Japan's Six Largest Banking Groups to Set New Record for Combined Profitability in FY 2005

By Aoki Masaru

Disposal of NPLs Is Finished; the "Lost Decade" Ends

JAPAN'S six largest banking groups – Mitsubishi UFJ Financial Group (MUFG), Sumitomo Mitsui Financial Group (SMFG), Mizuho Financial Group (FG), Resona Holdings, Mitsui Trust Holdings, and Sumitomo Trust & Banking – are expected to post a record-high total consolidated income for FY 2005. This will be the first time in 17 years that a new record has been established. According to the forecasts of fiscal-year performance contained in each group's financial reports for the period of April-December 2005, their combined consolidated income for the fiscal year is ¥2,835 billion. This will exceed the performance of the large banks (at that time, the city banks, the long-term credit banks and the trust banks) in FY 1988, the heart of the bubble, when they posted a combined consolidated income of ¥1,700 billion.

Over-the-counter sales of investment trusts and annuities to individual investors increased significantly, bringing growth in commission revenue. However, this was offset by declines in interest income resulting from increased funding competition, which exerted downward pressure on marginal yield. Nevertheless, as business conditions improve, the performance of shaky firms is recovering and reserves for loan losses are no longer needed; they are reverting to income, pushing overall profits upward.

Combined consolidated income for the six groups for the period of April-December 2005 was ¥2,644 billion, 2.3 times the figure of the previous year.[1] In October 2005, Mitsubishi Tokyo FG and UFJ Holdings merged to become MUFG, with consolidated income of ¥1,026.4 billion. This is more than Toyota Motor Corp.'s ¥968 billion (calculated by US accounting standards), and with it, MUFG became Japan's most profitable business for that fiscal period.

However, because of the huge write-offs of non-performing loans (NPLs) by each group, the MUFG first among them, each group has large losses for tax purposes and is as a result paying almost no corporate taxes. For this, no direct comparison can be made between these groups and Toyota, which is paying taxes.

Together with MUFG, SMFG and Mizuho FG are known as the "three megabanks." The consolidated income of SMFG for the period of April-December 2005 was ¥599.6 billion, 4.2 times the figure of the previous year. This was largely due to the steep decline in write-offs of NPLs, and is the highest figure since the Group commenced operations in December 2002. On the other hand, Mizuho FG's income fell 6.8% to ¥581.1 billion, since its reversion of reserves for loan losses had increased steeply during the previous year, relative to 2005.

The consolidated income of Resona Holdings was ¥265.7 billion, a 16.2% decline from the previous year, when the reversion of reserves for loan losses swelled income. The two trust groups posted strong commission revenues from the sale of investment trusts and other investment products and real-estate brokerage fees. In the same period of the previous year, Mitsui Trust Holdings had posted expenses for the pay-down of deferred tax assets, and as a result consolidated income increased a substantial 45.4% to ¥94.8 billion. Sumitomo Trust & Banking posted a 2.7% increase to ¥76.4 billion.

Net profit from banking operations shows the actual performance of primary operations, and for the period of April-December 2005 the six groups posted a combined ¥2,789.5 billion, virtually unchanged from a year earlier. At MUFG, net profit from banking operations declined 6.6% to ¥943.2 billion, as a result of the reduction in high-interest loans to shaky companies and the contraction of marginal yield on loans to healthy borrowers, which caused a decline in interest income. At Mitsui Trust Holdings, a decline in its core product, loan trusts, caused that figure to fall 7.8% to ¥116.3 billion.

Forecasts of consolidated income for FY 2005 are as follows: MUFG, ¥1,170 billion (on a par with Toyota's ¥1,300 billion); SMFG, ¥550 billion; and Mizuho FG, ¥630 billion. (Table 1)

In the consolidated financial statements of the six groups for the period of April-December 2005, indicators of sound finance showed improvement across the board. As of the end of 2005, their combined total NPLs were ¥5,865 billion, down 42% from the previous year's ¥10,172.7 billion. The average weight of bad loans in total loans for the six groups declined 1.5% to 2.0%, from 3.5% a year earlier.

This is around one-quarter of the peak level of over 8% in FY 2001. The lowest figure among the groups was 1.3% at Sumitomo Trust & Banking, the second lowest was 1.77% at Mizuho FG, and the highest figure was 2.79% at Resona Holdings.

The capital adequacy ratios of the various groups are at the 10 to 11% level, easily clearing the requirement of 4% for banks with only domestic operations and 8% for banks with international operations.

With the forecast of record-high profits for the large banking groups, critics have raised complaints of "profiteering."

Notes : 1) The figure for the same period of the previous fiscal year.
2) The article was written based on the data as of April 1.

