

Japanese Banks in the Age of Eternal Zeros

Takatoshi Ito

Professor, School of International and Public Affairs

Columbia University

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The Age of Eternal Zeros

- Zero inflation
- Zero policy interest rate
- Zero long-term (JGB) interest rate
- Zero deposit rate

Japanese financial institutions 2016: strength and weakness

- Did NOT suffer from GFC
- Well Capitalized
 - Resolution framework (bail out) is believed to have been tested and will work
 - Bail-in framework is established but not tested
 - Little public discussions on Basel-x, CoCo, TLAC, SIB surcharge
- Challenges
 - Low profit, low returns
 - Weak demand for bank loans (a real side problem)
 - Fixed costs (employment; branches) remain high
 - Ill-prepared for FinTech and digital revolution

Japanese Financial Supervision 2016

- J-FSA, est. 1998, is the integrated supervisor
 - Supervise all financial institutions and financial products
- J-FSA gained trust by tough on banks, shedding risk
- J-FSA is now encouraging banks to take more risks
 - Examination Manual may be revised
- Resolution framework have been established
 - Deposit Insurance Law, Article 102
 - BAIL OUT conditions for regionally important banks that are insolvent or near insolvent
 - Deposit Insurance Law, Article 126
 - BAIL IN conditions for SIBs

Monetary Policy, 2016

Impacts on commercial banks

- Jan 2016. BOJ introduced NIRP
- Banks complained
 - (-0.1%) Loss of interest income on excess reserves
 - (flattened yield curve) loss of term premium
 - (ZLB on deposits) loss of interest spread between deposit and lending
- BOJ countered
 - (-0.1%) three-tier system. Most excess reserves are grand-fathered and will receive (+0.1%) at the time of NIRP introduction
 - (yield curve control, Sept. 2016). Fix 10-yr at 0%, so as NIRP is deepened in the future, the yield curve will be steeper!
 - (ZLB on deposits) can be broken by commercial banks— no regulation.
- However, the longer the NIRP continues, the lower the banks' profitability. How can banks make profit at NIRP/ZIRP

Challenges of Japanese financial institutions and the supervisors

- Challenge: Ill-prepared for FinTech and digital revolution
- Will FinTech be a big opportunity or a big risk?
 - Japan is not ready.
 - Usage of cash is still high
 - Internet banking and mobile banking is not so popular
 - Will current banks adapt to the FinTech or will FinTech start ups will overtake the industry?
 - Risk. Branch networks, now assets, will be a big liability in the future
- Financial Sup & Reg has to cover FinTech, AI, Cyber attack