SECTOR IN-DEPTH
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Banks – Japan

Deposit competition will widen credit divergence, with regional banks more at risk

Summary

Intensifying deposit competition amid the normalization of monetary policy and structural changes will drive up funding costs for banks, diminishing the benefits of rising interest rates. While this is also true for the three megabanks, their superior digital capabilities and ability to limit balance sheet use through fee-based and distribution-led services position them better to absorb increases in funding costs. These factors will widen the competitiveness gap between three sector leaders and the others.

» **Intensifying competition for deposits will raise funding costs and reduce margin gains from rising rates.** The normalization of monetary policy, coupled with other factors including a structural shift in household funds from bank deposits to investment products, is resulting in a shrinking pool of low-cost deposits. This is forcing banks to raise deposit rates, which will reduce the benefits of higher interest rates for net interest margins (NIMs).

» **Megabanks' stronger digital capabilities will help attract deposits amid increasing competition and tighter system liquidity.** In acquiring or retaining customers, the megabanks will benefit from integrated digital platforms that encompass various financial services. This will allow them to compete more effectively for deposits without relying solely on rate increases. By contrast, regional and shinkin banks lack resources to invest in technology. They can form partnerships but even so, their digital offerings are likely to be more limited than those of the megabanks.

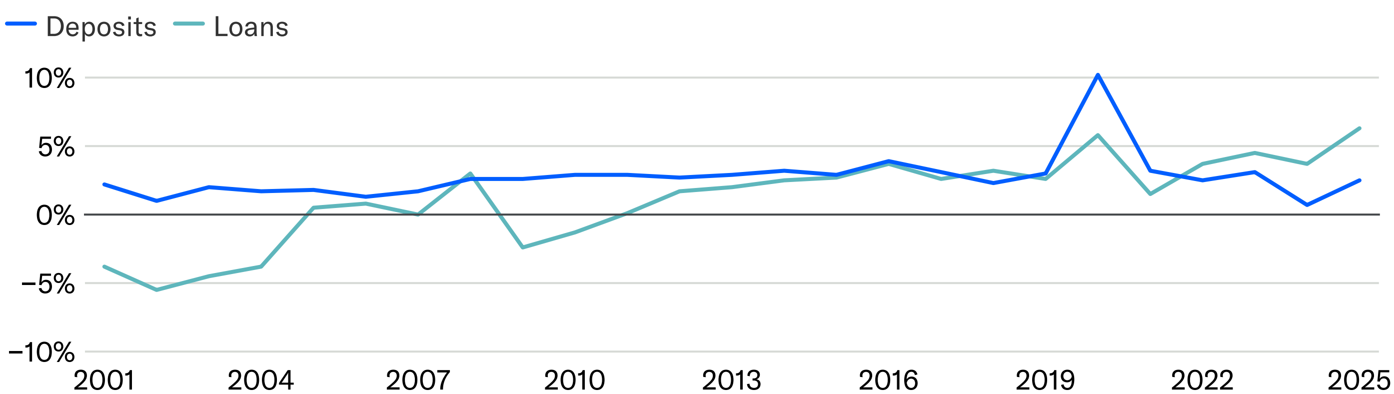
» **Diversified income sources and less reliance on deposits strengthen megabanks' resilience.** The megabanks can better withstand interest margin pressure because they have diversified fee income sources, such as asset and wealth management, transaction banking and capital market services. Also, they can meet growing financing demand without expanding their balance sheets through an originate-to-distribute model and a more capital-light corporate and investment banking strategy. Further, they can take advantage of their access to the bond market for funding.

Intensifying competition for deposits will raise funding costs and reduce margin gains from rising rates

Competition for deposits among banks in Japan is intensifying amid monetary policy normalization, which will push up banks' funding costs and reduce the benefits of rising interest rates for their NIMs.

Competition for deposits among banks is intensifying as loans are growing faster than deposits, fueled by businesses seeking financing for various purposes, such as restructuring, acquisitions and replenishment of working capital as the Japanese economy recovers (Exhibit 1).

