Daiwa Securities

JGB Insight

Supplementary Budget and JGB Issuance

- ✓ With the October consumption tax hike as a done deal, growing speculations on a large-scale supplementary budget
- ✓ The front-loading issuance for FY19 refunding bonds is a record high of about Y52.5tn. The "calendar-base market issuance" is unlikely to increase if the issuance financed in the market is limited around Y20-30tn
- ✓ Meanwhile, there may be adjustments between maturity segments
- ✓ Apart from the debt management policy, expectations for an increase in 20-year JGBs are likely to rise, while 1-year TDBs, 2-year JGBs, and 5-year JGBs will collect more vices to reduce.
- ✓ Still difficult to factor in a possible change in the JGB issuance plan driven by a supplementary budget, but we would like to keep it in mind.

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With the October consumption tax hike as a done deal, growing speculations on a large-scale supplementary budget

Winning the upper house election on July 21, the ruling parties secured the majority of re-elected seats at the house, although the number of seat pro-constitution reform forces got fell short of two thirds. A major contested ground in the election was the implementation of the consumption tax hike in October as scheduled. The ruling parties supported it while the opposition parties united to oppose it. The victory of the ruling parties thus made the tax hike as a done deal. Going forward, the markets will become more cautious about impact on the domestic economy by the tax hike amid lingering concerns about the global economy. While speculations about the government organizing a supplementary budget even in a large scale are increasing, many JGB market participants appear to hold the view that the JGB issuance in the market will not increase because of the supplementary budget. One of reasons is that the amount of front-loading issuance in FY18 for FY19 refunding bonds, i.e., front-loading refunding bonds, reached a record high of around Y52.5tn on a revenue basis. There is speculation that these front-loading refunding bonds will serve as a buffer to curb the market issuance via competitive auctions (i.e., calendar-base market issuance). In this report, we check trends in the amount of calendar-base market issuance when supplementary budgets were formed in the past, and check the reliability of the view that an increase in the JGB market issuance is unlikely.

Under the Abe administration, any of supplementary budgets have not been financed by increasing the market issuance of JGBs during the fiscal year except the one in FY17

Since the start of the second Abe cabinet in December 2012, the administration has introduced a lot of economic measures, starting with "Emergency Economic Measures for the Revitalization of the Japanese Economy." The government has formed supplementary budgets every time it has introduced economic packages. However, any of those supplementary budgets have not been financed by increasing the market issuance of JGBs during the fiscal year except the one in FY17, which was partly financed by increasing the Auction for Enhanced Liquidity (chart on page 3). In FY16, the introduction of the large-scale "Economic Measures for Realizing Investment for the Future" (on a business scale of around Y28.1tn and with fiscal measures worth Y13.5tn) led to a Y6.4tn yen increase in the market issuance compared to the initial plan via the second and third supplementary budgets. However, the amount of calendar-base market issuance was not increased due to utilization of non-price competitive auction II and adjustments between fiscal years (related to issuance of front-loading refunding bonds; chart on page 3). This step in FY16 was possible because there were front-loading refunding bonds worth around Y42.3tn.

Very small amount of front-loading refunding bonds issued at the time of the Lehman crisis led to a substantial increase in the calendar-base market issuance

Looking back a bit, when the large-scale economic pacage called "Policy Package to Address Economic Crisis" (on a business scale of around Y56.8tn and with fiscal measures worth Y15.4tn) was introduced in FY09 following the Lehman crisis, the JGB issuance amount was increased by around Y26tn compared to the initial plan via the first and second supplementary budgets, leading to a Y24.2tn increase in the calendar-basis market issuance during the fiscal year (chart on page 3). On the other hand, the increase in adjustments between fiscal years was only around Y2.6tn. In the fiscal year, the issuance amount of front-loading refunding bonds (in the previous fiscal year) was small at around Y5.3tn, which appears to have led to the large-scale increase in the market issuance.

