Japanese Banks
in the Age of Eternal Zeros

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Presentation at Fed Chicago conference, Chicago
November 04, 2016
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