BOJ Reports & Research Papers

Financial System Report Annex Series

Financial System Report – Annex

Financial Results of Japan's Banks for Fiscal 2019

FINANCIAL SYSTEM AND BANK EXAMINATION DEPARTMENT
BANK OF JAPAN

SEPTEMBER 2020

The total of major banks, regional banks, and *shinkin* banks covered in this *Report* is as follows (as at March 31, 2020).

Major banks comprise the following 10 banks: Mizuho Bank; MUFG Bank; Sumitomo Mitsui Banking Corporation; Resona Bank; Saitama Resona Bank; Mitsubishi UFJ Trust and Banking Corporation; Mizuho Trust and Banking Company; Sumitomo Mitsui Trust Bank; Shinsei Bank; and Aozora Bank. Regional banks comprise the 64 member banks of the Regional Banks Association of Japan (Regional banks I) and the 38 member banks of the Second Association of Regional Banks (Regional banks II). *Shinkin* banks are the 248 *shinkin* banks that hold current accounts at the Bank of Japan.

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Background

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

The *Financial System Report Annex Series* supplements the *Financial System Report* by providing more detailed analysis and insight into a selected topic. This paper covers the financial results of Japan's banks for fiscal 2019 to provide an annual analysis.

Abstract

The characteristics of the financial results of Japan's banks for fiscal 2019 are summarized in the three paragraphs below.

First, net income decreased for all types of banks: major banks, regional banks, and *shinkin* banks. For all types of banks, although net income was supported by an increase in realized gains on bondholdings, it was pushed down by the continued shrinking of domestic lending margins. At major banks and *shinkin* banks, an increase in credit costs also pushed down net income.

Second, pre-provision net revenue (PPNR) (excluding trading income), which shows core profitability, was at its lowest level on the whole since the bursting of the bubble economy, continuing to decline at major banks and regional banks while increasing at *shinkin* banks. For all types of banks, PPNR (excluding trading income) continued to be pushed down mainly by the decline in loan-related income owing to shrinking domestic lending margins and by weak sales of investment trusts and insurance products. At *shinkin* banks, an increase in profits from investment trusts due to cancellations supported their PPNR (excluding trading income).

Third, the capital adequacy ratios of financial institutions have been sufficiently above the regulatory requirements, although they have declined moderately on the whole.

Contents

I. Outline of Financial Results of Japan's Banks for Fiscal 2019[1]

A. Profits and Losses

Net income for fiscal 2019 at major financial groups was about 2.1 trillion yen, decreasing by 3.0 percent from the previous year. This was equivalent to a decrease of about 20 percent, if one-time losses incurred by a financial group were excluded. With a continued decline in net interest income owing to the shrinking domestic lending margins, although net income was supported by an increase in realized gains on bondholdings, it was pushed down by (1) a decrease in realized gains on stockholdings and (2) an increase in credit costs due in part to precautionary loan-loss provisions in response to the spread of COVID-19. Meanwhile, impairment losses on "goodwill" incurred by a group company of a financial group led to a larger decline in net income.

Net income for fiscal 2019 at major banks (on a non-consolidated basis) was about 0.4 trillion yen, a decrease of 69.9 percent from the previous year, due in part to impairment losses on stocks of group companies of a financial group.

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

100 mil.yen,%

	Major Financial Groups			Major Banks (non-consolidated)		
	FY2019	y/y chg.	y/y % chg.	FY2019	y/y chg.	y/y % chg.
Net interest income	46,440	-1,278	-2.7	30,456	-3,469	-10.2
Net non-interest income	51,057	-2,185	-4.1	20,550	-1,736	-7.8
General and administrative expenses	-69,733	-1,348	+2.0	-37,161	+66	-0.2
PPNR (excluding trading income)	31,544	-5,137	-14.0	13,845	-5,138	-27.1
(excluding profits and losses from investment trusts due to cancellations)	(31,239)	(-4,684)	(-13.0)	(13,540)	(-4,685)	(-25.7)
Realized gains/losses on bondholdings	7,456	+8,257	——	7,493	+8,101	——
Realized gains/losses on stockholdings	3,045	-2,359	——	2,172	-1,703	——
Credit costs	-6,830	-5,127	——	-2,783	-3,958	——
(Credit cost ratio)	——	——	——	(9bps)	(+13bps)	——
Other profit and loss items	-6,392	+3,513	——	-10,757	-5,700	——
Net income before income taxes	28,822	-853	-2.9	9,970	-8,399	-45.7
Tax-related expenses	-7,043	-456	+6.9	-5,557	-1,840	+49.5
Net income	20,698	-637	-3.0	4,414	-10,239	-69.9

Notes: 1. Regarding credit costs, negative numbers represent a rise in costs while positive numbers represent an increase in reversals.
2. For major financial groups, PPNR (excluding trading income) includes profits/losses on investments in affiliates. Some items for which there exist no data based on financial groups are calculated using banks' data on a non-consolidated basis.

Sources: Published accounts of each financial group; BOJ.

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

Net income for fiscal 2019 at regional banks was about 0.7 trillion yen, an 11.1 percent decline from the previous year. With a continued decline in net interest income owing to the shrinking domestic lending margins, although net income was supported by a reduction in general and administrative expenses and an increase in realized gains on bondholdings, it was pushed down by a decrease in realized gains on stockholdings.

Net income for fiscal 2019 at *shinkin* banks was about 0.2 trillion yen, a decrease of 13.7 percent from the previous year. Despite a continued shrinking of lending margins, net interest income was pushed up by an increase in profits from investment trusts due to cancellations and a reduction in general and administrative expenses. Net income was pushed down by increases in realized losses on stockholdings and in credit costs, although realized gains on bondholdings increased.

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

100 mil.yen,%

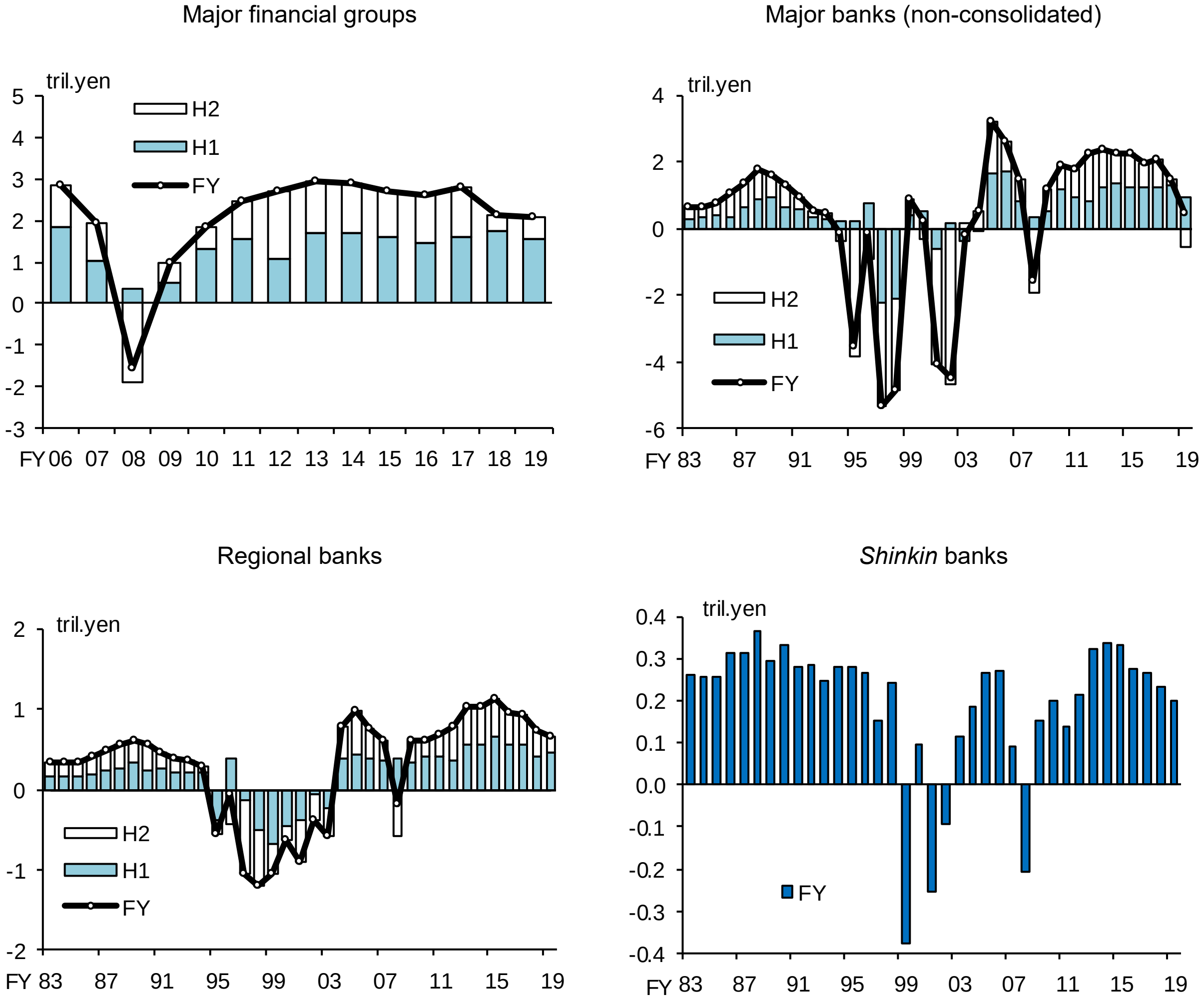
	Regional banks (non-consolidated)			*Shinkin* banks		
	FY2019	y/y chg.	y/y % chg.	FY2019	y/y chg.	y/y % chg.
Net interest income	35,320	-986	-2.7	15,590	+216	+1.4
Net non-interest income	5,227	+123	+2.4	648	+76	+13.3
General and administrative expenses	-28,990	+278	-0.9	-12,814	+117	-0.9
PPNR (excluding trading income)	11,556	-586	-4.8	3,424	+409	+13.6
(excluding profits and losses from investment trusts due to cancellations)	(10,747)	(-439)	(-3.9)	(2,984)	(+114)	(+4.0)
Realized gains/losses on bondholdings	787	+1,100	——	546	+167	——
Realized gains/losses on stockholdings	723	-1,770	——	-37	-377	——
Credit costs	-3,258	+9	——	-974	-463	——
(Credit cost ratio)	(12bps)	(-0bps)	——	(14bps)	(+6bps)	——
Other profit and loss items	-553	-377	——	-219	-80	——
Net income before income taxes	9,256	-1,625	-14.9	2,739	-343	-11.1
Tax-related expenses	-2,617	+798	-23.4	-736	+25	-3.3
Net income	6,638	-827	-11.1	2,003	-318	-13.7

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

B. Profit Levels from a Long-Term Perspective

Net income for fiscal 2019 for major banks (both on a consolidated and non-consolidated basis), regional banks, and *shinkin* banks declined for the second, fourth, and fifth consecutive year, respectively.

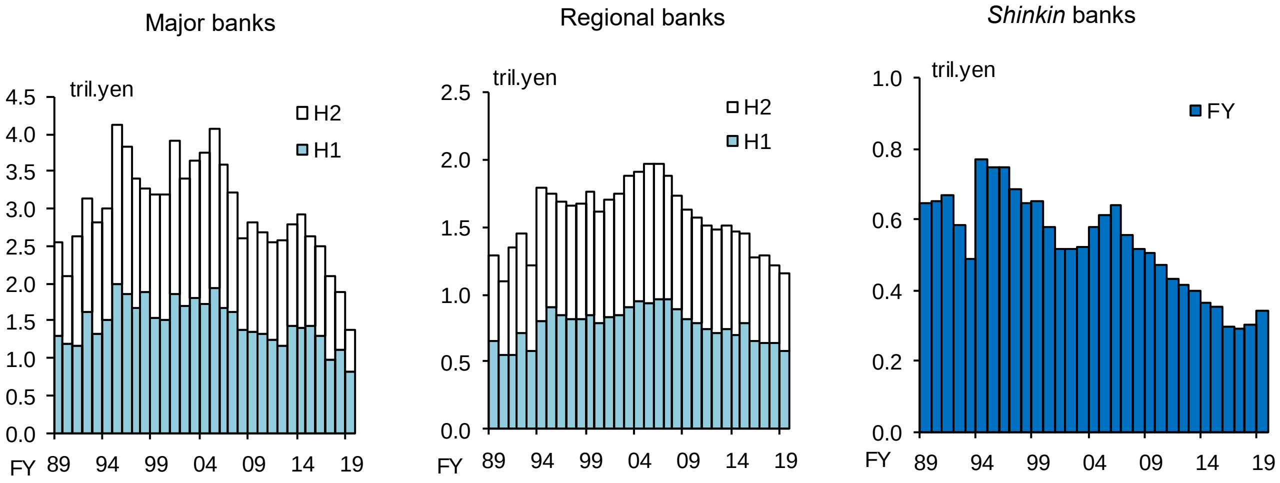
I-B-1: Net income



Source: BOJ.

With regard to core profitability, PPNR (excluding trading income) at major banks for fiscal 2019 declined by 27.1 percent, decreasing for the fifth consecutive year. At regional banks, PPNR (excluding trading income) decreased by 4.8 percent from the previous year, falling for the second consecutive year. At *shinkin* banks, such profits increased by 13.6 percent from the previous year, partly because of an increase in profits from investment trusts due to cancellations. From a longer-term perspective, amid the continued decline in domestic net interest income, for all types of banks, PPNR (excluding trading income) remains on a downward trend and is at its lowest level since the bursting of the bubble economy.

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



Source: BOJ.

C. Balance Sheets

Looking at developments in balance sheets for fiscal 2019 at major banks, total assets rose by 42.2 trillion yen due to increases in loans, foreign securities, and other assets (such as receivables under resale agreements and derivatives). On the liability side, the main increases were in deposits and in loans from the Bank of Japan (including those using U.S. Dollar Funds-Supplying Operations).

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

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	End-Mar. 2020	y/y chg.	Change from end-Sep. 2019		End-Mar. 2020	y/y chg.	Change from end-Sep. 2019
Loans and bills discounted	322.3	+9.7	+10.6	Deposits + NCD	540.5	+12.0	+14.1
Domestic business sector	218.6	+4.9	+4.5	Domestic business sector	434.6	+16.0	+15.6
International business sector	103.7	+4.8	+6.1	International business sector	105.9	-3.9	-1.5
Securities	139.3	+8.9	+6.9	Loans from BOJ	42.4	+18.3	+18.7
JGBs	45.2	+0.8	+2.1	Due to trust accounts	15.6	-1.1	+0.9
Stocks	13.1	-2.9	-2.2	Other liabilities	146.3	+14.8	+9.0
Foreign securities	59.3	+9.5	+7.1	Total liabilities	744.7	+44.1	+42.7
Cash and due from banks	200.6	-1.6	+2.4	Total net assets	32.1	-1.9	-2.6
Other assets	114.6	+25.1	+20.2	Retained earnings	11.9	-0.8	-1.4
Total assets	776.7	+42.2	+40.1	Net unrealized gains/losses on securities	4.4	-1.3	-1.3

Source: BOJ.

Total assets at regional banks increased by 9.1 trillion yen as loans increased while securities decreased due to a decline in their market value. On the liability side, the main increase was in deposits.

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

tril.yen

	End-Mar. 2020	y/y chg.	Change from end-Sep. 2019		End-Mar. 2020	y/y chg.	Change from end-Sep. 2019
Loans and bills discounted	270.1	+8.1	+5.1	Deposits + NCD	350.9	+5.4	+4.3
Securities	79.1	-0.7	-0.8	Current deposits	197.4	+10.1	+9.5
JGBs	16.5	-2.7	-0.6	Other liabilities	40.5	+4.6	+2.0
Cash and due from banks	50.3	+0.4	-0.3	Total liabilities	391.4	+10.0	+6.4
Other assets	13.4	+1.2	+0.9	Total net assets	21.6	-0.9	-1.4
Total assets	413.0	+9.1	+4.9	Net unrealized gains/losses on securities	2.3	-1.2	-1.4

Source: BOJ.

With regard to *shinkin* banks, total assets increased by 1.0 trillion yen as loans increased while securities decreased due to a decline in their market value. On the liability side, the main increase was in deposits.

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

tril.yen

	End-Mar. 2020	y/y chg.		End-Mar. 2020	y/y chg.
Loans and bills discounted	72.4	+0.7	Deposits + NCD	144.7	+1.9
Securities	42.9	-0.2	Current deposits	57.7	+3.2
JGBs	6.4	-0.4	Other liabilities	4.2	-0.5
Cash and due from banks	39.2	+0.3	Total liabilities	148.9	+1.4
Other assets	3.3	+0.2	Total net assets	8.9	-0.4
Total assets	157.8	+1.0	Net unrealized gains/losses on securities	0.2	-0.5

Source: BOJ.

