
The Impact of the Lifting of the Blanket Guarantee on Bank Deposits on Personal Financial Assets in Japan

Kaori Zeniya

On 1 April 2002 the blanket guarantee on Japanese bank deposits was lifted with the exception of demand deposits, the guarantee on which was extended for another year. Although depositors had been expected to withdraw money from their time deposits, the extent to which they transferred this money to demand deposits was greater than expected. Although it is unclear what will happen to personal financial assets as next year's deadline approaches, this report looks at what has recently been happening to some of the financial products that may benefit.

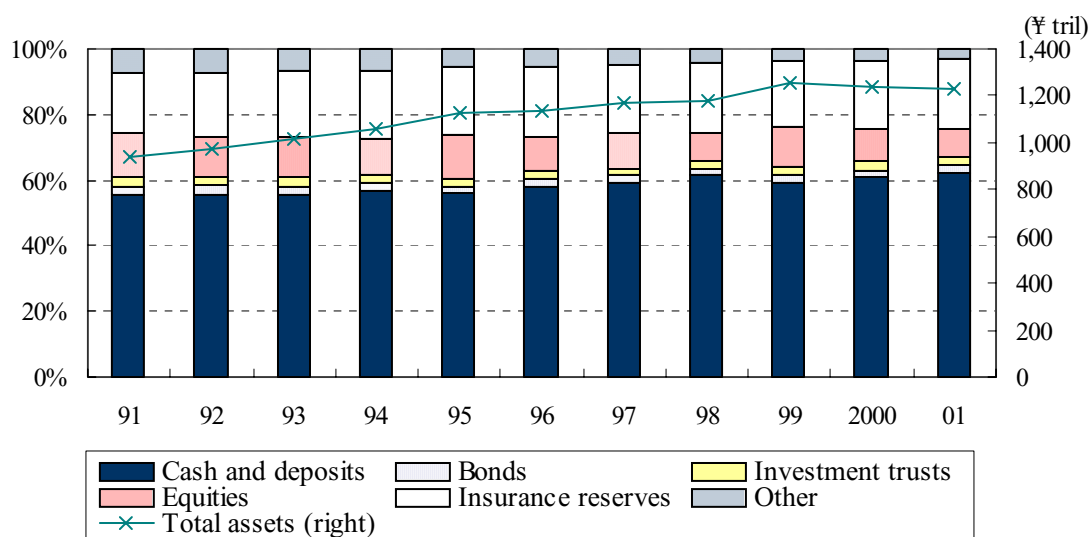
1. Some of the Distinctive Features of Japanese Personal Financial Assets

One of the distinctive features of Japanese personal financial assets is the high household savings ratio. Another is the fact that most of this money is held in the form of deposits and savings. All sorts of explanations have been offered for this phenomenon, including the fact that Japan is an aging society, the fact that ownership of risky assets in Japan is not very different from that in the United States if property is counted as a risky asset, and the fact that the Japanese have a strong tendency to behave like those around them. However, the finding by the Central Council for Financial Services Information in its 2001 Annual Household Opinion Survey of Financial Assets that "capital preservation" is the most important consideration in choosing an investment for more respondents (34.5%) than any other factor indicates that this is what has produced the bias towards holding money on deposit.

According to the Bank of Japan's Flow of Funds Accounts, as of end-March 2002 ¥767 trillion (or 54.1%) of the ¥1,417 trillion in personal financial assets in Japan was held in the form of deposits and savings. This figure of ¥1,417 trillion includes assets (e.g., occupational pension scheme assets) which the individuals concerned cannot be

said to have chosen. If we exclude "pension reserves," "deposit money"¹ and "accounts receivable/payable" from the total² in order to establish exactly how individuals have allocated their assets, the proportion of personal financial assets held in the form of deposits and savings rises to 62.4% (see Figure 1).

Figure 1 Composition of Personal Financial Assets



Notes: 1) "Pension reserves," "deposit money " and "accounts receivable/payable" are excluded.
 2) The data are for the end of the fiscal year in question.
 Source: NRI, from Bank of Japan, Flow of Funds Accounts.

2. The Aftermath of the Lifting of the Blanket Guarantee

The blanket guarantee on bank deposits was introduced as an exceptional measure in June 1996 and lifted again on 1 April 2002 with the exception of demand deposits. Whereas corporate depositors were quick off the mark to switch out of time deposits before the blanket guarantee was lifted, individuals did not make a move until just before the deadline.

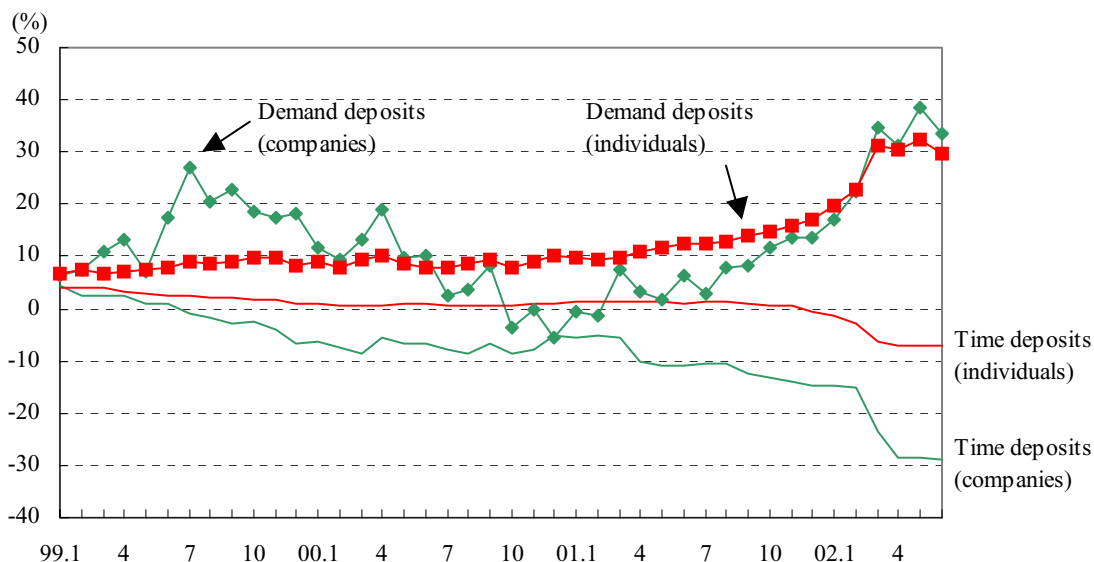
The Bank of Japan's money supply figures show that it was in December 2001 that the balance of individual depositors' time deposits turned negative year on year, indicating that individual depositors waited until just before the deadline before moving their money (see Figure 2). Although the decline appears quite small in year-

