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Financial Results of Japan's Banks for Fiscal 2013

Financial System and Bank Examination Department

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Bank of Japan

Financial Results of Japan's Banks for Fiscal 2013[1,2]

Summary

Net income for fiscal 2013 increased by around 5 percent at major banks and around 30 percent at regional banks relative to fiscal 2012. Net income at regional banks slightly exceeded the all-time high recorded in fiscal 2005.

Factors behind this increase in net income included a substantial decline in credit costs reflecting an improvement in the quality of assets as well as a rise in stock prices that boosted profits in a number of areas, as the economy continued to recover moderately.

Credit costs contributed to a rise in income: reversals in credit costs increased at major banks mainly due to a decrease in the amount of additional nonperforming loans (NPLs) and in the loan-loss provision ratio, and credit costs declined significantly at regional banks. The rise in stock prices boosted profits through (1) an improvement in realized gains/losses on stockholdings reflecting a decrease in losses on devaluation of stocks (losses from impairment of stocks) and an increase in gains on sales of stocks, (2) an increase in profits from investment trusts due to cancellations (including net interest income), and (3) an increase in fees and commissions for sales of investments trusts (including net non-interest income).

Interest rate spreads on loans in the domestic business sector continued to narrow. Consequently, core profitability in the domestic business sector remained on a downtrend, despite an increase in the amount outstanding of loans. This tendency was especially strong in the case of regional banks and unlike major banks, where lending in the international business sector contributed to an increase in profits.

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[1] Fiscal 2013 was the period from April 2013 to March 2014.

[2] This paper covers 10 major banks and 105 regional banks. Figures are on a non-consolidated basis, unless otherwise noted. The 10 major banks are 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.

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I. Outline of Financial Results for Fiscal 2013

A. Profits and Losses

Net income for fiscal 2013 was about 2.4 trillion yen at major banks, up by around 5 percent (100 billion yen) from fiscal 2012. Specifically, operating profits from core business increased due to expansion in both net interest income and net non-interest income. Reversals of credit costs increased. Meanwhile, realized gains on bondholdings decreased substantially, while realized gains/losses on stockholdings improved significantly (Chart 1).

Net income for fiscal 2013 at regional banks was about 1.0 trillion yen, up by around 30 percent (260 billion yen) from fiscal 2012 and slightly exceeding the all-time high recorded in fiscal 2005. Specifically, realized gains/losses on stockholdings improved and credit costs decreased while operating profits from core business rose marginally mainly due to an increase in net non-interest income (Chart 1).

Chart 1: Main profit and loss items

100 mil. yen

	Major banks		Regional banks	
	FY 2013	y/y chg.	FY 2013	y/y chg.
Net interest income	40,631	+1,115	39,878	+60
Net non-interest income	22,536	+1,929	5,662	+287
General and administrative expenses	35,350	+953	30,417	+28
Operating profits from core business	27,821	+2,096	15,123	+318
Realized gains/losses on bondholdings	1,845	-5,745	912	-1,019
Realized gains/losses on stockholdings	2,888	+5,198	1,246	+2,060
Credit costs (Credit cost ratio)	-3,219 (-12 bps)	-4,845 (-18 bps)	1,287 (6 bps)	-1,902 (-9 bps)
Others	-1,328	+613	-353	+449
Net income before income taxes	34,445	+7,007	15,643	+3,710
Tax-related expenses	10,852	+5,993	5,307	+1,105
Net income	23,593	+1,014	10,335	+2,604

Notes: 1. Net non-interest income = net fees and commissions + profits on specified transactions + net other operating profits – realized gains/losses on bondholdings

2. Tax-related expenses = current tax expenses + deferred tax expenses

3. Major banks' negative values of credit costs and credit cost ratios show reversals of allowance and recoveries of write-offs.

B. Balance Sheets

Relative to the end of March 2013, the balance sheets of major banks as of the end of March 2014 indicate that assets increased on the whole: loans and bills discounted increased and cash and due from banks expanded, while securities, particularly Japanese government bonds (JGBs), decreased substantially. Meanwhile, liabilities also increased, particularly ordinary deposits (Chart 2).

With regard to assets of regional banks, cash and due from banks as well as loans and bills discounted increased, and securities rose slightly on the whole as corporate bonds and foreign securities expanded with a decrease in JGBs. Meanwhile, liabilities increased, particularly ordinary deposits (Chart 2).

Chart 2: Main balance-sheet items

Major banks

tril. yen

	End of FY 2013	y/y chg.		End of FY 2013	y/y chg.
Loans and bills discounted	280.1	+14.3	Deposits	369.9	+18.1
Securities	160.2	-32.6	Ordinary deposits	170.7	+11.2
JGBs	89.1	-30.8	Time deposits	143.6	+3.5
Corporate bonds	8.8	-0.9	Other liabilities	196.5	-2.0
Stocks	15.4	+0.3	Total liabilities	566.5	+16.1
Foreign securities	42.7	-1.6	Share capital and capital surplus	17.3	-0.5
Cash and due from banks	85.3	+48.6	Retained earnings	9.4	+1.1
Other assets	70.7	-13.6	Net unrealized gains/losses on securities	3.3	+0.3
Total assets	596.2	+16.7	Total net assets	29.8	+0.6

Regional banks

tril. yen

	End of FY 2013	y/y chg.		End of FY 2013	y/y chg.
Loans and bills discounted	218.8	+6.3	Deposits	297.6	+9.1
Securities	93.7	+2.1	Ordinary deposits	142.6	+7.7
JGBs	40.8	-2.1	Time deposits	131.6	+0.9
Corporate bonds	21.1	+1.3	Other liabilities	27.7	+2.4
Stocks	6.0	+0.6	Total liabilities	325.4	+11.5
Foreign securities	10.3	+1.6	Share capital and capital surplus	5.8	-0.1
Cash and due from banks	20.8	+7.0	Retained earnings	9.8	+0.7
Other assets	10.5	-3.3	Net unrealized gains/losses on securities	2.5	+0.0
Total assets	343.7	+12.1	Total net assets	18.4	+0.6

II. Main Items

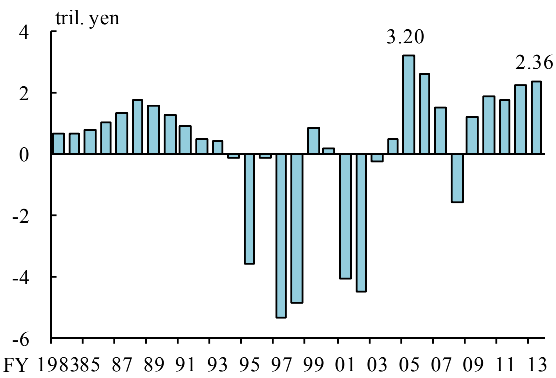
A. Net Income

Net income for fiscal 2013 was about 2.4 trillion yen at major banks, up by around 5 percent from fiscal 2012. Specifically, operating profits from core business increased due to expansion in both net interest income and net non-interest income. Reversals of credit costs increased. Meanwhile, realized gains/losses on stockholdings improved significantly, although realized gains on bondholdings decreased substantially (the left-hand sides of Charts 3 and 4).

Net income for fiscal 2013 at regional banks was about 1.0 trillion yen, up by around 30 percent from fiscal 2012 and slightly exceeding the all-time high recorded in fiscal 2005. Specifically, realized gains/losses on stockholdings improved and credit costs decreased, while operating profits from core business increased marginally mainly due to an increase in net non-interest income (the right-hand sides of Charts 3 and 4). Relative to fiscal 2005, the decrease in credit costs contributed to a boost in the level of profits, while operating profits from core business decreased (the right-hand side of Chart 4).