Exhibit 1
Loans have been growing faster than deposits since late 2022
Annual growth rateup



Data covers all depository institutions in Japan.
Years are fiscal years that end in March.
Deposits include demand deposits, term deposits, and negotiable certificate of deposits; loans include bank and trust account loans for both retail and corporate borrowers.
Sources: Bank of Japan and Moody's Ratings

As a result, the systemwide loan-to-deposit ratio (LDR) rose to 66% in the fiscal year ended March 2026 (fiscal 2025) from 64% in fiscal 2024 (Exhibit 2). The figure for regional banks rose faster than for city banks[1], reaching its highest level since fiscal 2000, because of slower deposit growth.

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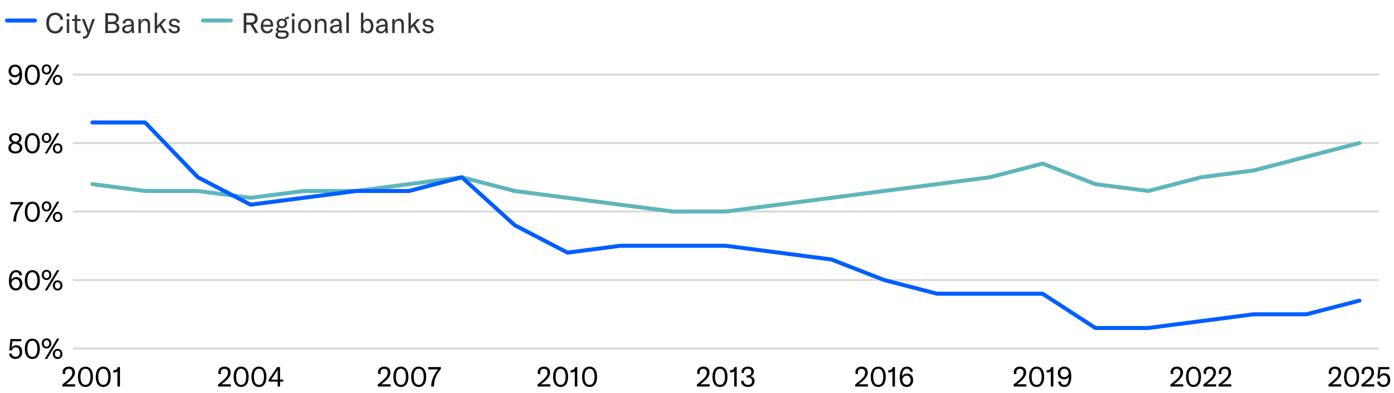
Exhibit 2
Regional banks' loan-to-deposit ratio rose substantially
Fiscal year ended March



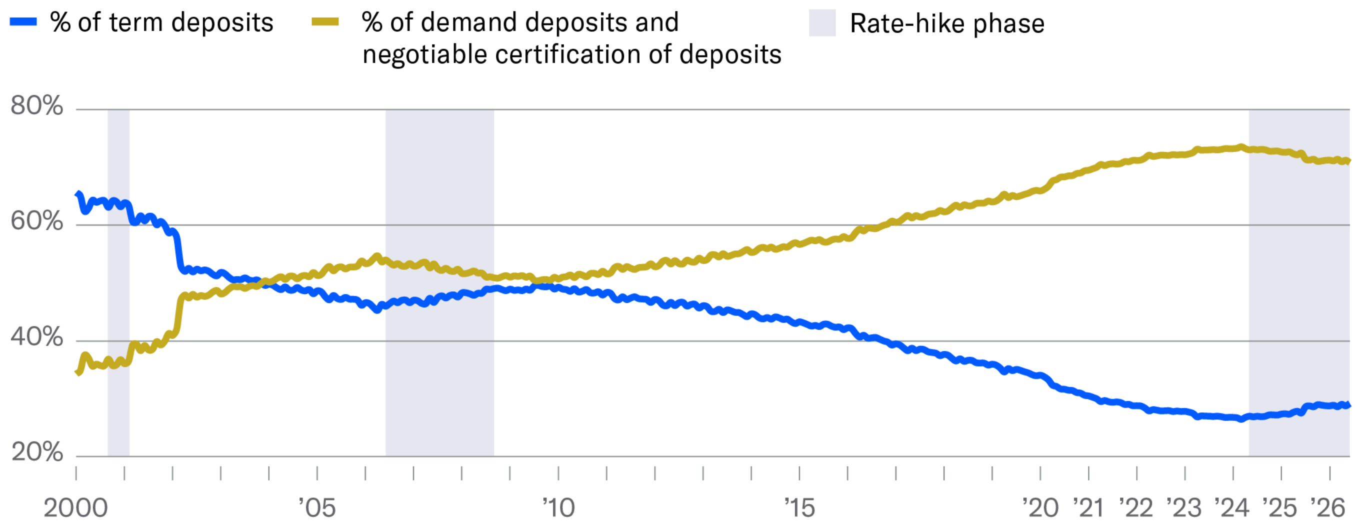
City banks are MUFG Bank Ltd., Sumitomo Mitsui Banking Corporation, Mizuho Bank, Ltd., Resona Bank, Limited, and Saitama Resona Bank, Limited.
Sources: Japanese Bankers Association and Moody's Ratings

