



FitchRatings

**Japanese Banks:
Risks and Opportunities**

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19 September 2013

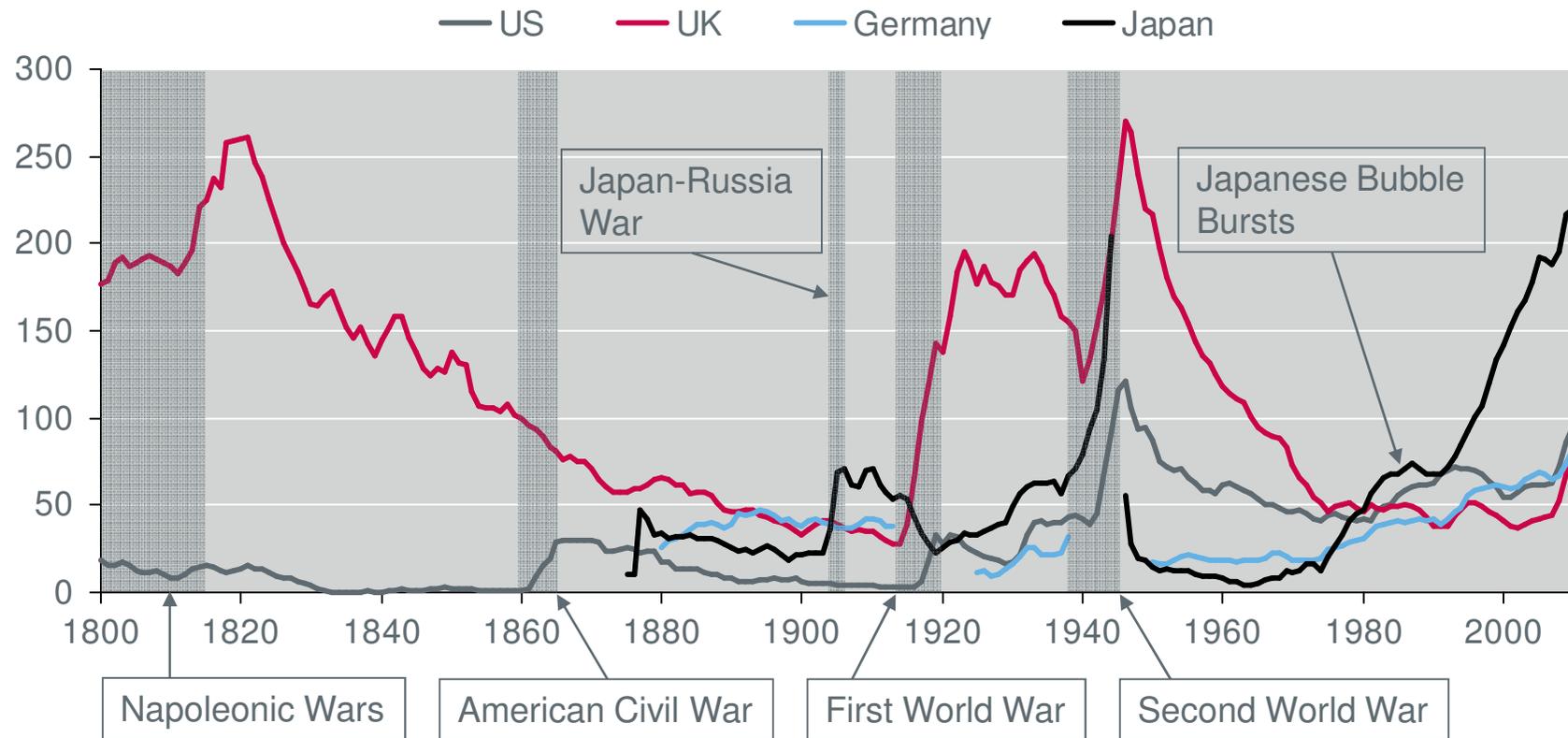
Agenda

Macro Environment

Risks and Opportunities for Japan's Banks

Run-up in Advanced Economies' Public Debt is Unprecedented in Peacetime

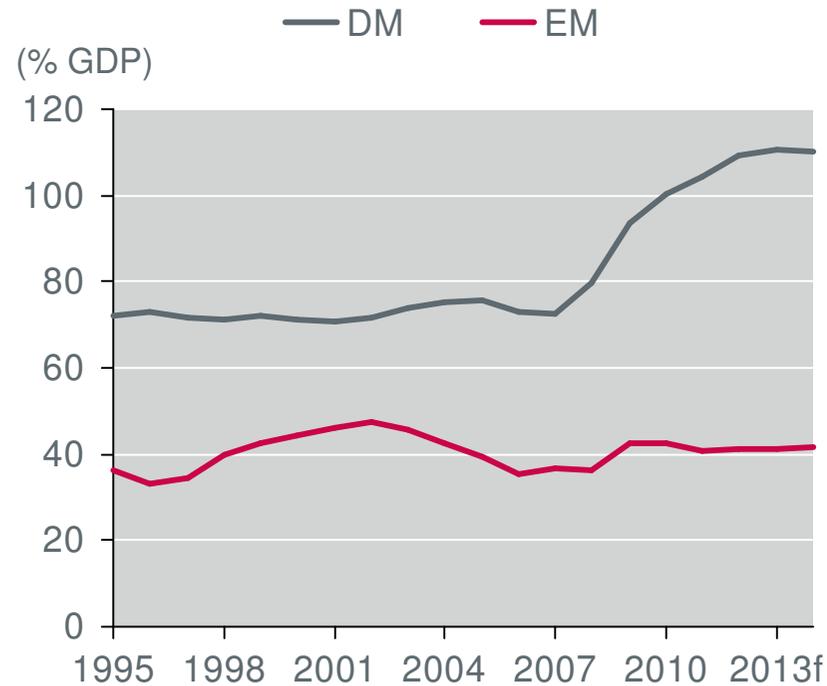
Gross Public Debt (% of GDP)



Source: IMF Public Finance Historical Dataset

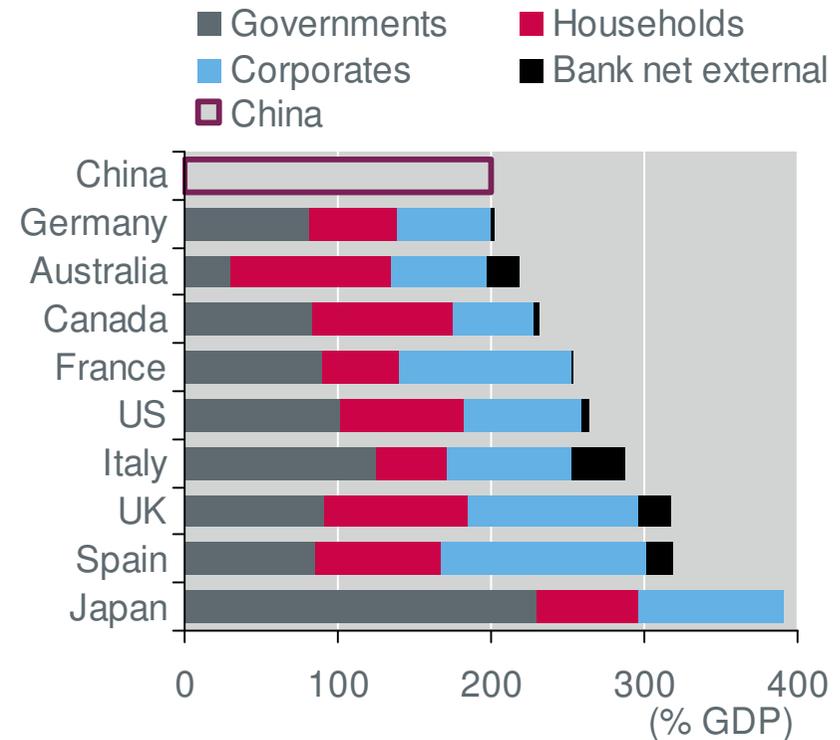
Debt Overhang to Weigh on Developed Countries