Chart 3: Net income/losses

Major banks



Regional banks

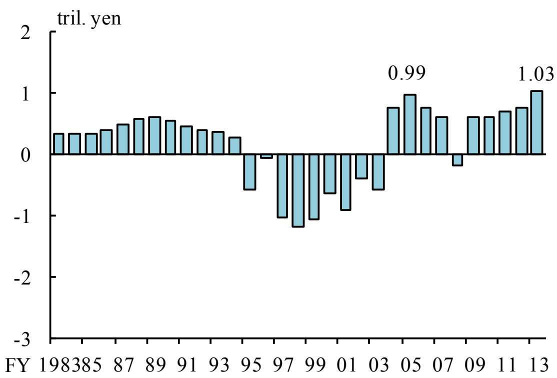
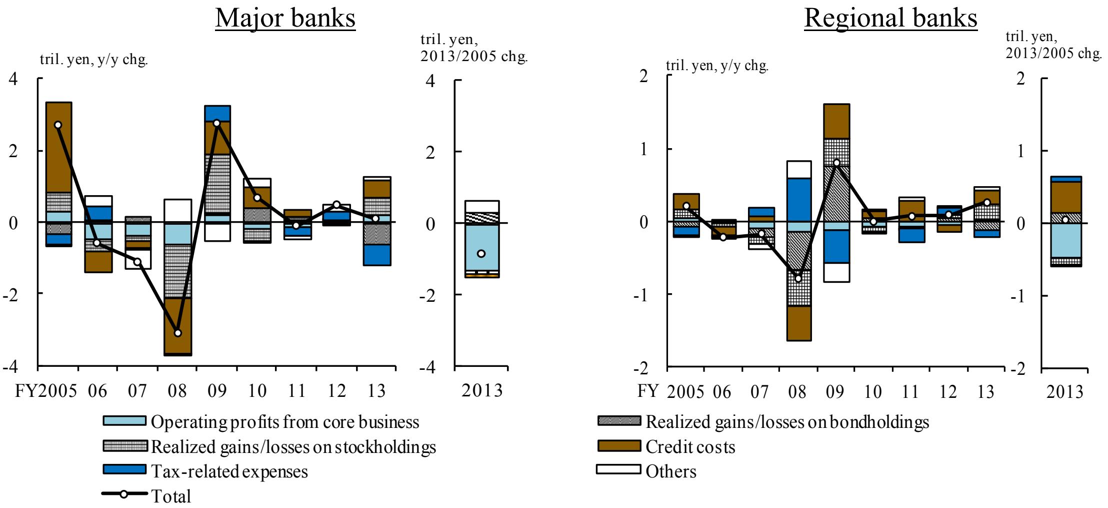


Chart 4: Factor decomposition of the change in net income/losses (change from a year earlier)[1]



Note: *1*. The factor decomposition for fiscal 2013 relative to fiscal 2005 (when all-time highs were recorded for both major and regional banks) 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 at major banks, as increases in net non-interest income and net interest income exceeded the increase in general and administrative expenses. On the contrary, regional banks experienced a rise in operating profits from core business for the first time in eight years, albeit marginally, mainly due to an increase in net non-interest income (Charts 5 and 6).

Operating profits from core business expanded at both major banks and regional banks, with a large amount of profits from investment trusts due to cancellations (realization of unrealized gains) recorded as an increase in net interest income at some banks.[3,4]

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3 Similar to interest and dividends mainly from bonds and stocks, profits from investment trusts due to cancellation are counted as "interest and dividends on securities," a component of net interest income, not as gains/losses on sales of securities. Consequently, profits from cancellations of investment trusts may cause a rise in yields (widening of spreads) on securities (interest and dividends from securities / average amount outstanding of securities holdings).

4 Profits from investment trusts due to cancellation for fiscal 2013 increased by about 130 billion yen at major banks and about 100 billion yen at regional banks relative to fiscal 2012.

Chart 5: Operating profits from core business

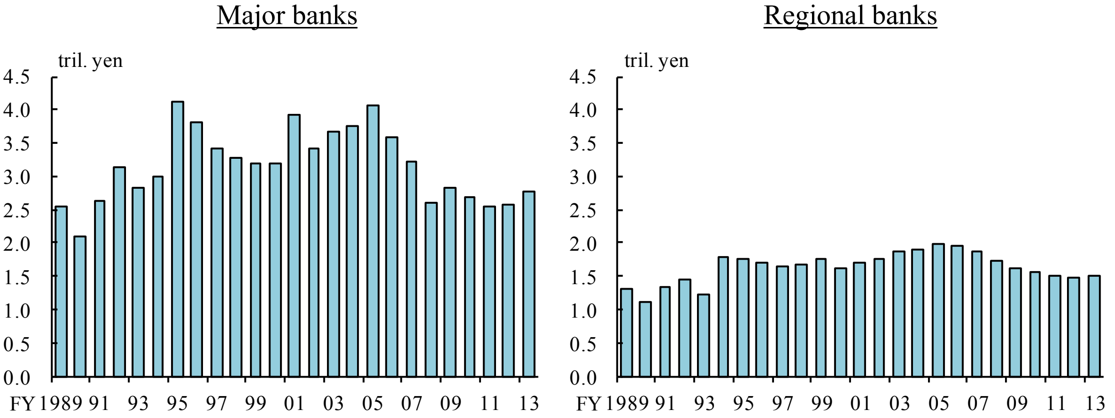
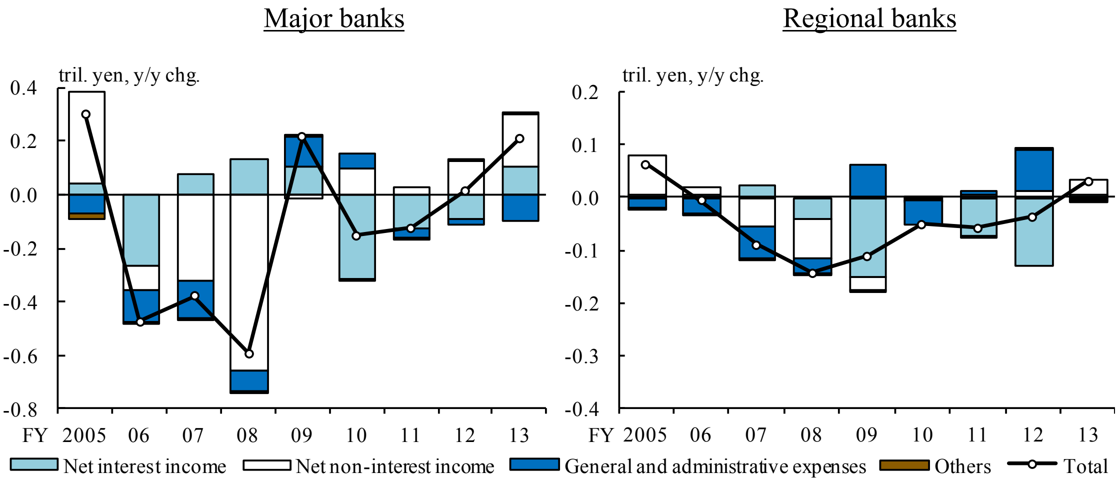


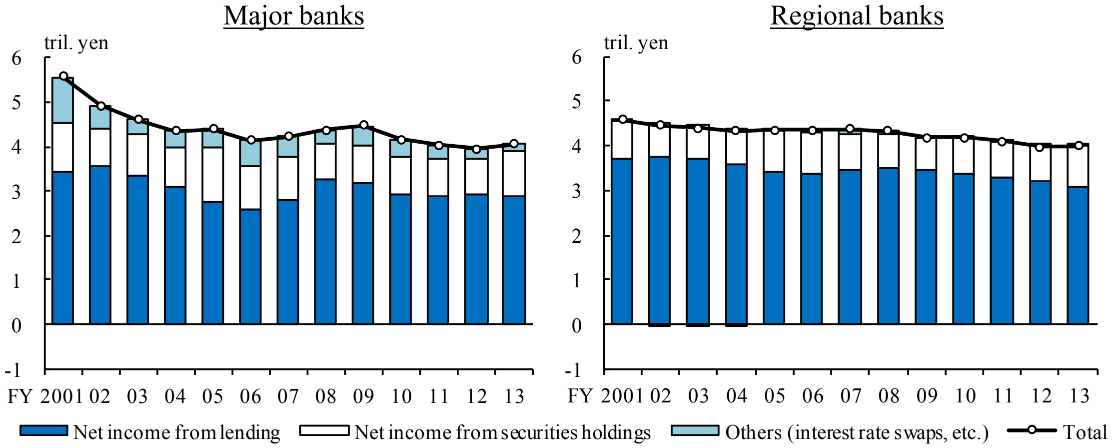
Chart 6: Factor decomposition of the change in operating profits from core business (change from a year earlier)



1. Net interest income

Net interest income as a whole expanded at major banks: income from lending decreased slightly, while income from securities holdings increased. At regional banks, net interest income as a whole remained more or less unchanged, as income from securities holdings increased while income from lending continued to decline (Chart 7).

Chart 7: Net interest income[1]



Note: *1.* Net income from lending
= net interest margin 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 net interest income into factors in terms of amount outstanding and interest rate spreads (investment rate minus the funding rate) in the domestic and international business sectors, respectively, shows that a widening of interest rate spreads on securities -- mainly reflecting the inclusion of profits from investment trusts due to cancellations -- as well as a rise in the amount outstanding of lending contributed to an increase in net interest income of the domestic business sector at major and regional banks. On the other hand, the narrowing of interest rate spreads on loans continued to push down net interest income (Chart 8).