II. Financial Results of Japan's Major Banks and Regional Banks for Fiscal 2019

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

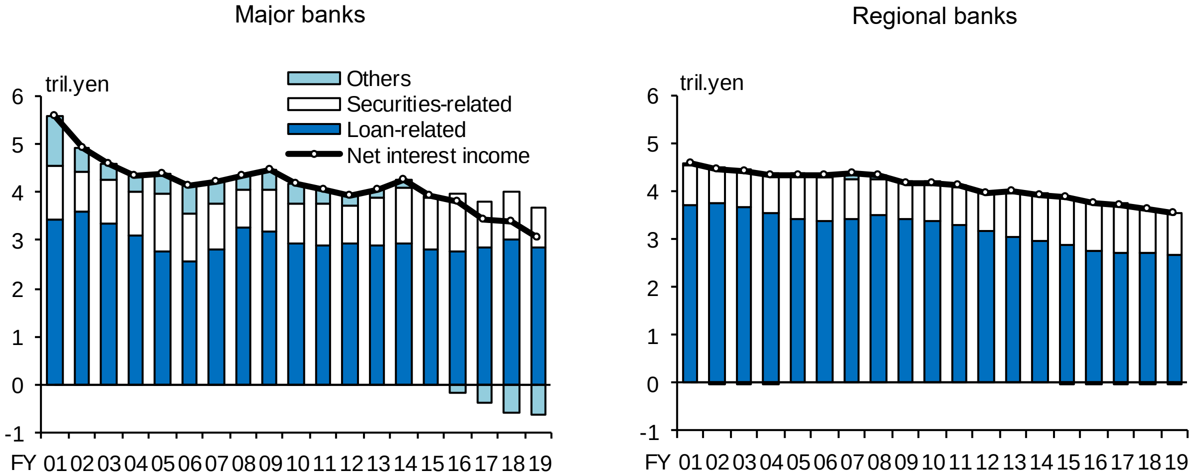
A. Core Profitability

1. Net Interest Income

<u>Net interest income at major banks</u> for fiscal 2019 decreased by 10.2 percent from the previous year. In the domestic business sector, loan-related income continued to decrease due to narrowing interest rate spreads on loans and securities-related income also declined. In the international business sector, loan-related income decreased as interest rate spreads on loans became narrow and the yen appreciated.

<u>Net interest income at regional banks</u> for fiscal 2019 declined by 2.7 percent from the previous year. Loan-related income continued to decrease due to narrowing interest rate spreads on loans. Securities-related income also continued to decline, reflecting the redemption of JGBs with relatively high yields and other securities.

II-A-1: Net interest income



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

Source: BOJ.

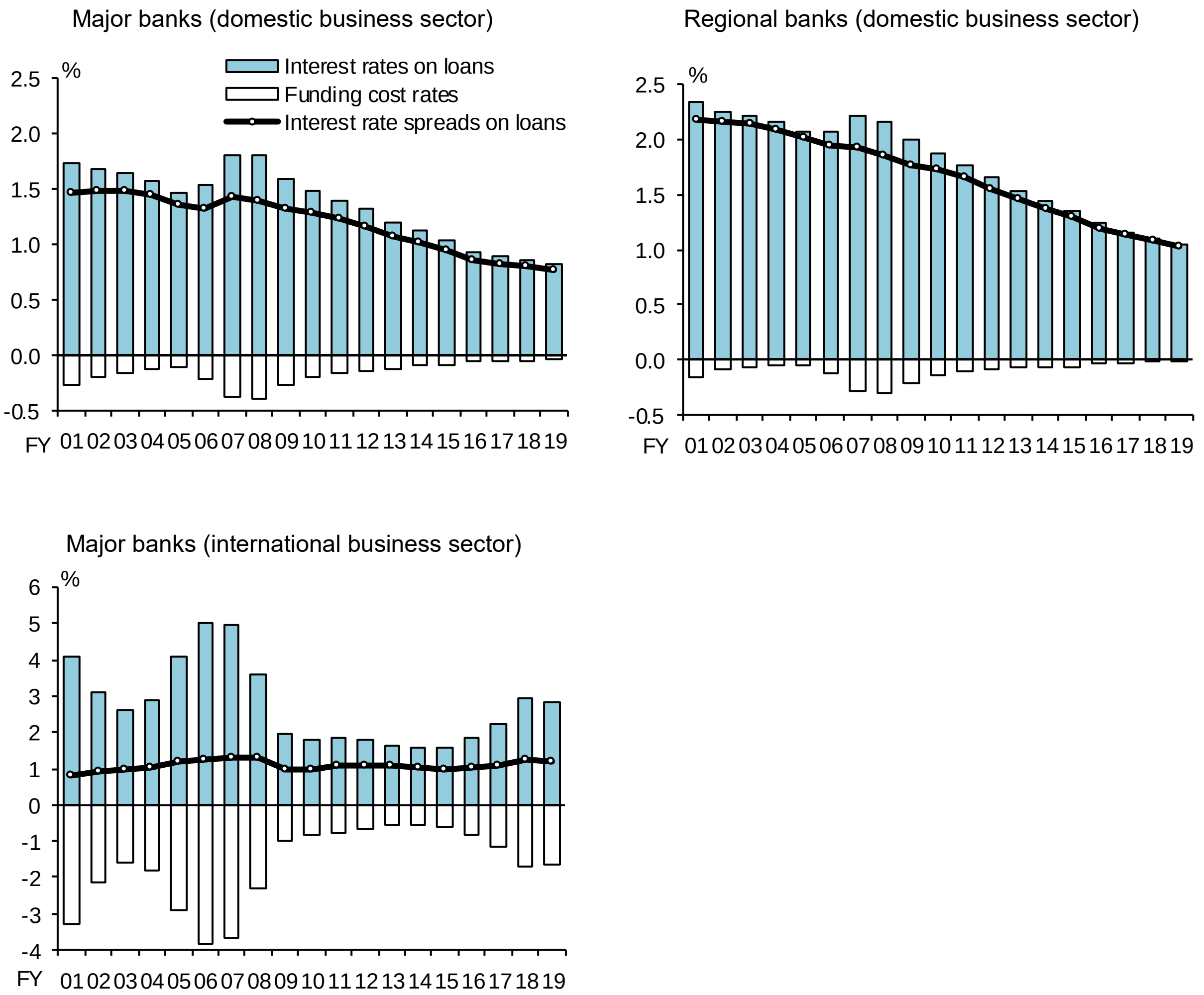
2. Interest Rate Spreads on Loans and Loans Outstanding

(1) Interest Rate Spreads on Loans

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

Interest rate spreads on loans in the international business sector at major banks became narrow. This was because, while both interest rates on loans and funding cost rates decreased, reflecting U.S. policy rate cuts, funding cost rates declined less than interest rates on loans.

II-A-2: Interest rate spreads on loans

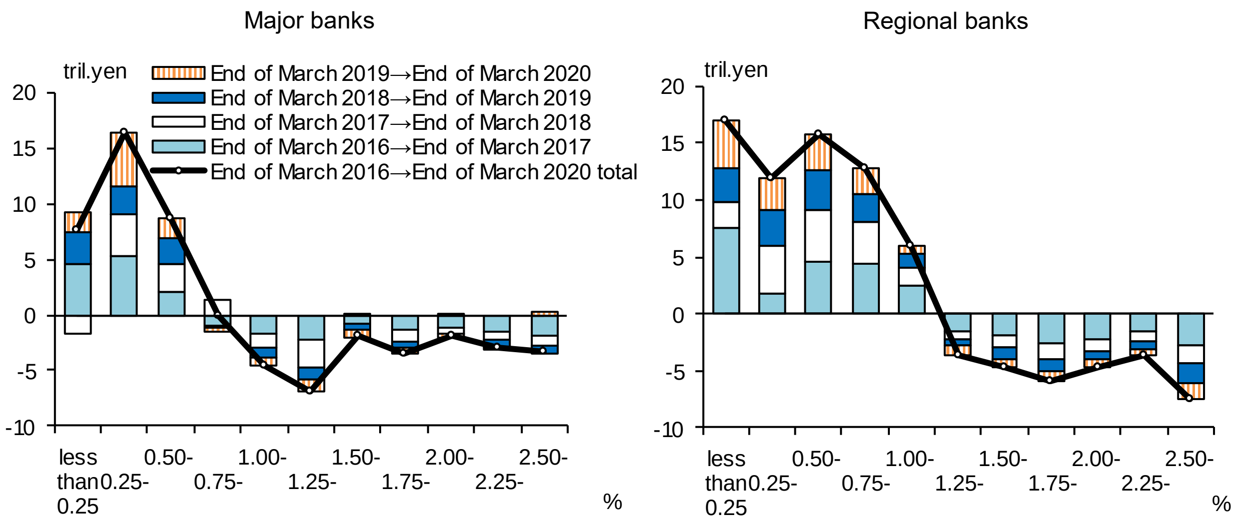


Note: In calculating the interest rate spreads, interest expenses on interest rate swaps are deducted from funding costs.
Source: BOJ.

(2) Loans Outstanding by Lending Rate

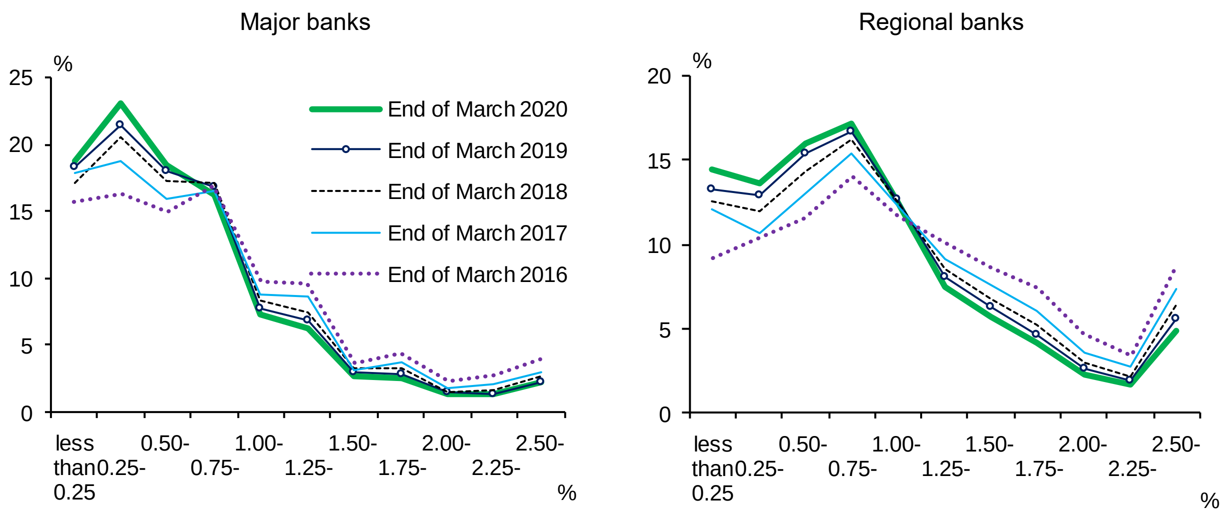
Looking at developments in loans outstanding by lending rate (yen loans at domestic branches) at both major banks and regional banks, those with low lending rates continued to increase.

II-A-3: Changes in loans outstanding by lending rate (from the end of March 2016 to the end of March 2020)



Note: 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.
Source: BOJ.

II-A-4: Changes in proportion of loans outstanding by lending rate (from the end of March 2016 to the end of March 2020)

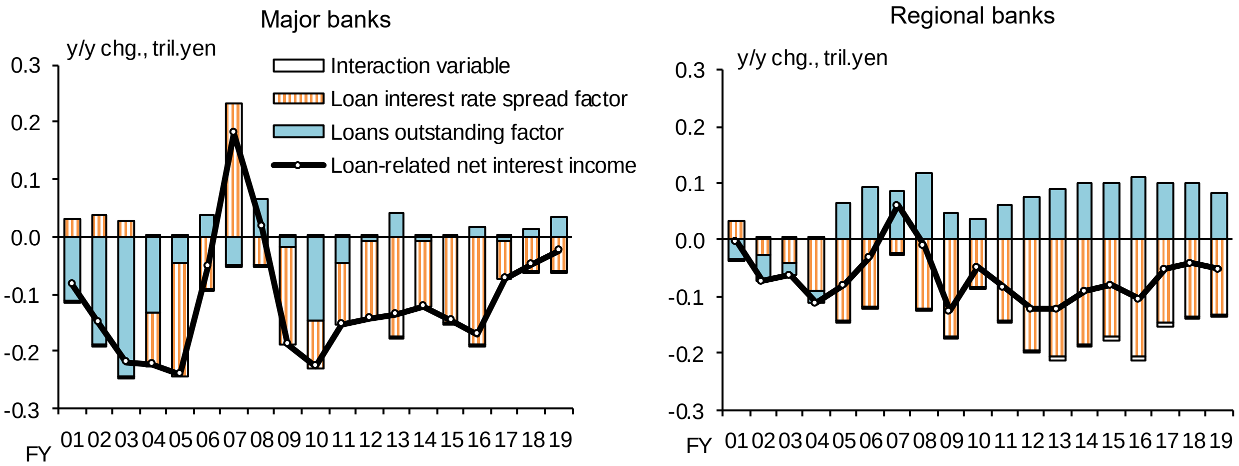


Note: The data are for yen loans outstanding in the domestic business sector (excluding loans to the financial sector) based on the amount outstanding at month-end.
Source: BOJ.

(3) Contributions of Loans Outstanding and Loan Interest Rate Spread Factors to Changes in Loan-Related Net Interest Income

Looking at the changes in net interest income from domestic lending activities, loan-related net interest income continued to decrease at both major banks and regional banks, with a narrowing of interest rate spreads on loans pushing down net income more than it was pushed up by an increase in loans outstanding.

II-A-5: Changes in loan-related net interest income (domestic business sector)

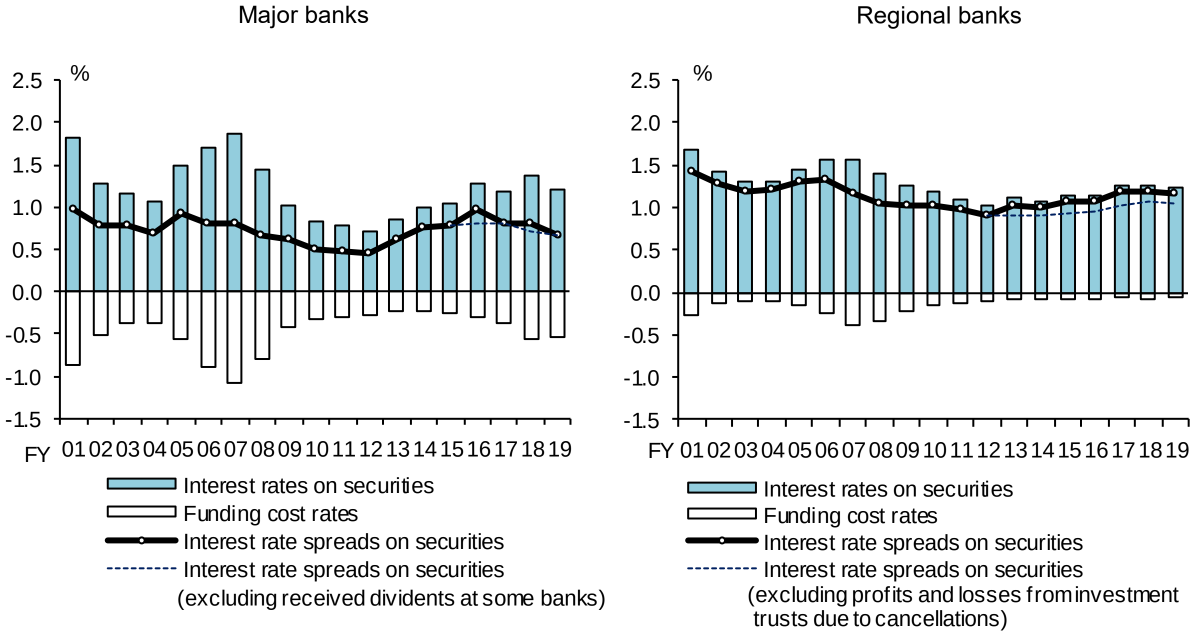


Notes: 1. In calculating the interest rate spreads, interest expenses on interest rate swaps are deducted from funding costs.
2. Loan-related net interest income = (average amount of loans outstanding) * (interest rate spreads on loans).
Source: BOJ.