Rising DM Public Debt Burden



Source: Fitch

Gross Debt Composition, 2012

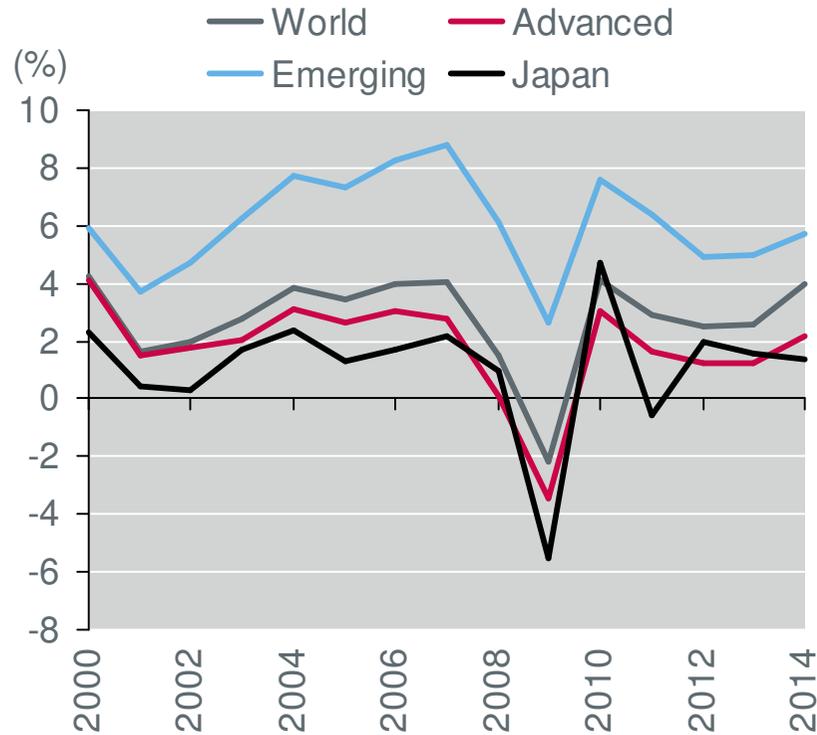


Source: McKinsey & Co for Households, Corporates (Q212 or latest); Fitch for governments, net bank external debt (2012); Fitch est. for total China credit end-2012

Global Economic Outlook

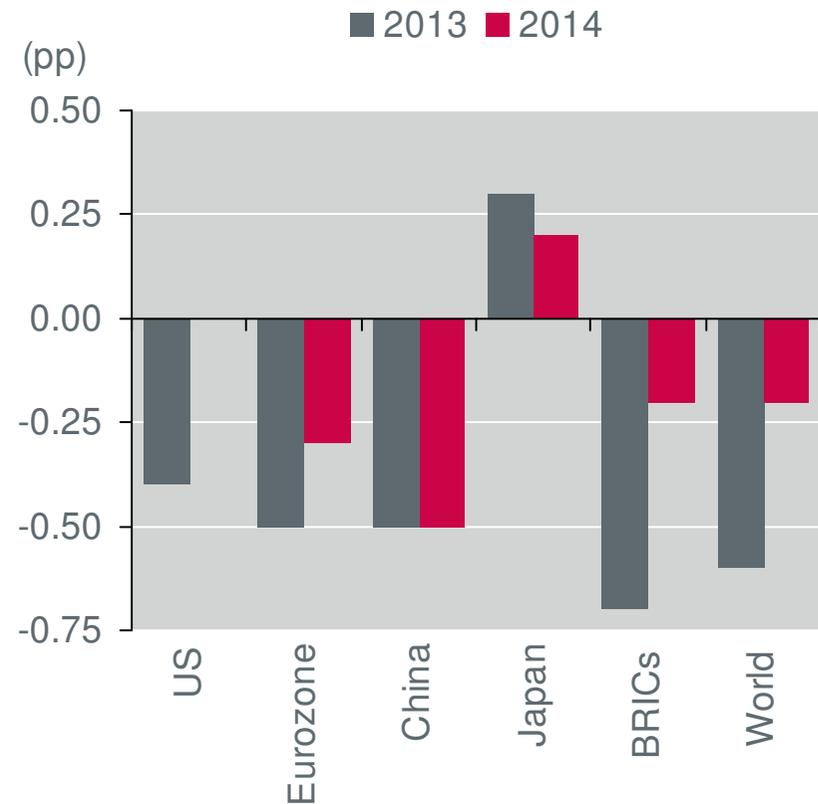
Weak Recovery; Growth Forecasts Revised (Down)

Global GDP Growth



Source: IMF "World Economic Outlook" July Update

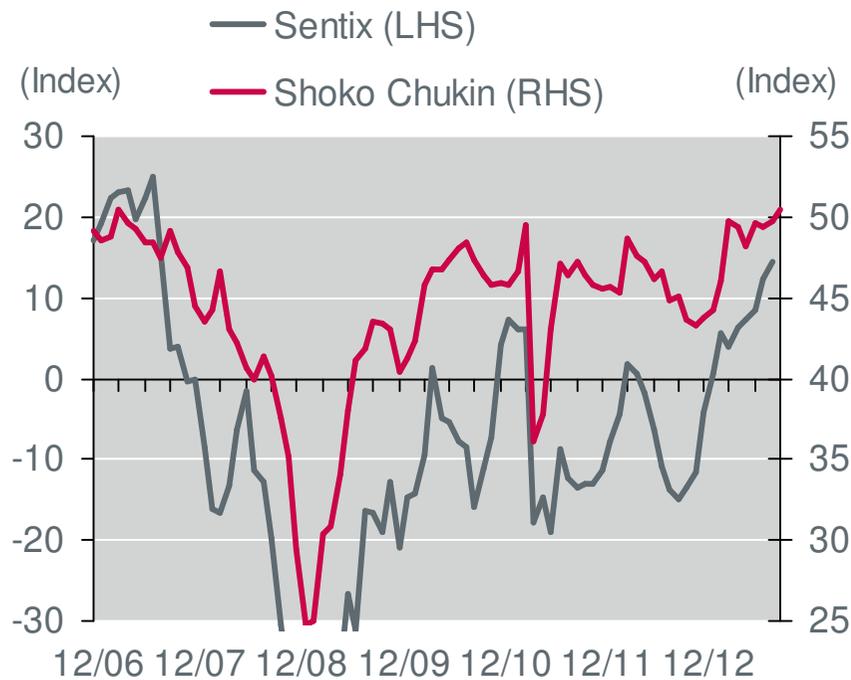
Growth Revisions Between 12/12 to 06/13



Source: Fitch "Global Economic Outlook"

