Japanese Banks: Risks and Opportunities

Jonathan Cornish, Managing Director

19 September 2013
Agenda

Macro Environment

Risks and Opportunities for Japan’s Banks
Run-up in Advanced Economies’ Public Debt is Unprecedented in Peacetime

Gross Public Debt (% of GDP)

- US
- UK
- Germany
- Japan

Source: IMF Public Finance Historical Dataset

FitchRatings
www.fitchratings.com
Debt Overhang to Weigh on Developed Countries

Rising DM Public Debt Burden

Gross Debt Composition, 2012

Source: Fitch

www.fitchratings.com
Global Economic Outlook
Weak Recovery; Growth Forecasts Revised (Down)

Global GDP Growth

Source: IMF “World Economic Outlook” July Update

Growth Revisions Between 12/12 to 06/13

Source: Fitch “Global Economic Outlook”
Abenomics: Can Wages, Investment Grow Sustainably?

Business Confidence

Wages Growth

Source: CEIC, Fitch

Source: CEIC, Fitch
Changing of Competitive Landscape

- EU/US bank deleveraging
  - Political pressure to boost lending in home markets
  - Many of the more “international banks” have support-driven IDRs …
  - … but resolution regimes will lead to the erosion of sovereign support in the future
  - Anticipate further improvement in financial profiles
    - Capital now sound, but regulation driving even larger buffers
    - Profit still subdued
  - Selective pull-back or restraint (mostly by EU banks) from APAC markets so far …
  - … but expected to expand again in APAC over the medium term

- APAC banks have been looking abroad in the region
  - Expansion organically and inorganically
  - Portfolio restructuring (expansion or divestment)
  - Interest also in new frontier EM countries
  - Varying degrees of financial capability and track record
    - Less attention on Basel 3 concerns, as the region is generally already compliant (or expected to be)
## Key Macro Prudential Risk Indicators for APAC

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<tr>
<th>Country</th>
<th>BSI</th>
<th>Mar 07</th>
<th>Sep 07</th>
<th>Oct 08</th>
<th>Nov 09</th>
<th>Jun 10</th>
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</tbody>
</table>

MPI: 3 = high vulnerability to potential systemic stress, 1 = low vulnerability
BSI: Weighted average of Bank Viability Ratings in System
Source: Fitch Macro-Prudential Risk Monitor

www.fitchratings.com
Rising Credit/GDP Ratio in Most APAC Markets

Credit/GDP

Note: China credit data excludes shadow financing
Source: Fitch, central banks
Agenda

Macro Environment

Risks and Opportunities for Japan’s Banks
Japan’s Mega Banks: What’s Driving the Ratings …

- Fundamental improvements led to VR upgrades
  - Further improvements expected (meeting future Basel 3 thresholds)
  - Standalone profiles not uniform
  - Mizuho’s IDR still support-driven
- Stable Outlook predicated on…
  - Strong domestic franchises
  - Executing stated plans to de-risk
  - Pro-actively managing market risk
  - Moderate offshore expansion (no major increase in risk appetite)
Abenomics: Major Uncertainties…

Trading Partners
Sustainable Economic Growth
Inflation and Investment
Competitive Corporate Sector
Balancing the Budget
Government Debt
JGB Yields
Ageing Population
Consumption & Corporate Tax
Direction of Indices
Asset Quality
JPY

Government Support prospects
Japan: Trade Partners
Reliance on China and Other China-Dependent Countries

Percentage of Trade Volumes

Source: JTIS
**Risk of JGB Holdings: Large Exposure Manageable**

**Government Bonds/Total Assets**

(%)  
<table>
<thead>
<tr>
<th>Bank</th>
<th>0</th>
<th>5</th>
<th>10</th>
<th>15</th>
<th>20</th>
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<td>MUFG (a)</td>
<td>1</td>
<td>1</td>
<td>1</td>
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<td>SMFG (a)</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
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<tr>
<td>Mizuho (b)</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
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<tr>
<td>BoC (b)</td>
<td>4</td>
<td>4</td>
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</table>

**Fitch’s Stress Test Results**

**Mega Banks’ Average FCC Ratio Under Stress**

<table>
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<tr>
<th>Period</th>
<th>FCC Average</th>
<th>+50bp</th>
<th>+100bp</th>
<th>+150bp</th>
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</thead>
<tbody>
<tr>
<td>Sep 12 (10yr JGB = 0.765%)</td>
<td>(1.265%)</td>
<td>(1.765%)</td>
<td>(2.265%)</td>
<td></td>
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<tr>
<td>City banks’ current a/c with BOJ (RHS)</td>
<td>9.3%</td>
<td>9.0%</td>
<td>8.6%</td>
<td>8.3%</td>
</tr>
</tbody>
</table>

**Duration Control Mitigates Risk**

**AFS at Cost: Exposure to Stabilise**

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*a* Japan banks at March 2013, other banks at December 2012.  
Source: JTIS
Equity Investment: Further Reduction Limits Volatility

- Abenomics has been positive so far!
- Lower holdings, lower market volatility
- Reduction targets: 25% of Tier 1
  - MUFG: 25.4% at end-March 2013
  - SMFG: 24.0%
  - Mizuho: 31.8%

Exacerbates Profitability Fluctuation...

