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Are deposits making a comeback? —an analysis of BoJ flow-of-funds data—

Nomura Research Institute, Ltd.

Time deposits held by households rose by 6.6 trillion yen in FY06, according to flow-of-funds data released by the Bank of Japan on 15 June. But we interpret this as an acceleration, and not a reversal, of the shift “from savings to investment.”

Data show growing shift “from savings to investment”

The outstanding value of publicly issued investment trusts surpassed 80 trillion yen at the end of June, underlining a growing shift of personal financial assets to investment products. Exhibit 1 illustrates this trend from the perspective of FY06 data published in June by the Bank of Japan. The black figures in the graph indicate average fund flows over the past five years; the red figures, flows in FY06.[1)]

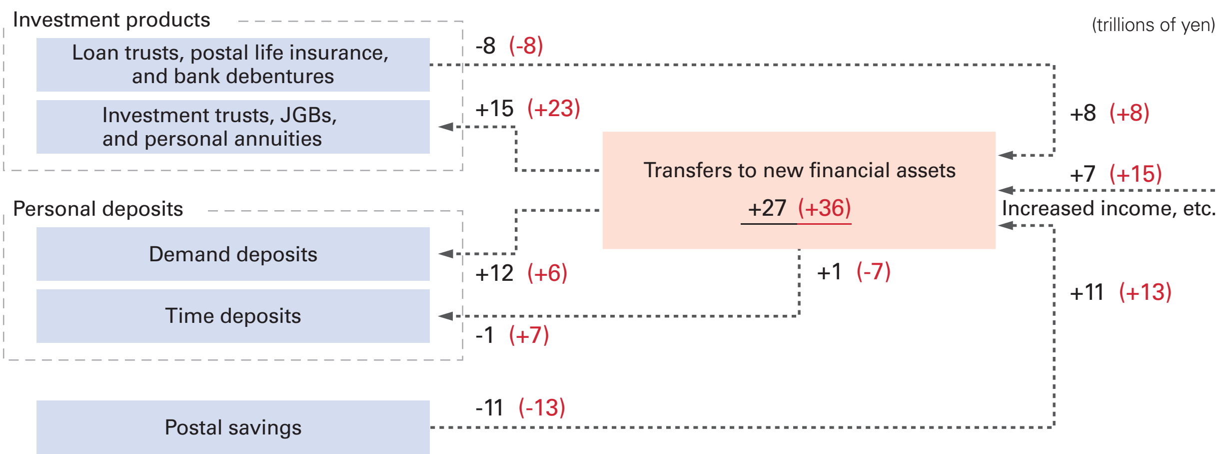
Over the past five years outflows from postal savings, loan trusts, and bank debentures have averaged just under 20 trillion yen a year. Together with the overall increase in household financial assets, this meant that Japanese households allocated some 27 trillion yen to new investments each year.

Of this amount, 12 trillion yen was parked in demand deposits, while the remaining 15 trillion yen flowed into such products as investment trusts, personal annuities, and Japanese government bonds. This trend gathered momentum in FY06, with some 23 trillion yen out of 36 trillion yen in new funds flowing into these three asset categories.

Loan trusts and bank debentures outstanding have already fallen substantially and are unlikely to generate large outflows going forward. On the other hand, the lump-sum retirement benefits received by retiring baby boomers are expected to top 50 trillion yen over the next five years. As such, the current phenomenon of 30 trillion yen flowing into new investments each year is likely to continue for some time.

The latest flow-of-funds data clearly support the idea of an accelerating shift from savings to investment. But a closer look at the statistics reveals an unusual phenomenon—time deposits actually increased in FY06.

Exhibit 1. Household fund flows



Note: Black figures indicate average fund flows over past five years; red figures, flows in FY06.
Source: Bank of Japan

Changes in time deposits varied with size of deposit

Over the past five years, outflows of household financial assets from time deposits have averaged about 1 trillion yen a year owing to extremely low interest rates. In FY06, however, such deposits rose by 7 trillion yen. This surge is typically attributed to the BoJ's decision to end its policy of zero interest rates in July 2006 and the subsequent rise in time deposit yields. But higher interest rates alone cannot explain the sharp increase.