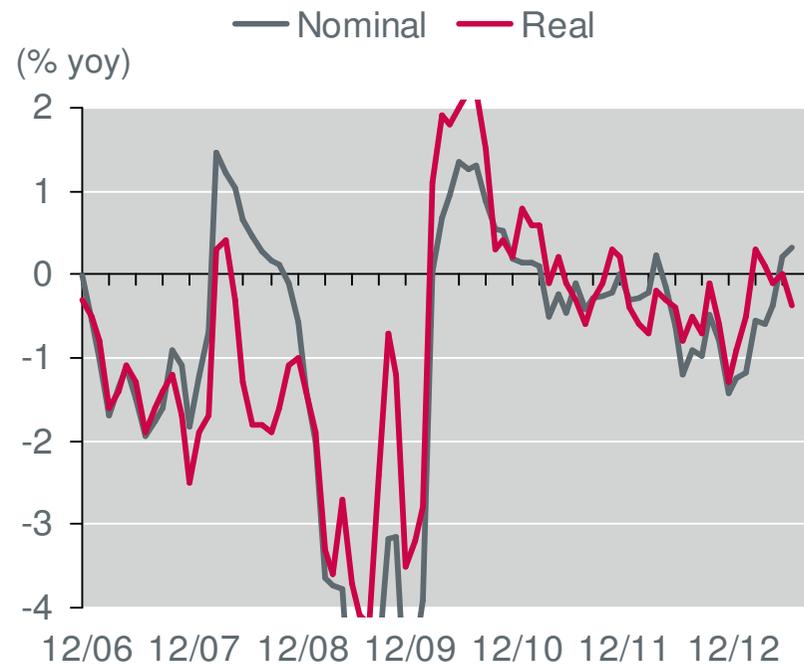
Abenomics: Can Wages, Investment Grow Sustainably?

Business Confidence



Source: CEIC, Fitch

Wages Growth



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

Country	BSI	Mar 07	Sep 07	Oct 08	Nov 09	Jun 10	Nov 10	Jun 11	Dec 11	Aug 12	Jan 13
Mongolia										3	3
China	bb	1	1	1	1	3	3	3	3	3	3
Hong Kong	a	1	1	1	1	1	3	3	3	3	3
Indonesia	bb	1	1	1	1	2	2	2	3	3	3
Sri Lanka		1	1	1	1	1	1	1	3	3	3
Vietnam	b	2	2	2	2	3	3	3	2	2	2
Australia	aa	3	3	3	3	2	2	2	2	2	1
Korea	bbb	1	3	3	3	2	2	2	1	1	1
Singapore	aa	1	1	1	1	1	1	1	2	2	2
India	bb	2	2	2	2	2	1	1	1	1	1
Taiwan	bbb	1	1	1	1	1	1	1	1	1	1
Thailand	bbb	1	1	1	1	1	1	1	1	1	1
Japan	a	1	1	1	1	1	1	1	1	1	1

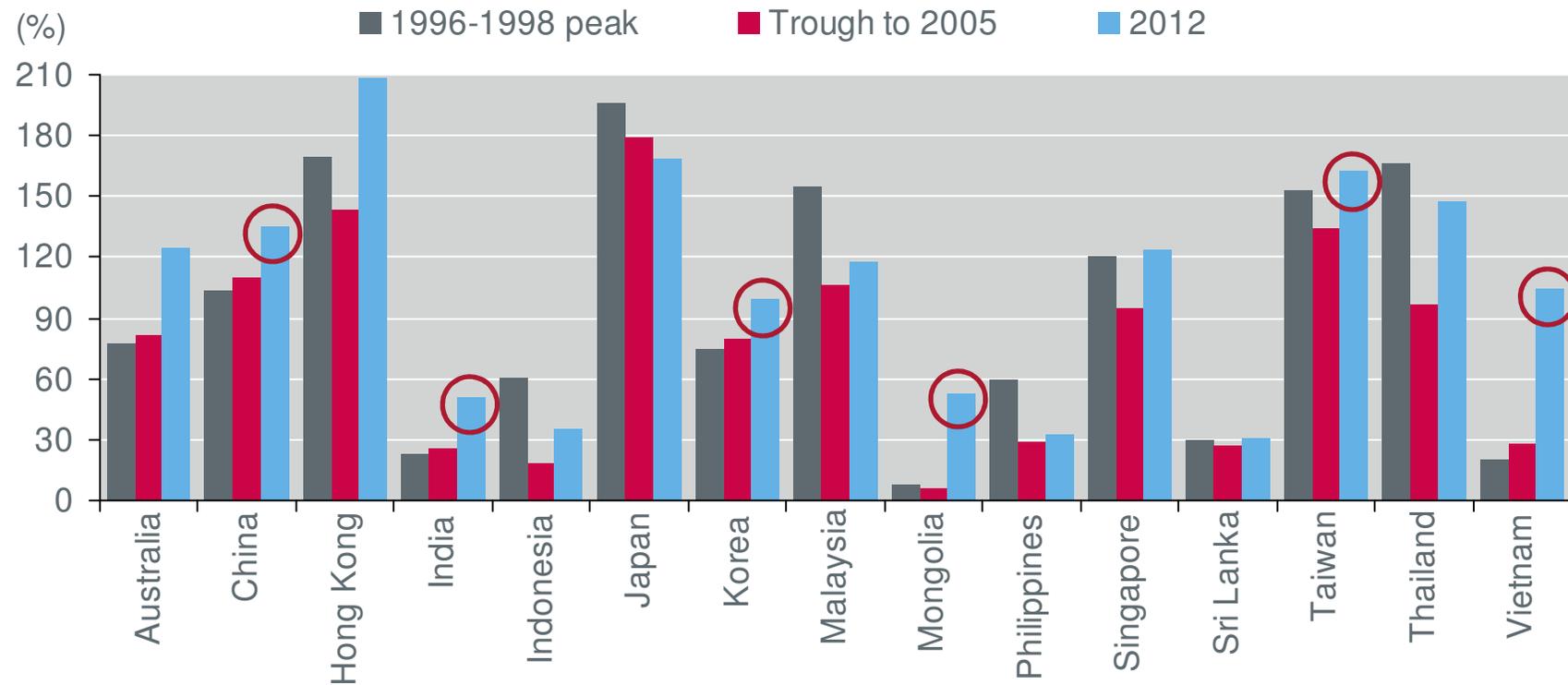
MPI: 3 = high vulnerability to potential systemic stress, 1 = low vulnerability

BSI: Weighted average of Bank Viability Ratings in System

Source: Fitch Macro-Prudential Risk Monitor

Rising Credit/GDP Ratio in Most APAC Markets

Credit/GDP



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

Agenda

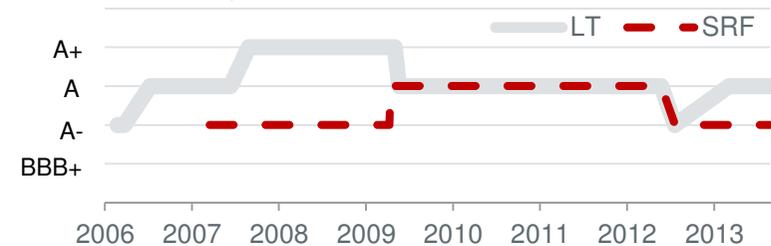
Macro Environment

Risks and Opportunities for Japan's Banks

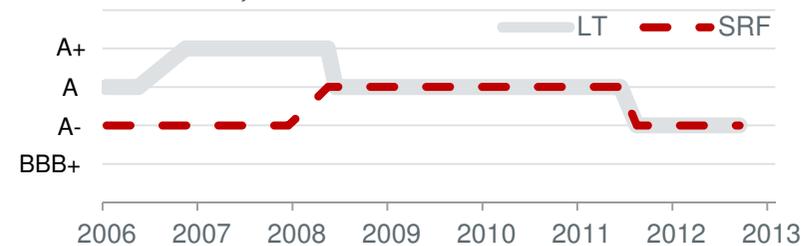
Japan's Mega Banks: What's Driving the Ratings ...