¹ Money deposited with an agent other than a bank, usually as a guarantee (e.g., money deposited as margin with a securities company or an exchange, and money deposited as a guarantee by a tenant with a landlord or by a member with a golf club) but occasionally for other purposes (e.g., money deposited by employees with their employer).

² Total personal financial assets (excluding "pension reserves," "deposits money " and "accounts receivable/payable ") as at end-March 2002 was ¥1,229 trillion.

on-year percentage terms, the fact that individual depositors have more than three times as much money on deposit as corporate depositors means that the actual outflow was considerable, totaling ¥16.1 trillion in the three months from end-December 2001 to end-March 2002—more than the outflow from corporate deposits of ¥15.9 trillion.

Figure 2 Annual Percentage Changes in Bank Deposits



Source: NRI, from Bank of Japan, Money Supply Statistics.

1) Shift to demand deposits

Much as had been expected, the shift that accompanied the lifting of the blanket guarantee on bank deposits was largely out of time deposits. In the six months to end-March 2002 there was an outflow of ¥13.7 trillion from individual depositors' time deposits with Japanese banks.³ Of this, ¥13.0 trillion was from deposits with a balance of at least ¥10 million.

Moreover, instead of diversifying what they did with that money, depositors transferred the bulk of it to demand deposits. In the six months to end-March 2002 there was an inflow of ¥22.9 trillion into demand deposits, of which ¥14.4 trillion was into demand deposits with a balance of at least ¥10 million. This shows that demand deposits were the destination for the money that was withdrawn.

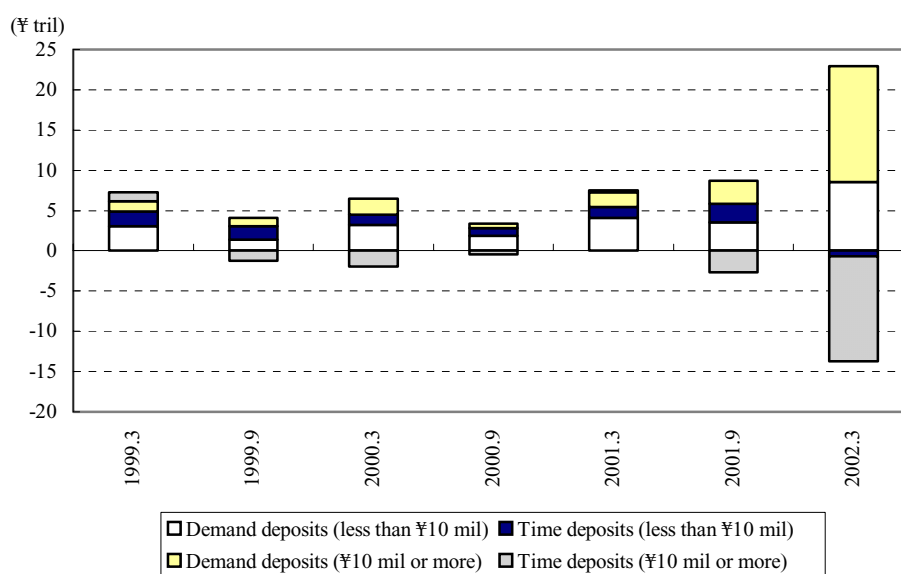
Similarly, there was an increase in the number of demand deposits with a balance of between ¥3 million and ¥10 million, showing that depositors with deposits of at

³ The total for city banks, regional banks, second-tier regional banks, long-term credit banks and trust banks.

least ¥10 million were reducing their balances at any one bank to less than ¥10 million by holding accounts at a number of banks.

This suggests that at a time when interest rates are at historically low levels and the expected return on marketable financial products is also low many depositors have decided to park their money in demand deposits that are still fully guaranteed while they wait for the next investment opportunity.

Figure 3 Net Inflows into and Outflows from Japanese Bank Deposits



Note: The data are for six-month periods.

Source: NRI, from Bank of Japan, Analysis of Bank Deposits by Depositor Category (Amount outstanding).

2) Depositors have started to cherry-pick

We have already seen that there has been a shift into demand deposits. However, as well as simply transferring money to other accounts with the same bank, depositors have also been switching between accounts with different banks. If we subtract the amount of money that has been withdrawn from time deposits from the amount that has been deposited in demand deposits over the past six months, we find that cherry-picking by depositors has led to an unmistakable shift in favor of the city banks, which have enjoyed a net inflow of ¥5 trillion compared with a net inflow of ¥2 trillion into the regional banks and a net outflow of ¥90.4 billion from the second-tier regional banks (see Figure 4).

As next year's deadline approaches, this trend is likely to increase.