Banks' LDRs are still low but they need to continue to expand deposits. Large banks must manage regulatory net stable funding ratios (NSFRs), while all banks, including regional banks under the Basel III domestic standard, must maintain Bank of Japan (BOJ) deposits above required reserve levels.

Against this backdrop, it is becoming increasingly difficult for banks to expand deposits at low costs for a number of reasons.

As interest rates rise, businesses and individuals are shifting their funds to term deposits, which are costlier for banks than demand deposits. After the BOJ ended its negative interest rate policy in March 2024, term deposits grew to 29% of total deposits from retail and business customers as of the end of March 2026 from 26% two years earlier, though the proportion is still smaller than during the rate-hike cycle during 2006-07, when it exceeded 45% (Exhibit 3). Term deposits accounted for most of overall deposit growth in fiscal 2024–25. The shift has been driven primarily by businesses seeking higher yields. We expect retail depositors to follow suit, leading to a further expansion of term deposits.

Exhibit 3
Rising interest rates are encouraging bank customers to shift to term deposits for higher yields
Share in total yen deposits



Deposits include demand deposits, term deposits, and negotiable certificate of deposits from retail and business customers across Japanese depository institutions.
The rate-hike phase is the period between the BOJ's initial policy rate increase and its first policy rate cut.
Sources: Bank of Japan and Moody's Ratings

The expiration of a BOJ funding program for banks will also contribute to the intensification of competition for low-cost deposits. Introduced in 2012 to stimulate credit growth and economic activity during Japan's prolonged deflationary period, the facility provided banks with low-cost funding at rates well below prevailing deposit costs. Outstanding bank borrowing from the BOJ under the program totaled about ¥5 trillion as of 12 September 2025. That is equivalent to about 5% of systemwide deposits as of the end of September 2025[2].

The BOJ stopped new disbursements in June 2025 and will fully end the program by March 2028. This will affect regional financial institutions more than large banks as they account for more than 70% of outstanding borrowing from the BOJ under the program. As this funding source disappears, banks will need to repay the BOJ and rebalance their balance sheets, primarily by reducing deposits held at the central bank. As banks seek to replace maturing BOJ funding, competition for deposits, particularly low-cost, stable retail and corporate deposits, is likely to intensify.

Also, a structural shift in household financial assets from deposits toward investment products is reducing the availability of retail deposits. An expansion of the Nippon Investment Savings Account (NISA), a tax exempt program, and an acceleration of inflation are spurring households to reallocate funds from bank deposits to investment products in search of higher returns and protection against inflation.