Meanwhile, the rise in the amount outstanding of lending continued to contribute to an increase in net interest income of the international business sector at major banks, offsetting the decrease in net interest income of the domestic business sector (Chart 9). Unlike major banks, at regional banks -- only a small portion of whose business comes from the international business sector -- the narrowing of interest rate spreads on loans in the domestic business sector led to a decline in core profitability.

Chart 8: Net interest income of the domestic business sector

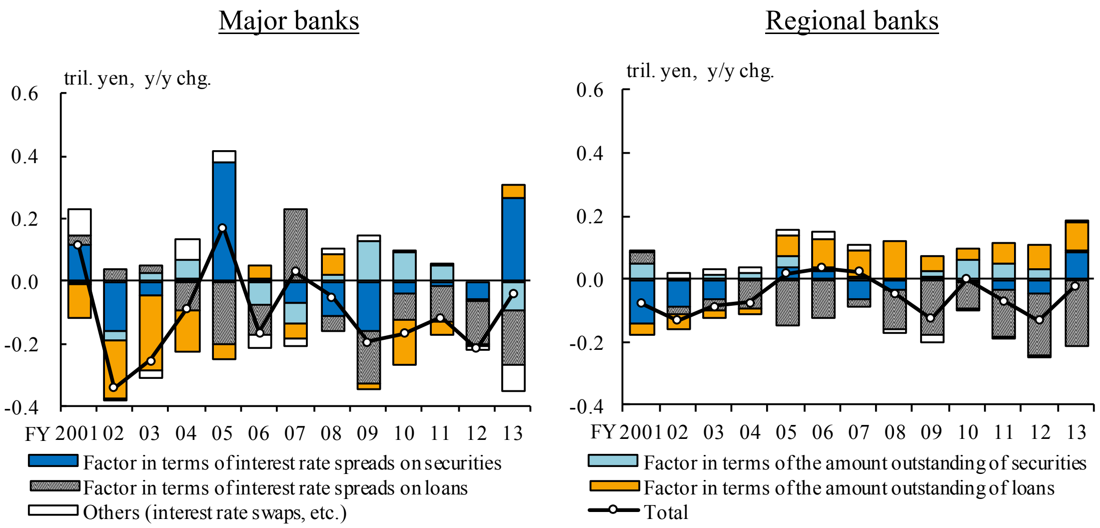
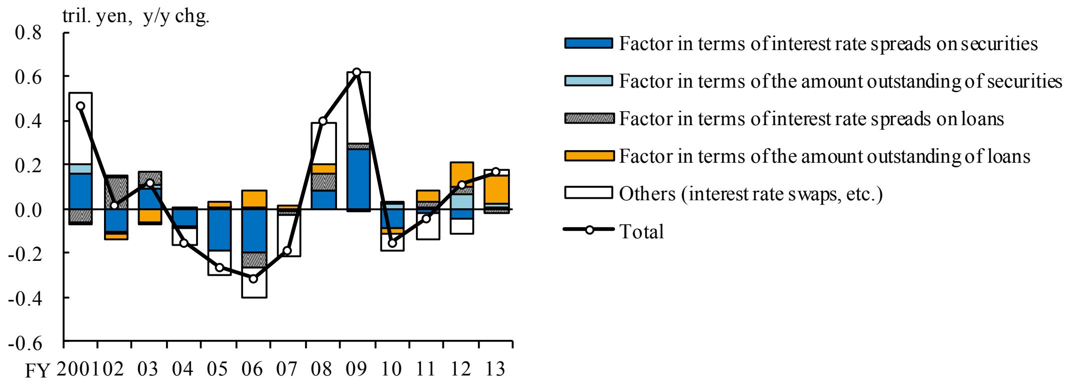


Chart 9: Net interest income of the international business sector (major banks)[1]



Note: *1.* Due to adjustments such as the exclusion of yen conversions and yen investments, changes in net interest income (the line graph) do not match those of the international business sector in the published financial results of each bank.

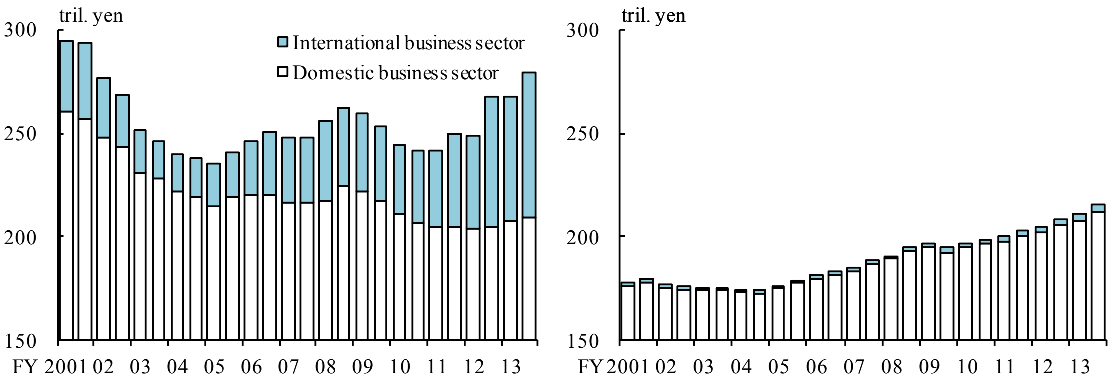
a. Net interest income (loans)

At major banks, loans outstanding (average amount outstanding) in the international business sector continued to increase substantially, while those in the domestic business sector also expanded. At regional banks, loans outstanding increased, particularly in the domestic business sector (Chart 10).

Chart 10: Average amounts outstanding of loans

Major banks

Regional banks

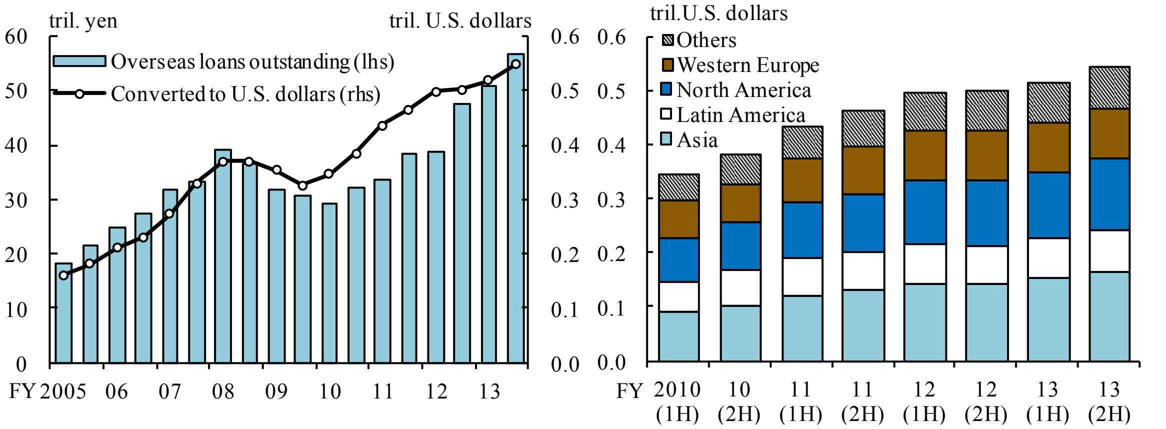


The amount outstanding of overseas loans at the three major financial groups as a whole continued to increase, particularly those to Asia and North America (Chart 11).

Chart 11: Overseas loans outstanding (end of the semiannual period)[1]

Amounts outstanding of loans

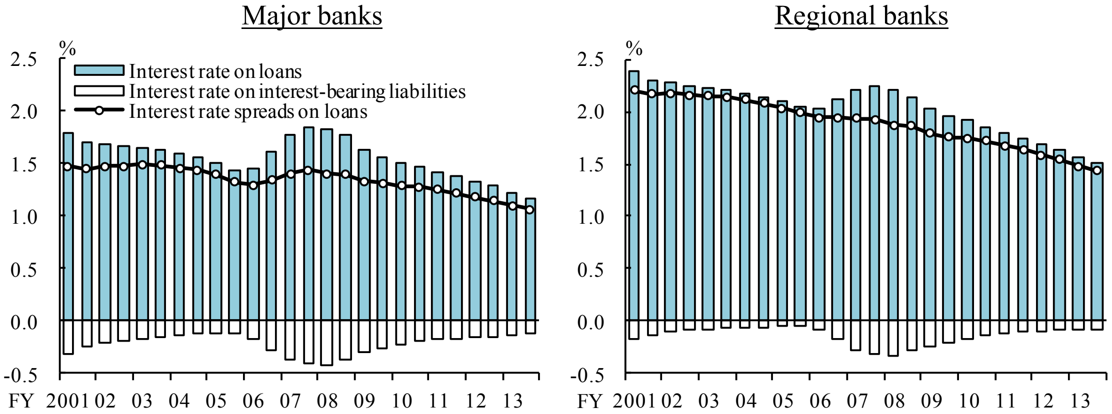
Amounts outstanding of loans by region (converted to U.S. dollars)



Note: *1.* The core commercial banks of the three major financial groups (Mizuho Financial Group, Mitsubishi UFJ Financial Group, and Sumitomo Mitsui Financial Group) are counted on a non-consolidated basis. Figures have been converted to U.S. dollars using exchange rates as of the end of each fiscal year.