- 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)

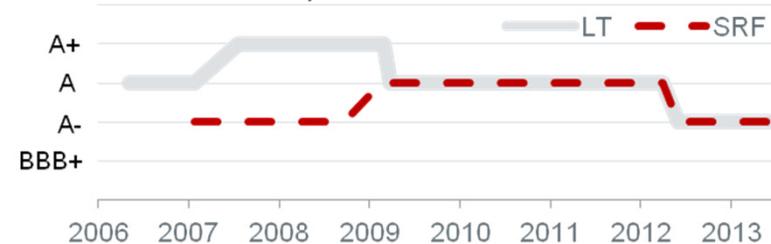
BTMU: VR = a; IDR = A



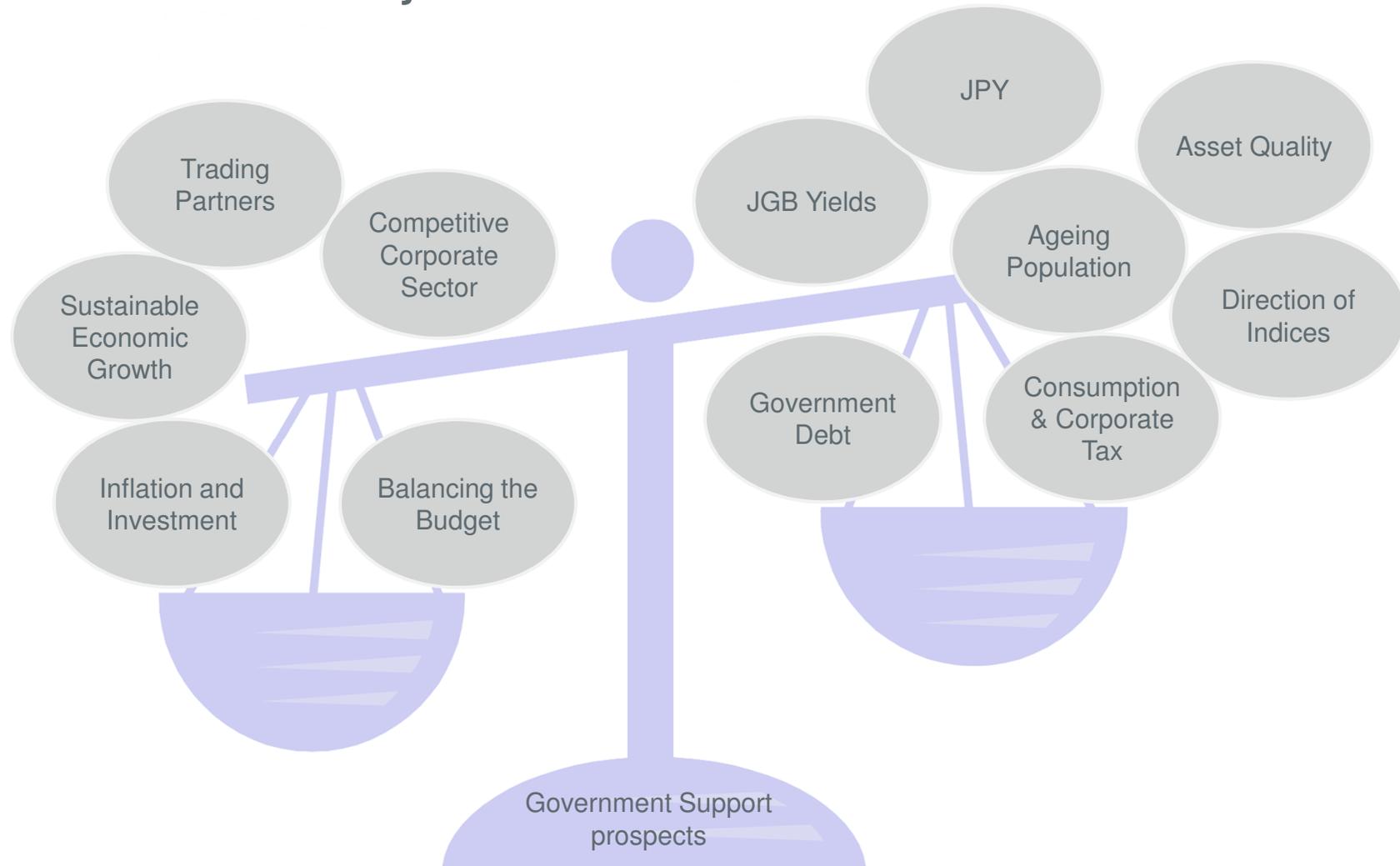
SMFG: VR = a-; IDR = A-



Mizuho: VR = bbb+; IDR = A-



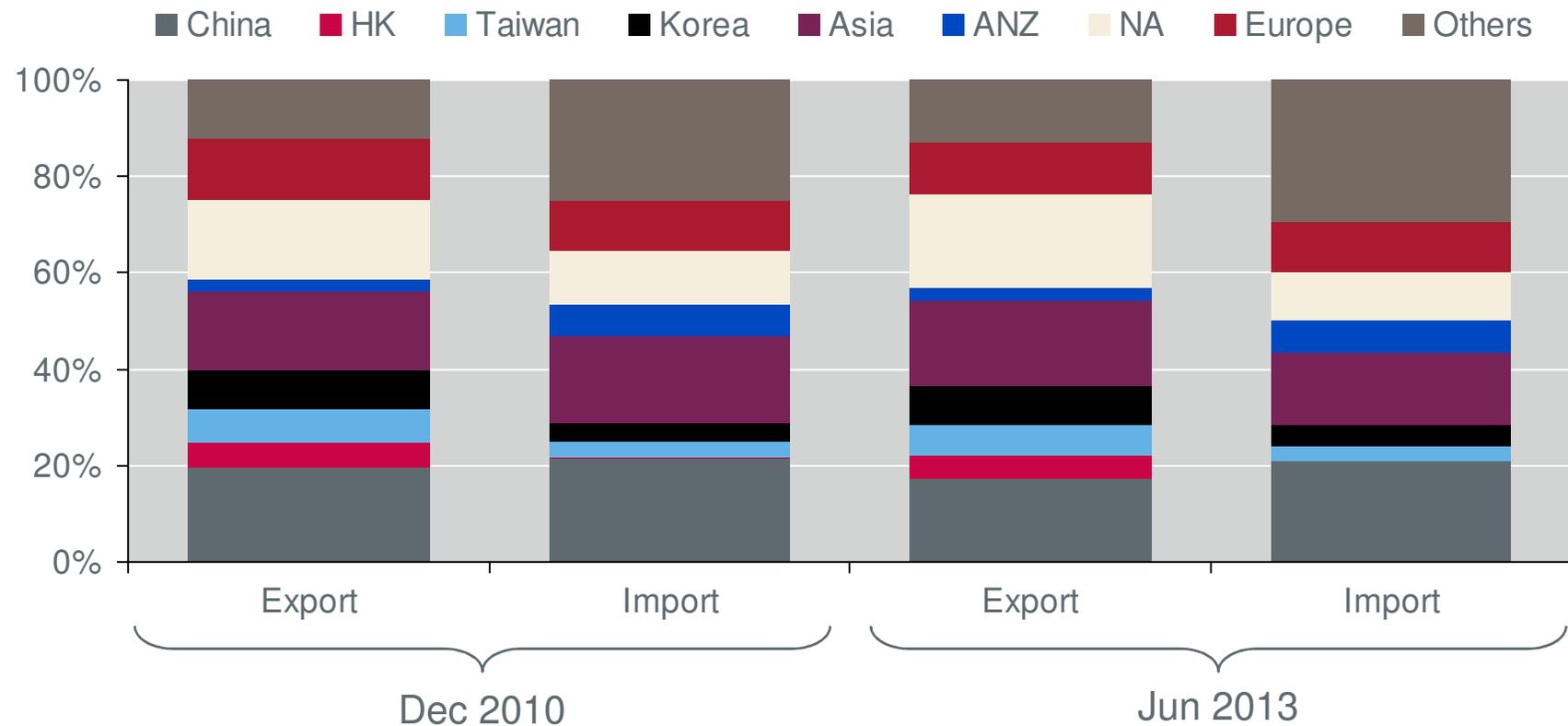
Abenomics: Major Uncertainties...



Japan: Trade Partners

Reliance on China and Other China-Dependent Countries

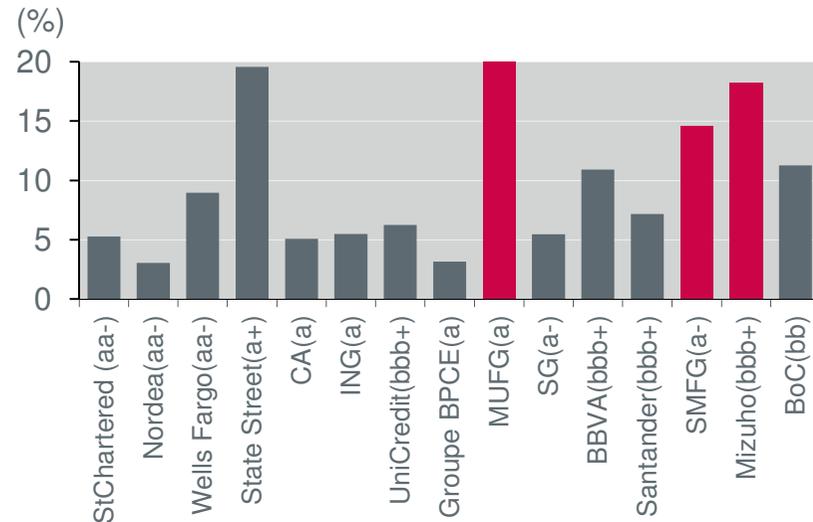