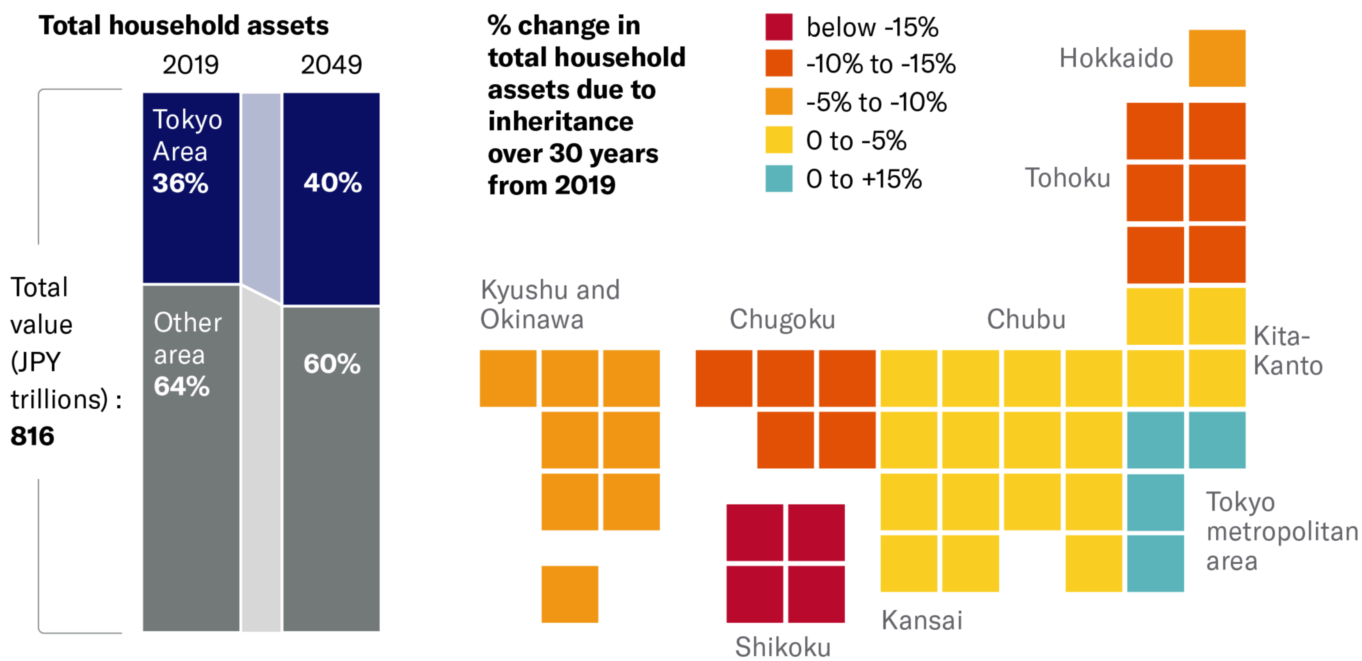
In addition, from January 2027, the Ministry of Finance will allow unlisted small and medium-sized enterprises (SMEs) and nonprofit organizations to purchase retail Japanese government bonds (JGBs), expanding eligibility beyond individual investors, the only permitted group under the current scheme. This could divert such institutions' deposits from regional and shinkin banks, which rely heavily on them for funding.

Some regional and shinkin banks are already facing challenges in maintaining their deposit bases, with competition with online banks, including Rakuten Bank, Ltd., exacerbating the situation. About 20% of listed regional banks and half of shinkin banks reported deposit decreases for fiscal 2025[3].

Regional and shinkin banks face structural challenges in defending deposit bases

Regional and shinkin banks are having greater difficulty defending their deposit bases than larger peers as they are bearing the brunt of Japan's demographic changes. Aging and declining populations are leading to declines in local depositor pools across many prefectures, while younger generations continue to migrate to large cities, particularly the Tokyo metropolitan area. This creates a structural disadvantage for regional and shinkin banks in attracting low-cost deposits. In addition, inheritance-related fund transfers may accelerate deposit outflows to banks serving major metropolitan areas, where beneficiaries are more likely to reside (Exhibit 4).