Interest rate spreads on loans in the domestic business sector continued to narrow at major and regional banks, as the loan interest rate remained on a downtrend (Chart 12).

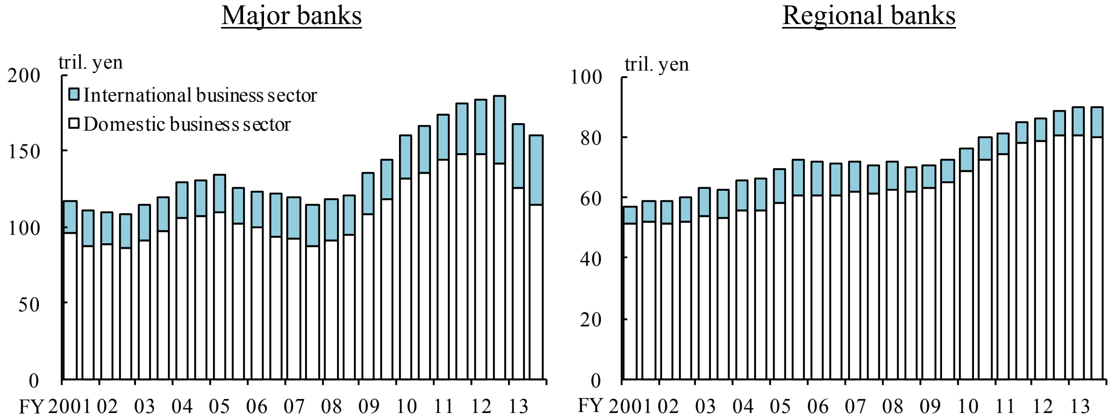
Chart 12: Interest rate spreads on loans in the domestic business sector



b. Net interest income (securities)

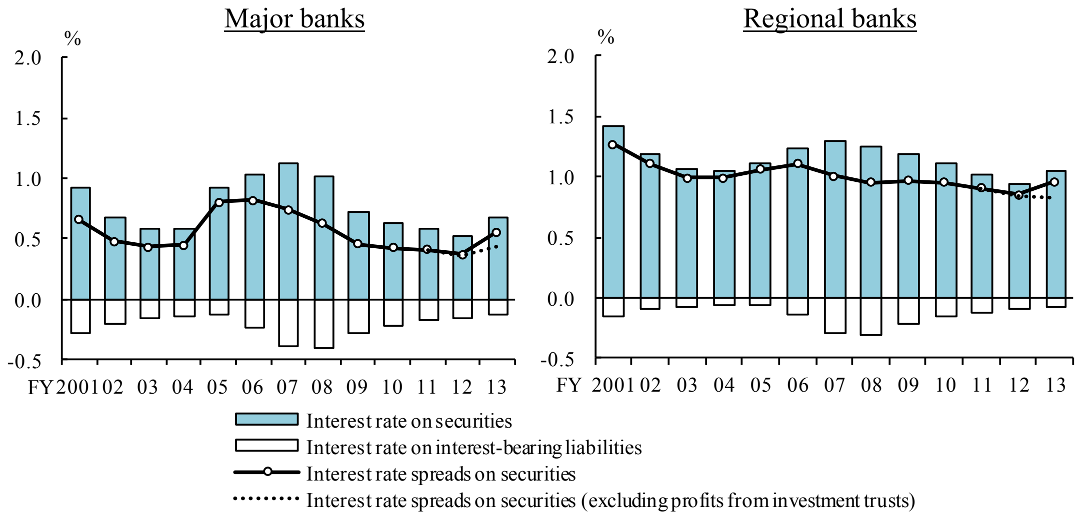
Securities holdings (average amount outstanding) decreased substantially at major banks, particularly in the domestic business sector. At regional banks, securities holdings continued to increase moderately on the whole, although those in the domestic business sector declined slightly in the second half of fiscal 2013 (Chart 13).

Chart 13: Average amounts outstanding of securities holdings



Spreads on securities in the domestic business sector widened at major and regional banks, as the yields on securities rose in response to an increase in profits from investment trusts due to cancellations (realization of unrealized gains) (Chart 14). Excluding these profits, spreads on securities at major banks widened marginally due to an increase in dividends on stocks, while those at regional banks narrowed, albeit slightly, due to a decrease mainly in JGB interest income.

Chart 14: Interest rate spreads on securities in the domestic business sector[1]

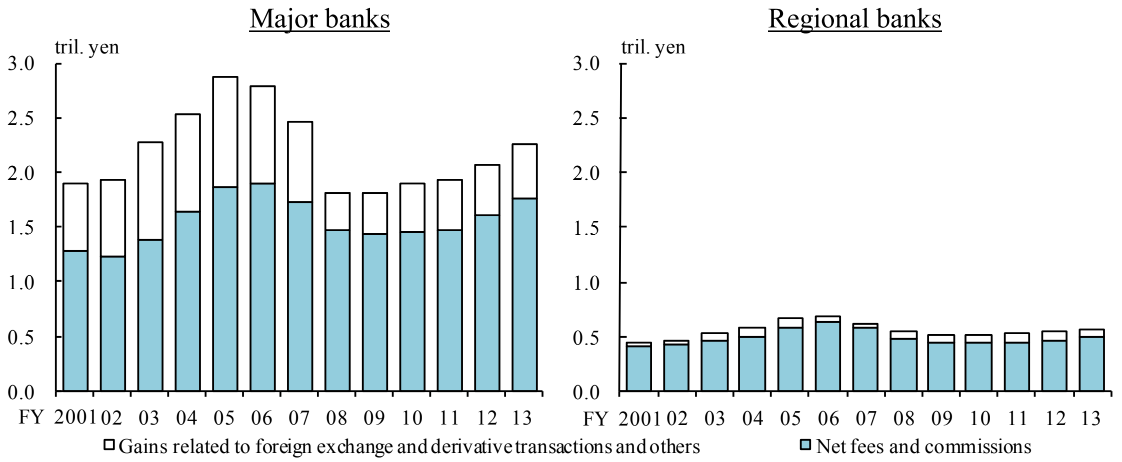


Note: *1*. Interest rate spreads on securities (excluding profits from cancellations of investment trusts) are shown only for fiscal 2012 and 2013.

2. Net non-interest income

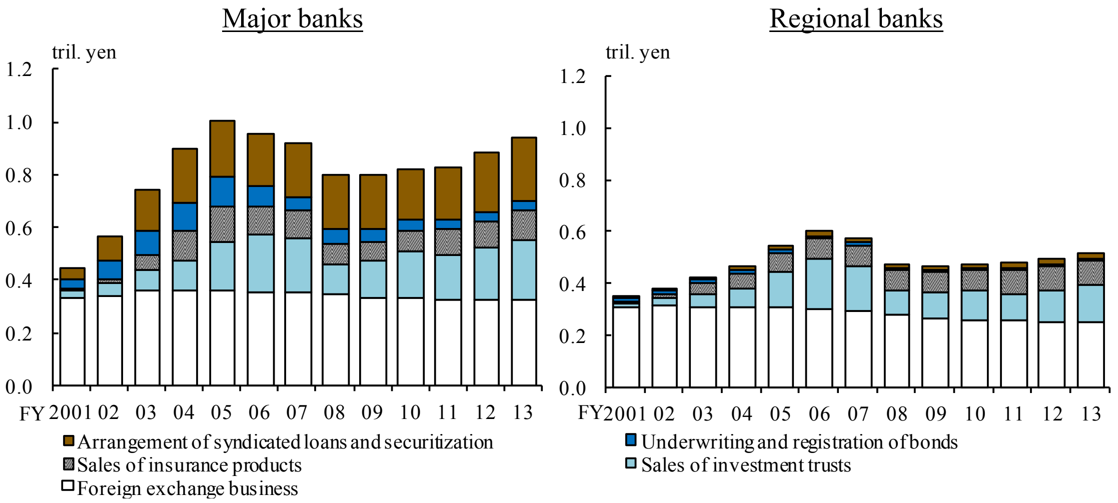
Net non-interest income increased at major and regional banks mainly due to a rise in net fees and commissions (Chart 15).

Chart 15: Net non-interest income



Among net fees and commissions, the breakdown of income from fees and commissions in 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 expanded (Chart 16).