Figure 4 Changes in Bank Deposits at Different Types of Bank

(¥100 mil)

	City banks				Regional banks				Second-tier regional banks			
	Total deposits: less than ¥10 mil		Total deposits: ¥10 mil or more		Total deposits: less than ¥10 mil		Total deposits: ¥10 mil or more		Total deposits: less than ¥10 mil		Total deposits: ¥10 mil or more	
	Demand	Time	Demand	Time	Demand	Time	Demand	Time	Demand	Time	Demand	Time
1999.3	8,393	-12,073	5,808	-2,602	13,436	5,489	4,974	1,440	7,675	9,915	1,548	5,319
1999.9	9,019	3,510	7,826	-9,001	4,814	7,401	2,461	-1,662	-448	-7,292	86	-6,732
2000.3	13,892	-138	11,551	-14,385	14,106	6,436	6,274	-4,802	3,107	-1,792	1,355	-3,962
2000.9	9,119	-2,405	3,519	-3,855	9,095	16,211	2,086	1,110	-335	-10,272	-175	-6,193
2001.3	16,508	-2,564	9,740	4,226	18,461	7,924	6,972	-5,635	4,946	-1,008	1,826	-2,231
2001.9	15,816	4,559	17,842	-17,569	13,873	5,938	8,173	-9,719	3,631	2,649	1,587	-3,007
2002.3	37,787	-5,868	81,228	-62,985	34,471	-8,156	41,481	-46,791	8,606	-5,575	13,675	-17,610

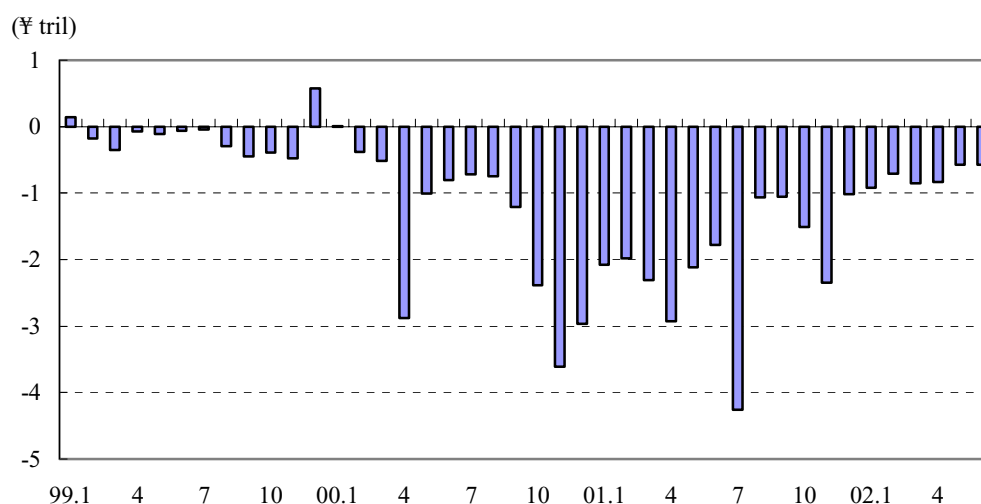
Source: NRI, from Bank of Japan, Analysis of Bank Deposits by Depositor Category (Amount outstanding).

3. Other Financial Assets

1) Withdrawals from Post Office savings accounts

As *teigaku* savings⁴ accounts opened with the Post Office at the beginning of the 1990s, when interest rates were at a historically high level, reached maturity in 2000-2001, accountholders withdrew their balances on a record scale. This year withdrawals have continued, but the rate has declined (see Figure 5).

Figure 5 Net Inflows to *Teigaku* Savings Accounts



Source: NRI, from Postal Services Agency data.

⁴ A savings certificate that can be closed at any time six months after opening and that can be maintained for up to 10 years; interest is compounded semiannually

Between April 2000 and December 2001 ¥94.78 trillion in maturing *teigaku* savings accounts was repaid. If (1) tax on interest and (2) the excess on balances of more than ¥10 million (the account limit) are deducted, this gives a maximum reinvestable amount of ¥72.29 trillion. In fact, ¥58.12 trillion (or 80%) has been reinvested in *teigaku* savings—a very high figure. Nevertheless, nearly ¥30 trillion has found a home elsewhere. The bulk has found its way into ordinary savings accounts with banks while the rest is probably being held in cash or has probably been used to buy investment trusts or government bonds.

Figure 6 Reinvestment in *Teigaku* Savings Accounts

(¥100 mil)

	Payment at maturity	Maximum reinvestable amount	Amount reinvested			Amount reinvested elsewhere
			in Post Office savings	Teigaku + time savings	Ordinary savings	
2000.04	66,351	50,567	43,791 (86.6)	35,700 (70.6)	8,091	17,528
2000.05	21,222	16,169	11,302 (69.9)	11,302 (69.9)	n.a.	8,310
2000.06	20,393	15,536	10,518 (67.7)	10,518 (67.7)	n.a.	8,328
2000.07	20,802	15,851	11,175 (70.5)	11,175 (70.5)	n.a.	8,049
2000.08	15,610	11,891	8,585 (72.2)	7,967 (67.0)	618	5,841
2000.09	24,047	18,380	13,932 (75.8)	12,829 (69.8)	1,103	8,291
2000.10	52,719	40,228	33,349 (82.9)	29,246 (72.7)	4,103	15,371
2000.11	79,865	60,926	52,274 (85.8)	44,232 (72.6)	8,042	21,533
2000.12	84,379	64,351	56,873 (88.4)	48,122 (74.8)	8,751	21,106
2001.01	57,265	43,683	34,385 (78.7)	32,552 (74.5)	1,833	18,538
2001.02	45,668	34,827	27,542 (79.1)	25,301 (72.6)	2,241	14,662
2001.03	46,385	35,368	26,099 (73.8)	24,438 (69.1)	1,661	16,767
2001.04	67,387	51,515	45,023 (87.4)	37,114 (72.0)	7,909	17,270
2001.05	47,542	36,273	25,326 (69.8)	25,326 (69.8)	n.a.	18,612
2001.06	40,889	31,180	22,934 (73.6)	22,119 (70.9)	815	14,852
2001.07	102,054	77,827	62,650 (80.5)	57,080 (73.3)	5,570	31,663
2001.08	27,658	21,075	14,752 (70.0)	14,684 (69.7)	68	10,804
2001.09	20,002	15,250	11,334 (74.3)	10,590 (69.4)	744	7,149
2001.10	29,606	22,575	17,439 (77.2)	15,150 (67.1)	2,289	9,919
2001.11	44,795	34,123	26,971 (79.0)	21,773 (63.8)	5,198	14,420
2001.12	33,157	25,271	24,989 (98.9)	16,565 (65.5)	8,424	5,648
2002.01	27,068	20,628	16,606 (80.5)	14,067 (68.2)	2,539	8,404
2002.02	14,670	11,177	10,403 (93.1)	7,518 (67.3)	2,885	3,152
2002.03	17,244	13,136	11,930 (90.8)	7,754 (59.0)	4,176	4,003