Exhibit 4
Inheritance-driven household asset outflows will exacerbate funding pressure for regional banks

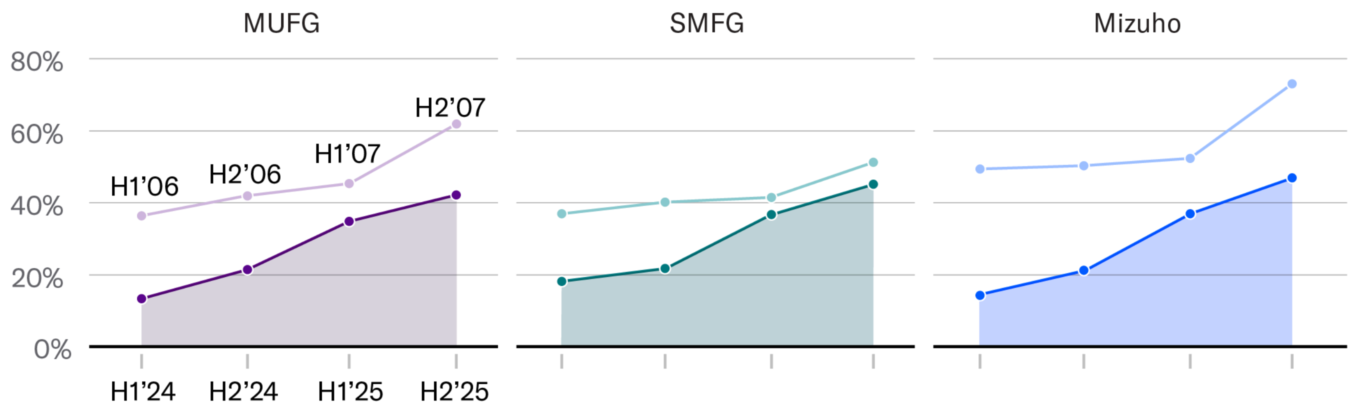


Estimates of reallocations of household financial assets are based on the number of households, assets per household, interprefectural migration and life tables. Total household assets are held constant.
The Tokyo metropolitan area comprises the prefectures of Tokyo, Kanagawa, Saitama, and Chiba.
Sources: Ministry of Internal Affairs and Communications, Ministry of Health, Labour and Welfare, National Institute of Population and Social Security Research and Moody's Ratings

All these factors are leading to greater competition for demand deposits. While banks offer services such as credit card settlement accounts to encourage customers to maintain demand deposits for day-to-day transactions, the situation is also forcing them to raise term deposit rates to attract and retain funds.

The faster growth of term deposits is driving up overall deposit pass-through rates, reflecting larger increases in deposit costs relative to changes in the policy rate. For example, the megabanks' overall deposit pass-through rates increased to about 40% in the second half of the year ended fiscal 2025 from about 20% in the first half of fiscal 2024 (Exhibit 5). During the rate hike cycle in 2024-26, banks have passed on about 40% of policy rate increases to demand deposit rates.

Exhibit 5
Megabanks' overall deposit pass-through rates are rising and could approach 2006-07 levels
Deposit pass-through rate