Chart 16: Income from fees and commissions in the domestic business sector



3. General and administrative expenses

As for general and administrative expenses, personnel expenses and non-personnel expenses increased at major banks mainly due to a rise in expenses at overseas branches. At regional banks, personnel expenses and non-personnel expenses remained more or less unchanged from fiscal 2012 (Charts 17 and 18).

Chart 17: Factor decomposition of the change in general and administrative expenses

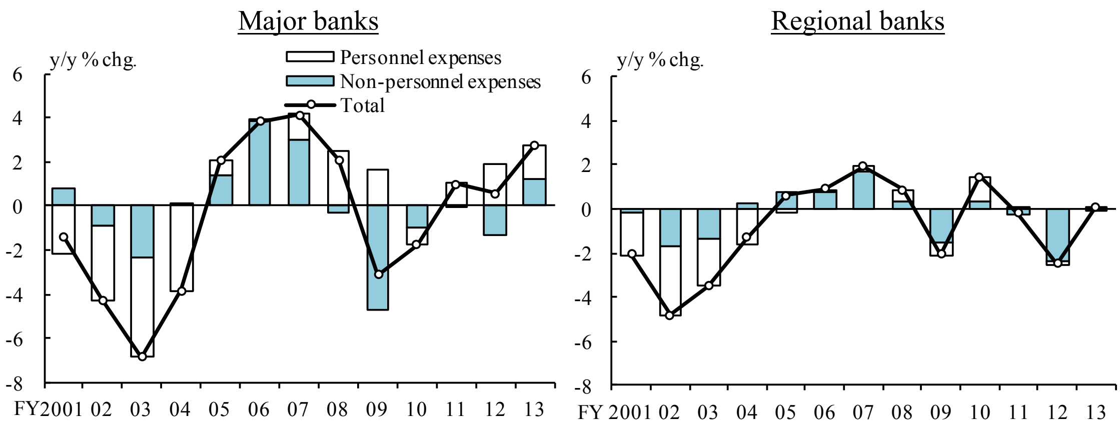
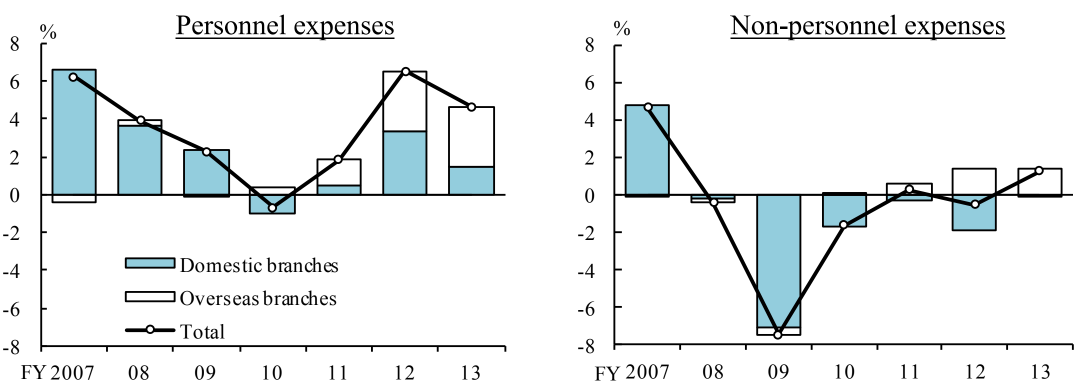


Chart 18: Factor decomposition of the change in domestic branches and overseas branches (major banks)[1]



Note: *1*. Banks that merged in fiscal 2007 to fiscal 2013 are excluded due to data limitations.

C. Securities

1. Realized gains/losses on securities holdings

Among realized gains/losses on securities holdings, realized gains on bondholdings decreased substantially -- particularly at major banks -- as gains on sales of bonds declined and losses on sales of bonds increased (Chart 19). By sector, realized gains on securities holdings of major banks in the international business sector dropped substantially (Chart 20).

Chart 19: Realized gains/losses on bondholdings

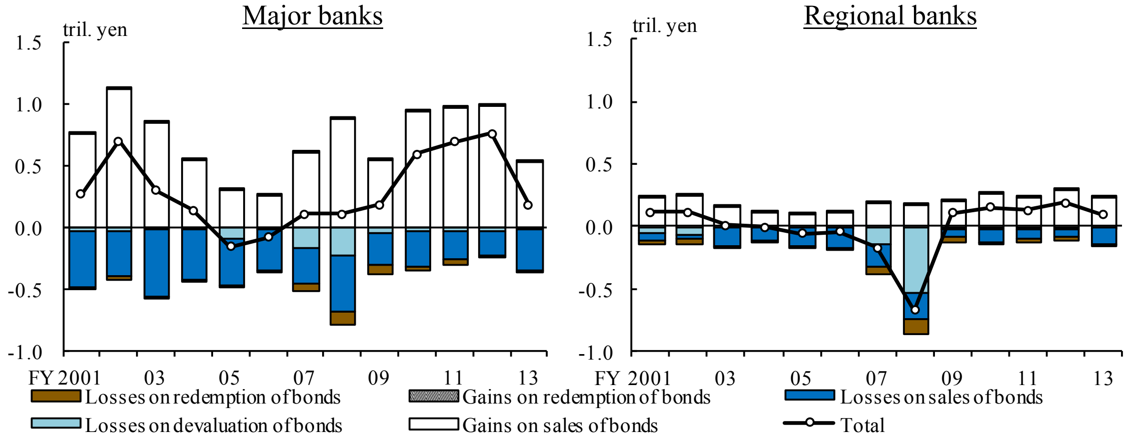
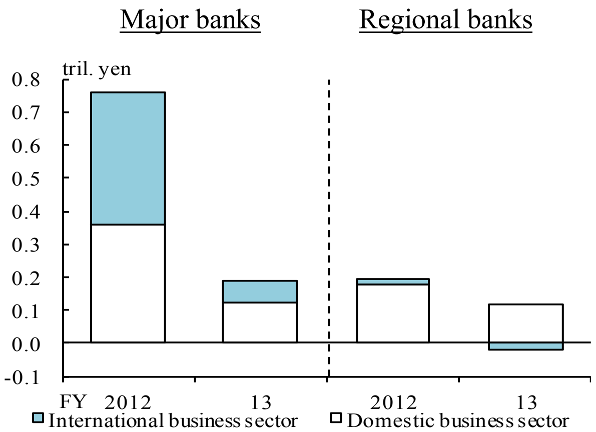
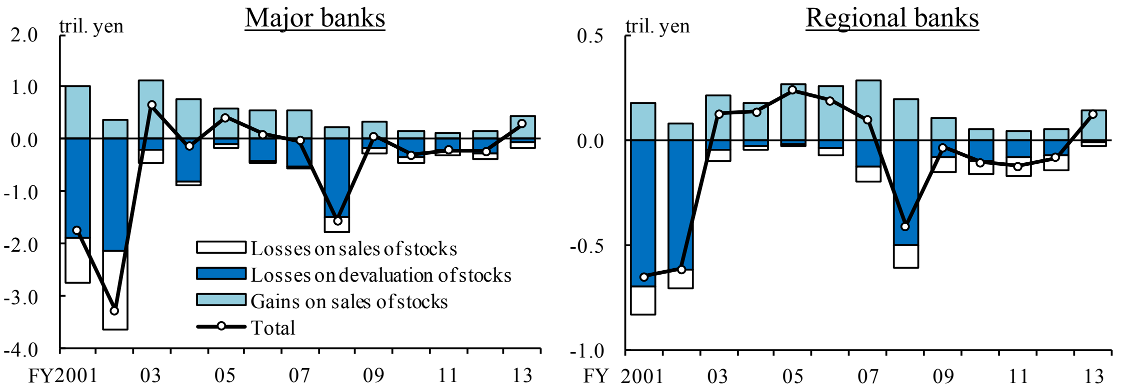


Chart 20: Composition of realized gains/losses on bondholdings of major banks and regional banks



As for realized gains/losses on stockholdings, both major and regional banks recorded net profits, improving substantially due to a decrease in losses on devaluation of stocks (losses from impairment of stocks) as well as an increase in gains on sales of stocks (Chart 21).

