

Results of Major Japanese Banks Improving but Bad Debts Still Weigh Heavily

By Tani Sadafumi

The business results of Japanese banks have been improving across the board. In the results announced by major Japanese banks in late May for the year ended March 2000 (April 1999 - March 2000), 15 of 17 banks had turned into the black. This represented a turnaround from the previous term (April 1998 - March 1999) when all banks had to post losses. It seems that, at last, Japanese banks have emerged from the worst of the period following the burst of the Japanese economic bubble in which they have been plagued by the disposal of bad loans. The business environment, however, remains severe.

Overall, the recurring losses of the 17 banks have now turned into a recurring profit of ¥1.9138 trillion, resulting in a net recurring profit of ¥762.6 billion after corporate taxes and other deductions. Net income from operations which the banks make their core business totaled ¥3.2876 trillion. The only exceptions to this in recording a recurring loss were Yasuda Trust and Banking, a subsidiary of Fuji Bank, and Japan Trust and Banking, a subsidiary of the Bank of Tokyo Mitsubishi. These two banks, however, are expected to turn into the black in the year to March 2001 (April 2000 - March 2001).

The Bank of Japan's zero interest rate policy begun in February last year can be given as a factor in this improvement in the accounts of the major banks. They were able to procure funds on the short-term money markets at virtually zero interest and their margins on funds increased because lending rates did not decrease that much.

Contributing even more to the improvement in results was a decrease in the bad loan disposal amount. The total of the reserves (bad loan disposal amounts) set aside by the 17 major banks for writing off bad loans or as a provision for loans which could become uncollectible amounted to ¥4.4946 trillion.

Compared to settlements of accounts before the burst of the bubble and those in the years immediately following it, the level of this provision was still very high, but it was less than half of last year's unprecedented level of ¥10.4358 trillion.

Although the burden of the bad loans arising from the burst of the economic bubble is still very severe, we could say that it has become lighter. This view was expressed by bank directors when they publicly announced their results, with a Fuji Bank official saying, "we have now reached a major watershed in resolving our bad loans."

However such statements are difficult to swallow. Since the mid 1990s, the major banks have made pledges to resolve their bad debts on several occasions. It was not just that they were guilty of doctoring their results with the intention of showing that the state of their operations was better than it actually was, they also underestimated the impact of the bursting of the economic bubble on the Japanese economy and the changes brought about in the global economic structure by the end of the Cold War, and therefore got their forecasts wrong.

When the major banks publicly announced their results in May 1999, the total bad debt disposal amount estimated for the year to March 2000 was ¥1.5 trillion. By the interim settlement of accounts in November 1999, the actual amount had swelled to ¥2.8 trillion and further to ¥4.5 trillion in the announcement of this May. Thus in just six months the amount necessary to deal with the disposal of bad debts had increased 1.6 fold and was three times the estimate of a year ago.

Many of the banks now aiming to merge their operations explained that this was because the amounts of bad debts they had to dispose of exceeded expectations, with Sumitomo Bank stating that this was because "the assessment of bank assets has become much stricter." In

order to make use of the advantages of merging operations at an early date, individual banks will have to settle the retrogressive issue of the disposal of bad debts. The explanation that the assessment of assets has become stricter reveals the true situation at present.

Banks were overly optimistic in their perception of land prices and the business of their borrowers. With land prices continuing to fall much more than expected, many of them have been forced to increase reserves to compensate for the falling value of collateral. In addition, suffering from bad business performance, many general contractors, distribution companies and trading companies have been asking banks to forgive their debts. These are the factors behind the very large bad debt disposal amount in the recently announced results.

In the year to March 1999, although banks had intended to perform drastic "surgery" to remove "sick parts" of their business, the "hemorrhage" from them has continued. The extent to which new bad loans arise in the future will depend on prevailing economic conditions, but in this regard we should also pay attention to the effects of the Civil Rehabilitation Law enacted this April.

As the basic assumption of this law is the rehabilitation of corporate operations, courts have been continually receiving applications to start procedures from large corporations as well as medium and small-sized companies. Among them, there seem to be many companies who should have embarked on drastic restructuring of their operations much earlier. Though there is no problem with banks who have already accurately assessed the true situation of their operations and set aside ample reserves for bad debts, for those banks who have not done this the Civil Rehabilitation Law is likely to be a factor in generating new bad debts.