3. Interest Rate Spreads on Securities

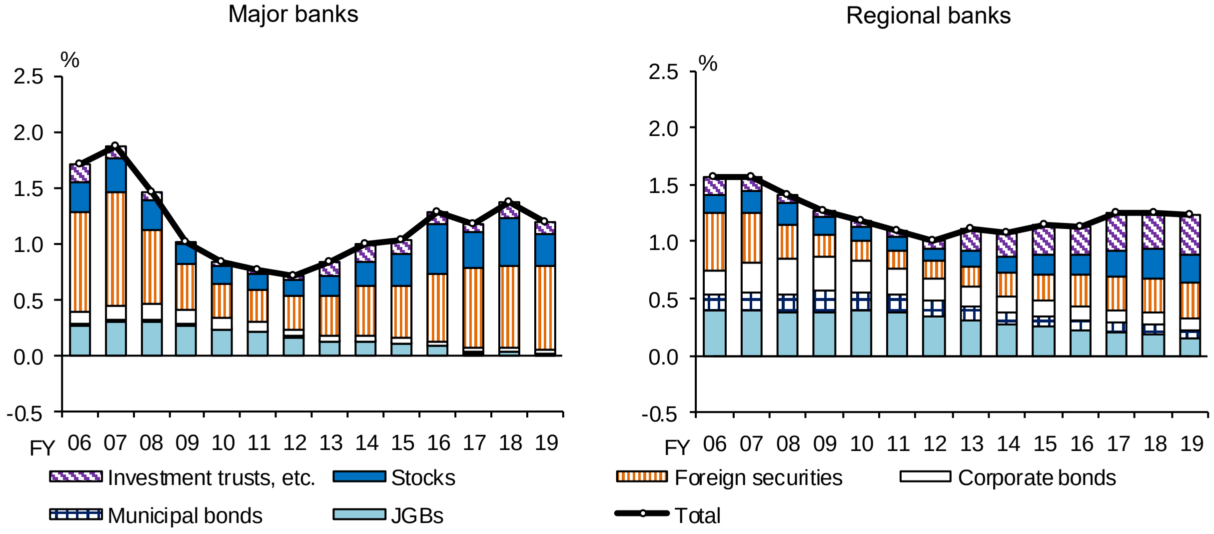
Interest rate spreads on securities narrowed at major banks partly because, in the previous year, interest rates on securities had been pushed up by large special dividends received by some banks. Such spreads on securities at regional banks were more or less unchanged. Important contributors to positive interest rate spreads on securities were foreign securities and stocks at major banks and "investment trusts, etc.", foreign securities, and stocks at regional banks.

II-A-6: Interest rate spreads on securities



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

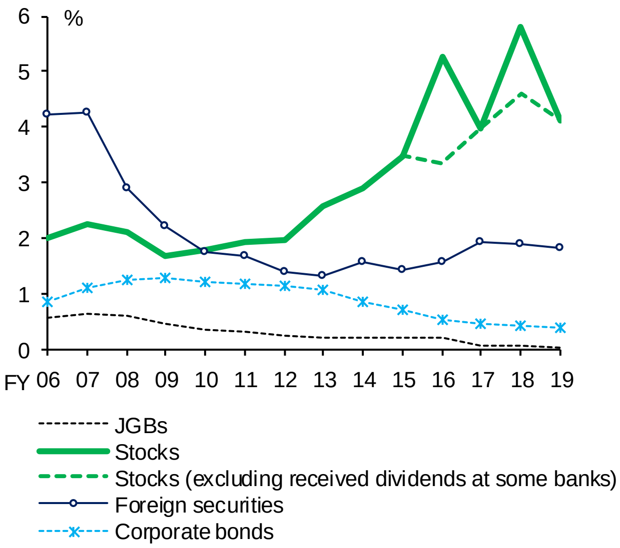
II-A-7: Decomposition of interest rate spreads on securities by product type

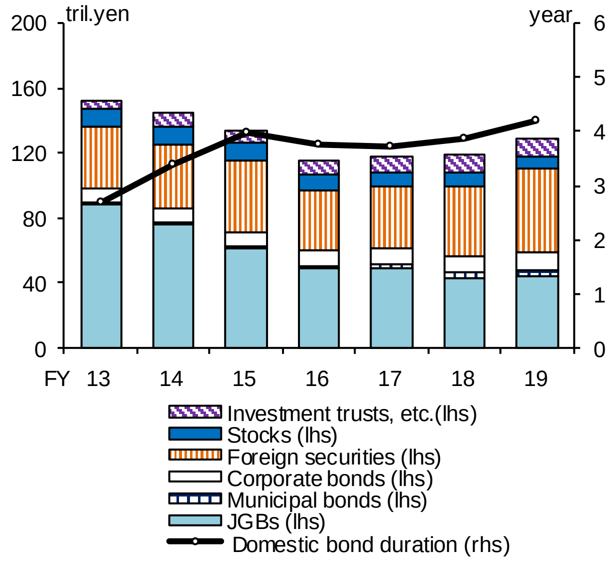


Note: For major banks, the rises in interest rate spreads on stocks in fiscal 2016 and 2018 reflect dividends received from subsidiaries at some banks.
Source: BOJ.

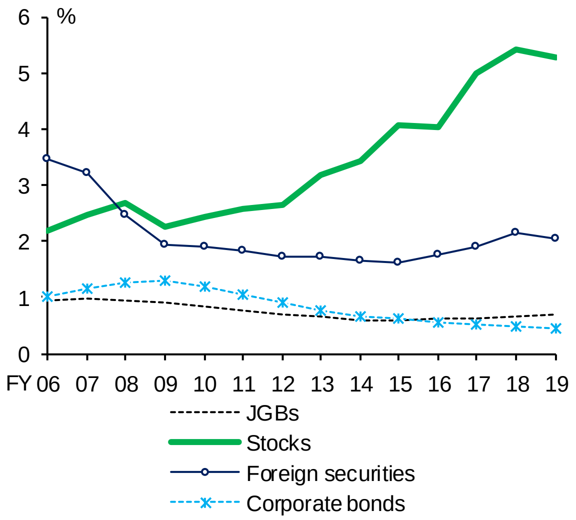
II-A-8: Interest rates on securities holdings and amounts outstanding by product type (at month-end)

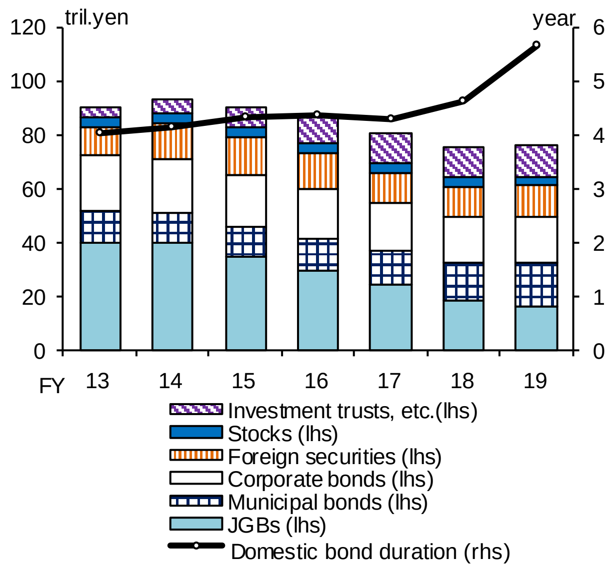
Major banks





Regional banks



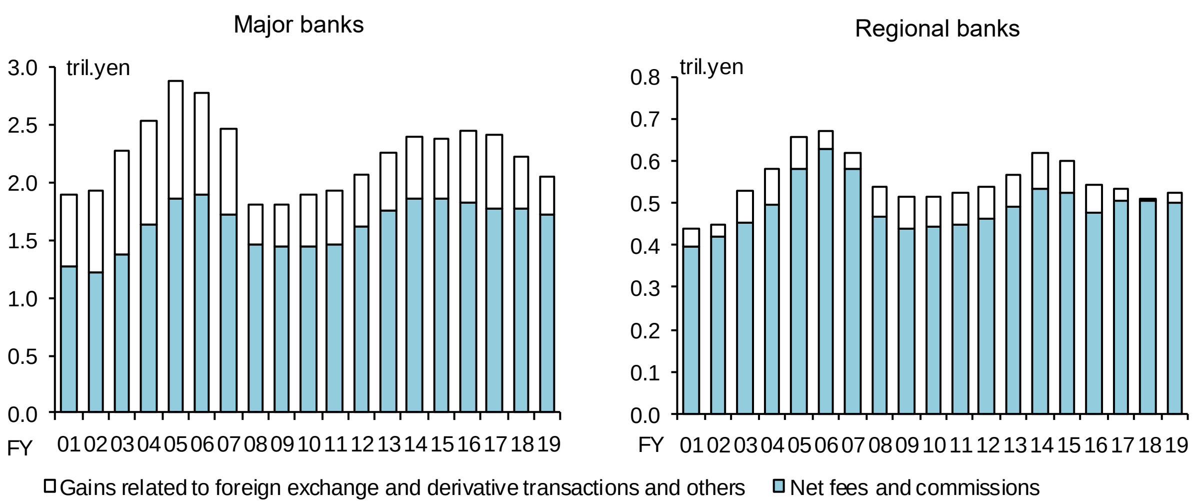


Source: BOJ.

4. Net Non-Interest Income

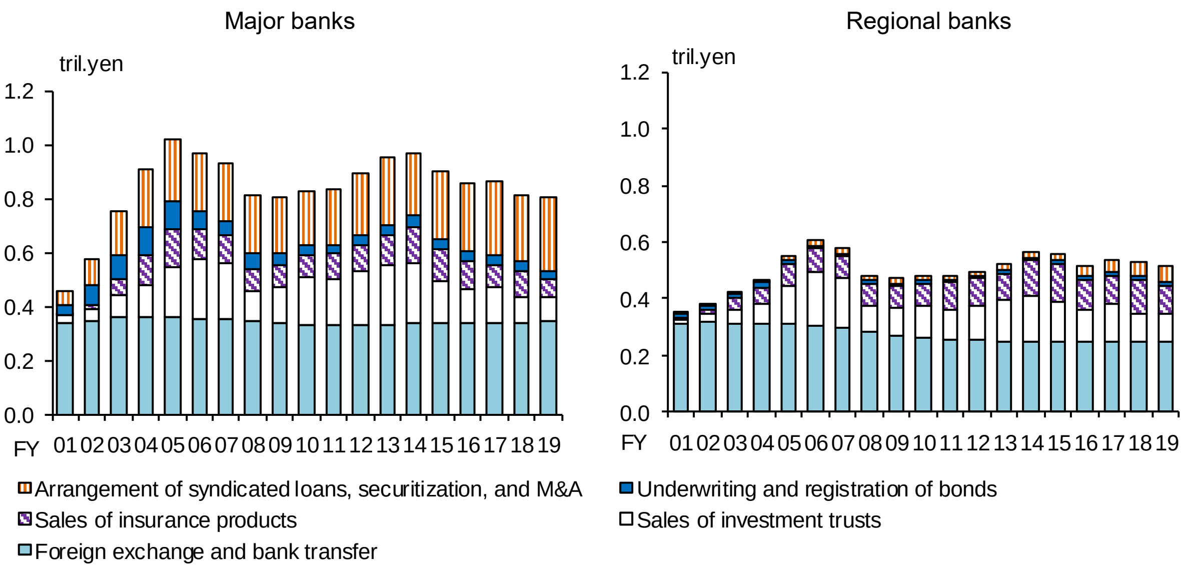
Net non-interest income decreased by 7.8 percent from the previous year at major banks. Specifically, income from fees and commissions was more or less unchanged in the international business sector, while such income decreased in the domestic business sector due to weak sales of investment trusts and insurance products. Gains related to foreign exchange and derivative transactions also decreased, reflecting hedging losses arising from declines in interest rates. Net non-interest income at regional banks increased by 2.4 percent from the previous year due to the rise in gains related to foreign exchange and derivative transactions, although income from fees and commissions decreased due to weak sales of investment trusts and insurance products.

II-A-9: Net non-interest income



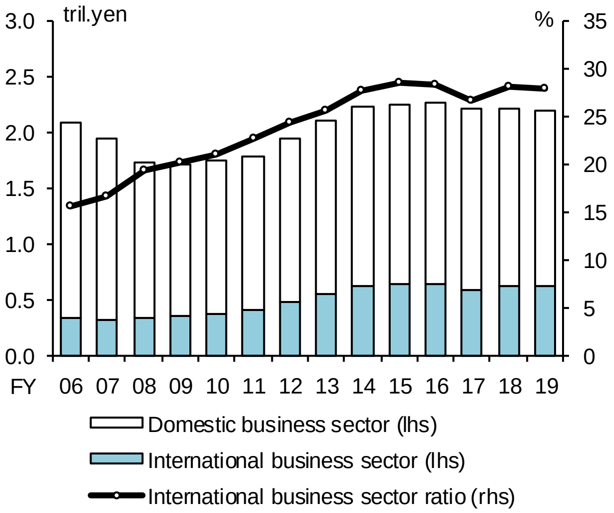
Source: BOJ.

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



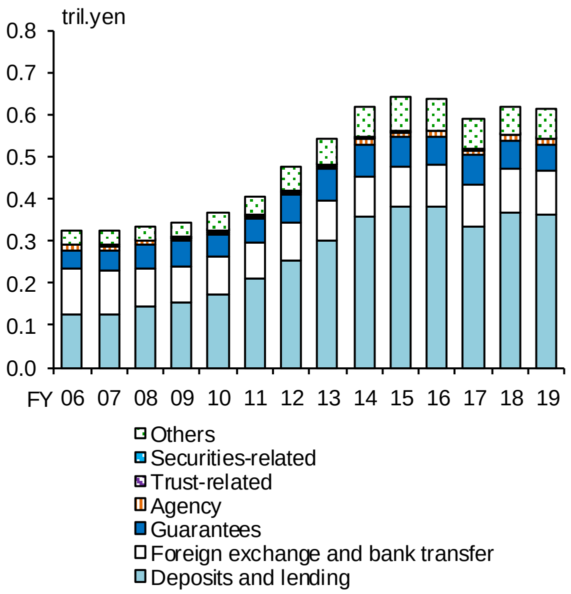
Note: Among items of income from fees and commissions, the 5 items listed above are counted.
Source: BOJ.

II-A-11: Income from fees and commissions at major banks (breakdown according to domestic and international business sectors)



Source: BOJ.

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



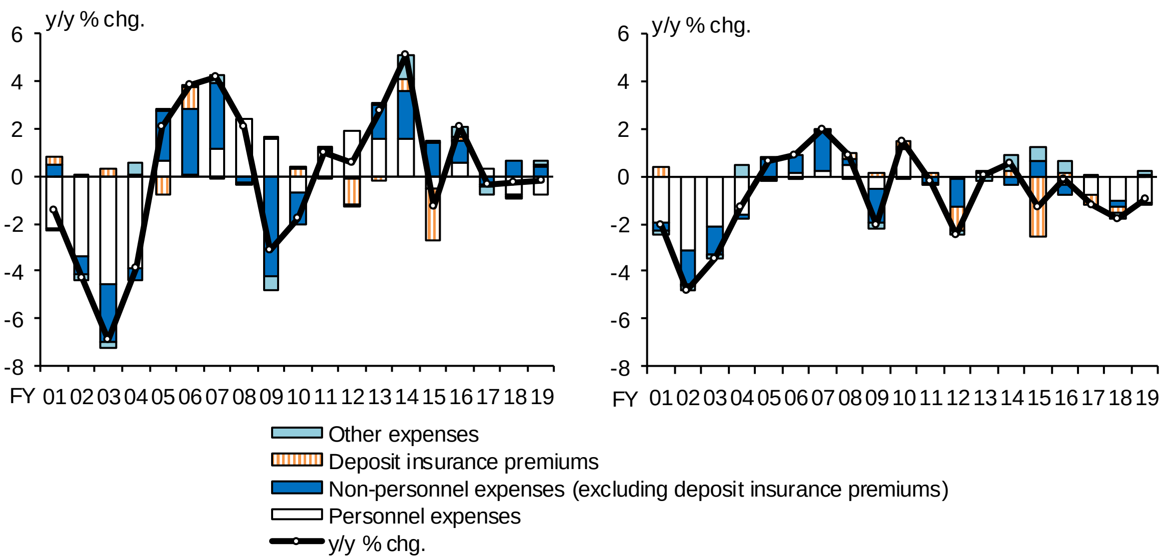
Note: The figures are categorized based on each bank's internal definition. "Deposits and lending" includes income from fees and commissions related to the arrangement of syndicated loans, commitment lines, securitization, and M&A transactions.

Source: BOJ.

5. General and Administrative Expenses

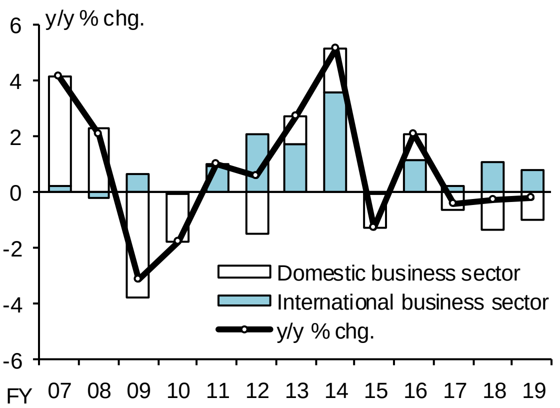
General and administrative expenses at major banks were more or less unchanged, declining by 0.2 percent from the previous year; they continued to decrease in the domestic business sector, while increasing in the international business sector. At regional banks, general and administrative expenses decreased by 0.9 percent from the previous year due to a decline in personnel expenses. The adjusted overhead ratios (OHRs) (= overhead costs / gross operating profits from core business (hereinafter referred to as "core gross operating profits"), excluding profits and losses from investment trusts due to cancellations) continued to increase, because core gross operating profits decreased at both major and regional banks.

II-A-13: Decomposition of general and administrative expenses



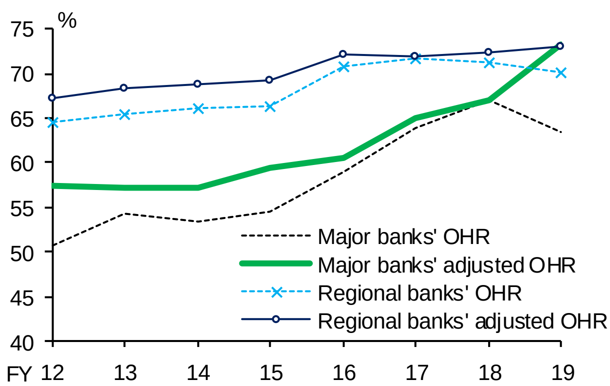
Source: BOJ.