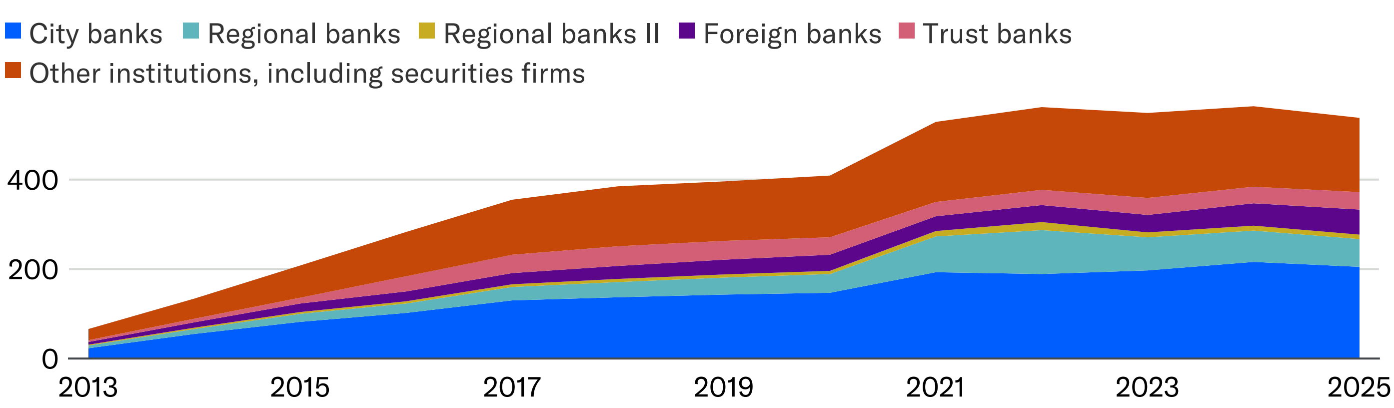


Figures are annualized.
Data for fiscal 2024-25 is for MUFG Bank, Ltd., Sumitomo Mitsui Banking Corporation (SMBC) and Mizuho Bank, Ltd. (Mizuho Bank). Data for fiscal 2006-07 is for the Bank of Tokyo-Mitsubishi UFJ, Ltd., which has been renamed; SMBC; and Mizuho Corporate Bank, Ltd. and Mizuho Bank, which have been merged.
Sources: Banks and Moody's Ratings

Overall deposit pass-through rates could rise further toward elevated levels in 2006-07, an outcome of the BOJ's exit from its negative rate policy, as term deposits expand. In response, regional banks are seeking to attract customers from other institutions, including Japan Post Bank Co., Ltd. (A1 stable, baa2) and shinkin banks, to their payroll and pension deposit products. Although competition will inevitably drive up rates for such deposits as well, they are still much lower than interest for term deposits. Also, payroll and pension deposits are sticky.

Banks' BOJ deposit balances are also likely to decrease as they repay funds they borrowed through the central bank's expiring program (Exhibit 6). About 60% of listed regional banks reported year-on-year reductions in BOJ deposits for the end of March 2026, and this trend is likely to accelerate. For banks losing deposits, BOJ balances are typically the first source of liquidity to cover funding needs.

Exhibit 6
Banks' BOJ deposit balances will decrease as the central bank's funding program expires
BOJ deposit balance (in trillion of yen)



City banks are MUFG Bank Ltd., Sumitomo Mitsui Banking Corporation, Mizuho Bank, Ltd.,Resona Bank, Limited, and Saitama Resona Bank, Limited.
Sources: Bank of Japan and Moody's Ratings

Still, banks generally maintain substantial liquidity buffers at the BOJ, which, combined with low LDRs, give them ample capacity to absorb deposit outflows. Therefore, we do not expect banks to sell investment securities to free up liquidity. Instead, banks are gradually redeploying parts of their BOJ deposits into higher-yielding loans and securities to shore up NIMs. This shift is likely to continue and could accelerate as the BOJ's policy rate approaches its terminal rate, encouraging banks to invest excess reserves in JGBs and other higher-yielding assets.

However, banks cannot draw down their BOJ deposits below required reserve levels. If a bank with insufficient cash holdings fails to grow deposits, it may need to securitize assets or obtain wholesale funding to increase liquidity. This would result in higher funding costs and require access to capital markets.

Stronger digital capabilities will help megabanks attract low-cost deposits as competition intensifies

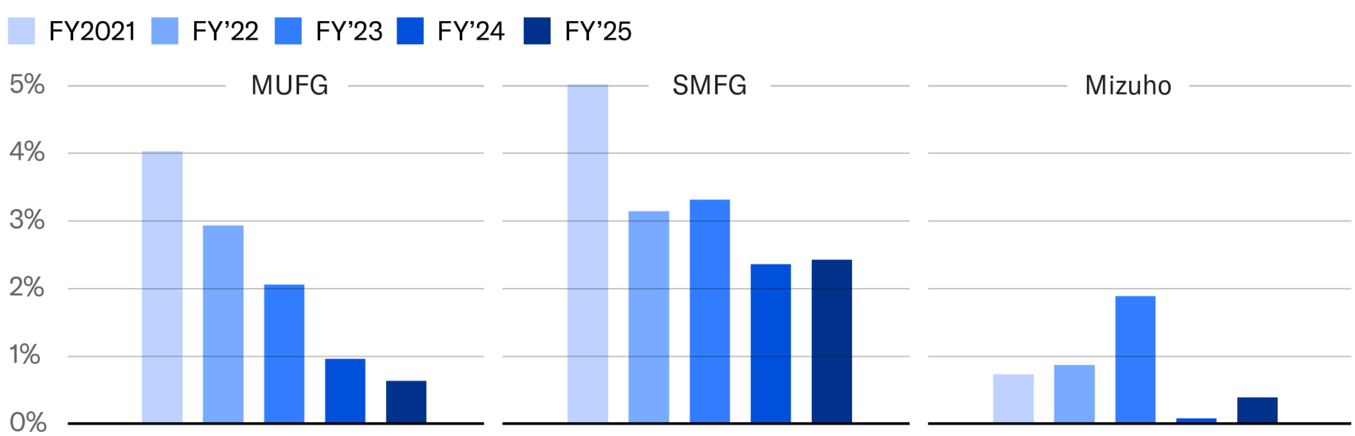
The megabanks have better digital platforms than their smaller peers, which gives them a crucial advantage in attracting low-cost deposits.