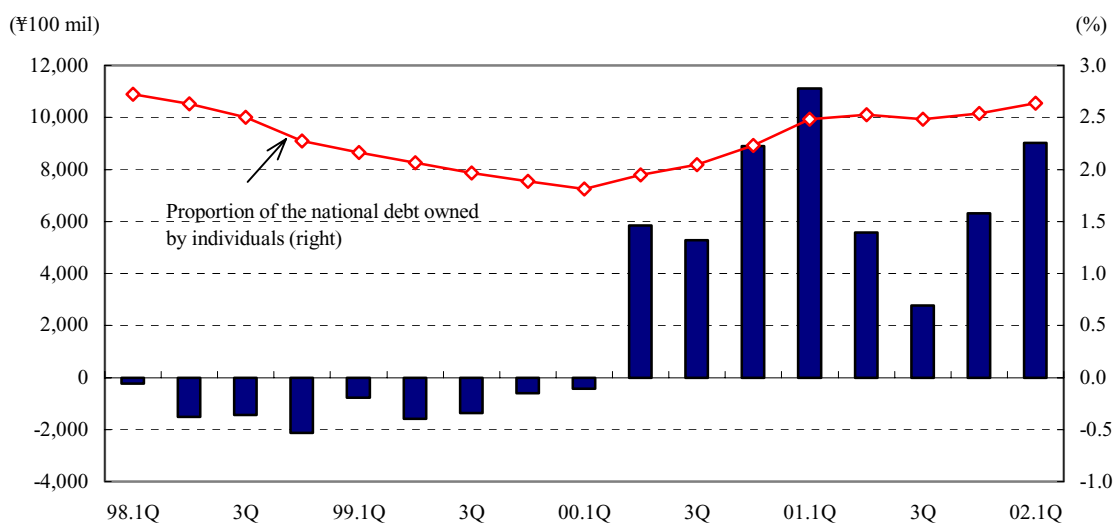
- Notes:
- 1) The "maximum reinvestable amount" is "payment at maturity" less (1) tax on interest and (2) the excess on balances of more than ¥10 million (the account limit), which cannot be reinvested. The figures for this item are estimates by the Postal Services Agency.
 - 2) The figures for "amount reinvested in Post Office ordinary savings" are also estimates by the Postal Services Agency.
 - 3) The figures in parentheses are a percentage of the "maximum reinvestable amount."
 - 4) The figures for "amount reinvested elsewhere" include the excess on balances of more than the account limit of ¥10 million (estimated by NRI), which cannot be reinvested.

Source: NRI, from Postal Services Agency data.

2) Purchases of government bonds continue to exceed sales

Since the second quarter of 2000, purchases of government bonds (by individual investors), which failed to match sales until the first quarter of 2000, have continued to exceed them by more than ¥500 billion each quarter, reaching a cumulative total of ¥12 trillion (or 2.6% of government bonds outstanding) by end-March 2002 (see Figure 7).

Figure 7 Net Inflows to Government Bonds and the Proportion of the National Debt Owned by Individuals

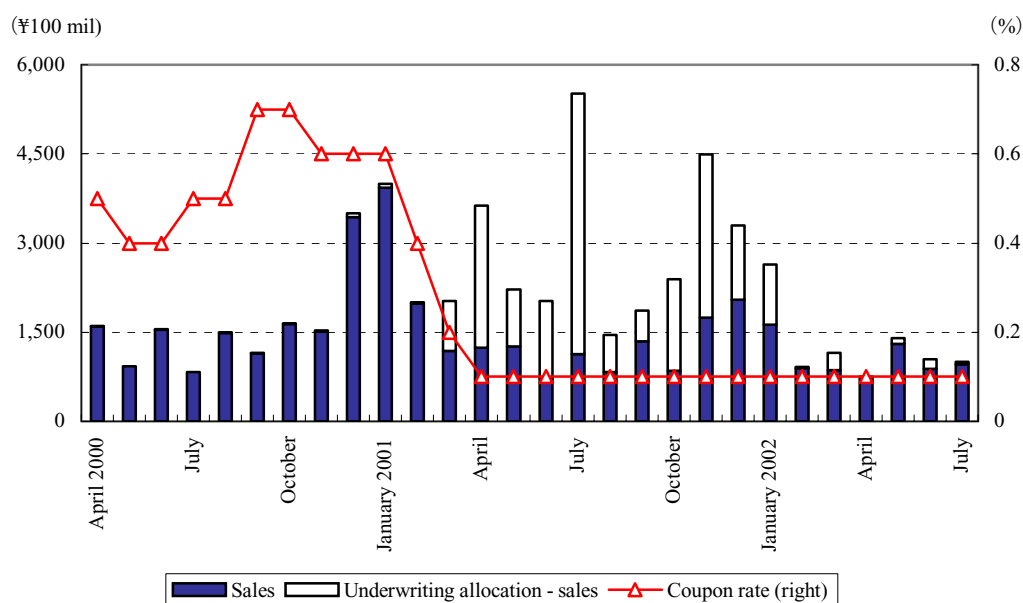


Source: NRI, from Bank of Japan, Flow of Funds Accounts.