II-A-14: Decomposition of changes in general and administrative expenses according to domestic and international business sectors at major banks



Source: BOJ.

II-A-15: OHRs



Note: OHR = overhead costs / gross operating profits.
Adjusted OHR = overhead costs / core gross operating profits (excluding profits and losses from investment trusts due to cancellations).
Source: BOJ.

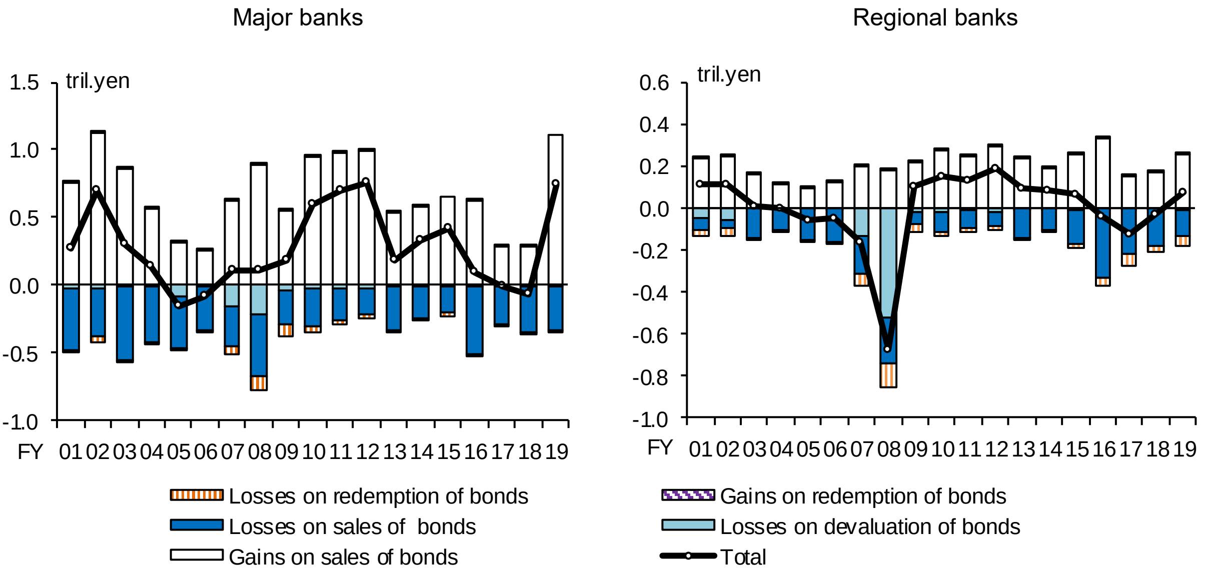
B. Realized and Unrealized Gains/Losses on Securities Holdings

1. Realized Gains/Losses on Securities Holdings

Realized gains/losses on bondholdings turned significantly positive at both major banks and regional banks due to higher profits from sales of foreign and domestic securities.

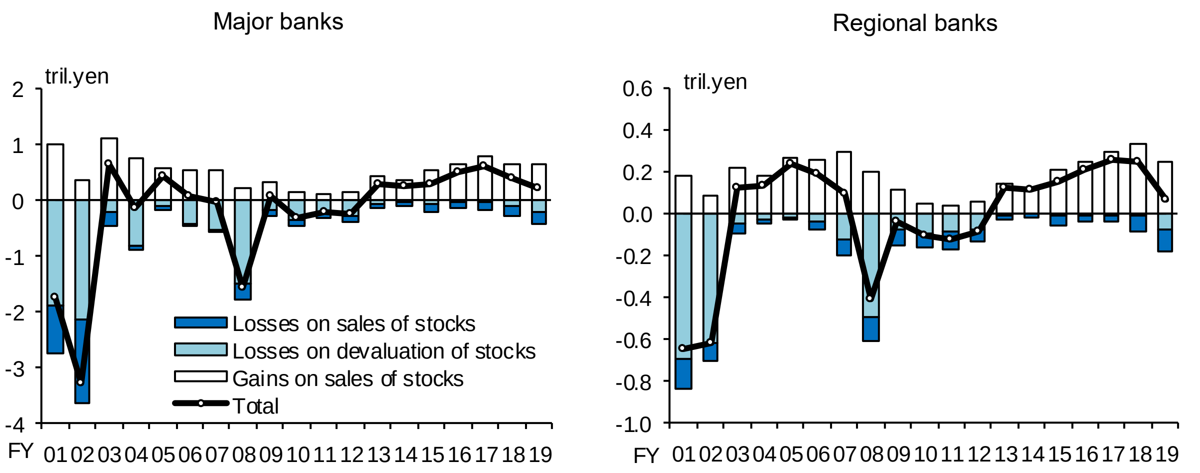
As for realized gains/losses on stockholdings, the extent to which such gains exceeded losses continued to decrease at both major banks and regional banks, partly because losses on the devaluation of stocks were incurred due to the decline in stock prices at the end of fiscal 2019 although the reduction of strategic holdings continued.

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



Source: BOJ.

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

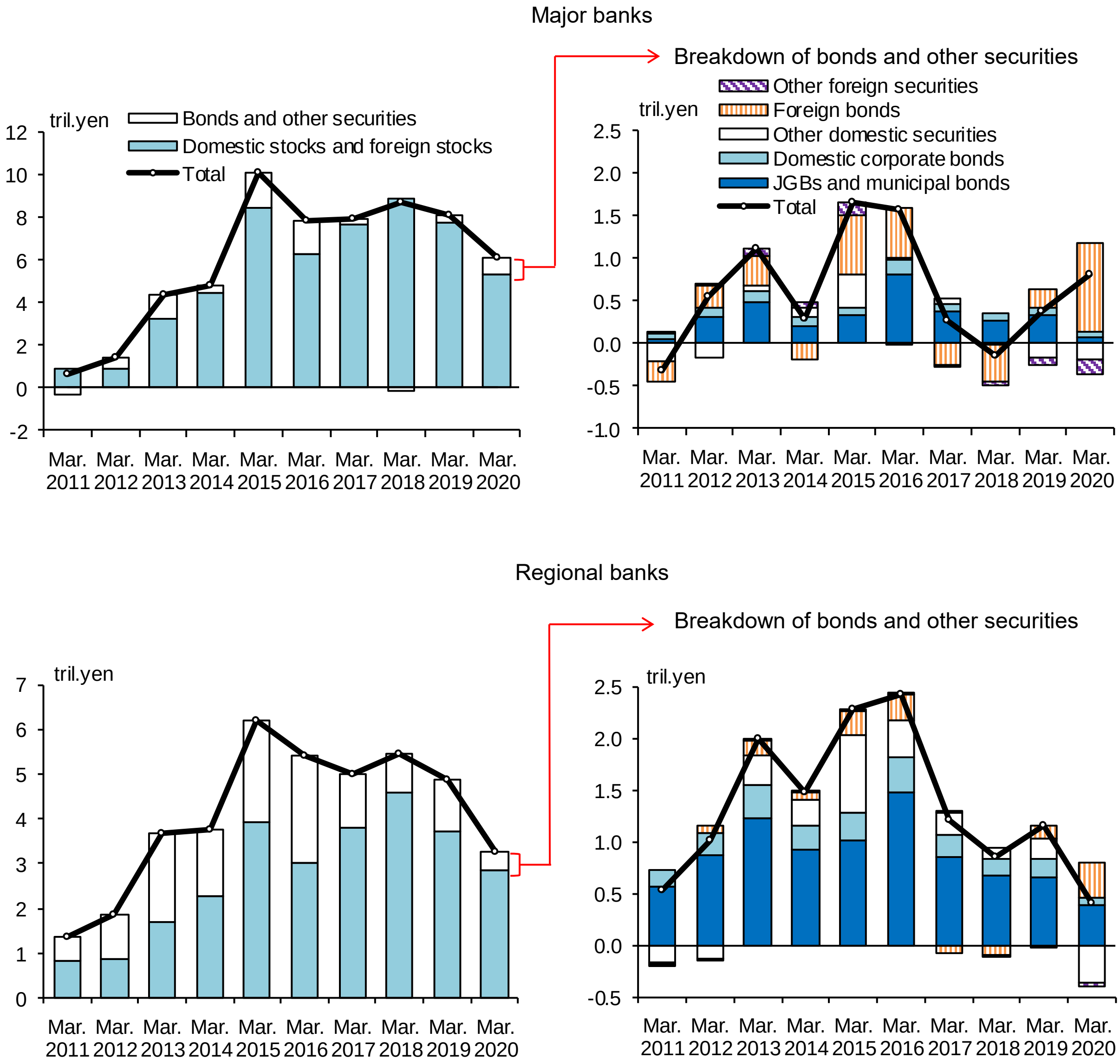


Source: BOJ.

2. Unrealized Gains/Losses on Securities Holdings

Looking at unrealized gains/losses on available-for-sale securities holdings as of the end of March 2020, the extent to which unrealized gains exceeded losses remained high at both major banks and regional banks, but decreased from the end of March 2019 to about 6 trillion yen at major banks and about 3 trillion yen at regional banks. Looking more closely at the breakdown, the amount by which unrealized gains in stockholdings exceeded losses, which accounts for a large share of the total gains on securities holdings, decreased at both major banks and regional banks, as the amount outstanding was reduced due to the sales of strategic shareholdings and as stock prices declined at the end of fiscal 2019. The amount by which unrealized gains on holdings of "bonds and other securities" exceeded losses rose at major banks due to an increase in the extent to which unrealized gains on foreign bondholdings exceeded losses amid the decline in long-term interest rates. On the other hand, such amount decreased at regional banks as unrealized gains/losses on the holdings of "other domestic securities," which include investment trusts, turned negative mainly due to the decline in stock prices at the end of fiscal 2019.

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



Note: The breakdown of bonds and other securities at both major and regional banks is shown on the right. "Other domestic securities" and "other foreign securities" include investment trusts and funds.

Source: BOJ.

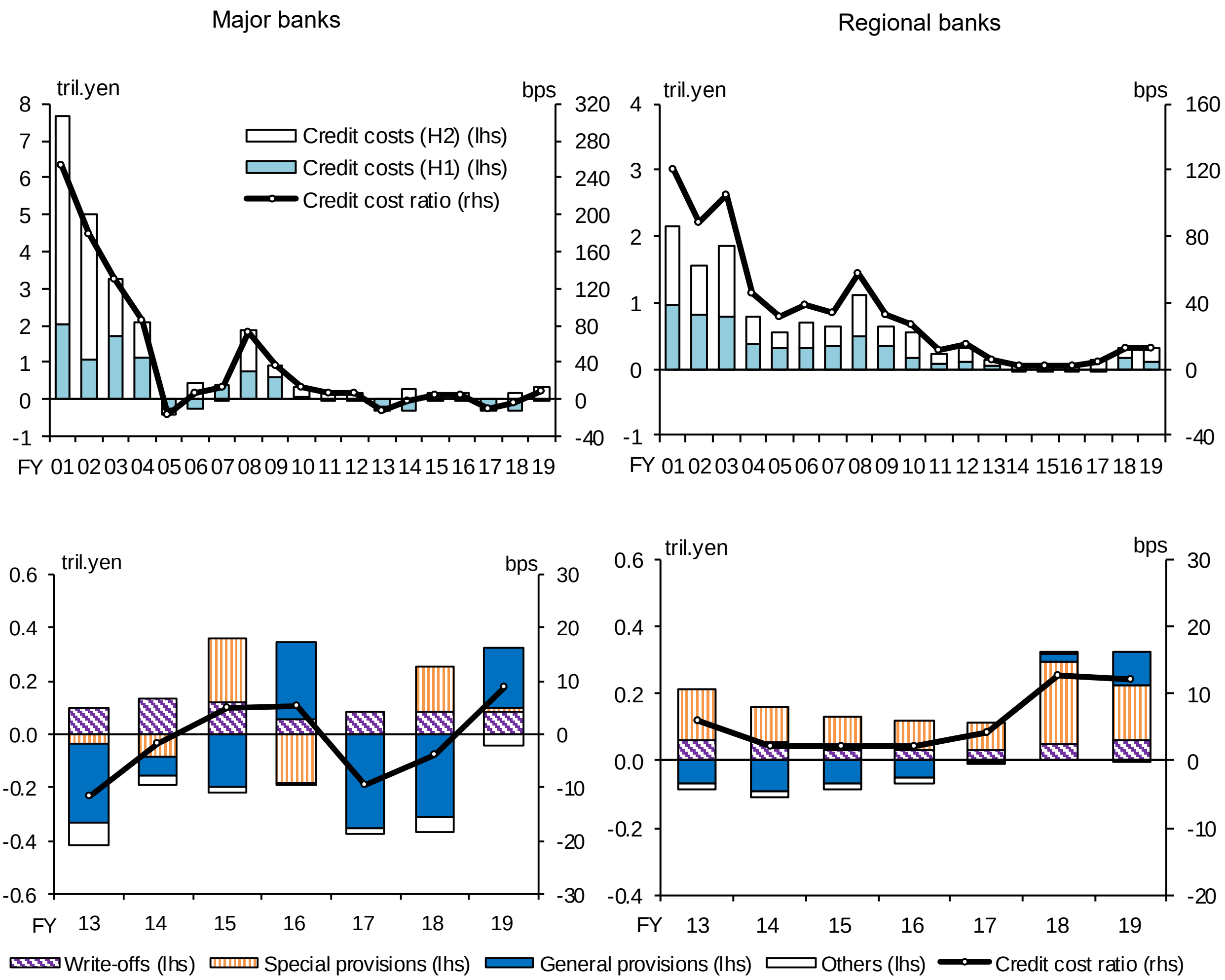
C. Credit Costs and Non-Performing Loans

1. Credit Costs

Credit costs turned up at major banks not only due to a rise in loan-loss provisions caused by the deterioration of business conditions, especially of small and medium-sized companies, but also due to the recording of precautionary loan-loss provisions in response to concern about the possible worsening of domestic and overseas credit conditions caused by the spread of COVID-19. Credit costs at regional banks were at the same level as the previous year, when high credit costs were incurred by a bank.

The credit cost ratio (= credit costs / total loans outstanding) was 9 basis points (an increase of 13 basis points from the previous year) at major banks and 12 basis points (no change from the previous year) at regional banks.

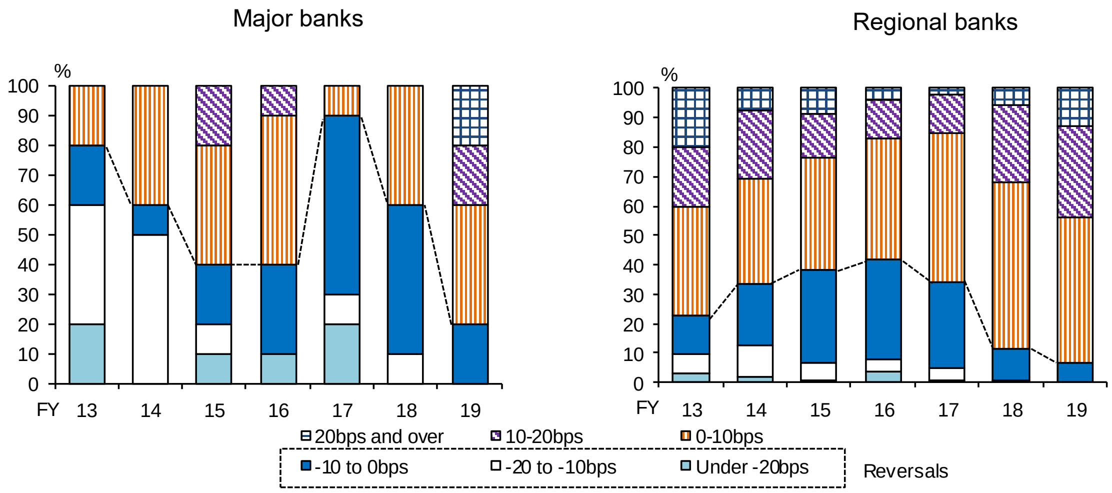
II-C-1: Credit costs and credit cost ratios



Note: The lower charts show the breakdown of credit costs at major banks and regional banks, respectively.
Source: BOJ.

The distribution of credit cost ratios among banks shows that, at major banks, the share of those with credit costs reversed decreased significantly from the previous year, and there were banks with credit costs of 10 basis points or greater for the first time in three years. For regional banks, the share of those with credit costs accounted for more than 90 percent, with the share of those with credit costs reversed decreasing further, and the share of banks with credit costs of 10 basis points or greater continued to increase.

