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By Shigeru Sato

Jan. 29 (Bloomberg) -- Sumitomo Mitsui Financial Group Inc. led gains in Japanese banking shares, rising the most in more than four months on speculation the country's stock-market rally boosted earnings last quarter.

Japan's second-biggest bank by market value jumped 4.4 percent at the close of Tokyo trading, the biggest advance since Sept. 14, to 3,450 yen. It was the fifth-biggest gainer on the Nikkei 225 Stock Average, which rose 0.4 percent.

The rebound in stocks, fueled by Prime Minister Shinzo Abe's pledge to stimulate the economy, probably helped banks make up some of the losses they incurred on their equity holdings in the fiscal first half, said analysts at UBS AG and BNP Paribas SA. Signs are emerging that domestic lending is recovering, with loans at city banks climbing for the first time in three years in December.

"Megabanks look attractive to investors given the recent rally in the stock market," said Shinichi Ina, a Tokyo-based analyst at UBS. "That's cutting impairment losses tied to banks' shareholdings as well as pushing up their sales of mutual funds and spurring income at their brokerage units."

Mitsubishi UFJ Financial Group Inc., the country's biggest bank, increased 3.8 percent, the most since Jan. 4, to 497 yen.

Mizuho, the third-largest lender by market value, advanced 2.9 percent to 175 yen, the highest in almost two years.

Profit Boost

Sumitomo Mitsui may tomorrow report net income rose to more than 500 billion yen (\$5.5 billion) in the nine months ended Dec. 31, the Nikkei newspaper said today. That compares with 411 billion yen a year earlier.

Mitsubishi UFJ's nine-month profit also exceeded 500 billion yen, and Mizuho's totaled about 400 billion yen, the newspaper reported, without saying where it got the information.

Mizuho is scheduled to post earnings on Jan. 31 and Mitsubishi UFJ will do so on Feb. 1.

"We expect third-quarter profit boosts from stock impairment charge reversals, ongoing low credit costs, and bond trading profits," Toyoki Sameshima, an analyst at BNP Paribas in Tokyo, wrote in a note dated yesterday.

Sumitomo Mitsui is a "top pick" among Japanese banks, Goldman Sachs Group Inc. analyst Katsunori Tanaka said today. He cited the bank's expansion of overseas loans and consumer finance business as well as improved earnings at its SMBC Nikko Securities Inc. brokerage unit.

The Nikkei 225 climbed 17 percent last quarter as Abe's Liberal Democratic Party won an election on a campaign to weaken the yen and end more than a decade of deflation with fiscal stimulus and monetary easing. The central bank last week adopted a 2 percent inflation target and promised open-ended asset purchases starting next January.

"We've been optimistic about banks as they're relatively cheap and have opportunities to grow abroad," said Tamiji Shinada, executive director of investment research at Nomura Securities Co. in Tokyo. "Plus, they will get a boost from reflation hopes on the back of bold monetary easing by the Bank of Japan."

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