Percentage of Trade Volumes



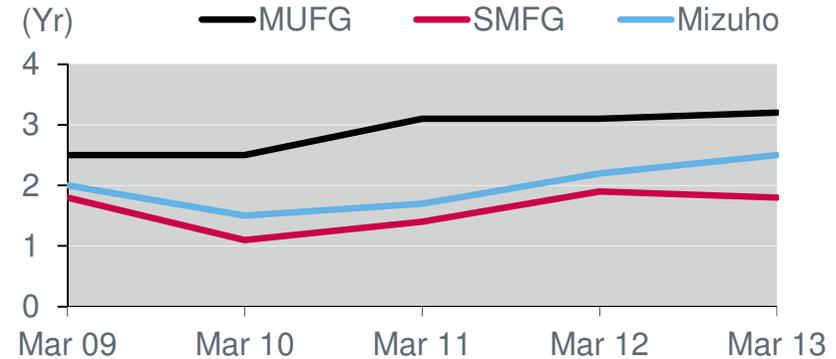
Source: JTIS

Risk of JGB Holdings: Large Exposure Manageable

Government Bonds/Total Assets^a



Duration Control Mitigates Risk



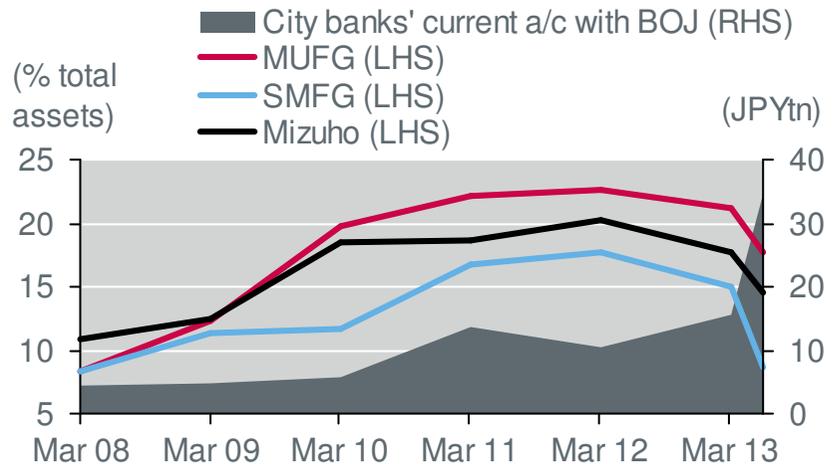
Fitch's Stress Test Results

Mega Banks' Average FCC Ratio Under Stress

Sep 12 (10yr JGB = 0.765%)	FCC average	+50bp (1.265%)	+100bp (1.765%)	+150bp (2.265%)
Mega banking groups	9.3%	9.0%	8.6%	8.3%