The second quarter of 2000 was also the period when a growing number of investors began to close their *teigaku* savings accounts when they reached maturity, and some of the proceeds are likely to have been invested in government bonds. With coupons at historically low levels, purchases of new long-term government bonds by individuals have remained consistently low (at just over 1%), with most of the interest from individuals being concentrated in shorter maturities (e.g., 2-year bonds).

As there are no statistics on purchases of 2-year coupon bonds by individuals, I have used data on sales of government bonds by post offices instead. According to these data, post offices sold all their allocation of new government bonds from April 2000 to January 2001. Although lower coupons have led to a decline in sales since February 2001, the fact that interest rates on time deposits and *teigaku* savings accounts with the same maturity are even lower has helped to maintain sales (see Figure 8).

Figure 8 Sales of 2-Year Coupon Bonds by Post Office



Source: NRI, from Postal Services Agency data.

3) Money market funds showing signs of recovery

Following the collapse of Enron in October 2001, some Japanese money market funds fell below their issue price in November. This had a knock-on effect on money market funds in general, and, as a result, there were large net redemptions of money market funds for several months afterwards. Between end-October 2001 and end-March 2002 these net redemptions totaled ¥12.5 trillion, reducing the outstanding of money market funds from ¥18.6 trillion to ¥6 trillion. Ninety percent (or ¥11.3 trillion) of these redemptions were by corporate investors.

Until the collapse of Enron occurred, corporate investors were the main holders of money market funds in Japan, with individual investors holding only 22.4% (in October 2001). Following the large-scale redemptions by corporate investors, however, individual investors suddenly found themselves holding 49.4% (as of end-March 2002).⁵

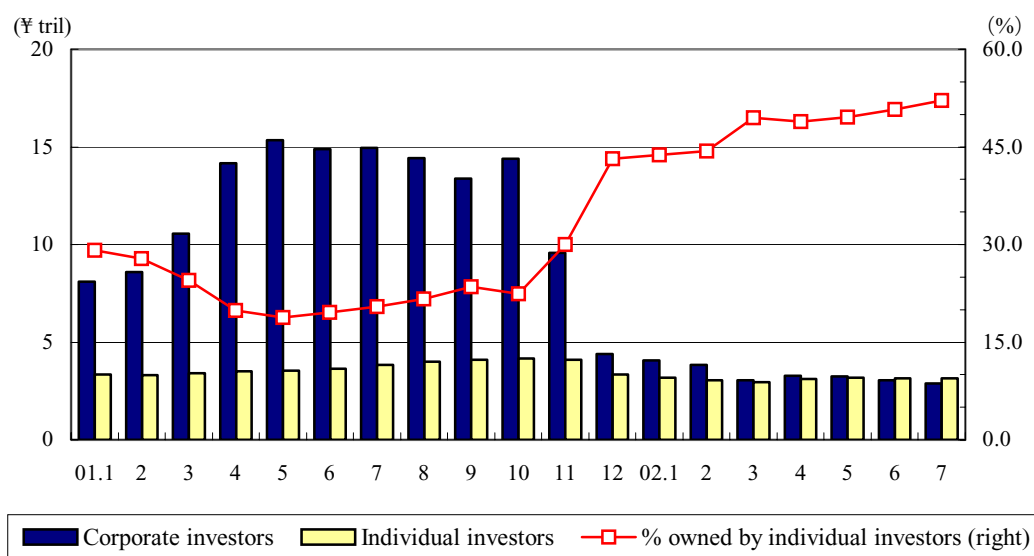
In April 2002, however, the trend changed. The outstanding of money market funds, which had declined for five months in a row since November 2001, began to rise again in April and May. The driving force behind this development was individual investors.

⁵ By end-June 2002 the positions were reversed, with individual investors in the majority, holding 50.7%.

In January 2002 the Japan Investment Trust Association, which was concerned by (1) the fact that many investors in Japan appeared to believe, in defiance of reality, that there was virtually no risk that a money market fund could fall below its issue price and (2) the fact that there were many disadvantages to investing both (relatively long-term) money from individual investors and (relatively short-term) money from corporate investors in the same product, published a set of self-regulatory rules (entitled "Reducing Risk to Money Market Funds") defining money market funds. The rules endeavor to minimize the risk of these products and maximize capital preservation by requiring that fund assets satisfy certain criteria on creditworthiness and residual life while endeavoring to aim these products principally at individual investors by requiring corporate investors to give advance notice of redemption and limiting the amount of redemptions they may make in a single day.

Although it is too soon to say whether the rules, which were only adopted on 15 February 2002, have been successful, the fact that the outstanding of money market funds increased, albeit only slightly, in April suggests that the endeavor has had a measure of success.

Figure 9 Balance of Money Market Funds Outstanding



Source: NRI, from Japan Investment Trust Association data.

4) Sales of equity investment trusts by banks continue to increase

While the net asset value of bond investment trusts and money market funds declined in the wake of the collapse of Enron,⁶ that of equity investment trusts rose to ¥15 trillion⁷ as of end-March 2002—a year-on-year increase of 5.9%. As not all Japanese equity investment trusts invest exclusively in Japanese equities, a comparison with the performance of the stock market may be misleading. However, the fact that the TOPIX underwent a double-digit correction during the same period suggests that the gain in net asset value was the result of cash inflows rather than rising share prices. In fact, in fiscal 2001, publicly offered equity investment trusts enjoyed a net cash inflow of ¥2.90 trillion.⁸

The net asset value of equity investment trusts sold by banks has consistently enjoyed double-digit year-on-year growth, and in the year to end-March 2002 the figure was 59.5%. As a result, the net asset value of equity investment trusts sold by banks is now ¥4 trillion (a quarter of the net asset value of all publicly offered equity investment trusts), making banks one of the most important outlets for such products.