II-C-2: Credit cost ratio distribution



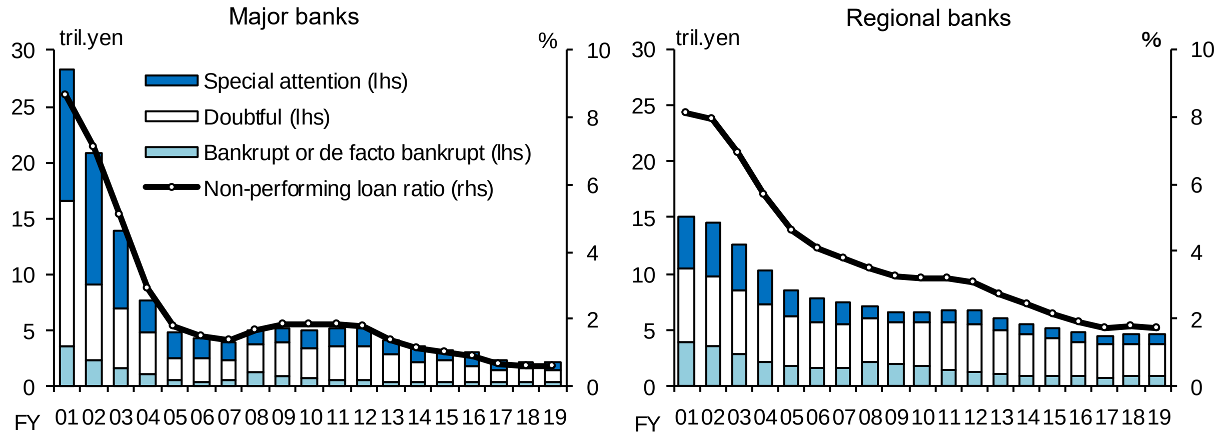
Note: Proportion of the number of banks by credit cost ratio.
Source: BOJ.

2. Non-Performing Loans

Non-performing loan (NPL) ratios were more or less unchanged, remaining at low levels at both major banks and regional banks. Meanwhile, the NPL ratios for overseas loans at the three megabanks remained at low levels on the whole, although they increased slightly in some regions.

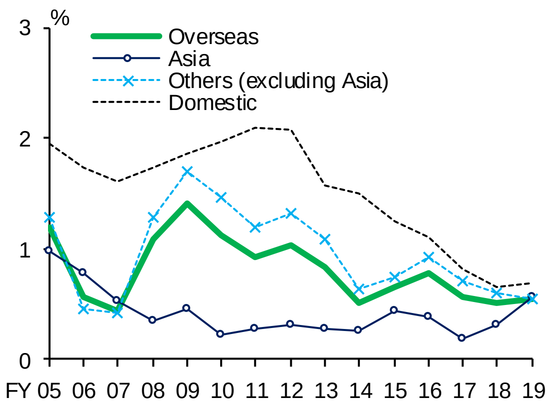
Looking at the proportion of loans outstanding by borrower classification, the ratio of normal loans at both major banks and regional banks remained high, exceeding 95 percent at major banks and marking almost 90 percent at regional banks.

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



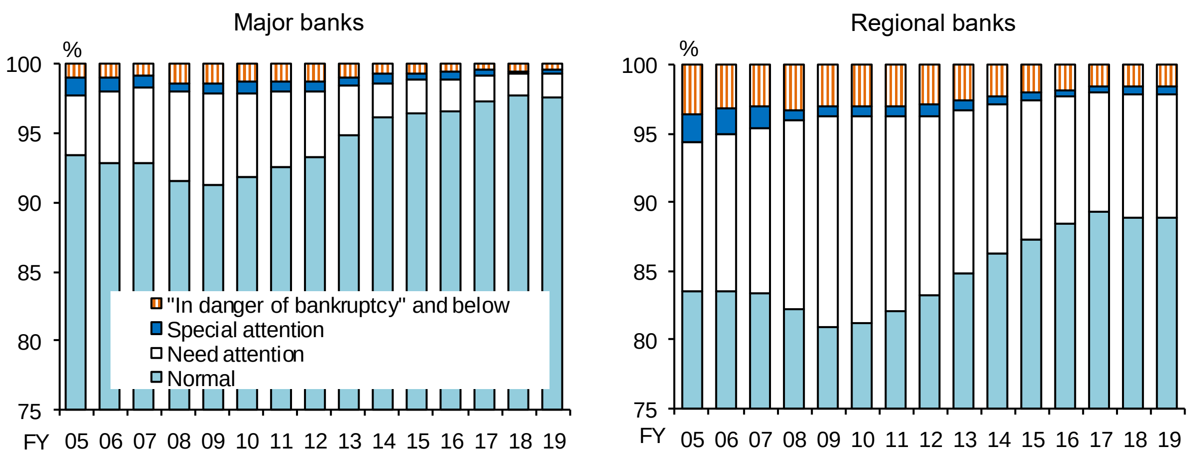
Source: BOJ.

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



Source: Published accounts of each bank.

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



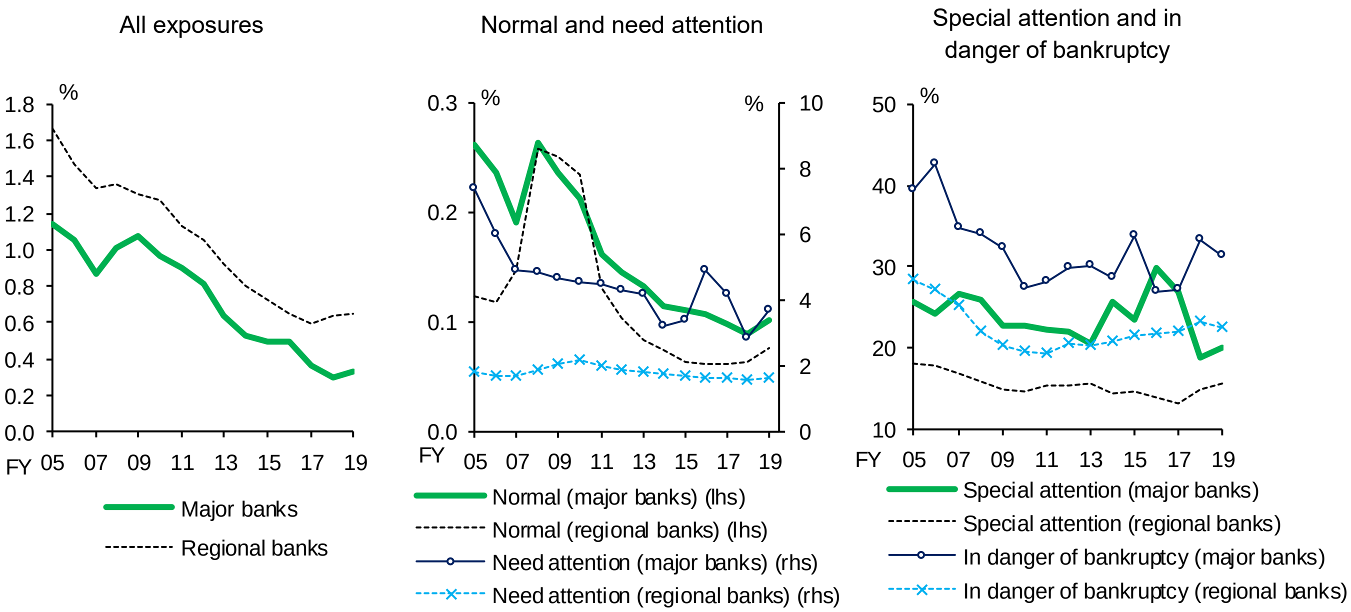
Note: The data are calculated on a write-off basis.
Source: BOJ.

3. Loan-Loss Provisions

(1) Loan-Loss Provision Ratios

The average loan-loss provision ratio for all exposures at major banks increased slightly from the previous year, although remaining at low levels, as loan-loss provision ratios for normal loans and "need attention" loans increased. Such ratio at regional banks was more or less unchanged, after having turned up in the previous fiscal year.

II-C-6: Loan-loss provision ratios

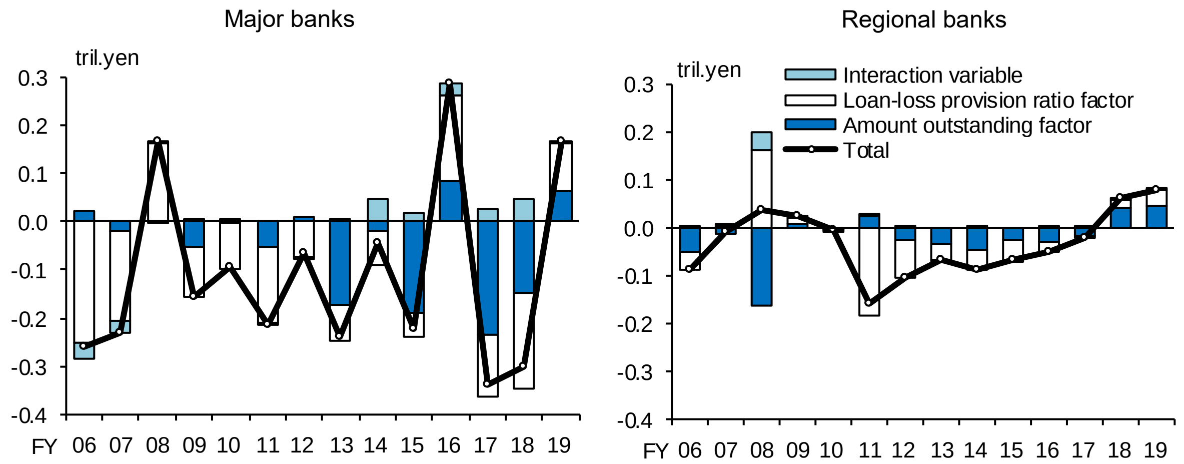


Notes: 1. The data include loans to which the discounted cash flow method is applied.
2. The loan-loss provision ratio is calculated as loan-loss provisions divided by the total amount of claims (not the uncovered amount of claims).
Source: BOJ.

(2) Outstanding Amount of Loan-Loss Provisions

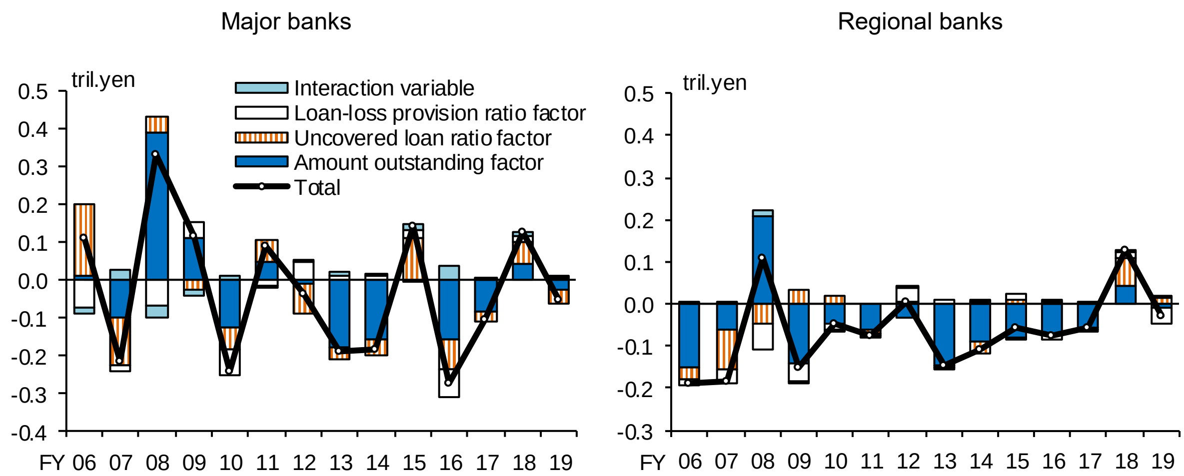
Looking at the outstanding amount of loan-loss provisions, general provisions turned up at major banks and continued to increase at regional banks, while special provisions turned down at both major banks and regional banks.

II-C-7: Decomposition of outstanding amount of general loan-loss provisions



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

II-C-8: Decomposition of outstanding amount of special loan-loss provisions



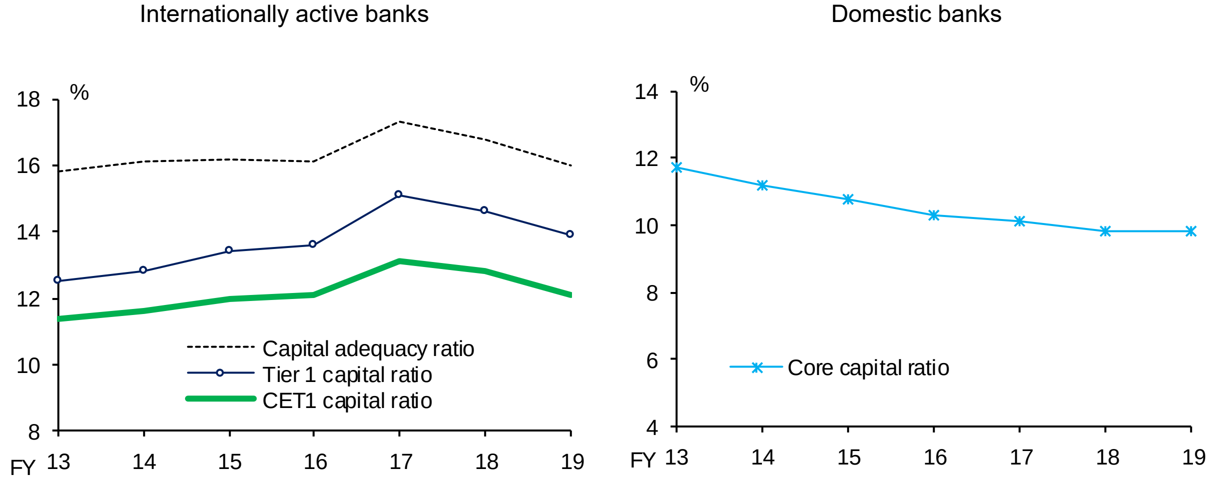
Note: Each factor represents the sum of the amount calculated by borrower classification.
Source: BOJ.

D. Capital Adequacy Ratios

Both the common equity Tier 1 capital ratio (CET1 capital ratio) and the capital adequacy ratio of internationally active banks on a consolidated bank basis remained high, but continued to decrease. This was because the amount of capital decreased due to (1) an insufficient accumulation of retained earnings caused by lower profits and the fact that many banks maintained dividend payouts despite such lower profits (see Box 2), (2) a decline in unrealized gains on available-for-sale securities holdings, which are included in CET1 capital, and (3) an increase in risk-weighted assets.

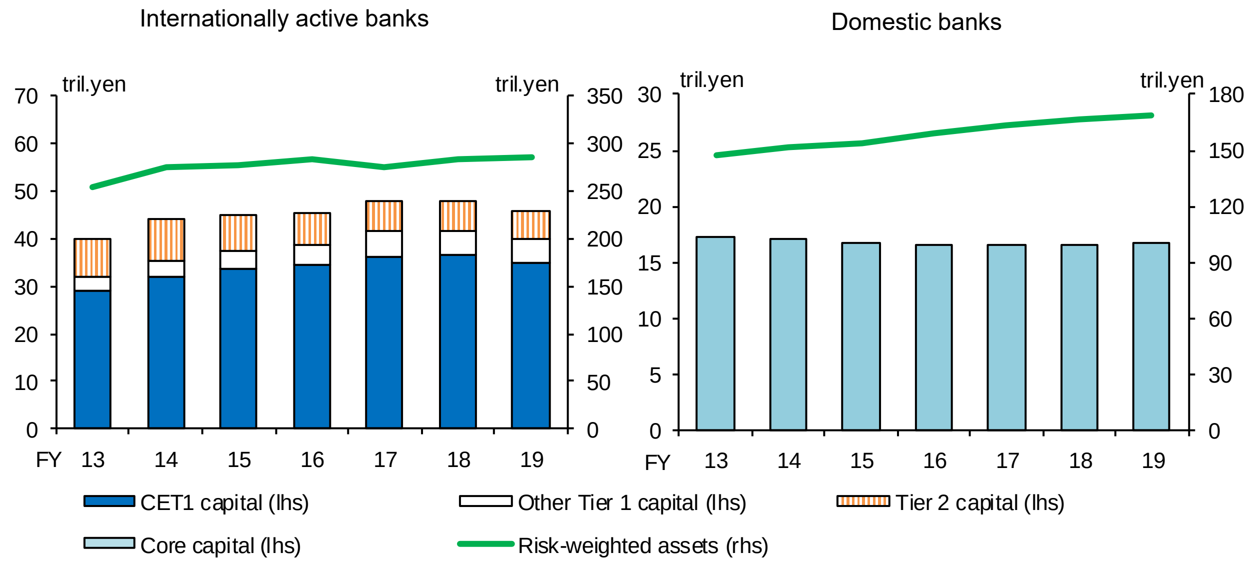
The capital adequacy ratio of domestic banks continued to follow a secular downward trend.

II-D-1: Capital adequacy ratios



Source: BOJ.

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



Note: The numerator of the capital adequacy ratio at domestic banks has been referred to as "core capital" in order to distinguish the definition of "capital" in the current Financial Services Agency public notice from that in the former public notice (the same applies to Chart III-D-1).
Source: BOJ.