Front-loading issuance for FY19 refunding bonds reached a record high of around Y52.5tn; calendar-base market issuance is unlikely to increase if the market issuance limited around Y20-30tn

The JGB market already recognizes that front-loading issuance in FY18 for FY19 refunding bonds reached a record high of around Y52.5tn. Based on a comparison with the situation in FY16, even if the FY19 supplementary budget leads to a Y16.4tn increase in the market issuance compared to the initial plan, there is a good possibility that the budget will not lead to an increase in the calendar-base market issuance. Even if we make the extreme assumption that around Y20-30tn in the outstanding amount of front-loading refunding bonds needs to be left for the purpose of 1) smooth adjustments between fiscal years in FY20 and 2) preparation for the case that the JGB issuance is behind schedule, an approximately Y20-30tn increase in the market issuance may be covered without an increase in the calendar-base market issuance. Since the Lehman crisis, there have been no cases in which the market issuance has increased by the amount for supplementary budgets. From this point of view, the possibility that the calendar-base market issuance will increase for the FY19 supplementary budget appears to be quite small.

Meanwhile, there may be adjustments between maturity segments

Meanwhile, it is also noteworthy to consider that there is a possibility that, for example, a decrease (or an increase) in the amount in some maturity segments will lead to an increase (or a decrease) in other maturity segments by the same amount even without an increase in the calendar-base market issuance. This was seen when the second supplementary budget was formed in FY16. At that time, the amount of market issuance increased by around Y5.4tn compared to the initial plan, but the calendar-basis market issuance was kept unchanged. By maturity segment, however, the issuance of 40-year JGBs was increased, while that of JGB linkers was reduced by the same amount.

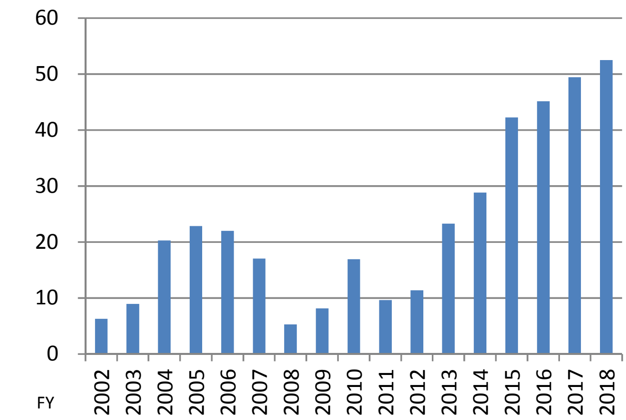
Apart from the debt management policy, expectations for an increase in 20-year JGBs are likely to rise, while 1-year TDBs, 2-year JGBs, and 5-year JGBs will collect more vices to reduce.

We have the impression that the 40-year JGB auction, conducted by the Ministry of Finance on July 23, had a weaker-than-expected result. After the auction, 40-year JGBs remained soft, while that for 20-year and 30-year JGBs traded relatively solidly. That led the 20-40Y zone of the JGB yield curve under steepening pressure. However, the market sentiment of 40-year JGBs improved on the next day partly on robust dip-buying. Since then, superlong JGBs have mostly firmed up across the board. Amid the global yield downtrend, yields of JGBs with residual maturity up to around 13 years are falling below zero. Partly because of this, potential demand appears strong for superlong JGBs with residual maturity longer than 13 years, which are carrying positive yields. Given the current conditions, we think expectations for an increase in the issuance amount of 20-year JGBs are likely to grow easily, while 1-year TDBs, 2-year JGBs, and 5-year JGBs seem to have scope for reduction. An increase in superlong JGBs and reduction in short-term/intermediate JGBs extends the average maturity to redemption. As the extension will lower JGB issuance risks but increase JGB cost, it could be an unpleasant action in term of the current debt management policy. However, we are unable to say that the possibility is zero.

Still difficult to factor in a possible change in the JGB issuance plan driven by a supplementary budget, but we would like to keep it in mind

At the post-election press conference this month, Prime Minister Shinzo Abe stated, “We will take expeditious and full-blown measures to cope with economic downside risks, without hesitation.” However, we forecast that a supplementary budget will be formed after the cabinet reshuffle, which is expected in mid-September. At the moment, it is still difficult to factor a change in the JGB issuance plan for a supplementary budget into the market direction and the shape of the curve, but we would like to keep it in mind.

