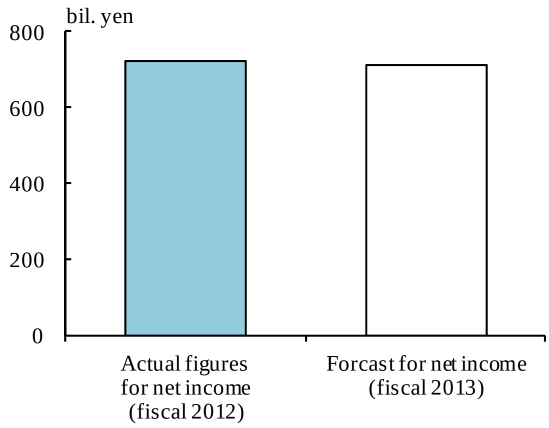


B. Regional Banks

Net income for fiscal 2013 is expected to decrease marginally relative to the actual figures for fiscal 2012 (the left-hand side of Chart 32). The number of regional banks forecasting that their net income would decrease exceeded slightly the number of regional banks forecasting an increase (the right-hand side of Chart 32).

Chart 32: Banks' forecast for net income of regional banks for fiscal 2013[1]





Note: *1*. In this chart, 102 banks are counted (excluding a bank that merged during fiscal 2012, etc.).
Sources: Financial Quest and the published financial results of each bank.

Appendix 1: Decrease in Tax-Related Expenses in the Financial Results for Fiscal 2012

A decline in tax-related expenses, which contributed to an increase in net income for fiscal 2012, was mainly induced by two factors in terms of tax-effect accounting, as described below.

A. Effects Due to a Change in the Income Tax Rate Induced by the Fiscal 2011 Tax Reform

The reduction in the income tax rate applied in and after fiscal 2012 due to the fiscal 2011 tax reform decreased the future tax burden and, as a result, the amount of deferred tax assets, which were calculated based on a higher tax rate, turned out to be excessive. Therefore, in the financial results for fiscal 2011, a portion of deferred tax assets commensurate with the reduction in the tax rate was charged off, and thus tax-related expenses increased. In fiscal 2012, tax-related expenses declined in accordance with the abating of such effects observed in fiscal 2011, and this contributed to an increase in net income.

B. Effects Due to a Recovery in Business Conditions

Since the restrictions on calculating deferred tax assets were relaxed in fiscal 2012 for some banks reflecting the recent improvement in their business conditions, banks' capability to recognize a larger amount of deferred tax assets increased, causing tax-related expenses to decline to the extent that deferred tax assets had accumulated.

Under tax-effect accounting, there are five example categories in accordance with the degree of the stability in banks' business conditions (categories in terms of the recoverability of deferred tax assets). For each category, a certain period of time is set for estimating future taxable income that can be used in calculating deferred tax assets. Banks with stable business conditions can recognize a larger amount of deferred tax assets based on estimated future taxable income in the longer term, causing tax-related expenses to decline, and therefore the upgrading of categories boosts banks' net income.

Appendix 2: Glossary

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 securities holdings = realized gains/losses on stockholdings
+ 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

Tier I capital ratio = Tier I capital / risk-weighted assets

Tier I capital is the core capital including common equities and retained earnings.