Exhibit 2 shows changes in outstanding time deposits held by individuals. Deposits were broken down into three categories: those of less than 3 million yen, those of at least 3 million yen but less than 10 million yen, and those of 10 million yen or more. Interestingly, the three categories behaved quite differently. In FY06, the two larger classes of deposit both increased substantially, while deposits of less than 3 million yen fell by 5 trillion yen. It is true that banks offer somewhat higher interest rates for larger deposits. However, the disparity is at most about 0.05%. Given that the average yield on time deposits rose by about 0.5% in FY06, this tiny spread was clearly insufficient to cause such a shift in the behavior of individual investors.

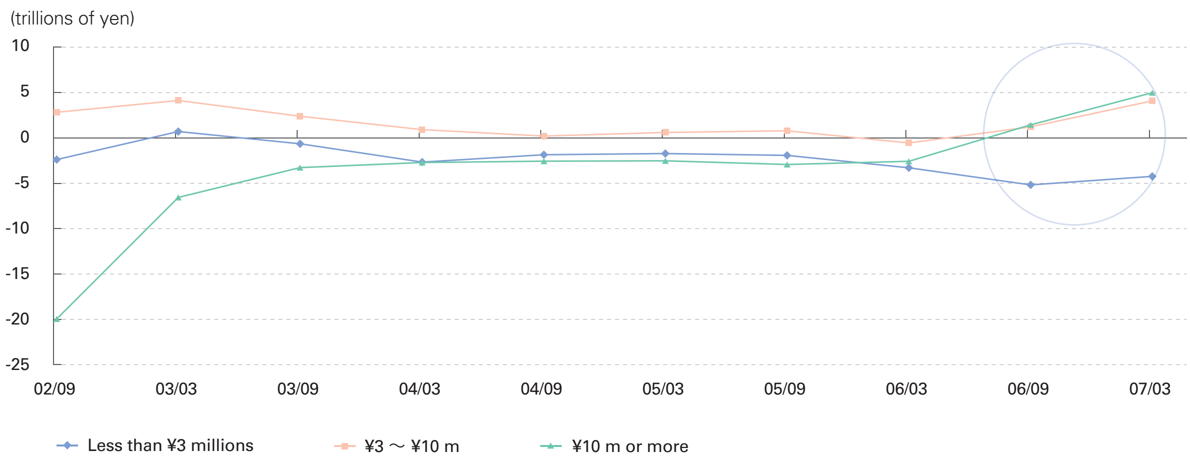
The real cause: competition for lump-sum retirement benefits

The pronounced flow of funds back into time deposits appears to be related to increasingly active efforts by trust banks and the megabanks from around 2005 to encourage baby boomers to deposit their lump-sum retirement benefits. "Teaser" interest rates have been offered—some institutions, for example, offered an initial yield of 6.0% on any time deposit made in conjunction with an investment trust purchase of the same value. Financial institutions have not published the data needed to determine to what extent these efforts contributed to time deposit growth in FY06. That said, the fact that household time deposits outstanding grew by 6.6 trillion yen in FY06 indicates that these campaigns were probably quite successful.

Further support for this argument is offered by the fact that the 5–10 million yen minimum set by many financial institutions for products targeting retirement benefits meshes perfectly with the results shown in Exhibit 2 (ie, the disparity in inflows by deposit size).

In most cases "teaser rates" were offered for only the first three months. Ultimately, therefore, most of the funds attracted by such rates are likely to be transferred to investment products such as investment trusts and annuities. So while at first glance time deposits would appear to be making a comeback among households, in fact this trend will help to further

Exhibit 2. Year-on-year change in time deposits held by individuals



Source: Bank of Japan

accelerate the broad shift of household assets from savings to investment products.

Note

1) Figures were adjusted to eliminate the impact of changes in market value and rounded off to the nearest trillion. Annual fund inflows and outflows to asset categories not shown in the graph average less than 1 trillion yen and have been omitted for the sake of clarity.

Author's Profile

Yasuki Okai

General Manager
Financial Technology and Market Research Department

E-mail : kyara@nri.co.jp

Inquiries to : Financial Technology and Market Research Department
Nomura Research Institute, Ltd.
Marunouchi Kitaguchi Bldg.
1-6-5 Marunouchi, Chiyoda-ku, Tokyo 100-0005, Japan
E-mail : kyara@nri.co.jp

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