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This month's focus: **Management Strategy at Regional Banks**

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This paper studies the challenges facing Japanese regional banks amid declining profitability under Japan's harsh competitive dynamics and low interest rate environment / BOJ's negative interest rate policy.

In the first part discussing macroeconomic conditions, the paper analyzes not only the national economy but also varied economic growth in the 47 prefectures by conducting multiple regression analysis using two variables.

The paper next looks at the low profitability of Japanese regional banks by way of a global comparison of regional financial institutions in three major countries (the US, Germany, and Japan).

Then, the paper finally considers the public nature (and benefits) of banks which is often held up as a counterargument to the low profitability of regional banks. In view of the statement of public benefit that stipulated at Japanese Banking Law, the paper concludes that Japanese regional banks should undertake strategic restructuring to improve profitability for survival over the medium-to long-term.

Current Issues Facing Japanese Regional Banks: Role of Equity Investments and Balance Sheet Adjustment	<i>Arito Ono</i>	17
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The profitability of Japanese regional banks has been declining for a decade, especially in terms of domestic commercial banking business. This study offers two possible solutions for Japanese regional banks to overcome their difficulties. First, based on empirical findings in Ono, Suzuki, and Uesugi [2018], it examines the role of equity investments by regional banks. Holding equity claims over client firms by a bank will increase its competitiveness through the complementarity between shareholding and lending activities, and contribute to mitigating shareholder-creditor conflict. Second, based on a simplified model in Ono et al. [2018], the necessity of balance sheet adjustment by regional banks under the negative interest rate policy is pointed out. In particular, regional banks should increase cost structure flexibility and introduce fees on deposits.

Increase in Low-return Lending and Financial Vulnerabilities	<i>Takuji Kawamoto</i>	28
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Japanese regional banks' profitability has been under strong downward pressure due to a secular decline in loan demand as well as the prolonged low interest rate environment. To maintain their profitability, regional banks have increased risk-taking, particularly on lending to "middle-risk" firms. However, returns on these loans have declined with bank competition intensifying and their overall profitability has remained subdued. Under these circumstances, regional banks' capital adequacy ratios have gradually decreased because the pace of increase in their capital has not necessarily kept up with the pace of increase in the amount of risky assets. Regional banks need to enhance their risk management, bearing in mind possible recession risk.

Post-War Business Model of Japanese Regional Banks and Strategy Changes	<i>Hajime Takata, CMA / Tsuyoshi Oki, CMA</i>	38
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The post-war business model of Japanese regional banks was built on a stable funding infrastructure based on bank deposits. However, under the ultra easy monetary policy of the Bank of Japan, the profitability of regional banks has been undermined and the industry exposed to structural recession. Strategy in this environment is to make use of the "trading company model" and trust bank function of regional banks, which business model harks back to the original purpose of establishment in the pre-war period.

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