

## “Downgrade of Japanese Government Bonds (JGBs)”

Rating companies give “credit rating” of government bonds and corporate bonds analysing their repayment capability of capital and interest. Generally, bond rating is described by a combination of alphabet and numbers (AAA and Aa3 etc.). There are global rating companies such as Moody’s and Standard & Poor’s (S&P).

### Point 1

#### Moody’s downgraded the JGB’s ratings from Aa3 to A1 Downgrading for the first time in three years and four months

- On December 1st, the large US rating company downgraded JGB’s rating by one notch from Aa3 (equivalent to AA- of S&P’s rating) to A1 (equivalent to A+). The new rating is ranked fifth from the highest rating. Generally, rating of Baa3 (equivalent to BBB-) or above is considered as “Investment Grade” which is suitable for institutional investors. By this downgrade, Japan’s rating became lower than that of China (PRC) and South Korea who used to have the same rating before, and became the same as those of Israel and Czech.

### Point 2

#### Following the postponement of consumption tax hike Pointing out the concern over possibility of fiscal deficit improvement

- Followings are the Moody’s key reasons for their downgrading.
  - (i) Increased uncertainty over the progress of fiscal deficit improvement,
  - (ii) Uncertainty over sufficient implementation of economic growth strategy,
  - (iii) As a consequence, increased risk of JGB yields’ rise and reduced debt affordability.
- In the bond market, concern is building up that the Japanese government may not achieve their targets of fiscal deficit improvement in 2015 and 2020 as the second consumption tax hike was postponed to April 2017. In addition, the fact that Japan’s GDP growth rate went into a negative territory for two consecutive quarters as a result of the first consumption tax hike in April and the delay in acceleration of economic growth through structural reform.

### Future Outlook

#### Its impact on the JGB market is limited.

##### ■ Rating outlook is “stable”

Moody’s set its rating outlook for the new rating “stable”, which means that the new rating will remain unchanged for future twelve to eighteen months. The reasons were (i) Existence of many domestic institutional investors who have solid need for JGB investments, (ii) Surplus of private sector and, (iii) Proactive monetary policy of the BOJ to buy large amount JGBs. In addition, Japan’s resilience against the shock of global economy and financial markets is deemed as a positive factor because Japan has huge net external assets beyond 60% of its GDP.

## ■ It is important to show the path to fiscal reconstruction once again

Other rating companies such as S&P and R&I expressed no intention of conducting an immediate downgrade of the JGB following the decision of postponement of further tax hike. Meanwhile, Fitch suggested a possible downgrading within this year. However, we anticipate their impact on the JGB market is limited as most of JGBs is held by Japanese domestic investors. Having stated that, we think it is important responsibility for new government to show a solid path for fiscal reconstruction after the general election of the Lower House.

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