^a Japan banks at March 2013, other banks at December 2012.
Source: JTIS

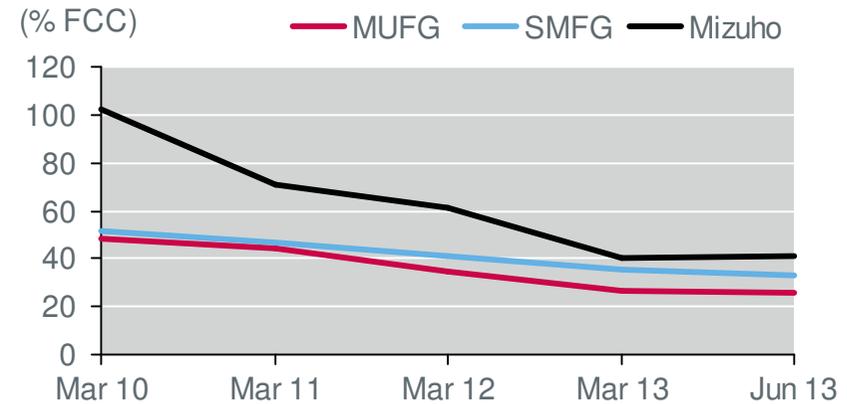
AFS at Cost: Exposure to Stabilise



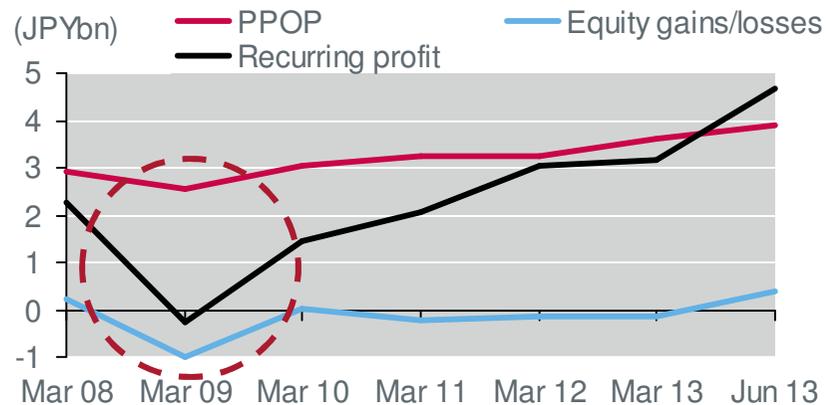
Equity Investment: Further Reduction Limits Volatility

- 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%

Exposure (at Cost) Declining Gradually

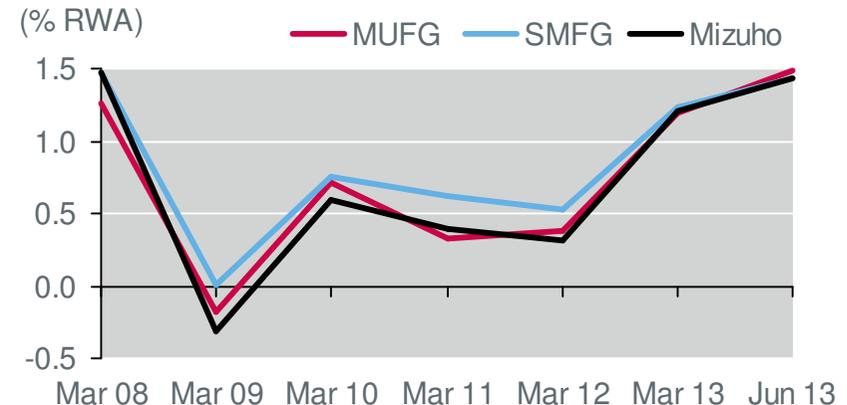


Exacerbates Profitability Fluctuation...



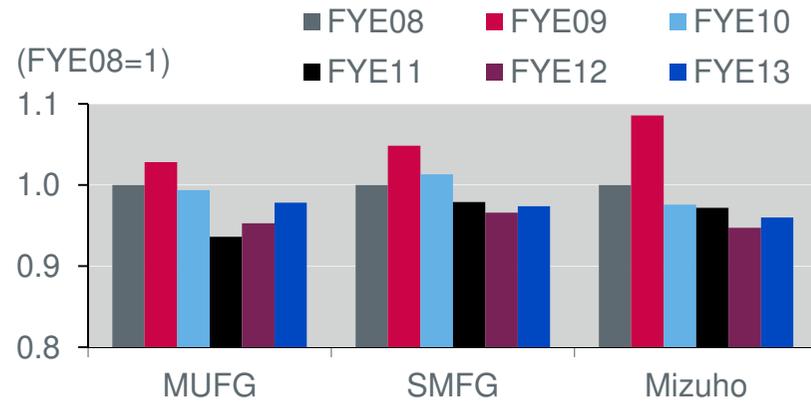
Source: Banks, Fitch

... and Volatility in Capital

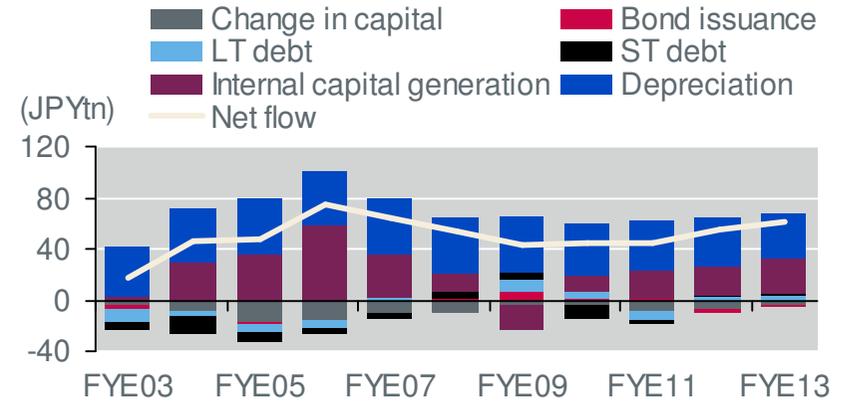


Domestic Landscape: Little Attraction for Banks

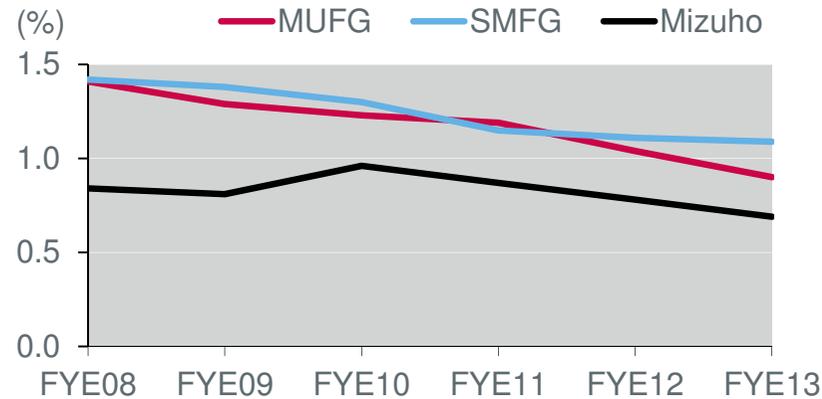
Lending has Ticked Upwards in 2013



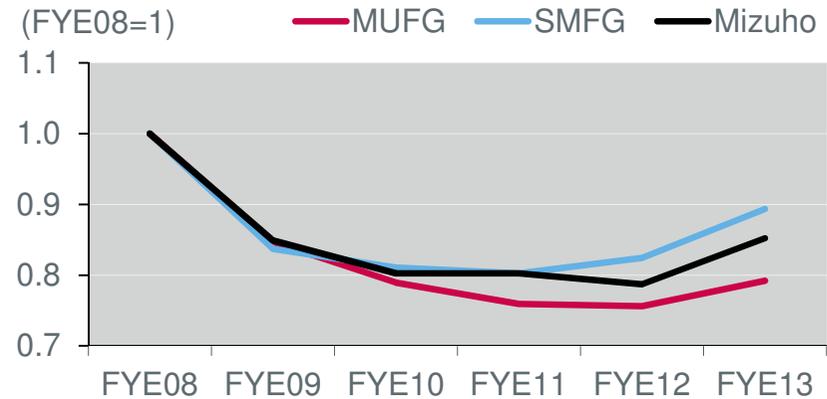
Corporate Funds Flow Drives Loans



Risk/Return Reward Evident in NIM?