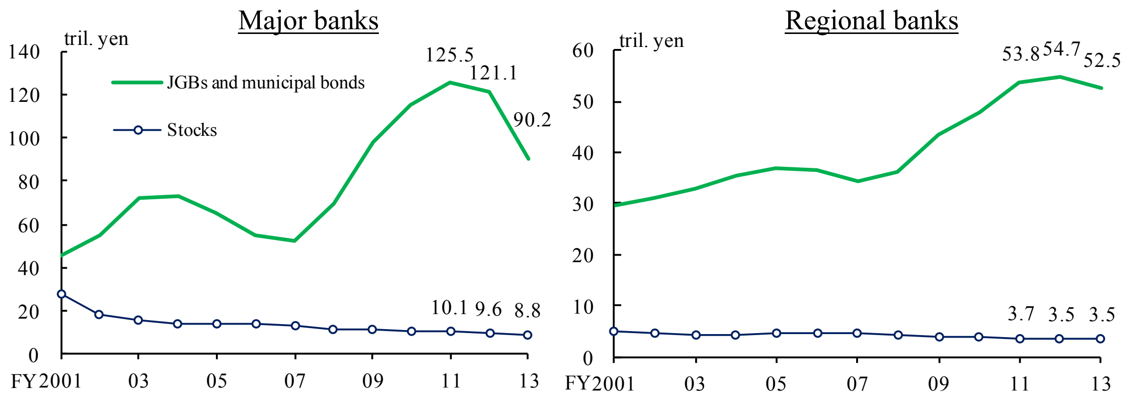
Chart 21: Realized gains/losses on stockholdings



2. Amount outstanding of securities holdings

Regarding the amount outstanding of securities holdings at the end of March 2014, the amount of holdings of JGBs and municipal bonds decreased substantially at major banks and declined, albeit marginally, at regional banks (Chart 22).

Chart 22: Outstanding amount of securities holdings (end of fiscal year)[1]

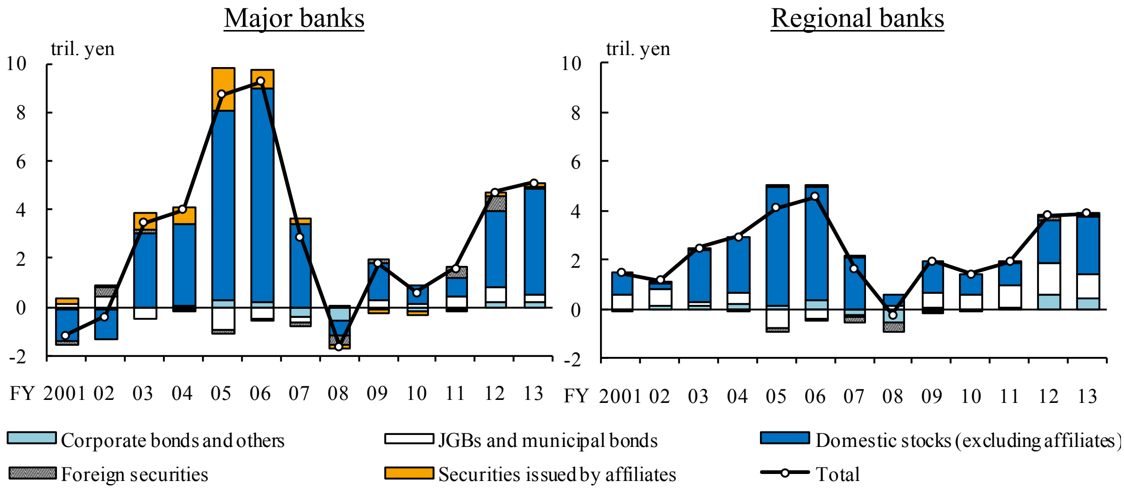


Note: *1.* "Stocks" indicates acquisition costs on a consolidated basis.

3. Unrealized gains/losses on securities holdings

Unrealized gains/losses on securities holdings as of the end of March 2014 improved only marginally on the whole at major and regional banks: unrealized gains on holdings of domestic stocks increased, while unrealized gains decreased, particularly those on holdings of JGBs and municipal bonds as well as those on holdings of foreign securities (Chart 23).

Chart 23: Unrealized gains/losses on securities holdings[1]



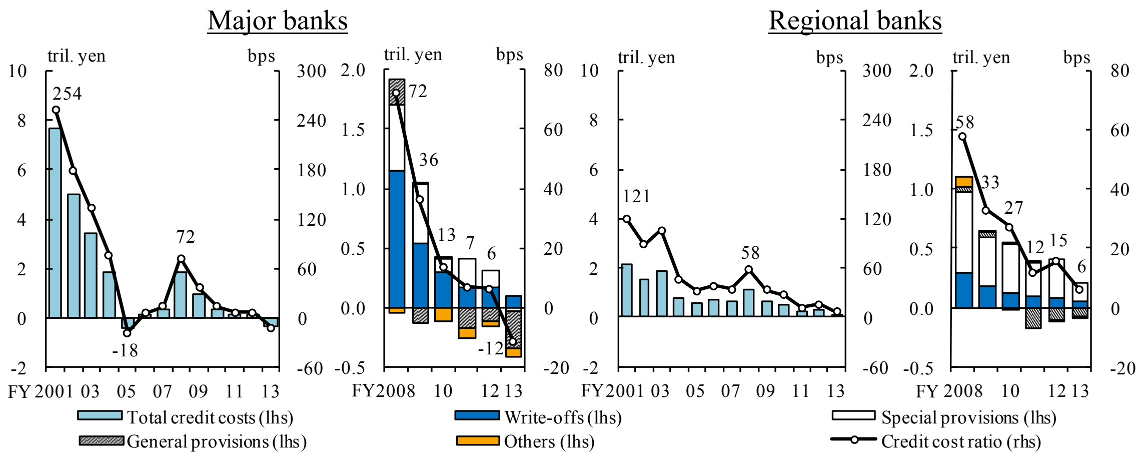
Note: *1*. On a consolidated basis.

D. Credit Costs and Nonperforming Loans

1. Credit costs

Credit costs as a whole turned to a reversal at major banks for the first time since fiscal 2005, as reversals of special loan-loss provisions occurred and those of general loan-loss provisions increased further while the number and amount of corporate bankruptcies remained at low levels. At regional banks, credit costs decreased significantly mainly due to a decline in special loan-loss provisions. As a result, credit cost ratios (credit costs / loans outstanding) decreased further to minus 12 basis points at major banks and to as low as 6 basis points at regional banks (Chart 24).

Chart 24: Credit costs and credit cost ratios[1,2]



Notes: 1. Figures in the charts indicate the credit cost ratio.

2. The factor decomposition from fiscal 2008 to fiscal 2013 is shown in detail on the right-hand sides of the charts for major and regional banks.

The substantial decrease in credit costs -- that is, the increase in reversals -- at major banks was attributable to an improvement in borrower classification and a decline in the loan-loss provision ratio. In other words, the improvement in borrower classification contributed to the decrease in credit costs, in that (1) there was a drop in the number of "special attention" loans and "need attention" loans -- loans potentially giving rise to general loan-loss provisions -- mainly due to progress in repayments and an upgrading of borrower firms (Charts 25 and 26); and (2) there was a decline in loans "in danger of bankruptcy" and below -- loans potentially giving rise to special loan-loss provisions -- mainly due to a drop in the number of additional nonperforming loans (NPLs) (Charts 28 and 29). Another factor behind the decrease in credit costs was (3) the moderate decline in loan-loss provision ratios corresponding to actual loan losses, as the number and amount of corporate bankruptcies remained at low levels (Chart 26).

Chart 25: Amount outstanding of general loan-loss provisions

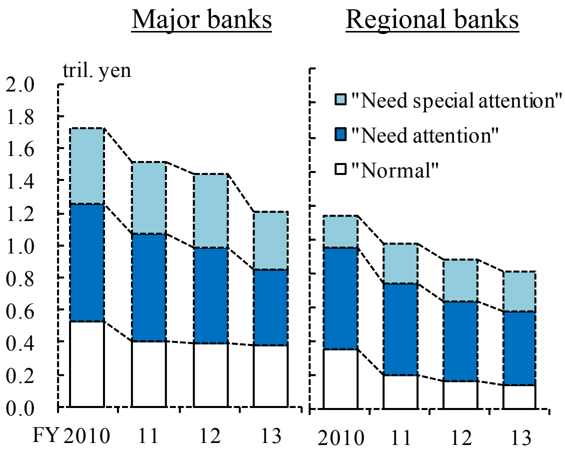
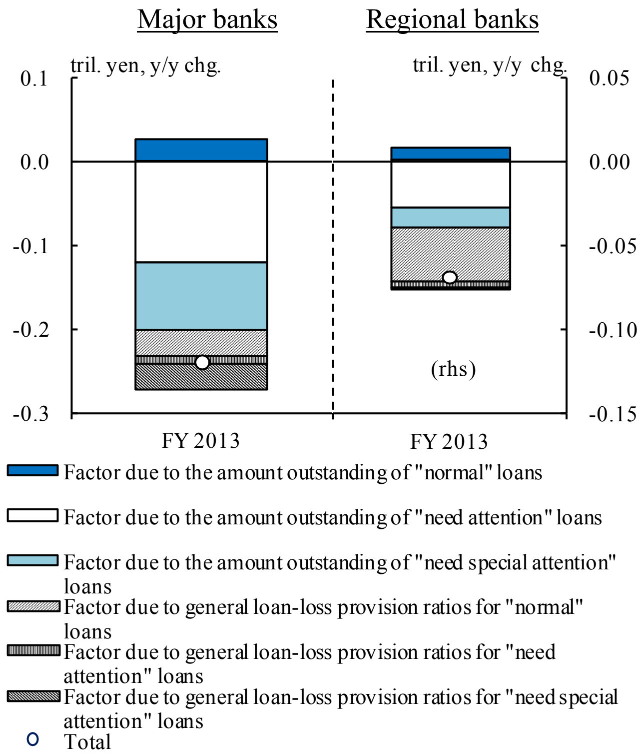
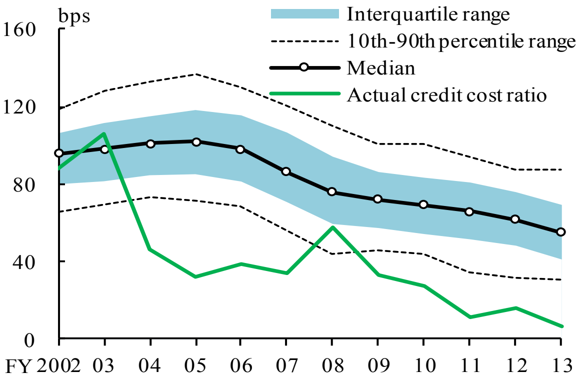