Box 1: Banks' profit projections for fiscal 2020

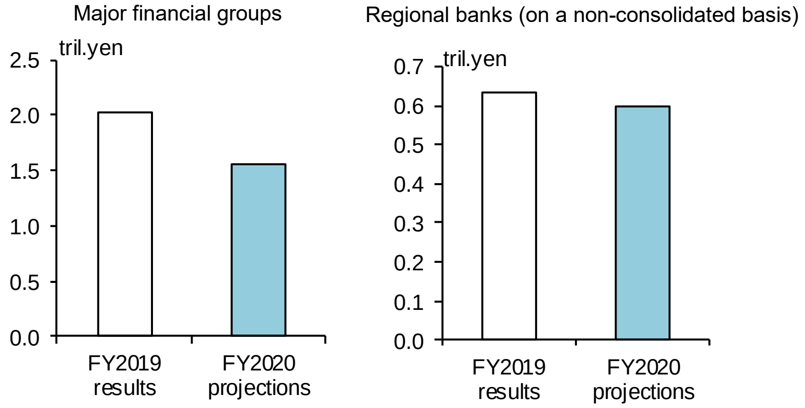
Based on data available as of July 2020, net income for fiscal 2020 is projected to decline both at major financial groups and at regional banks (on a non-consolidated basis).

At major financial groups, net income is projected to decrease by slightly over 20 percent from this year. This is partly because credit costs of over 1 trillion yen are projected, reflecting concern about the possible worsening of domestic and overseas credit conditions caused by the spread of COVID-19. This projected level of credit costs is low compared to the level observed during the global financial crisis in fiscal 2008-2009, even if precautionary loan-loss provisions recorded during fiscal 2019 are included.

At regional banks as a whole, net income is projected to decrease only by about 5 percent from this year. However, looking at individual regional banks, more than 60 percent of these banks project a decline in net income, and more than a few of them project net income to decline by greater than 20 percent from this year.

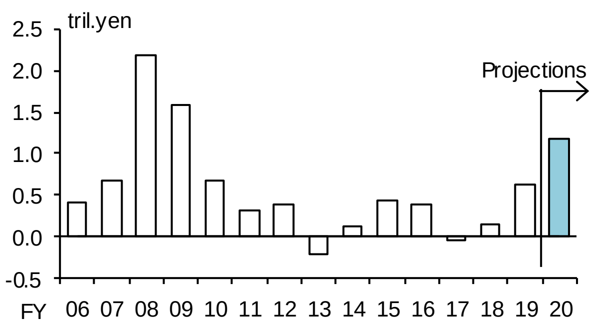
It should be noted that the outlook is subject to considerable uncertainty, including the impact of COVID-19 on the economy.

B1-1: Net Income projections for fiscal 2020



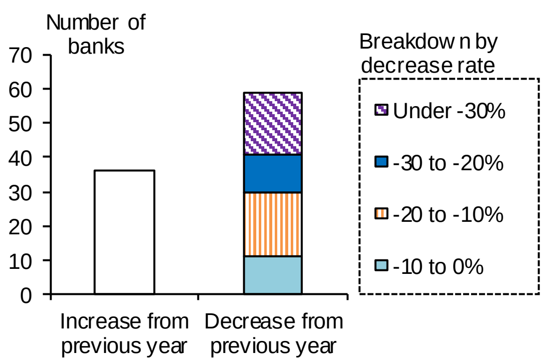
Note: Covers only banks that have announced their profit projections for fiscal 2020. The same applies to the charts below.
Sources: Published accounts of each major financial group and each regional bank; BOJ.

B1-2: Credit costs of major financial groups



Sources: Published accounts of each bank; BOJ.

B1-3: Number of regional banks by net income projection for fiscal 2020



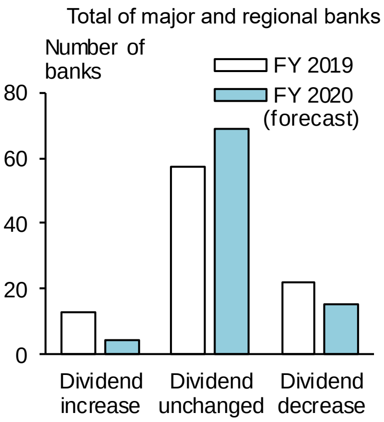
Sources: Published accounts of each bank; BOJ.

Box 2: Payouts to shareholders by banks

A large number of major banks and regional banks prioritize stable dividend payouts despite a continued decline in their profitability and some banks conduct share buybacks.

As a result, both dividend payout ratios and total payout ratios have been trending upward, and the distributions of these ratios among regional banks have been skewed upward. Thus far, these trends are likely to largely continue in fiscal 2020.

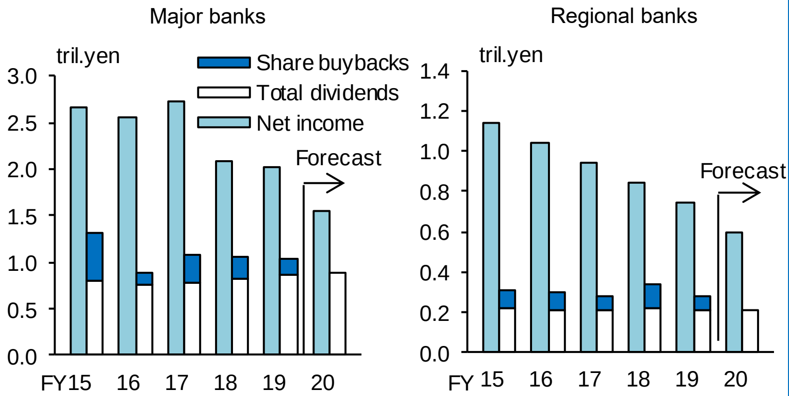
B2-1: Proportion of banks with changed yearly dividends



Note: The data for the fiscal 2020 forecast only cover banks that have announced their projections.

Sources: Published accounts of each bank; BOJ.

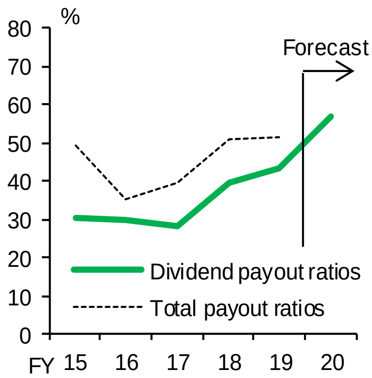
B2-2: Net income and payouts to shareholders



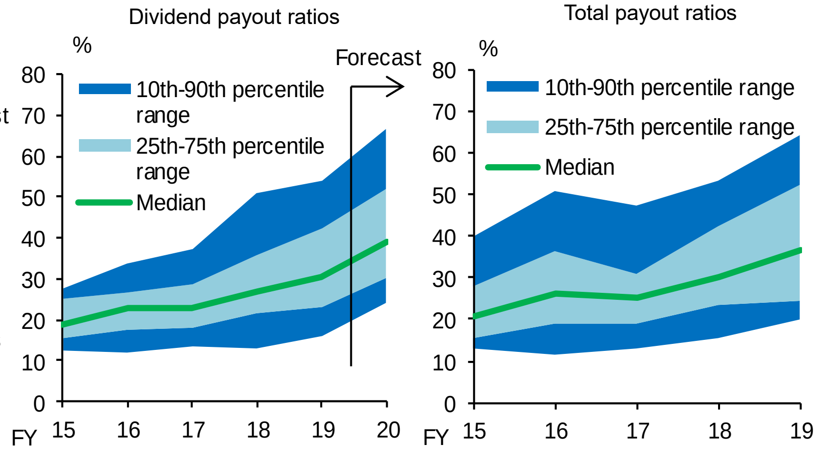
Notes: 1. The data cover banks that have announced their projections of net income and total dividends for fiscal 2020.
2. The data are on a consolidated financial group basis. For some regional banks, the data are on a consolidated bank basis.
3. The data for share buybacks include those for the repayment of public funds.
4. Footnotes 1-3 apply to the charts below.

Sources: Published accounts of each bank; BOJ.

B2-3: Dividend payout ratios and total payout ratios of major banks



B2-4: Distributions of dividend payout ratios and total payout ratios of regional banks



Note: Dividend payout ratio = total dividends / net income. Total payout ratio = (total dividends + share buybacks) / net income.

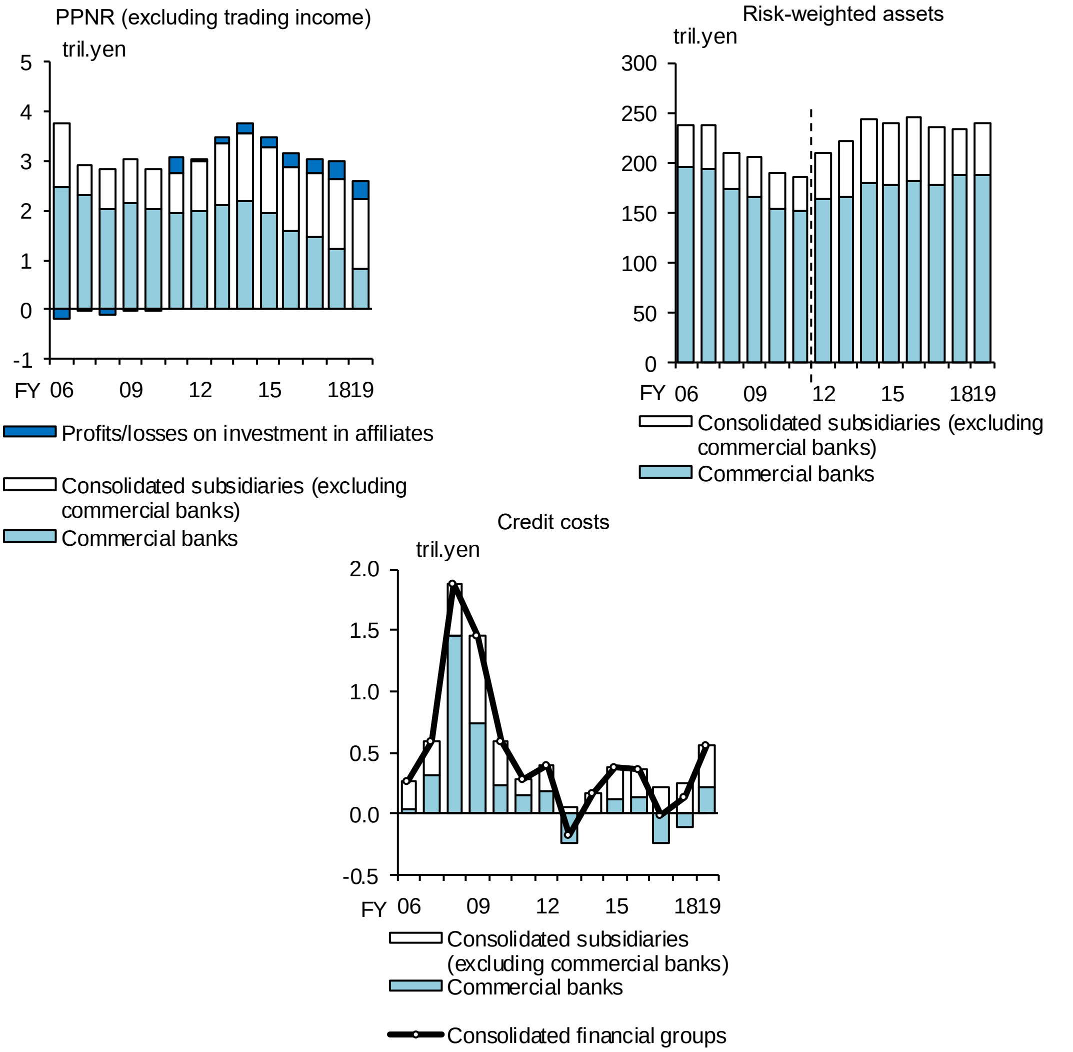
Sources: Published accounts of each bank; BOJ.

Box 3: Profit contribution of group companies at major banks

At major financial groups, group companies other than domestic commercial banks have increased their profit contributions in recent years. In particular, the three mega financial groups have been working to raise group-wide profit levels through acquisitions of and investments in domestic non-financial corporates and foreign commercial banks, while the profitability of domestic commercial banks has continued to decline. Meanwhile, the three mega financial groups have been making efforts to restrain the increase in risk-weighted assets with a focus on capital efficiency. Their consolidated subsidiaries, excluding commercial banks, have continued to incur a certain amount of credit costs.

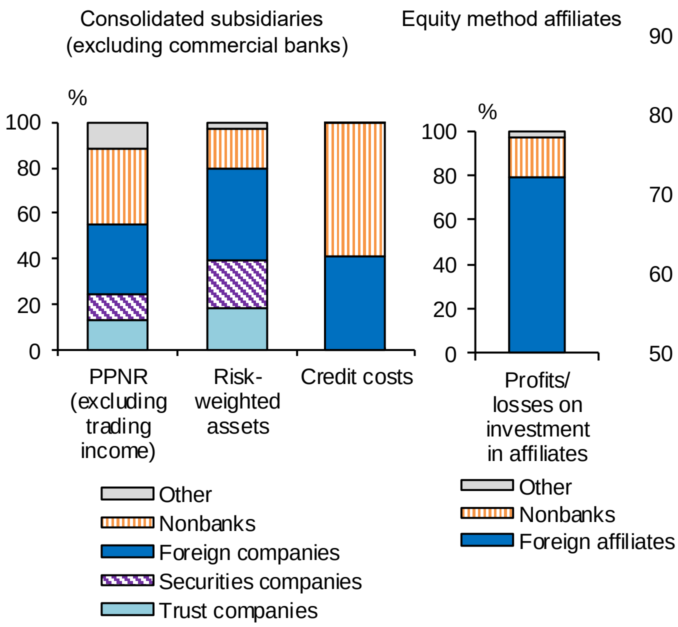
Looking at group companies, excluding commercial banks, by type, nonbanks and overseas subsidiaries and affiliates account for large shares. These companies seem likely to contribute to increasing group-wide profitability and operating efficiency. Nonetheless, it should be noted that the expansion of group-wide business activities could be associated with the risk of considerable downward pressure on profits, such as through impairment losses on "goodwill" incurred by an investee company, as actually observed in a financial group in fiscal 2019.

B3-1: PPNR (excluding trading income), risk-weighted assets, and credit costs of the three mega financial groups

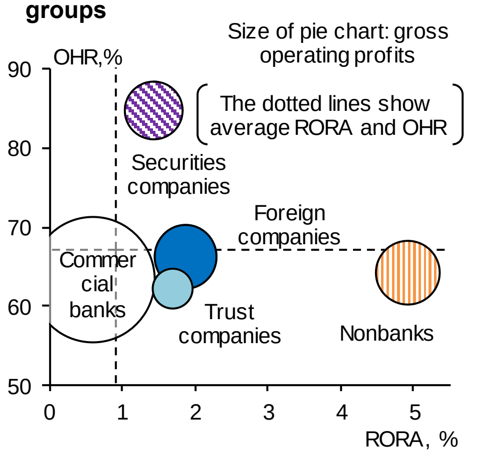


Notes: 1. The data for commercial banks are on a non-consolidated basis.
2. The data for risk-weighted assets from fiscal 2012 onward are based on the Basel III framework.
Sources: Published accounts of each financial group; BOJ.

B3-2: Proportion breakdown by type of group company at the three mega financial groups



B3-3: Comparison of RORA, OHR, and gross operating profits of consolidated subsidiaries at the three mega financial groups



Notes: 1. The data are as of fiscal 2019.
2. Covers some of the group companies with large gross operating profits and profits on investments among consolidated subsidiaries and equity method affiliates, respectively.
3. Footnotes 1 and 2 apply to Chart B3-3.

Sources: Published accounts of each financial group; BOJ.

Note: RORA = PPNR (excluding trading income) / risk-weighted assets. OHR = overhead costs / gross operating profits.

Sources: Published accounts of each financial group; BOJ.

III. Financial Results of Japan's *Shinkin* Banks for Fiscal 2019

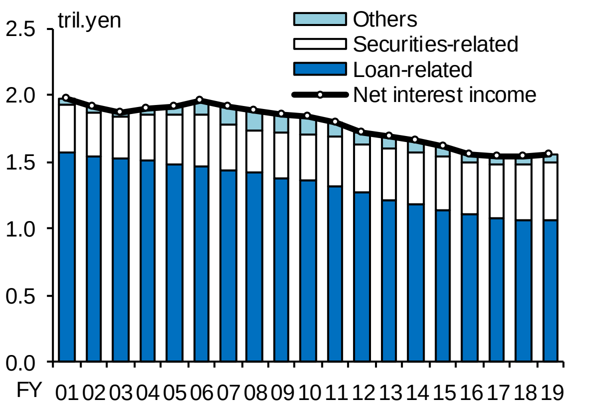
This chapter analyzes *shinkin* banks' core profitability (net interest income, net non-interest income, and general and administrative expenses), realized and unrealized gains/losses on securities holdings, credit costs and non-performing loans, as well as capital adequacy ratios.