Fee Income to Supplement NIR

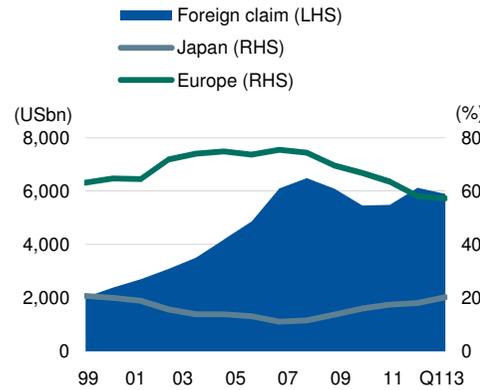


Note: Figures are each group's consolidated figures. Source: Banks, Fitch

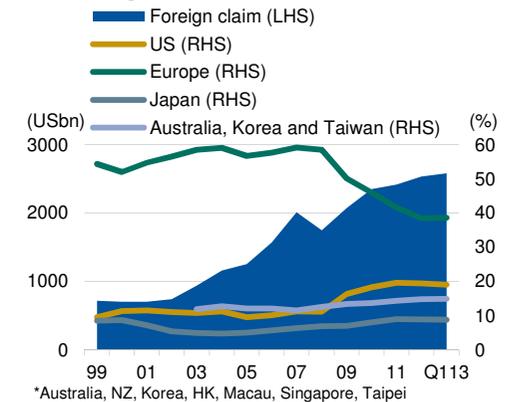
Non-APAC Bank Deleveraging = Opportunities

- 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

Share of Foreign Claims: US

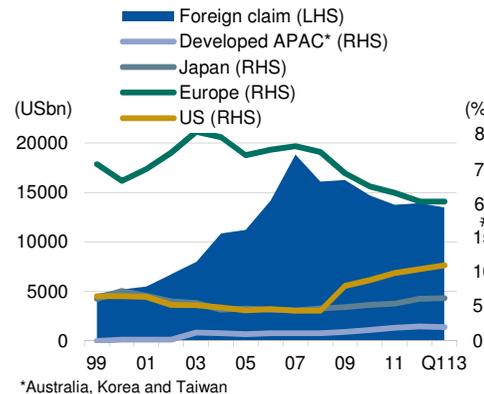


Share of Foreign Claims: Developed APAC*



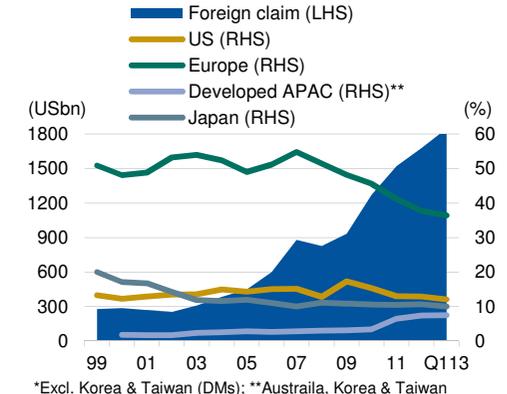
*Australia, NZ, Korea, HK, Macau, Singapore, Taipei