Sumitomo Mitsui Financial Group, Inc.'s (SMFG, A1 stable[4]) launched its own digital platform named Olive in March 2023 and Mitsubishi UFJ Financial Group, Inc.'s (MUFG, A1 stable) followed suit with Emut in June 2025. These online systems combine payment, credit card and asset-building services. Mizuho Financial Group, Inc. (Mizuho, A1 stable) has a partnership with Rakuten Group to leverage the online shopping company's vast financial ecosystem spanning credit cards and securities. All three megabanks are offering point-based services to attract retail customers.

With the digital platforms, the megabanks do not need to compete for deposits solely by offering higher rates. Deposits collected through the online channels are typically sticky and carry low rates because they are backed by recurring payments and frequent fund movements for wealth accumulation and investment services. Also, the digital platforms help the megabanks acquire new customers in areas where they have limited physical branch networks.

SMFG is benefiting from a first-mover advantage, expanding retail deposits faster than its peers since the introduction of Olive (Exhibit 7).

Exhibit 7
SMFG is boosting retail deposits faster than other megabanks
Annual domestic retail deposit growth



Data for SMFG covers its main operating subsidiary, Sumitomo Mitsui Banking Corporation (A1/A1 stable, a3[5]) while data for MUFG covers its subsidiary banks, MUFG Bank, Ltd. (A1/A1 stable, a3) and Mitsubishi UFJ Trust and Banking Corporation (A1 stable, a3). Data for Mizuho Financial Group, Inc. (Mizuho, A1 stable) covers its subsidiary banks, Mizuho Bank, Ltd. (A1/A1 stable, baa1) and Mizuho Trust & Banking Co., Ltd. (MHTB, A1 stable, baa1).
Retail deposits accounted for 52% of total yen deposits for MUFG, 46% for SMFG, 40% for Mizuho as of the end of June 2026.
Fiscal years end in March.
Sources: Banks and Moody's Ratings

Hence, the megabanks' deposit pass-through rates are likely to remain lower than those of regional, shinkin, and online banks.

By contrast, regional and shinkin banks are facing increasing challenges in defending their deposit bases and customer relationships as the importance of physical branches diminishes.

Small banks have limited resources to invest in technology so they have little choice but to rely on partnerships with technology companiesS or other banks. For example, in December 2025, Tsukuba Bank, Ltd. announced a plan to introduce a mobile banking platform developed by a regional bank alliance.

Yet any digital offerings developed through such partnerships are likely to be limited compared to those of the megabanks.