One of the main reasons why the net asset value of equity investment trusts sold by banks continues to grow is probably that they encourage customers to buy products that are designed to be relatively immune to short-term market movements. For example, many of the equity investment trusts they sell offer the option of an investment savings plan—a feature that would appeal to long-term investors.

In fact, the redemption ratio of investment trusts sold by banks is lower than that of those sold by securities companies. Using NRI's Fundmark classification for Japanese investment trusts,⁹ we estimated¹⁰ the average annual redemption ratio of trusts sold

⁶ The adoption of market value accounting in April 2002 was a major contributor to the decline in the net asset value of bond investment trusts.

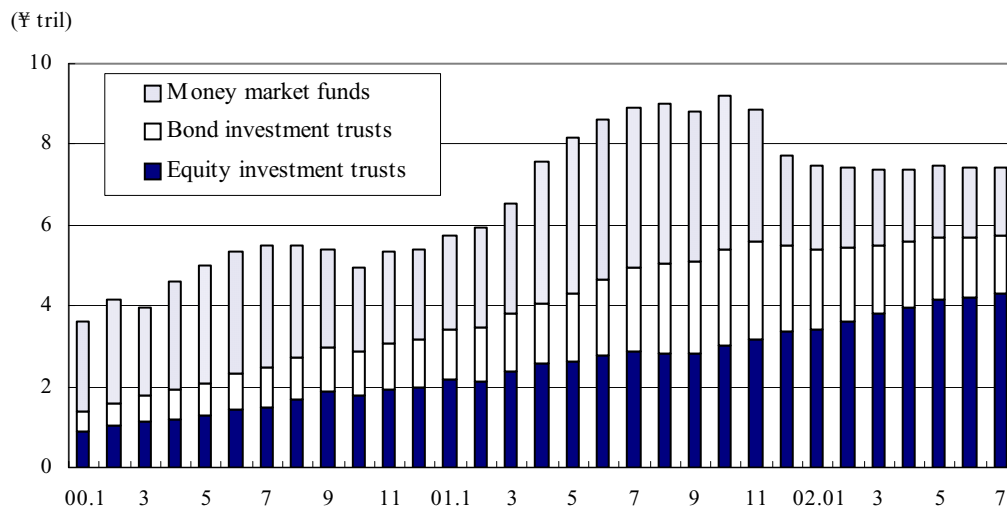
⁷ This figure is for publicly offered investment trusts only and includes purchases and redemptions by corporate investors.

⁸ Much of the increase was due to the launch of exchange-traded funds in fiscal 2001.

⁹ Fundmark classifies open-end equity investment funds according to their investment aims and actual investments. There are six general categories: "Japanese equity funds," "non-Japanese equity funds," "Japanese bond funds," "non-Japanese bond funds," "Japanese hybrid funds" and "non-Japanese hybrid funds."

mainly by banks at 14.8% and that of those sold mainly by securities companies at 53.3%. This compares with an estimated redemption ratio of 25% for equity investment trusts in the United States. Although this is higher than the figure for equity investment trusts sold by banks in Japan, it would probably be higher still were it not for the fact that a high percentage of investment trusts in the United States are held in the form of 401(k) defined-contribution pension plans.

Figure 10 Net Asset Value of Investment Trusts Sold by Banks



Source: NRI, from Japan Investment Trust Association data.

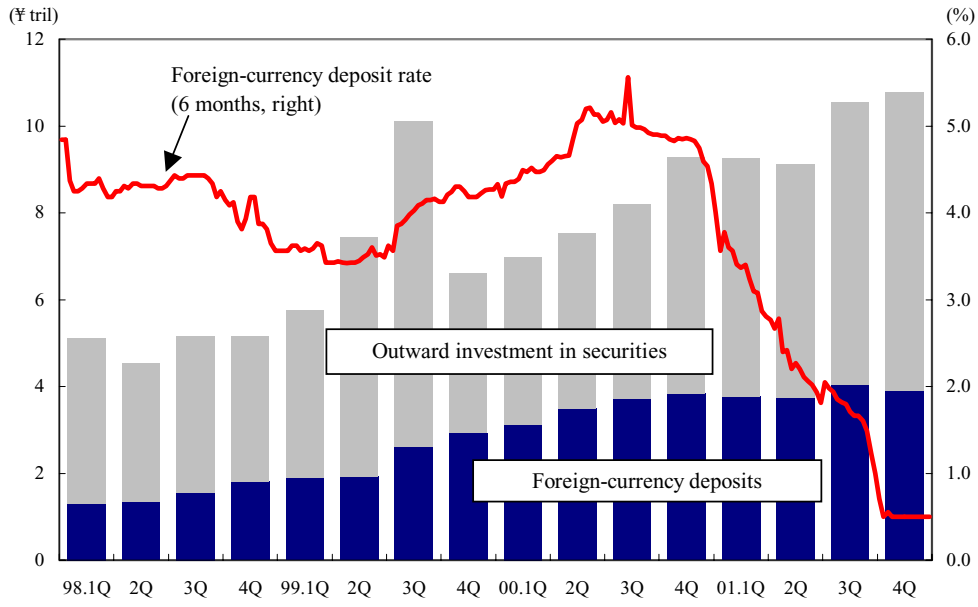
5) Inflows into foreign-currency assets

High interest rates overseas led to an annual increase of 31.2% in foreign-currency deposits held by Japanese investors in 2000. In 2001, however, the increase slowed to 1.8%—mainly because interest rates on foreign currencies declined. Between May and August 2000 a combination of 5%-plus interest rates and the low perceived risk of a sharp appreciation in the yen led to a surge in Japanese foreign-currency deposits, the bulk of which are held in US dollars. However, a series of interest-rate cuts in the

