Japanese regional banks hold out in bid for survival amidst profit crunch

JAPAN

The share of Japanese regional banks losing money on their core businesses is set to rise to about 60% by 2025, according to projections from the Financial Services Authority (FSA). As it is however, banks look set to meet the estimates earlier than expected as 52 out of 106 the country's regional banks have been bleeding from losses on their lending businesses in the past two years, data from the FSA show, in a development highlighting the struggle of banks operating outside Japan's major cities.

The crippling operating conditions caused by the ultra-low interest rate environment may have pushed banks to unscrupulous practices to turn a profit as seen in the resignation of the Higashi-Nippon Bank chairman in August 2018 over a lending scandal. Suruga Bank also published a report that revealed how employees resorted to fraudulent activity to meet unrealistic targets."The tough domestic environment has affected the whole Japanese banking sector, and other banks may have allowed governance standards to slip in response to these challenges," according to Fitch Ratings.

Following reports of improper conduct, the FSA launched onsite inspections in August 2018 to monitor the internal auditing activities of regional banks, with plans to progressively widen the scope of oversight.

Regional banks have come under the most pressure in the sustained squeeze on the banking sector as they generate around 85% of gross profit from net interest revenue. They also do not have the luxury of turning to overseas markets like their larger counterparts that have been steadily growing their overseas footholds in an effort to counter challenging conditions back home.

Regional banks also have limited expertise in developing complex products like savings and wealth management, insurance, retirement planning, and re-mortgaging that could respond to the evolving needs of Japan's rapidly ageing population."Regional banks face the challenge of developing infrastructure to efficiently service less-densely populated markets with older customers who can be uncomfortable with technology," added Fitch.

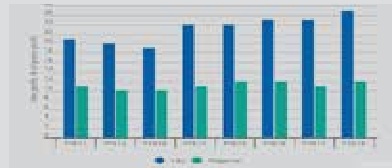
Fintech ventures, M&As

In May 2018, seven Japanese regional banks namely Senshu Ikeda Bank, Gunma Bank, San-in Godo Bank, Shikoku Bank, Chiba Kogyo Bank, Tsukuba Bank and Fukui Bank have joined forces to create a financial technology research company that aims to use AI to analyse deposit account activity and study the use of technologies to reduce office work and bring costs down.

The government is also studying the feasibility of easing rules on regional bank consolidation following orders from Prime Minister Shinzo Abe to boost the efficiency and competitiveness of the struggling sector whilst lending support to geographical diversification and address risk concentrations. One area that advisers could possibly look at may be the drawn-out process to approve bank mergers after it took two years and two months to clear the merger between Shinwa Bank and Eighteenth Bank.

Although regional banks have begun consolidation efforts as early as 1990s with smaller Tier 1 regional banks merging with city banks, consolidation has been slow, Fitch Ratings analyst Kaori Nishizawa noted. Moreover, around 50% of Japanese companies rely heavily on regional banks as their main source of borrowing, government documents show, highlighting the spillover risk should regional banks fail.

Fee income has been in a slump



Source: Fitch Ratings

MYANMAR

Myanmar warms up to foreign banks in sector overhaul

Foreign banks in Myanmar are now allowed to lend to local businesses in the latest move by the central bank in November to speed up the rehabilitation of the country's banking sector.

In a letter signed by deputy governor Soe Thein, the Central Bank of Myanmar said that the aim was to give local businesses more access to financing. "Employed properly, this new capital will allow the expansion of existing enterprises, fund the establishment of new businesses, and along the way stimulate the creation of new products, new markets, new employment opportunities – and improved economic growth broadly," Sean Turnell, economic advisor to Aung San Suu Kyi said.

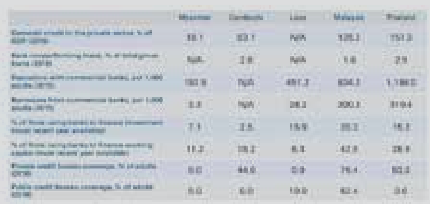
Myanmar's banking sector, which has suffered decades of mismanagement under the former ruling military junta, only recently opened its door to foreign banks as part of sector overhaul that began in 2011. As part of this agenda, the country has allowed 13 foreign banks to add import financing to their trade finance service suite in August 2018 months after enabling seven overseas lenders to provide export financing solutions.

However, the current administration still has miles to go to fully liberalise the financial services sector and keep up with its Southeast Asian neighbours given the dominance of the country's four state-owned banks that account for over 60% of total banking assets.

Although Myanmar has welcomed privately owned lenders as early as 1990s, the 1997 Asian financial crisis as well as the 2003 domestic banking crisis has severely held back the development of the sector. International banks could only operate in Myanmar via joint venture agreements with local banks or assist foreign-invested companies, data from ASEAN Briefing show. Such banks are also restricted to just one branch per banks and are mandated to invest a minimum paid-up capital of $75m.

Foreign banks operating branches in Myanmar include ANZ, ICBC, OCBC, UOB, Mizuho, MUFG, Sumitomo Mitsui Banking Corporation, Shinhan Bank, Maybank, State Bank of India, E.Sun Commercial Bank, Bangkok Bank and VietinBank.

Myanmar's banking sector significantly lags behind its regional peers



Source: Milken Institute