... and Volatility in Capital

Source: Banks, Fitch
Domestic Landscape: Little Attraction for Banks

Lending has Ticked Upwards in 2013

Corporate Funds Flow Drives Loans

Risk/Return Reward Evident in NIM?

Fee Income to Supplement NIR

Note: Figures are each group's consolidated figures. Source: Banks, Fitch
Non-APAC Bank Deleveraging = Opportunities

- Deleveraging confined mostly to EU banks
  - Pronounced in most markets, but already tapering
- US claims growth flat to modest
  - Gaining share where foreign claims are falling
- Growing Japanese share of foreign claims
  - Complement organic growth with stakes in higher-growth markets in APAC…
  - …but more patient in EU

Source: BIS, Fitch
Mega Banks: Offshore Expansion

APAC: A Loan Growth Engine

Overseas Loans: Enhancing NIM

Oversea Loans: Fee Income Growth

Note: Figures are each group's consolidated figures
ª Sumitomo Mitsui Banking Corporation (SMBC) non-consolidated. Source: Banks, Fitch

Note: Figures are operating banks non-consolidated
BNPP, HSBC and SG FCC ratios as of end-2012, 'Look-through' Basel III CET1 ratio Q113; B3 RWA not disclosed by all banks; FCC includes completed capital raisings

Sources: Fitch, Bloomberg, Banks
## Offshore Expansion: Non-Organic Growth

<table>
<thead>
<tr>
<th>Date</th>
<th>Name</th>
<th>Country</th>
<th>Stake acquired (%)</th>
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<tr>
<td>Jun 2008</td>
<td>Dah Sing Financial Holdings Limited</td>
<td>Hong Kong</td>
<td>15.0</td>
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<tr>
<td>Oct 2008</td>
<td>Morgan Stanley</td>
<td>US</td>
<td>21.8</td>
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<tr>
<td>Oct 2008</td>
<td>Aberdeen Asset Management</td>
<td>UK</td>
<td>18.8</td>
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<tr>
<td>Nov 2008</td>
<td>UnionBanCal Corporation</td>
<td>US</td>
<td>100.0</td>
</tr>
<tr>
<td>Apr 2010</td>
<td>Tamalpais Bank</td>
<td>US</td>
<td>100.0</td>
</tr>
<tr>
<td>Apr 2010</td>
<td>Frontier Bank</td>
<td>UK</td>
<td>100.0</td>
</tr>
<tr>
<td>Nov 2010</td>
<td>The Royal Bank of Scotland</td>
<td>UK</td>
<td>n.a.</td>
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<tr>
<td>Apr 2011</td>
<td>SWS MU Fund Management Co., Ltd.</td>
<td>China</td>
<td>33.3</td>
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<tr>
<td>Apr 2013</td>
<td>PB Capital Corporation (sub. of Deutsche Bank; U.S. commercial property loans)</td>
<td>US</td>
<td>n.a.</td>
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<tr>
<td>Jul 2013</td>
<td>Bank of Ayudhya</td>
<td>Thailand</td>
<td>max 75%</td>
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<tr>
<td>Jul 2008</td>
<td>Barclays PLC</td>
<td>UK</td>
<td>1.4</td>
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<td>Dec 2008</td>
<td>KB Financial Group</td>
<td>Korea</td>
<td>1.1</td>
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<td>Jan 2010</td>
<td>The Bank of East Asia Ltd.</td>
<td>Hong Kong</td>
<td>9.5</td>
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<tr>
<td>Jun 2010</td>
<td>Kotak Mahindra Bank Ltd</td>
<td>India</td>
<td>4.5</td>
</tr>
<tr>
<td>Jan 2012</td>
<td>The Royal Bank of Scotland (aircraft leasing assets)</td>
<td>UK</td>
<td>n.a.</td>
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<tr>
<td>Mar 2012</td>
<td>PT Indonesia Infrastructure Finance</td>
<td>Indonesia</td>
<td>14.9</td>
</tr>
<tr>
<td>Apr 2012</td>
<td>China Post &amp; Capital Fund Management Co., Ltd</td>
<td>China</td>
<td>24.0</td>
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<td>May 2013</td>
<td>BTPN</td>
<td>Indonesia</td>
<td>24.26 (max 40%)</td>
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<tr>
<td>Jan 2008</td>
<td>Merrill Lynch &amp; Co., Inc (converted to a stake in Bank of America)</td>
<td>US</td>
<td>n.a.</td>
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<tr>
<td>Aug 2011</td>
<td>PT Imora Motor/PT Balimor Finance</td>
<td>Indonesia</td>
<td>51.0</td>
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<td>Sep 2011</td>
<td>Vietcombank</td>
<td>Vietnam</td>
<td>15.0</td>
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<tr>
<td>Jun 2012</td>
<td>West LB Brasil</td>
<td>Brazil</td>
<td>100.0</td>
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Japanese Banks: Challenges of Expansion

- Credit and operating risks
  - Limited track record in target markets
  - Limited funding ability (i.e. wholesale versus retail)
  - FX
  - Control and governance

- Management resources
  - More aggressive expansion increases burden on management
  - Shareholder expectations – compromise prudence in return for growth

- Increasing complexity
  - Compliance/reporting costs (regulatory frameworks differ across countries)
  - Cultural differences

- Basel 3
  - Full deductions for large minority stakes
  - What if impairments coincide with future target minimum capital thresholds?
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