A. Core Profitability

1. Net Interest Income

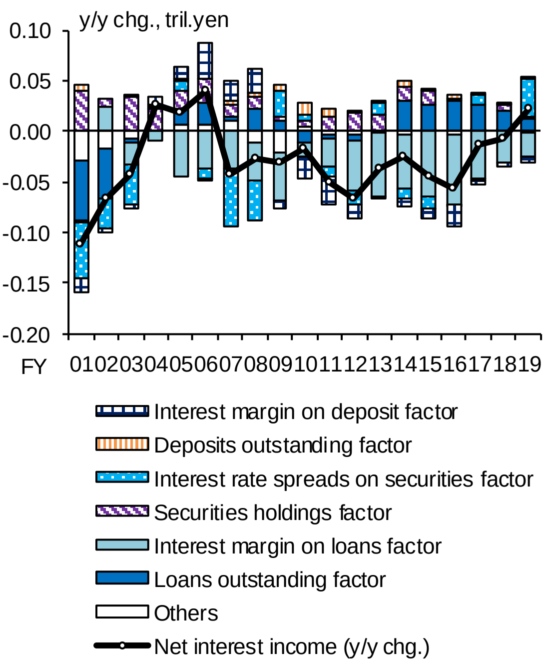
Net interest income turned up as interest rate spreads on securities widened on the back of an increase in profits from investment trusts due to cancellations, although interest rate spreads on loans continued to narrow.

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).
Source: BOJ.

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



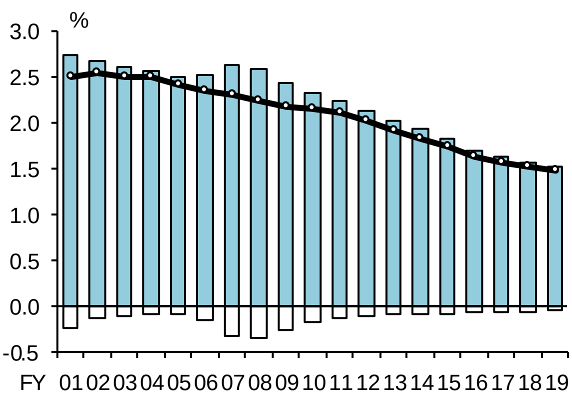
Source: BOJ.

2. Interest Rate Spreads on Loans and Loans Outstanding

(1) Interest Rate Spreads on Loans

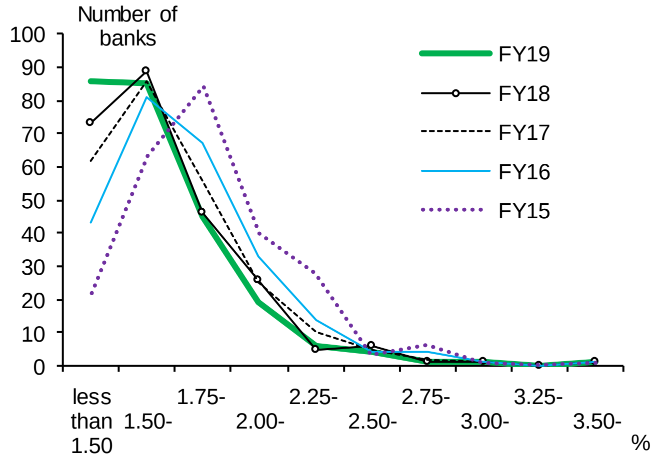
Interest rate spreads on loans continued to narrow due to a decline in interest rates on loans. The distribution of interest rate spreads for individual *shinkin* banks also continued to shrink on the whole.

III-A-3: Interest rate spreads on loans



Note: In calculating the interest rate spreads, interest expenses on interest rate swaps are deducted from funding costs. The same applies to Chart III-A-4.
Source: BOJ.

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

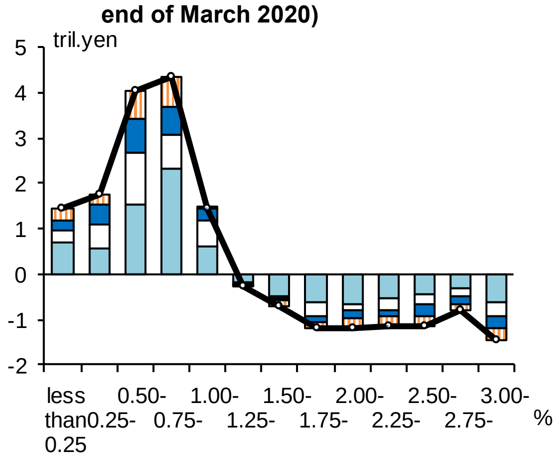


Source: BOJ.

(2) Loans Outstanding by Lending Rate

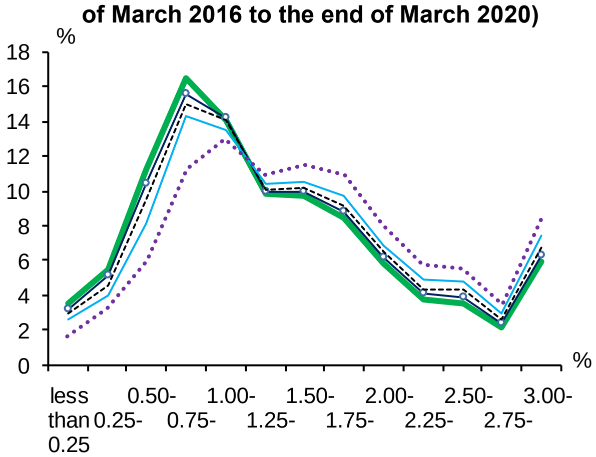
Looking at developments in loans outstanding, those with low lending rates continued to increase.

III-A-5: Changes in loans outstanding by lending rate (from the end of March 2016 to the end of March 2020)



Source: BOJ.

III-A-6: Changes in proportion of loans outstanding by lending rate (from the end of March 2016 to the end of March 2020)

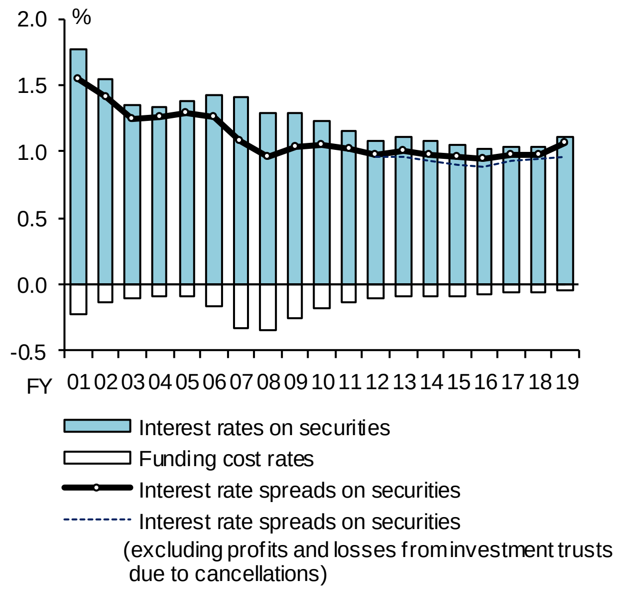


Source: BOJ.

3. Interest Rate Spreads on Securities

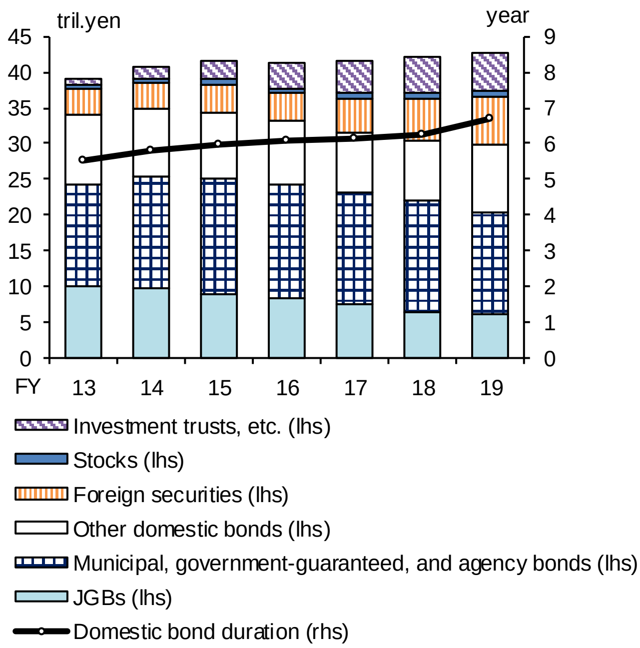
Interest rate spreads on securities widened on the back of an increase in profits from investment trusts due to cancellations.

III-A-7: Interest rate spreads on securities



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

III-A-8: Amounts outstanding of securities by product type (at year-end)

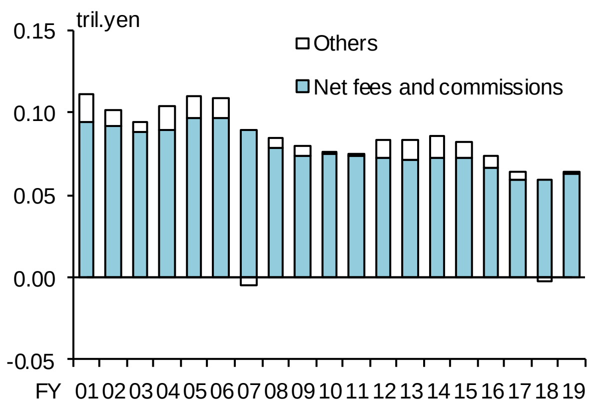


Source: BOJ.

4. Net Non-Interest Income

Net non-interest income increased due to an increase in income from fees and commissions.

III-A-9: Net non-interest income

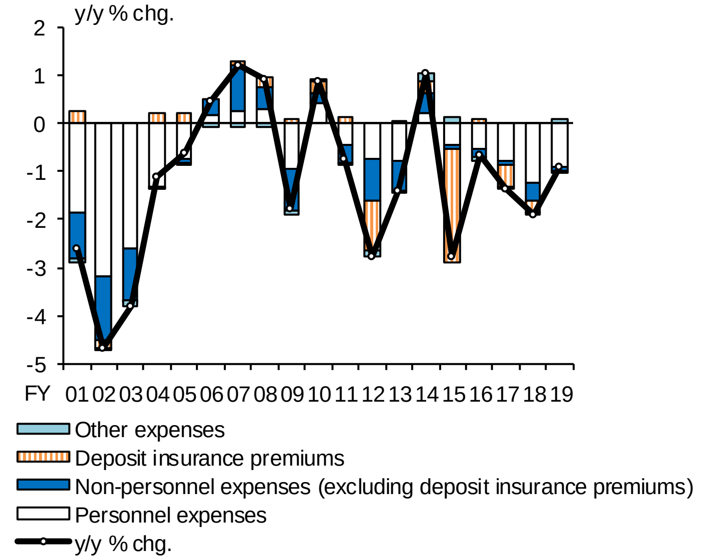


Source: BOJ.

5. General and Administrative Expenses

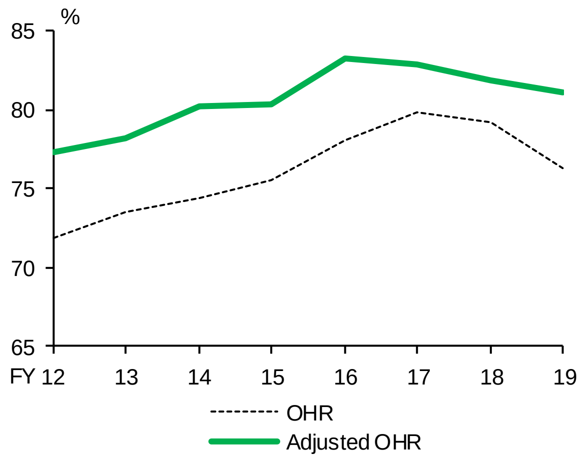
General and administrative expenses continued to decrease, particularly with respect to personnel expenses. The adjusted OHR (= overhead costs / core gross operating profits, excluding profits and losses from investment trusts due to cancellations) continued to decrease as administrative expenses declined and core gross operating profits were more or less unchanged.

III-A-10: Decomposition of general and administrative expenses



Source: BOJ.

III-A-11:OHRs



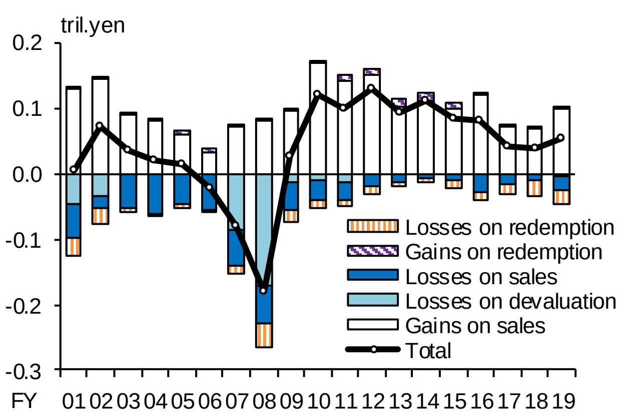
Source: BOJ.

B. Realized and Unrealized Gains/Losses on Securities Holdings

1. Realized Gains/Losses on Securities Holdings

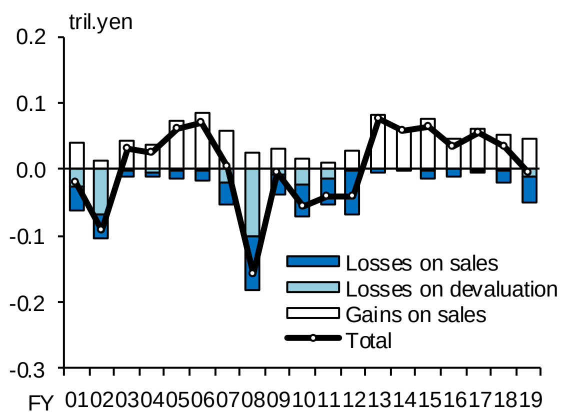
Looking at realized gains/losses on bondholdings, the extent to which gains exceeded losses increased due to higher profits from sales mainly of domestic securities. On the other hand, those on stockholdings turned negative as losses on sales of stocks were incurred due to the decline in stock prices at the end of fiscal 2019.

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



Source: BOJ.

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

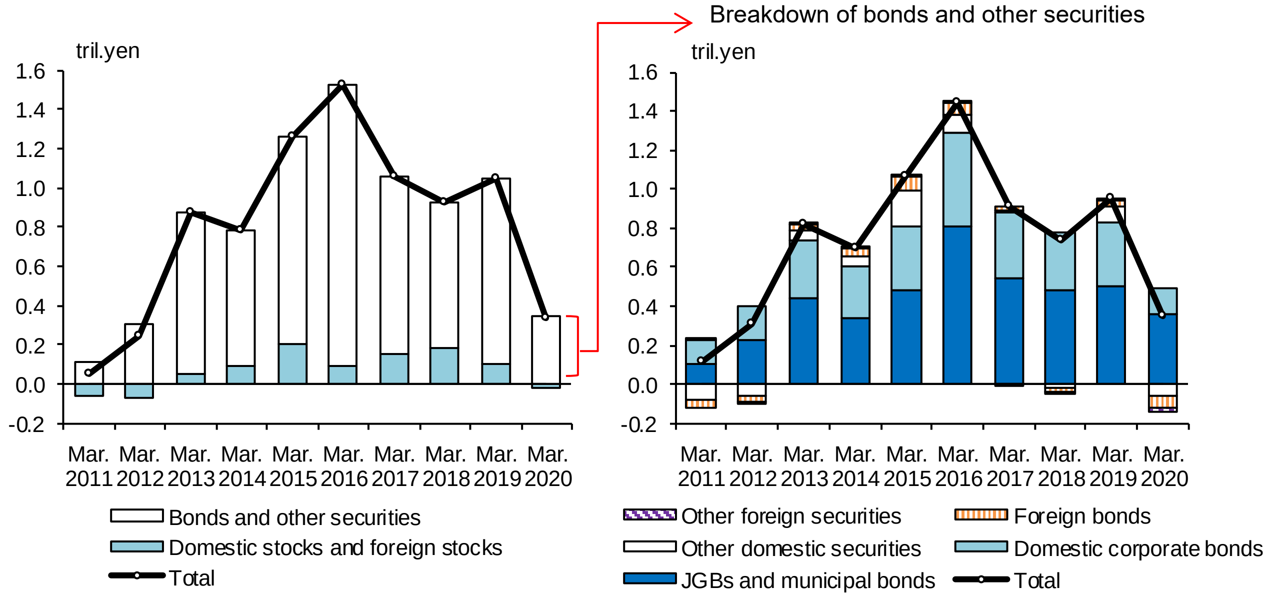


Source: BOJ.

2. Unrealized Gains/Losses on Securities Holdings

Looking at unrealized gains/losses on available-for-sale securities holdings as of the end of March 2020, the extent to which gains exceeded losses decreased significantly as (1) unrealized gains/losses on the holdings of foreign bonds, "other domestic securities" (including investment trusts), and "other foreign securities" turned negative and (2) the extent to which gains on domestic corporate bonds exceeded losses decreased. This was due to the decline in stock prices and the widening of credit spreads at the end of fiscal 2019.