Share of Foreign Claims: Developed Europe



*Australia, Korea and Taiwan

Share of Foreign Claims: Emerging APAC*

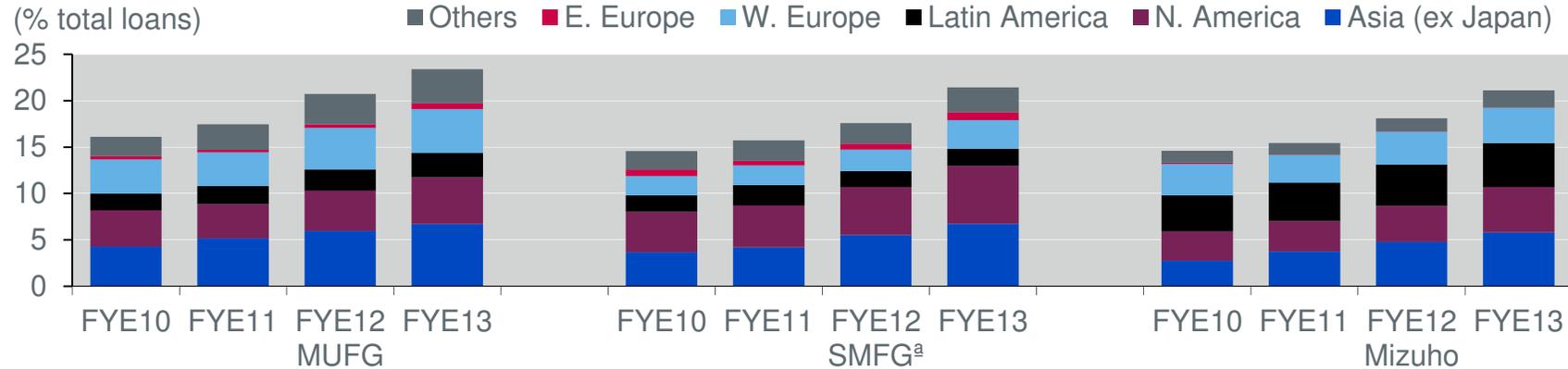


*Excl. Korea & Taiwan (DMs); **Australia, Korea & Taiwan

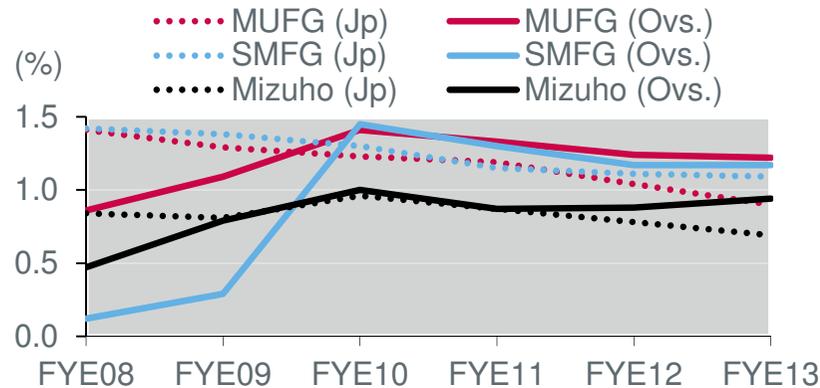
Source: BIS, Fitch

Mega Banks: Offshore Expansion

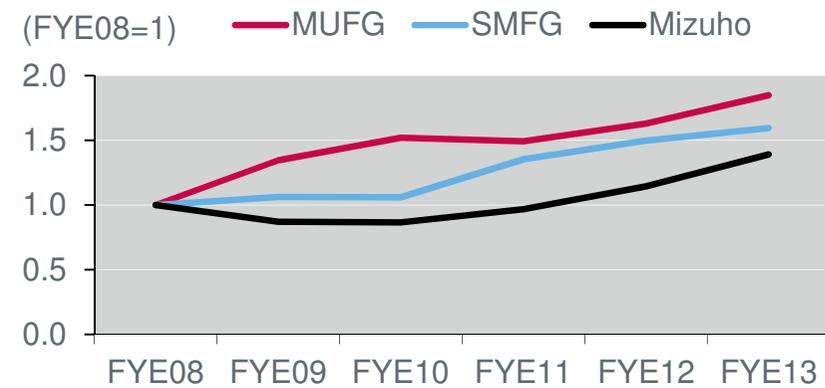
APAC: A Loan Growth Engine



Overseas Loans: Enhancing NIM



Overseas Loans: Fee Income Growth



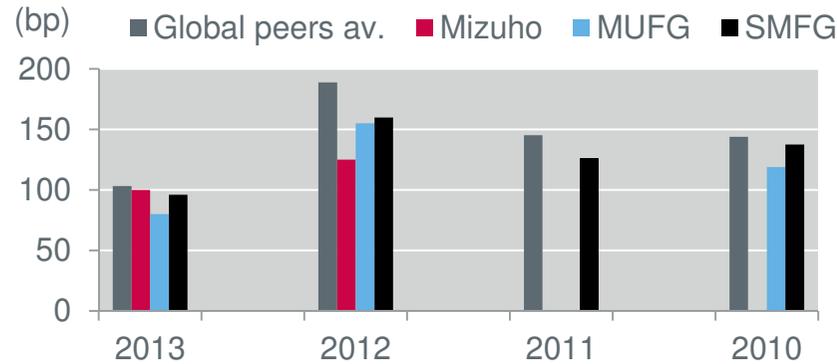
Note: Figures are each group's consolidated figures

^a Sumitomo Mitsui Banking Corporation (SMBC) non-consolidated. Source: Banks, Fitch

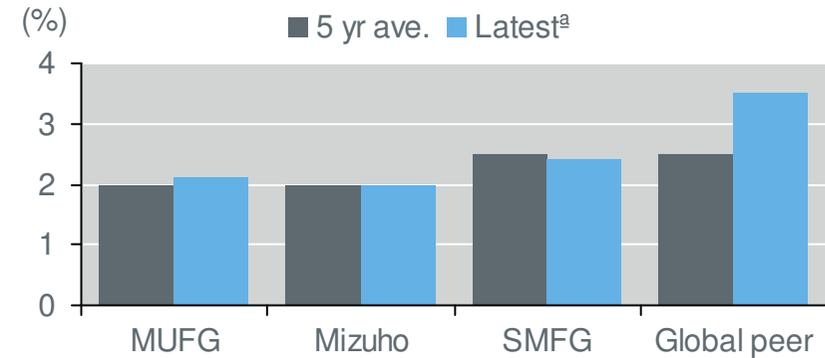
Note: Figures are operating banks non-consolidated

Competitiveness in Overseas Expansion: Pricing

Cheaper Funding (5-year bond spreads)

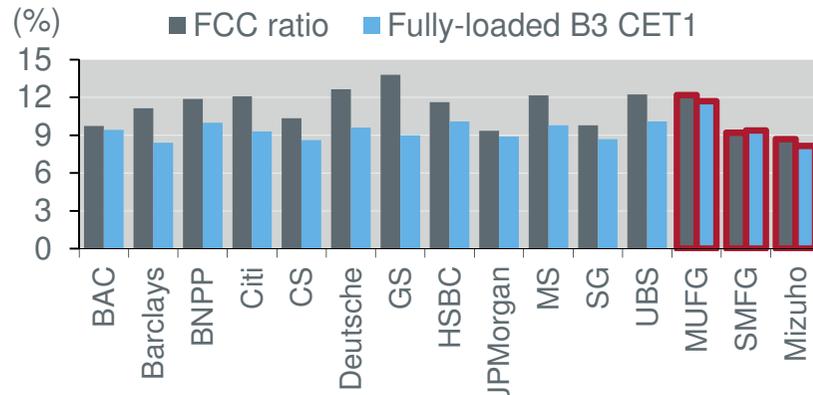


Sound and Stable Asset Quality



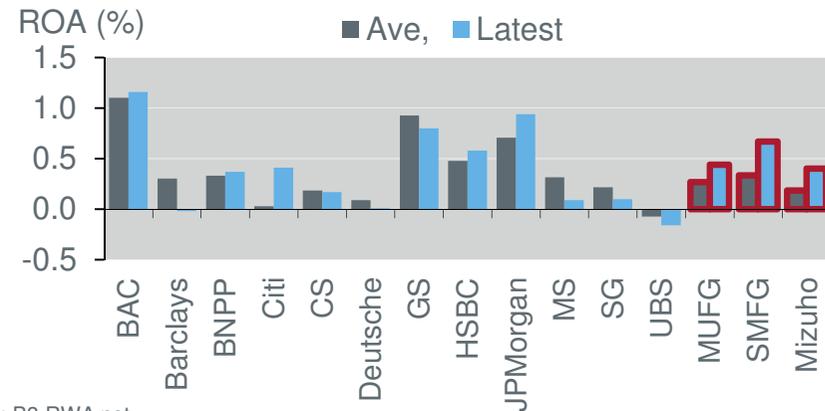
^a End-March 2013 for mega banks. End-2012 for global peers ave.

Satisfactory Capital Levels



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

Lower Profitability Expectations (ROA)



Sources: Fitch, Bloomberg, Banks

Offshore Expansion: Non-Organic Growth

	Date	Name	Country	Stake acquired (%)
MUFG	Jun 2008	Dah Sing Financial Holdings Limited	Hong Kong	15.0
	Oct 2008	Morgan stanley	US	21.8
	Oct 2008	Aberdeen Asset Management	UK	18.8
	Nov 2008	UnionBanCal Corporation	US	100.0
	Apr 2010	Tamalpais Bank	US	100.0
	Apr 2010	Frontier Bank	US	100.0
	Nov 2010	The Royal Bank of Scotland	UK	n.a.
	Apr 2011	SWS MU Fund Management Co.,Ltd.	China	33.3
	Dec 2012	Vietnam Joint Stock Commercial Bank for Industry and Trade (VietinBank)	Vietnam	20.0
	Apr 2013	PB Capital Corporation (sub. of Deutsche Bank; U.S. commercial property loans)	US	n.a.
	Jul 2013	Bank of Ayudhya	Thailand	max 75%
	SMFG	Jul 2008	Barclays PLC	UK
Dec 2008		KB Financial Group	Korea	1.1
Jan 2010		The Bank of East Asia Ltd.	Hong Kong	9.5
Jun 2010		Kotak Mahindra Bank Ltd	India	4.5
Jan 2012		Moelis & Company	US	n.a.
Jan 2012		The Royal Bank of Scotland (aircraft leasing assets)	UK	n.a.
Mar 2012		PT Indonesia Infrastructure Finance	Indonesia	14.9
Apr 2012		China Post & Capital Fund Management Co.,Ltd	China	24.0
May 2013		BTPN	Indonesia	24.26 (max 40%)
Mizuho	Jan 2008	Merrill Lynch & Co., Inc (converted to a stake in Bank of America)	US	n.a.
	Aug 2008	Evercore Partners Inc	US	14.7
	Nov 2010	BlackRock, Inc.	US	n.a.
	Aug 2011	PT Imora Motor/PT Balimor Finance	Indonesia	51.0
	Sep 2011	Vietcombank	Vietnam	15.0
	Jun 2012	West LB Brasil	Brazil	100.0

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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