

Relation between negative interest rate and bank stocks

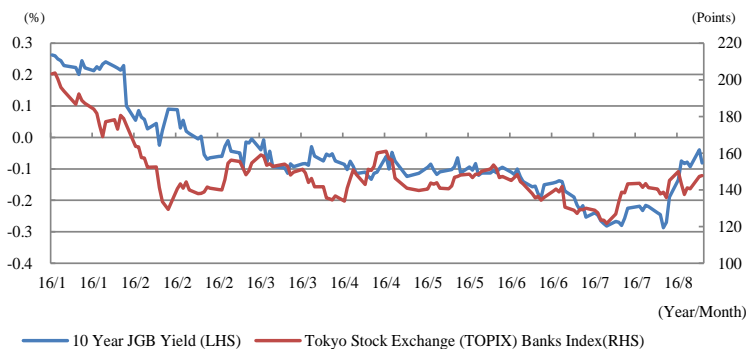
- Negative interest rate policy has increased volatility in JGB yields and impacted bank stocks significantly.
- Bank stocks have fallen over earnings concern due to possible margin squeeze caused by lowering interest rate. The fall of bank stocks have a significant impact on TOPIX.
- Monetary policy can affect performance of bank stocks as it impacts banks' financial results. We should focus on BOJ's monetary policy review scheduled in September.

Negative interest rate policy has increased volatility in JGB yields and impacted bank stocks significantly

At the policy meeting held on 28th and 29th January 2016, BOJ decided to launch “Quantitative and Qualitative Monetary Easing with a Negative Interest Rate”. From this policy meeting to today, each financial market in Japan saw salient price movement as i) JPY appreciated against USD in the currency market, ii) Nikkei 225 index and TOPIX had fallen in the stock market and iii) JGB yield curve had fallen significantly in JGB market in almost all period.

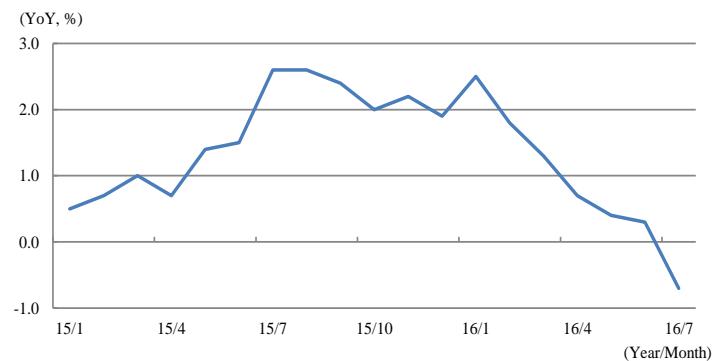
Taking a closer look at movement of JGB yields, we can observe that they have significantly risen across different terms after BOJ's Monetary Policy Meeting (MPM) on 28th and 29th July 2016. This was due to reversal reaction of JGB market participants who had expected further cut in negative interest rate at BOJ's MPM in the month but saw no extension to the policy. Introduction to negative interest rate had increased volatility of JGB yields and has also impacted bank stocks significantly in the Japanese stock market.

"Chart 1: Trend of JGB Yield and Bank Stocks"



(Note) Data period is from 4th January 2016 to 8th August 2016.
(Source) SMAM, based on Bloomberg L.P. data.

"Chart 2: Outstanding Loan of City Banks"



(Note) Data period is from January 2015 to July 2016. City Banks are Sumitomo Mitsui Banking Corporation, The Bank of Tokyo-Mitsubishi UFI, Mizuho Bank, Resona Bank and Saitama Resona Bank.
(Source) SMAM, based on Japanese Bankers Association data.

Bank stocks have fallen over earnings concern due to possible margin squeeze caused by lowering interest rate. The fall of bank stocks have a significant impact on TOPIX

Now, let's see impact of negative interest rate on bank stocks. From 28th January 2016 to 28th July 2016, 2-year JGB yield fell by 31.9 basis points (bp, 1bp=0.01%) and 10-year JGB yield fell by 49.9bp. While TOPIX fell 6.1% during the same period, bank stock index out of total of 33 sector indices fell the most by 24.1%. Probably, this is due to deepening concern over decline in banks' earnings as lowering JGB yields can cause margin squeeze (Chart 1).

Next, let's check movement of JGB yields from 28th July 2016 to 8th August 2016. 2-year JGB yield rose 18.1bp and that of 10-year rose 22.4bp. During this period, TOPIX fell 0.1%, however, bank stock index out of total of 33 sector indices was the best performer with a 8.5% up. This is probably because earnings concern was mitigated, as the hike of JGB yields was expected to stop margin squeeze. The bank sector accounts for a larger part of market capitalization in TOPIX (7.7% as of 8th August which is fourth in total of 33 sector indices), which apparently will have a certain impact on TOPIX as a whole.

Monetary policy can affect performance of bank stocks as it impacts banks' financial results. We should focus on BOJ's monetary policy review scheduled in September

The media reported that aggregate of profit after tax of April-June 2016 of 5 major Japanese banks (Sumitomo Mitsui Banking Corporation, The Bank of Tokyo-Mitsubishi UFJ, Mizuho Bank, Resona Bank and Sumitomo Mitsui Trust Bank) declined 27% YoY to JPY 585.9 billion. While total income from lending of the 5 banks declined 16% YoY due to margin squeeze, trading income of bonds including JGB sales to BOJ increased 38% to JPY 2,163 billion. It is reasonable to assume that performance of bank stocks are influenced by the monetary policy as it apparently affects banks' financial results.

Outstanding loans of the five major banks as of July end 2016 declined 0.7% YoY according to data released by Japanese Bankers Association (Chart 2), the first decline in 3 years and 9 months, which shows that despite negative interest rate environment, corporations' capital demand is not increasing. In such environment, BOJ will conduct comprehensive review of the policy effect at MPM scheduled on 20th and 21st September 2016. Bank stocks may react vigorously depending on the result of BOJ's review.

*** We are not recommending any particular company mentioned in this report.**

*** Please note that this report is a translation of Japanese report written on 9th August, 2016.**

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