Table 1 Financial Reports of the Six Largest Banking Groups for the April-December 2005 Period (Unit: ¥1billion)

	Net profit from banking operations	Consolidated income	Consolidated income
		Actual performance	FY 2005 (forecast)
MUFG	943.2 (▲0.66)	1,026.4 (—)	1,170.0 (—)
SMFG	706.3 (0.05)	599.6 (31.97)	550.0 (—)
Mizuho FG	645.1 (1.54)	581.1 (▲0.68)	630.0 (0.04)
Resona HDs	262.1 (▲0.40)	265.7 (▲1.62)	270.0 (▲2.61)
Sumitomo Trust & B.	116.5 (2.35)	76.4 (0.27)	95.0 (▲0.19)
Mitsui Trust HDs	116.3 (▲0.78)	94.8 (4.54)	120.0 (2.76)
Totals	2,789.5	2,644.0	2,835.0

Table 2 Public Funds Received by Large Banks and Unpaid Balances (Unit: ¥1billion)

	Funds received	Balance (as of Apr. 1, 2006)
Mizuho FG	2,949.0	600.0
SMFG	1,501.0	1,100.0
MUFG	2,200.0	640.2
Resona HDs	3,128.0	2,925.3
Mitsui Trust HDs	710.3	432.3
Sumitomo Trust & B.	300.0	0
Totals	10,788.3	5,697.8

Notes : 1. Parentheses are percentage changes from the same period of the previous fiscal year.
2. Triangles indicate declines; bars indicate that no data are available for comparison.
3. Net profit from banking operations does not include reversions from ordinary reserves for loan losses, depreciation on trust accounts, or income from group banks.
4. Mizuho FG's net profit from banking operations excludes dividends received from subsidiaries.

In response, the groups have taken steps to share profits through higher dividends to shareholders. MUFG increased its year-end dividend by ¥1,000 per share, to ¥7,000 per share, and Mitsui Trust Holdings plans to raise its year-end dividend by ¥1.5 to ¥4. In addition, Mizuho FG has adopted a policy of increasing its initial year-end dividend from ¥3,500.

The various groups are rapidly recovering their operational strength, and have accelerated repayment of the ¥10,788.3 billion in public funds that they collectively received for recapitalization in 1998/1999, when the instability of the financial system emerged. As of April 1, 2006, the accelerated repayment by the various groups had reduced the total outstanding to ¥5,697.8 billion. Sumitomo Trust & Banking surged ahead of the other groups, and had completely repaid public funds of ¥300 billion by January 2006.

Of the remaining five groups, MUFG had repaid ¥180.3 billion by March 1, 2005, leaving a balance of ¥640.2 billion. Mizuho FG is working to complete the repayment of its ¥600 billion balance by the fall of 2004.

Taking a cue from the early repayment intentions of these two groups, SMFG has moved up the projected repayment of its ¥1,100 billion balance, which is the largest figure of the three megabanks, by a year from FY 2007 to FY 2006. Mitsui Trust Holdings has also moved up repayment of a portion of the ¥432.3 billion in public funds by the fall of 2006.

The institution that is lagging behind in this "race to repayment" is Resona Holdings, which was substantially nationalized in 2003. This firm has the highest balance among the six groups, having received ¥2,925.3 billion in public funds, and is still far from the road to complete repayment.

During the 1990s, as the performance of the large banks deteriorated, their overseas businesses contracted rapidly. Now, however, as their performance is strongly recovering, they have once again begun to expand those operations. Upon completely repaying the public funds they have received, MUFG and Mizuho FG will be able to apply for permission to establish financial holding companies in the United States as early as FY 2006. In the international financial markets, where strong US and European financial institutions are engaged in fierce competition, these groups are strengthening their capabilities in investment banking operations such as corporate fund procurement that cross national borders, securities underwriting and M&A.

At present, the securities operations of Japanese banks in the United States are limited to introducing Japanese stocks to US investors through securities subsidiaries and the offices of the securities companies of business partners, and underwriting US bonds and privately placed bonds. If Japanese banks receive authorization from the US financial authorities to establish financial holding companies, the securities companies under their umbrella will act as lead managing underwriters for stock and bond issues within the United States, and it is possible that underwriting syndicates will be added.

In another area, the Bank of Tokyo-Mitsubishi UFJ (BTMU) is planning to inject US$300 million into the Bank of China, one of the four largest state-owned commercial banks in China, and is negotiating policies for an alliance with that bank. Negotiations with the Chinese authorities have become prolonged, so a number of factors remain unclear, but if this is achieved, it will be the first case of a Japanese bank injecting capital into a Chinese bank. The concept is to gain a toehold in China, where high growth is predicted, through capital injections into top banks.

The Bank of China will be listed on the Hong Kong Stock Exchange within the year. In step with this, the BTMU will be undertaking a capital increase. Operationally, they will form an alliance in investment banking operations, joint product development, and the provision of yuan-denominated financing to Japanese-owned firms with operations in China. The BTMU is also studying the possibility of providing consumer-banking services through the Bank of China's network of 12,000 branches.

Over the past 10 years, the large banking groups have resolved their NPL problem by writing off approximately ¥60 trillion in NPLs, a huge sum. In addition, due to the dissolution of the system of cross-holding of shares, they have eliminated the structural forces that put downward pressure on profits through losses on revaluation of securities holdings caused by the drop in share prices, showing that the problems of the "lost decade" are almost about to be end.[2] JS

Aoki Masaru is a deputy editor in the Economic Division of Jiji Press Co., Ltd. His work focuses on economic policy.