Another special feature of the settlements of accounts for the year to March

Financial settlements of major banks in March 2000

Name of major banks	Net operating profit	Recurring profit and loss
The Dai-ichi Kangyo Bank, Ltd.	345,7 (93.6)	218,9 (-)
The Fuji Bank, Ltd.	264,5 (37.2)	223,3 (-)
The Sanwa Bank, Ltd.	326,6 (32.5)	175,4 (-)
The Tokai Bank, Ltd.	142,4 (-12.7)	118,9 (-)
The Asahi Bank, Ltd.	155,4 (85.3)	88,0 (-)
The Sumitomo Bank, Ltd.	350,5 (59.2)	176,4 (-)
The Sakura Bank, Ltd.	328,0 (89.7)	159,9 (-)
The Bank of Tokyo-Mitsubishi, Ltd.	394,5 (-29.4)	218,9 (-)
The Daiwa Bank, Ltd.	78,2 (-18.0)	37,6 (-)
Total of city banks	2386,3	1417,8
The Mitsubishi Trust and Banking Corporation	211,8 (4.3)	126,4 (-)
The Sumitomo Trust and Banking Co., Ltd.	151,9 (-30.1)	76,7 (-)
The Chuo Trust and Banking Co., Ltd. (Former)	63,3 (47.9)	36,2 (-)
The Mitsui Trust and Banking Co., Ltd. (Former)	92,8 (-11,8)	117,9 (-)
The Toyo Trust and Banking Co., Ltd.	96,5 (2.2)	29,4 (-)
Yasuda Trust and Banking	42,8 (-47.1)	▲ 18,9 (-)
Nippon Trust and Bank Ltd.	20,5 (2816.3)	▲ 10,6 (-)
Total of trust banks	679,9	357,1
The Industrial Bank of Japan, Ltd.	221,3 (4.4)	138,8 (-)
Grand total	3287,6	1913,8

Units : billion, ▲ : Red figure. Figures enclosed in parentheses are the percentage of increase / decrease of previous term. (-) : No comparison

2000 is the huge profits on the sale of stocks that banks have realized. The total for the 17 banks was ¥3.4089 trillion, five times the previous term's level. A possible reason for this is the introduction of current market value accounting from the year to March 2001 onwards. In Japan, up till now there has been a general tradition for banks to hold shares in companies to whom they lent money under a share cross-holding system whose purpose was to maintain stable business relationships with their customers. However, with the introduction of current market value accounting, it will be necessary for banks to gradually dispose of shares that they hold in their customers.

However, the increase in profits derived from the sale of stocks cannot be explained by this alone. The true situation is perhaps that, as previously mentioned, banks must dispose of more bad loans than they anticipated and they have sold off shareholdings to source this. Viewed overall, the profit on stock sales is equivalent to 3/4 of the bad loan disposal amount. Further, there are indications that some banks are picking up profits from the sale of stocks in consideration of the amount of bad loans they have to dispose of, with many of them securing amounts either equivalent to or in excess of the amount of bad loans to be

disposed of.

This has been made possible by a rise in share prices. At the end of March 1999, the Nikkei stock index stood at ¥15,836 and at the end of March this year it was ¥20,337.32, and was thus around ¥4,500 higher than it was a year ago. It is likely that the disposal of bad loans would not have gone so well if the slump in stock prices had continued.

On the other hand, bond income was down greatly compared to the previous term. The total amount of income gained by the 17 banks from bond dealing was ¥18.5 billion, clearly much less than the previous term's amount of ¥716.7 billion. Further, the number of banks recording losses on bond dealing rose to eight from three in the previous term, and the proportion of gross profit on banking business gained from bonds fell from last term's level of 9.4% to 0.2%.

Bond prices fall when interest rates rise. In addition, in the recent settlements of accounts, there is evidence that banks who anticipated a lifting of the zero interest rate policy slipped up in bond futures trading. However, the effect of the rise in interest rates will become fully apparent in the times to come and the risk of bonds held by banks falling in price will steadily increase. In the last few years, though bond dealing has been an impor-

tant source of income for major banks, there is a possibility that it will drag down their earnings in the future.

Finally, something very unusual happened in the year to March 2000: local governments started to impose their own tax on banks. In accordance with the proposal of Governor Ishihara Shintaro, the Tokyo Metropolitan Government introduced a tax on the gross operating profits of major banks in April this year, though the tax will not actually begin to be applied until the settlement of accounts for the year to March 2001. However, the benefits of tax benefit accounting (accounting system in which the taxable portion of tax to be returned in the future for former bad loans that have been written off is reflected in the settlement of accounts) have decreased and this had the effect of reducing income by a total of ¥355.5 billion for the 17 banks in the recent settlement of accounts. From the year to March 2001 onwards, the total amount of tax payable by banks is estimated at around ¥80 billion.

The Osaka Prefectural Government will introduce a similar tax one year after Tokyo. The effect of this is seen as reducing the benefit of tax benefit accounting by ¥140 billion in the first year and by ¥30 - 40 billion in subsequent years.

By his kind of assessment, we cannot be too optimistic about the future for the major banks even though they have been recovering their profitability. For the resolution of their bad debts, economic recovery is essential. Though the Japanese economy is gradually showing signs of a recovery, as many economists have said, we still cannot expect it to be sustained and will have to wait until the effects of the reorganization of the financial system become apparent before the major banks are able to enjoy a full recovery of their results. **JTI**

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