Diversified income sources and less reliance on deposits strengthen megabanks' resilience

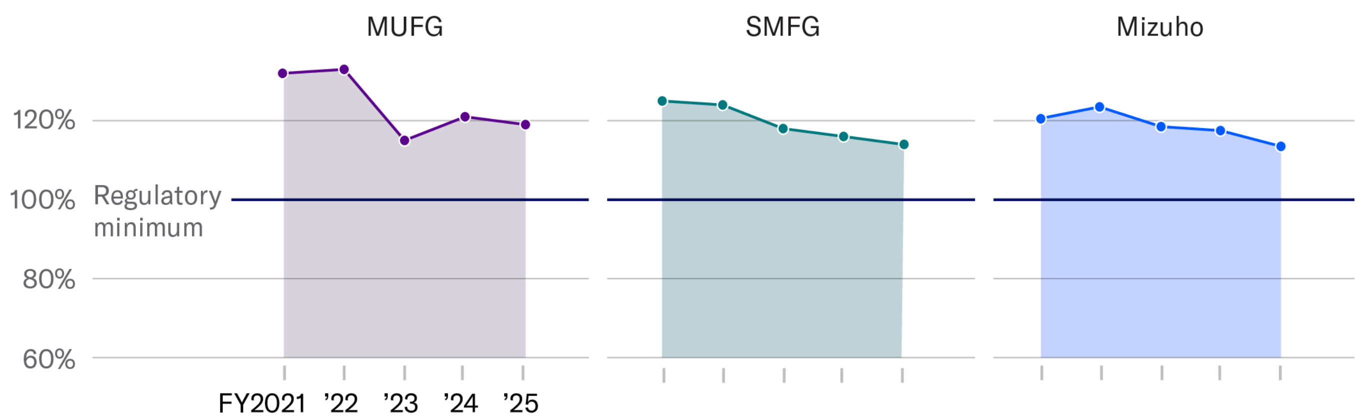
The megabanks can also benefit from diversified fee income sources, such as asset and wealth management, transaction banking and capital market services. Further, they can meet growing financing demand without expanding their balance sheets, which makes them less susceptible to the slowdown in deposit growth.

While bank deposit growth is slowing, demand for financing among companies is increasing, particularly for acquisitions, leveraged buyouts, business succession, privatization and corporate carve-outs. Although the megabanks have superior capabilities to attract deposits, their NSFRs have declined (Exhibit 8).

Exhibit 8

Yen depreciation, increases in domestic loans and slower growth in deposits have led to declines in megabanks' regulatory NFSRs

NFSR



Sources: Banks and Moody's Ratings

Growing overseas lending is adding to funding needs. Overseas loans account for about 40% of the megabanks' loans, and yen depreciation has increased the yen-equivalent values of these assets, inflating their balance sheets and increasing required stable funding, the denominator of NSFRs. In addition, banks often rely on short-term foreign-currency funding and foreign-exchange swaps to support overseas asset growth. Because those instruments are not fully recognized as stable funding under the NSFR framework, loan expansion through them weakens the metric.

As such, bond issuance is becoming a more important funding tool for lenders, including the megabanks. In April 2026, Sumitomo Mitsui Banking Corporation (SMBC, A1/A1 stable, a3[6]) sold ¥150 billion of senior unsecured bonds, its first issuance since 2014, and a few other banks have also reentered the domestic debt capital market. The megabanks and some large regional banks can resort to bonds because they have built investor bases through past issuance. By contrast, access to the bond market is limited for small institutions.

Long-term bond issuance, like deposits, qualifies as stable funding under the NSFR framework. As for the megabanks, while their total loss-absorbing capacity meets minimum requirements, foreign-currency bond issuance provides an additional boost to their NSFRs.

To facilitate capital market access, the megabanks are leveraging their trust, asset management and fiduciary businesses to build or expand relationships with institutions investors, including insurers and private credit funds.

To improve capital efficiency, the megabanks are also gradually shifting from traditional hold-to-maturity lending toward an originate-to-distribute model and a more capital-light corporate and investment banking strategy. This allows them to meet financing needs without expanding balance sheet capacity or eroding regulatory capital.

Endnotes

1 City banks are MUFG Bank Ltd., Sumitomo Mitsui Banking Corporation, Mizuho Bank, Ltd., Resona Bank, Limited and Saitama Resona Bank, Limited.

2 Source: Japanese Bankers Association.

3 Source: FactSet and the Bank of Japan's Financial Stability report published in April 2026.

4 The ratings shown in this report are senior unsecured debt rating and outlook

5 The banking ratings shown in this report are the bank's deposit rating, senior unsecured debt rating and Baseline Credit Assessment.

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