Chart 26: Change in the amount outstanding of general loan-loss provisions



The break-even credit cost ratio (the ratio at which credit costs and operating profits from core business match, that is, operating profits from core business / loans outstanding) at regional banks continued to decline (Chart 27).

Chart 27: Break-even credit cost ratios of regional banks[1,2]



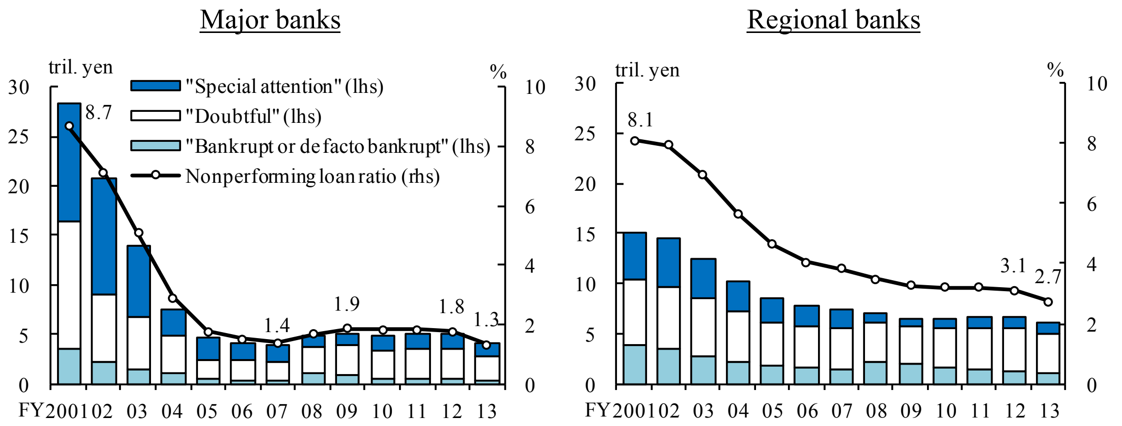
Notes: 1. Break-even credit cost ratios of regional banks are sorted in ascending order, and the 10th percentile point, 25th percentile point, 50th percentile point (median), 75th percentile point, and 90th percentile point are calculated.

2. Operating profits from core business for fiscal 2012 and 2013 exclude profits from investment trusts due to cancellations.

2. Nonperforming loans

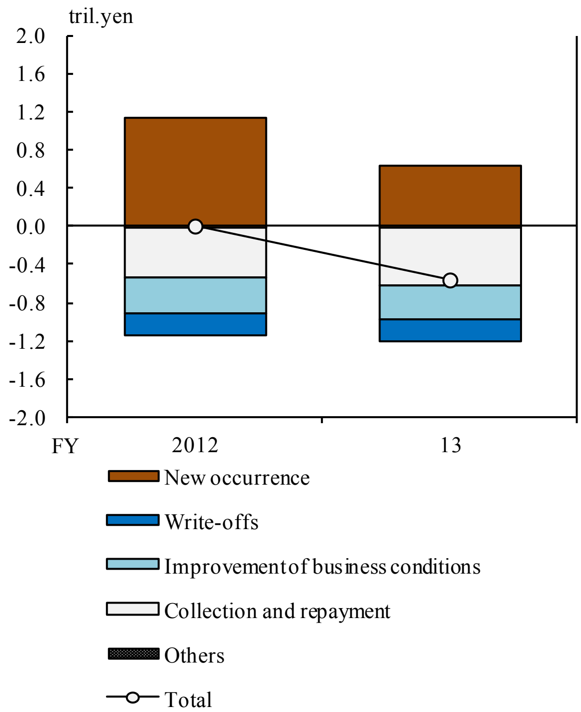
The ratios of NPLs in fiscal 2013 declined relative to fiscal 2012: to 1.3 percent at major banks and 2.7 percent at regional banks (Chart 28).

Chart 28: Amount outstanding and ratio of nonperforming loans



Among NPLs held by major banks, a comparison of factors behind changes in the amount of "doubtful" loans and "bankrupt or de facto bankrupt" loans, relative to fiscal 2012, shows that efforts to contain additional NPLs had an increasing effect (Chart 29).

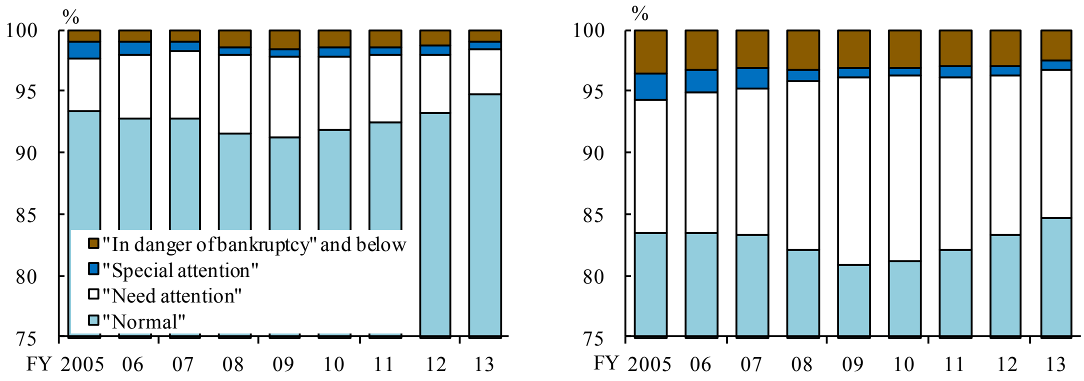
Chart 29: Change in "doubtful" loans and below (major banks)[1]



Note: *1.* In this chart, three banks are excluded due to data limitations.

As for loans outstanding by borrower classification, the proportions of "normal" loans continued to increase both at major and regional banks (Chart 30).

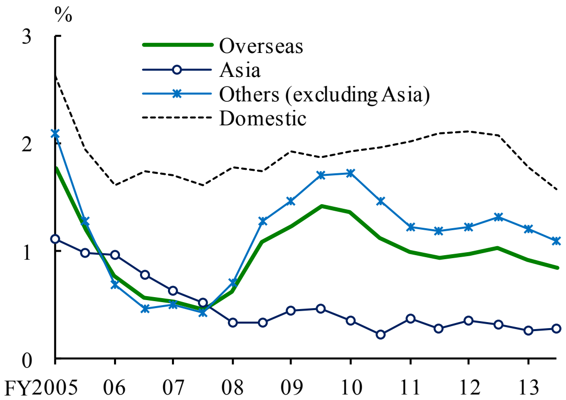
Chart 30: Proportion of loans outstanding by borrower classification[1]



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 a low level of around 1 percent at the three major financial groups as a whole (Chart 31).