¹⁰ Our survey covered investment trusts in the category "Japanese equities/general/free" that met the following two requirements: 1) launched before June 2001 and 2) with an average net asset value of at least ¥100 million during the period June 2001-end May 2002. Using data from Japan Financial News Co, we labeled all investment trusts sold entirely by banks during the period October-December 2001 as "funds sold mainly by banks" and all investment trusts with only 10% or less of their sales accounted for by banks as "funds sold mainly by securities companies." However, as the survey was by questionnaire, it was not always possible to determine the distribution of the sales. In such cases, we excluded the investment trusts in question. As a result, not every investment trust that met the above two requirements (including, for example, funds belonging to the top three investment trust companies) was included. The redemption ratio was calculated by dividing total redemptions between June 2001 and end-May 2002 by the average net asset value for the same period.

United States pushed rates on dollar deposits down to 0.5%. The possibility cannot be ruled out that this interest-rate-sensitive money could be withdrawn, depending on what happens to interest rates and foreign exchange rates.

Figure 11 Foreign-Currency Assets Owned by Individuals



Source: NRI, from Bank of Japan, Flow of Funds Accounts.

6) The popularity of non-Japanese-bond funds

Foreign-currency deposits are not the only product that have benefited from a weaker yen and high interest rates overseas. A study of some of the open-end equity investment trusts that have recently been popular shows that those that invest mainly in non-Japanese bonds have been particularly popular.¹¹ A comparison of the 20 most popular investment trusts in January 2002 and June 2002 reveals that 11 funds were in the top 20 in both months and that six of these funds invest mainly in non-Japanese bonds (see Figure 12).

Figure 12 Top 20 Funds in Terms of Net Inflows in January and June 2002

Name of fund	Fund manager	Fundmark category	Net inflows	Net asset
Global Sovereign Open (Settlement Schedule:monthly)	Kokusai	Non-Japanese bond funds/Global	2,427	6,971
Nissay/Putnam Income Open	Nissay	Non-Japanese bond funds/US dollar bonds	922	2,102
Euro Land Sovereign Income	Kokusai	Non-Japanese bond funds/Euro and sterling bonds	870	1,644
Nomura Bond & Loan Fund	Nomura	Non-Japanese bond funds/US dollar bonds	770	1,356
Euro Short-term Bonds Fund	Daiwa SB	Non-Japanese bond funds/Euro and sterling bonds	269	328
Foreign Government Bonds Fund	Shinko	Non-Japanese bond funds/Global	234	275
Profit Return Growth Open	Nikko	Japanese equity funds/General	206	629
Index Fund 225	Nikko	Japanese equity funds/Index	197	1,923
Fidelity Japan Growth Fund	Fidelity	Japanese equity funds/General	195	2,671
YUMEGAKUSHO Nikkei Average Open	UFJ Partners	Japanese equity funds/Index	145	338
Stock Index Fund 225	DKA	Japanese equity funds/Index	144	933

Notes: 1) Net inflow(s) size is "total inflow(s) size" less "total redemptions" for the period December 2001-May 2002.

2) Fundmark is a classification system devised by NRI. The table gives the medium-level classification.

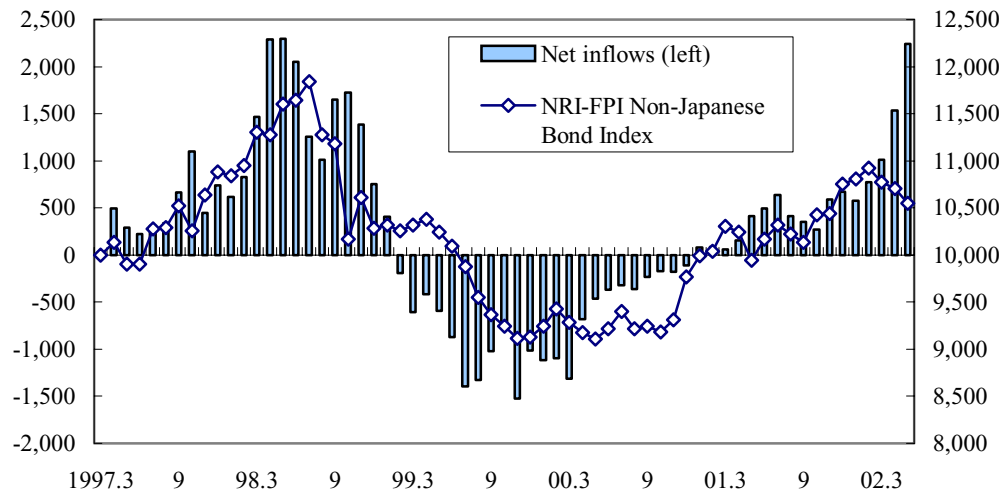
Source: NRI.

A comparison of NRI's FPI index of non-Japanese bond investment trusts and net inflows (inflows - redemptions) into newly launched trusts in this category (according to NRI's Fundmark classification) shows that for the period April 1997-May 2002 they have a high positive correlation (0.80) (see Figure 13). The fact that other fund categories do not have this high positive correlation with the index¹² also suggests that sales of non-Japanese bond investment trusts are highly dependent on their performance and may therefore fluctuate considerably, depending on what happens to interest rates and foreign exchange rates.

¹¹ Because the Investment Trust Association's classification includes all funds permitted to invest in equities as "equity funds," many funds that invest mainly in bonds fall into this category.