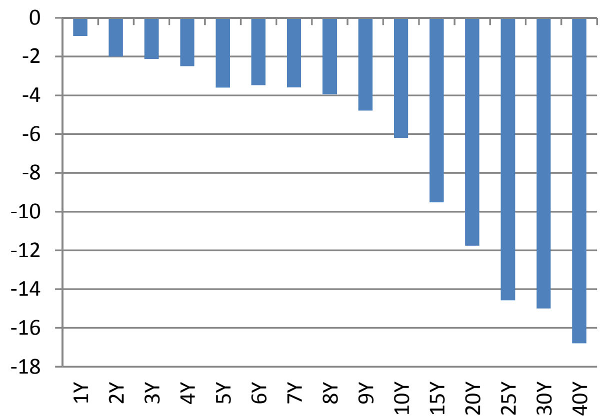
Front-loading Issuance of Refunding Bonds (Yen trillions)



Note: Revenue basis

Source: Ministry of Finance, compiled by Daiwa Securities

JGB Yield Change (bp): March 29 v. July 24



Source: Daiwa Securities.

Supplementary Budget and JGB Issuance

FY	Decided by the Cabinet*	Total JGB Issuance	Financed in the market:				Front-loading Issuance
			JGB market issuance (calendar base)	Non-price competitive auction II and others	Adjustment between fiscal years	Sub-total	
2012	1/15/13	6.30	-0.30	2.05	5.15	6.90	9.6
2013	12/12/13	-2.91	-	3.40	-6.72	-3.32	11.4
2014	1/9/14	-3.88	-0.60	2.41	-5.79	-3.98	23.3
2015	12/18/15	-3.29	-0.40	3.53	-6.21	-3.07	28.8
2016	5/13/16 (1st)	-	-	-	-	-	42.3
	8/24/16 (2nd)	5.93	-	1.28	4.15	5.43	
	12/22/16 (3rd)	7.60	-	3.08	3.32	6.40	
2017	12/22/17	2.16	0.10	1.45	0.61	2.16	45.1
2018	10/15/18 (1st)	0.70	-	-	0.70	0.70	49.4
	12/21/18 (2nd)	2.29	-	-0.02	0.90	0.89	
2019							52.5
2009	4/27/09 (1st)	16.92	16.90	-	0.02	16.92	5.3
	10/16/09 (1st rev.)	16.92	19.00	-	-	19.02	
	12/15/09 (2nd)	26.12	24.20	1.41	2.61	28.22	

* The day submitted to the Diet as for FY2009 1st supplementary budget

Source: Ministry of Finance, compiled by Daiwa Securities

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Registered Credit Rating Agencies are subject to the following regulations:
1) Duty of good faith.
2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
3) Prohibition of the ratings in cases where Credit Rating Agencies have a close relationship with the issuers of the financial instruments to be rated, etc.
4) Duty to disclose information (preparation and publication of rating policies, etc. and public disclosure of explanatory documents).

In addition to the above, Registered Credit Rating Agencies are subject to the supervision of the Financial Services Agency ("FSA"), and as such may be ordered to produce reports, be subject to on-site inspection, and be ordered to improve business operations, whereas unregistered Credit Rating Agencies are free from such regulations and supervision.

■ Credit Rating Agencies

[Standard & Poor's]

The Name of the Credit Rating Agencies group, etc

The name of the Credit Rating Agencies group: S&P Global Ratings ("Standard & Poor's")
The name and registration number of the Registered Credit Rating Agency in the group: S&P Global Ratings Japan Inc. (FSA commissioner (Rating) No.5)

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[Moody's]

The Name of the Credit Rating Agencies Group, etc

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The name and registration number of the Registered Credit Rating Agency in the group: Moody's Japan K.K. (FSA commissioner (Rating) No.2)

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[Fitch]

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May 2018

IMPORTANT

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

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If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥ 2 million (including tax) per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.
** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

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