Chart 31: Ratios of nonperforming overseas loans[1]



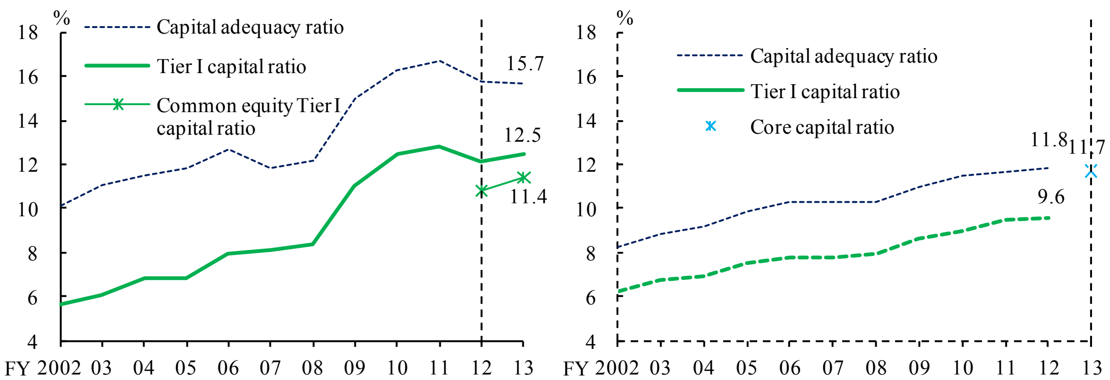
Note: 1. The core commercial banks of the three major financial groups (Mizuho Financial Group, Mitsubishi UFJ Financial Group, and Sumitomo Mitsui Financial Group) are counted on a non-consolidated basis.

E. Capital Adequacy Ratio (Consolidated Basis)

As for the capital adequacy ratio (on a consolidated basis) as of the end of March 2014, looking at the capital adequacy ratio of internationally active banks, which have shifted to the Basel III requirement since the end of March 2013, <u>the common equity Tier I (CET I) capital ratio</u> was 11.4 percent and <u>the total capital adequacy ratio</u> was 15.7 percent. With regard to domestic banks, <u>the core capital ratio</u> (after taking into account the Basel III requirements in the initial year of implementation) was 11.7 percent -- more or less the same level as <u>the capital adequacy ratio</u> as of the end of March 2013 -- due to factors such as an increase in retained earnings and the implementation of the phase-in arrangements (Charts 32 to 34).[5]

Chart 32: Capital adequacy ratio[1]

<u>Internationally active banks</u> <u>Domestic banks</u>



Note: *1*. Internationally active banks and domestic banks are classified as of end-March 2014.

[5] Upon shifting to the new regulatory requirements for domestic banks, while efforts were made to enhance the quality of capital, various phase-in arrangements were put in place. For example, for former means of securing capital that did not meet the new requirements, such as subordinated bonds, a 100 percent inclusion in core capital was allowed for 1 year following their implementation.

Chart 33: Capital components and risk-weighted assets

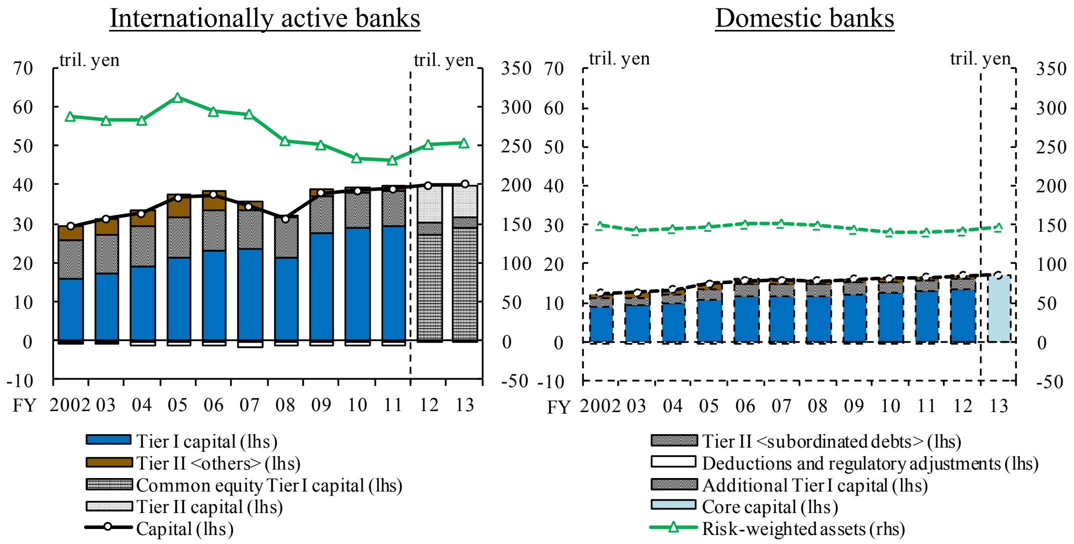
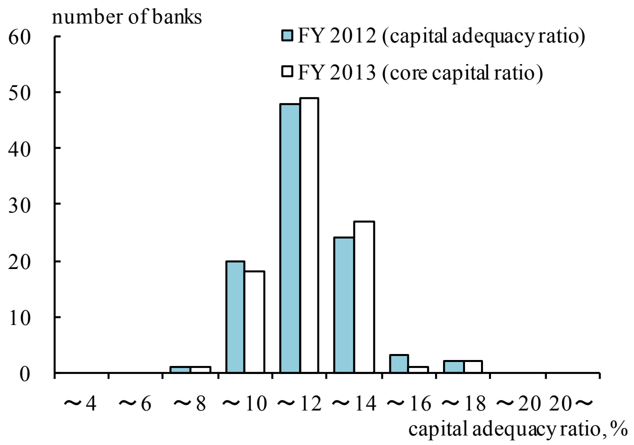


Chart 34: Distribution of capital adequacy ratio (domestic banks)

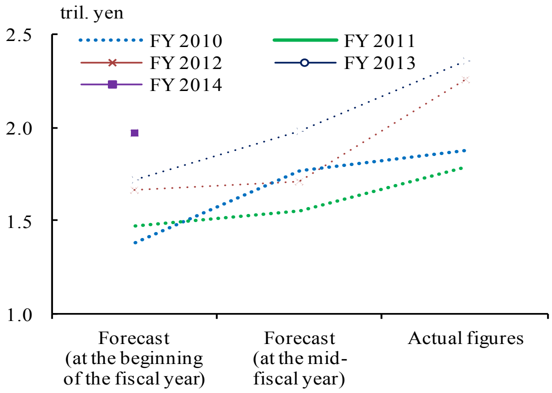


III. Outlook for Financial Results for Fiscal 2014

A. Major Banks

As for the outlook for financial results for fiscal 2014, net income is expected to decline by around 20 percent relative to the actual figures for fiscal 2013, mainly because of an increase in credit costs (that is, a marginal rise in costs following the increase in reversals in fiscal 2013) (Chart 35). Nevertheless, looking at the data for the past few years, the profit level is relatively high for a forecast made at the beginning of the fiscal year.

Chart 35: Comparison between major banks' forecast and actual figures for net income

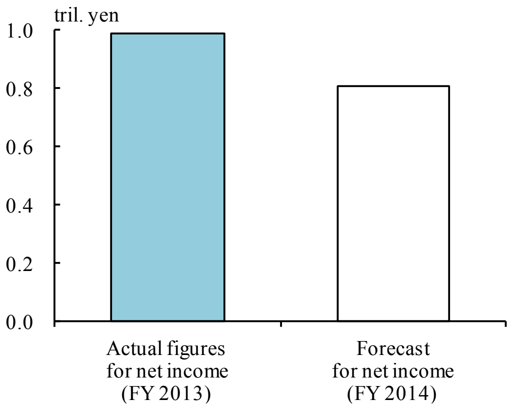


B. Regional Banks

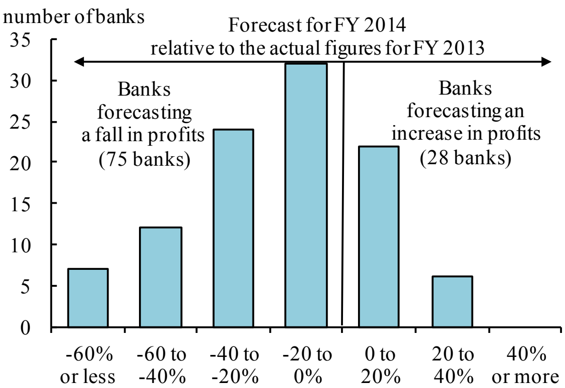
Net income for fiscal 2014 is expected to decrease relative to the actual figures for fiscal 2013, due to a decline in realized gains on securities holdings and an increase in credit costs (the left-hand side of Chart 36). The number of regional banks forecasting that their net income will decrease exceeds the number of regional banks forecasting an increase (the right-hand side of Chart 36).

Chart 36: Regional banks' forecast for net income for fiscal 2014[1]

Profit level



Number of banks forecasting an increase in profits or a fall in profits



Note: 1. In this chart, 103 banks are counted (excluding two banks that did not release their forecasts).

Appendix: Glossary

Financial statements of financial institutions

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.