¹² By way of comparison, the correlation coefficients of other fund categories for the same period were as follows: "Japanese equities" (0.23), "Japanese bonds" (0.19) and "non-Japanese equities" (-0.40).

Figure 13 The NRI-FPI Non-Japanese Bond Index and the Net Inflows into Newly Launched Non-Japanese Bond Funds



Note: NRI-FPI Non-Japanese Bond Index base: 31 March 1997 = 10,000.
Source: NRI Fundmark.

7) Corporate bonds designed for individual investors

Issuance of corporate bonds designed for individual investors¹³ and purchases of new corporate bonds by such investors have moved very much in tandem since the beginning of 2001 (see Figure 14). Although individual investors also buy other kinds of corporate bonds and other investors also buy corporate bonds designed for individual investors, it would appear that individuals do buy a high percentage of them.

Following the collapse of Mycal in September 2001, no corporate bonds designed for individual investors were issued in October of that year; but, in November, new issues of such bonds resumed and had returned to pre-Mycal levels by February 2002.

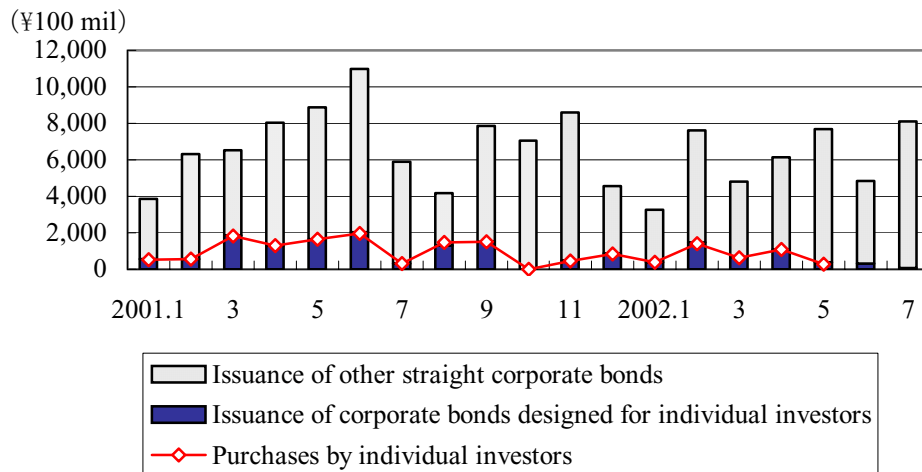
Mycal's default produced a widening of yield spreads on low-grade bonds (see Figure 15), and, since then, fewer low-grade bonds have been issued. Whereas 9.7% of straight corporate bonds issued between January and September 2001 were rated BBB, only 2.9% of straight corporate bonds issued since then have been rated BBB.¹⁴ Corporate bonds designed for individual investors have always tended to be low-grade.

¹³ There is no official definition of the term "corporate bonds designed for individual investors." What we mean by it, however, is corporate bonds 1) with a face value of not more than ¥1 million and 2) a subscription period of several days.

¹⁴ Where a bond has more than one credit rating, we have used the highest.

However, the percentage of such bonds rated BBB declined from 33.5% in the period before September 2001 to 25.0% in the period October 2002-May 2002.

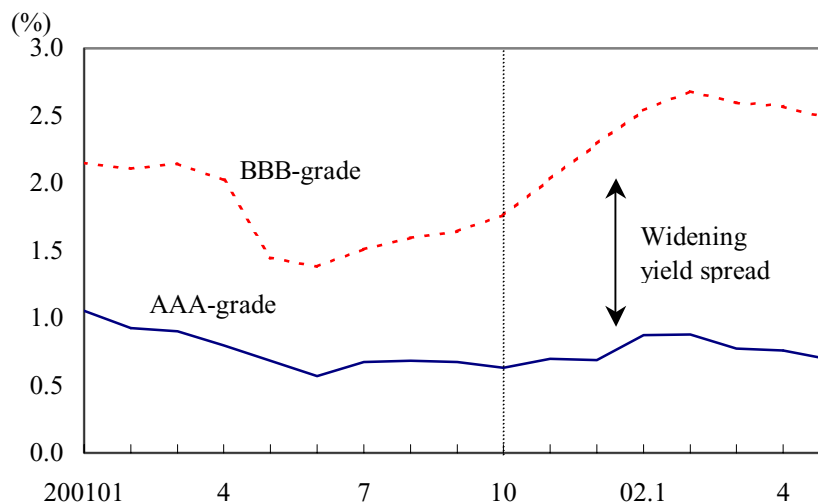
Figure 14 Issuance of Corporate Bonds Designed for Individual Investors



Note: The figures for purchases by individual investors for May and June 2002 were not available at the time of writing.

Source: NRI, from Japan Securities Dealers Association data.

Figure 15 Bond Yields in the Period Following Mycal's Default



Note: The yields are the arithmetic mean of the compound yield calculated using indications for par-value trades of approx. ¥500 million at 3pm on the previous day.

Source: NRI, from Bank of Japan, Monthly Bulletin of Financial and Economic Statistics.

4. Conclusion

Following the partial lifting of the blanket guarantee on Japanese bank deposits in April 2002, a vast amount of money was withdrawn from time deposits. As the blanket guarantee still covers demand deposits for the time being, most of the money was reinvested in these. However, when the remaining blanket guarantee is lifted next year, there are likely to be withdrawals on an even larger scale. As investors are still biding their time (partly because of the volatility on financial markets), there have been no major moves so far, and it is difficult to forecast what depositors will do with the money they can be expected to withdraw.

There have been high hopes for some time that many different financial products, including equities, bonds and investment trusts, would benefit from an inflow of money from individual investors. Next year's lifting of the remaining blanket guarantee on Japanese bank deposits could well trigger such an inflow.