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



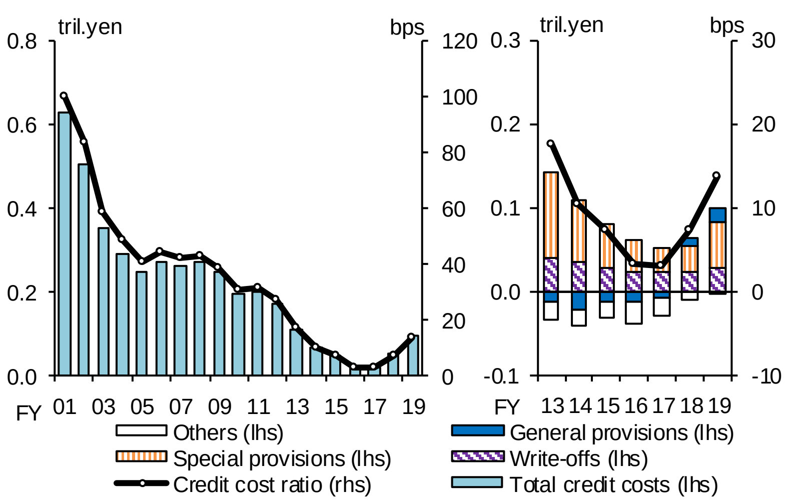
Note: "Other domestic securities" and "other foreign securities" include investment trusts and funds.
Source: BOJ.

C. Credit Costs and Non-Performing Loans

1. Credit Costs

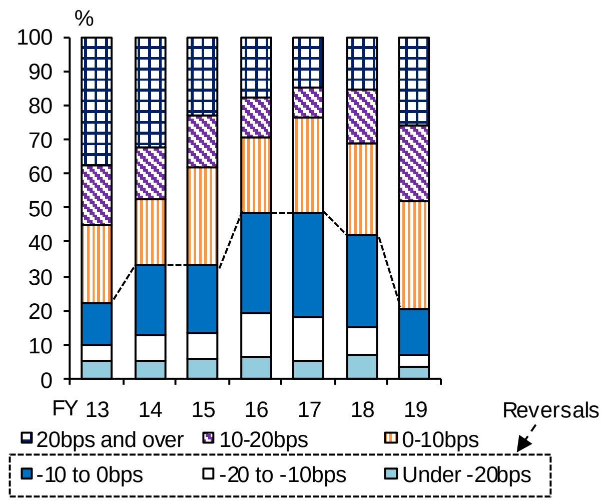
Credit costs continued to increase as both general and special loan-loss provisions were higher than the previous year. Looking at the distribution of credit cost ratios among *shinkin* banks, the share of banks with credit costs reversed decreased further from the previous year, and the share of banks with credit costs of 10 basis points or greater continued to increase.

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



Source: BOJ.

III-C-2: Distribution of credit cost ratios

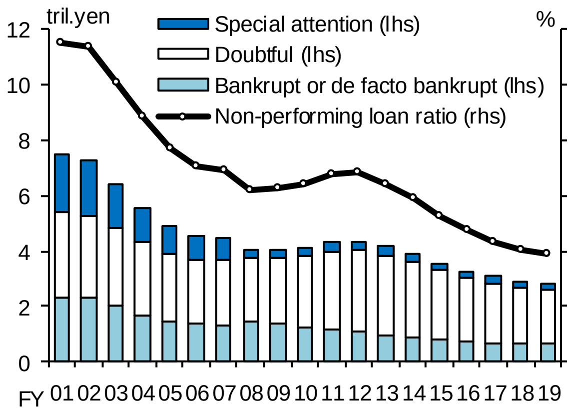


Note: Proportion of number of banks by credit cost ratio.
Source: BOJ.

2. Non-Performing Loans

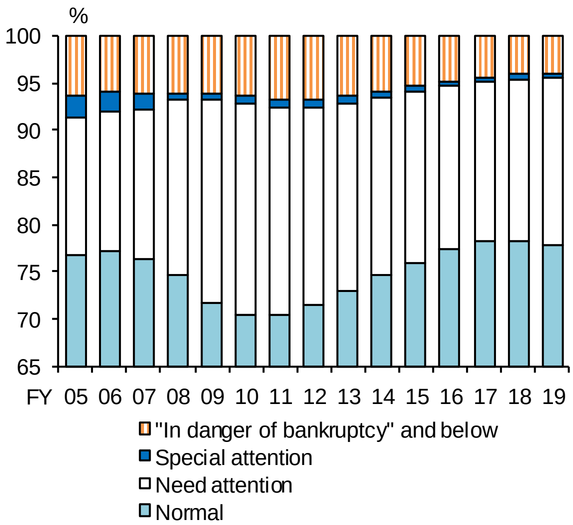
The NPL ratio continued to decline moderately and reached its lowest level since fiscal 2001, when the relevant data were first recorded. The proportion of loans outstanding for normal loans remained large.

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



Source: BOJ.

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



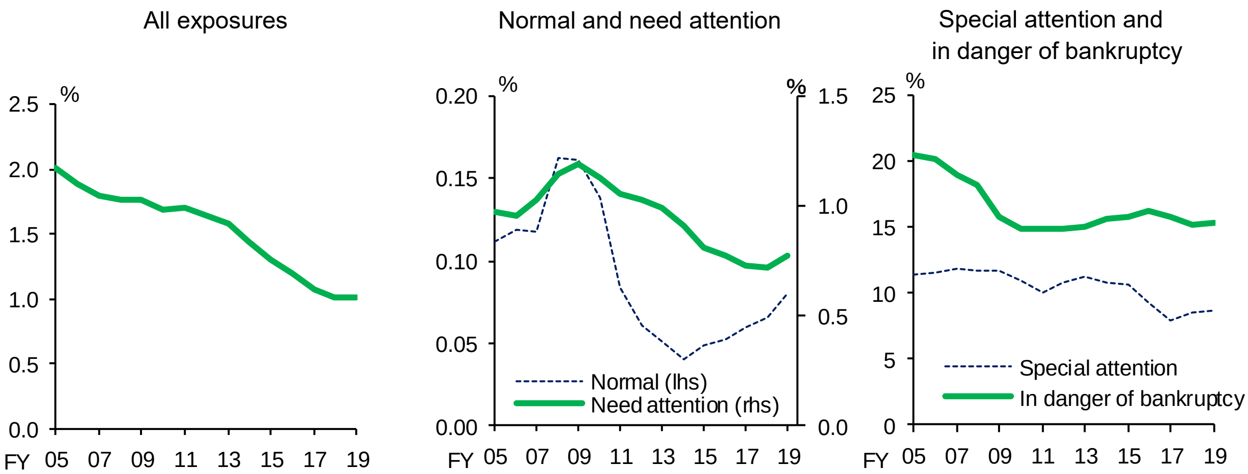
Note: The data are calculated on a write-off basis.
Source: BOJ.

3. Loan-Loss Provisions

(1) Loan-Loss Provision Ratios

Looking at loan-loss provision ratios by borrower classification, such ratios increased for all classifications. However, the average ratio for all exposures was more or less unchanged due to a decline in the proportions of amounts outstanding of loans requiring "special attention" and the lower borrower classification.

III-C-5: Loan-loss provision ratios

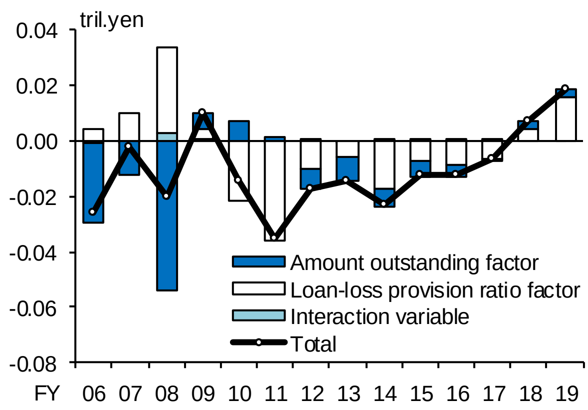


Notes: 1. The data include loans to which the discounted cash flow method is applied.
2. The loan-loss provision ratio is calculated by dividing loan-loss provisions by the total amount of claims (not the uncovered amount of claims).
Source: BOJ.

(2) Outstanding Amount of Loan-Loss Provisions

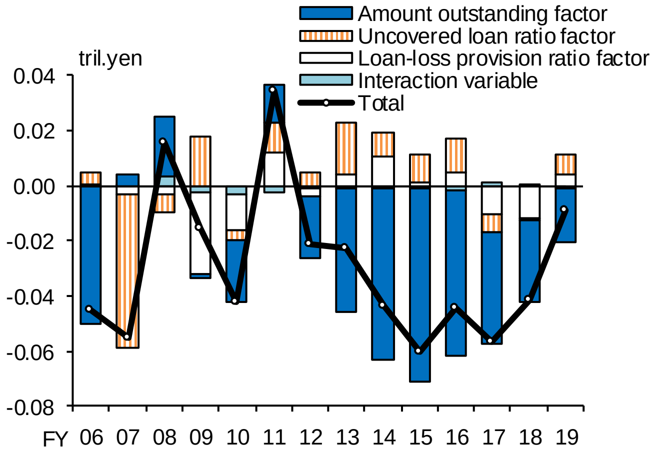
As for the outstanding amount of loan-loss provisions, general provisions continued to increase mainly due to the rise in loan-loss provision ratios for normal loans and "need attention" loans. Special provisions continued to decrease mainly due to the decline in the outstanding amount of loans requiring special provisions.

III-C-6: Decomposition of the outstanding amount of general loan-loss provisions



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

III-C-7: Decomposition of the outstanding amount of special loan-loss provisions

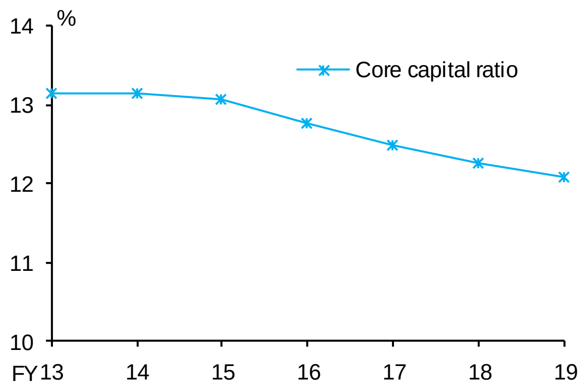


Note: Each factor represents the sum of the amount calculated by borrower classification.
Source: BOJ.

D. Capital Adequacy Ratios

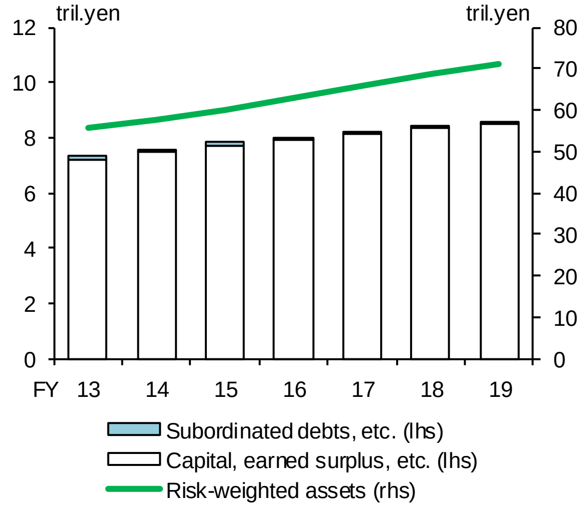
The capital adequacy ratio decreased slightly. The amount of capital increased, mainly due to the accumulation of retained earnings, but this was outpaced by an increase in risk-weighted assets.

III-D-1: Capital adequacy ratios



Source: BOJ.

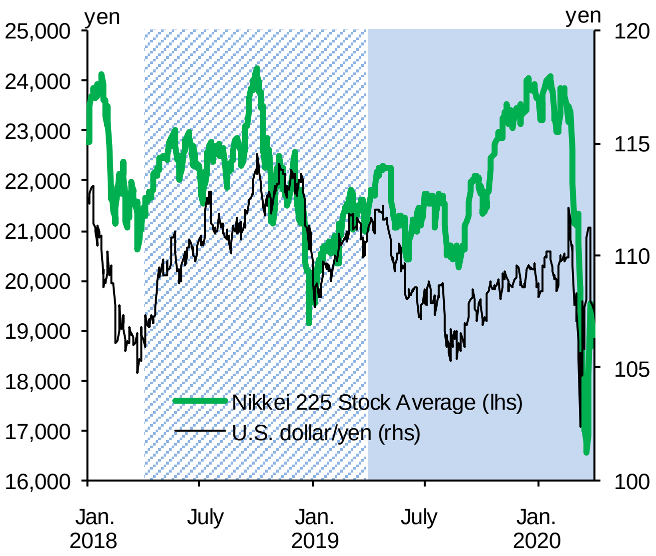
III-D-2: Capital components and risk-weighted assets



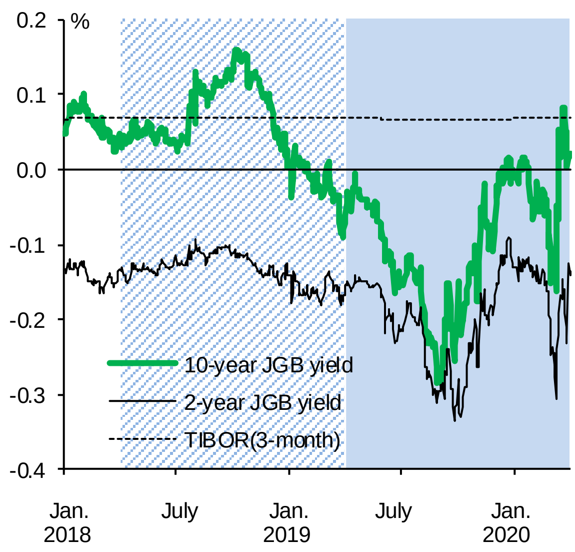
Source: BOJ.

Reference: Developments in Financial Markets

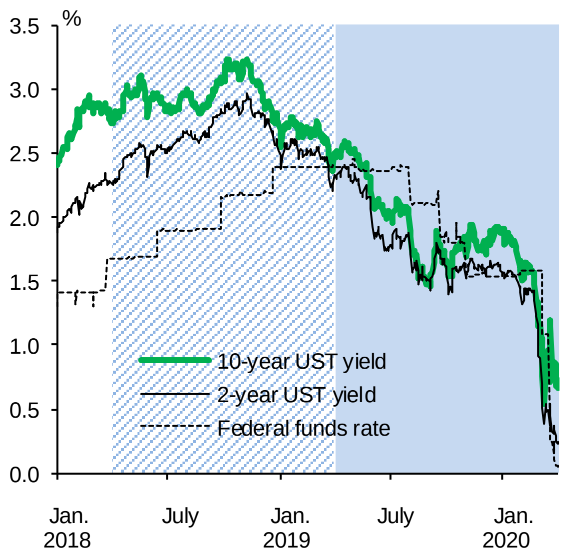
▽ Nikkei 225 Stock Average and foreign exchange rates



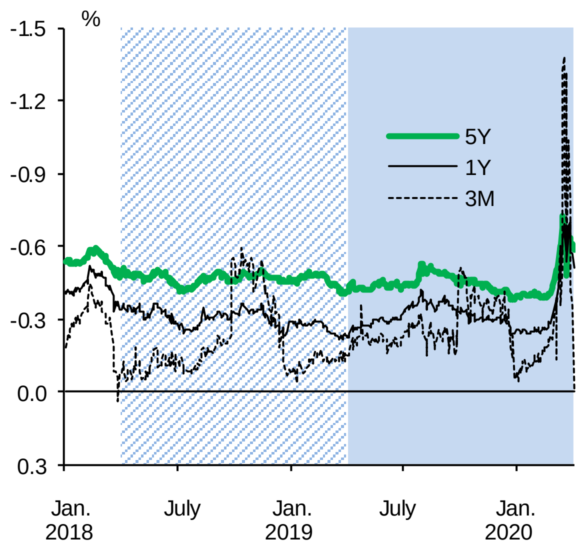
▽ JGB yields, etc.



▽ U.S. treasury yields, etc.



▽ U.S. dollar funding premiums



Notes: 1. Latest data as at end-March 2020. U.S. dollar funding premiums indicate the additional interest costs on U.S. dollar LIBOR in financing U.S. dollar funds collateralized by yen funds. 3M dollar funding premiums, which are expressed in opposite signs, show U.S. dollar funding costs on U.S. dollar LIBOR spreads through currency and foreign exchange swaps. Both 1Y and 5Y dollar funding premiums are U.S. dollar/yen cross-currency basis swaps.
2. The lightly shaded areas show the data in fiscal 2018. The darker shaded areas show the data in fiscal 2019.

Source: Bloomberg.

Glossary

Financial statements of financial institutions

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

Gross operating profits from core business = core gross operating profits = net interest income + net non-interest income

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

Net interest income = interest income – interest expenses

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

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

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

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

Credit cost ratio = credit costs / total loans outstanding

Capital adequacy ratios of internationally active banks

Common equity Tier 1 (CET1) capital ratio = CET1 capital / risk-weighted assets

CET1 capital comprises common equities and retained earnings.

Risk-weighted assets are financial institutions' risk-weighted assets.

Tier 1 capital ratio = Tier 1 capital / risk-weighted assets

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

Total capital adequacy ratio = Total capital / risk-weighted assets

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

Capital adequacy ratios of domestic banks

Core capital ratio = core capital / risk-weighted assets

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

Risk-weighted assets are financial institutions' risk-weighted assets.