

## Daiwa's View

### Things to watch for in FY20 third extra budget, FY21 initial budget

- Size of COVID-19 pandemic response measures and budget allocation, as well as scale of economic measures and estimated tax revenue

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Daiwa Securities Co. Ltd.

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### Things to watch for in FY20 third extra budget, FY21 initial budget

The third supplementary budget in FY20 and initial budget in FY21 still contain many uncertain factors. Noteworthy points are (1) the size of measures to cope with the COVID-19 pandemic and budget allocation, (2) the scale of economic measures, and (3) the outlook for tax revenues. We first describe the conclusion on the JGB issuance amount—new JGBs worth Y15tn are expected to be issued for the third supplementary budget, but calendar-base issuance may remain roughly flat given FILP bonds that are not issued according to the initial plan. We forecast that the aggregate JGB issuance amount in the FY21 initial budget (newly issued JGBs + FILP bonds + refunding bonds) will decline by around Y30tn vs. the figure in FY20 after the second supplementary budget. We do not think that our figures are a major surprise, but there are many trillion yen-basis assumptions and we have rounded off figures. Accordingly, we ask readers to interpret the figures with latitude.

In particular, it is difficult to forecast the first item of budget allocation. Regarding economic measures (such as public works) included in the FY20 third extra budget, the implementation can be carried forward to FY21 if a concrete construction plan is set by the end of FY20. This enables the booking of a large amount in the third extra budget. As for measures to cope with the COVID-19 pandemic, there are many programs whose feasibility is uncertain despite securing budgets in both the general account and FILP plan. As these programs cannot be carried forward, there is no point in booking a large amount in the FY20 third extra budget. Therefore, a certain amount of budget needs to be secured again in FY21.

We also look at the methods to secure the budget in FY21. In general, temporary programs, such as disaster restoration and economic packages, are funded by supplementary budgets, instead of booking in the general account's initial budget or the initial FILP plan. Therefore, another focus of attention is whether a large amount of pandemic response measures (see explanation later in this report) will be booked in the FY21 general account's initial budget or the initial FILP plan. If (1) the amount of pandemic response measures is small and (2) the size of the initial budget or the initial FILP plan change little vs. past figures, we need to assume that a first supplementary budget will be compiled at the beginning of FY21.

In any case, we think that the pandemic-related budget will be included in the FY20 third extra budget, the FY21 initial budget, or the FY21 first extra budget. Note that our estimate for the JGB issuance amount is based on this assumption. We then consider the project size.

First, we look at the budget for pandemic response measures. The chart on the next page shows the breakdown of Y57.6tn in the budget included in the first and second extra budgets in the FY20 general account, including contingency funds that have already been used. We think that the following items will continue to be needed—expenses to prevent the spread of COVID-19 infections, support for testing/medical treatment providers, the development of therapeutic agents, local revitalization grants, an employment adjustment subsidy, a subsidy for business continuation, and Go To campaigns. The addition of even a slight amount on

each item becomes a rather large Y15tn. However, as mentioned above, the project expenses in FY20 cannot be basically carried forward to FY21. We thus assume that Y5tn and Y10tn will be allocated in the FY20 extra budgets and the FY21 initial budget, respectively. Moreover, we think that around Y5tn in contingency funds for the COVID-19 pandemic is also necessary in FY21.

#### COVID-19 Pandemic Response Measures in General Account (actual and estimate)

| (Y tn)  |   | FY20 first/second extra budgets | Contingency funds for COVID-19 pandemic | Total | FY20 third extra budget (estimate) | FY21 initial budget (estimate) |
|---|---|---------------------------------|---|-------|------------------------------------|--------------------------------|
| Expenses to prevent spread of COVID-19 infections, support for testing/medical treatment providers, development of therapeutic agents |   | 1.4                             | 2.2                                     | 3.6   | 1.0                                | 2.0                            |
| For local gov't   | Emergency comprehensive support grant   | 2.4                             |   | 2.4   |                                    |                                |
|   | Local revitalization subsidy  | 3.0                             |   | 3.0   |                                    | 2.0                            |
| For business operators  | Employment adjustment subsidy   | 0.3                             |   | 0.3   | 1.0                                | 1.0                            |
|   | Financing measures (capital injection to policy-based financial institutions) | 11.2                            |   | 11.2  |                                    |                                |
|   | Financing measures (subsidies, grants, etc.)                                  | 4.3                             |   | 4.3   |                                    |                                |
|   | Subsidy for business continuation   | 4.3                             | 0.9                                     | 5.2   | 2.0                                | 2.0                            |
|   | Rent support subsidy  | 2.0                             |   | 2.0   |                                    |                                |
|   | Go To campaigns   | 1.7                             |   | 1.7   | 1.0                                | 1.0                            |
|   | Other   | 1.5                             |   | 1.5   |                                    | 1.0                            |
| For households  | Special cash payment  | 12.9                            |   | 12.9  |                                    |                                |
|   | Others  | 0.8                             | 0.6                                     | 1.4   |                                    | 1.0                            |
| Contingency funds for COVID-19 pandemic   |   | 11.5                            | -3.7                                    | 7.8   |                                    | 5.0                            |
| Others  |   | 0.3                             |   | 0.3   |                                    |                                |
| Total   |   | 57.6                            | 0.0                                     | 57.6  | 5.0                                | 15.0                           |

Source: MOF; compiled by Daiwa Securities.

Next, we look at the FY20 third extra budget (chart below). The meaning is now uncertain regarding the figures of "Y10-15tn" or "Y15-20tn" in remarks by executive members of the ruling parties, but we assume that these figures are major expenditures in the general account. The total of post-disaster restoration of Y0.7tn, the disaster prevention/mitigation project of Y2tn (higher than FY18 and FY19 extra budgets), economic measures/other policy costs of Y10tn (much higher than FY19), and the above-mentioned pandemic response measures of Y5tn is Y17.7tn. Tax revenues were revised downward by Y7.1tn in FY08 and Y9.2tn in FY09 after the global financial crisis. However, the progress of FY20 tax revenues has not been so bad up to September, and we thus estimate a downward revision of Y6tn. All in all, the issuance amount of new JGBs is calculated at around Y15tn.

#### Year-end Extra Budget in General Account (actual and estimate)

| (Y bn)   | 2017      |           | 2018       |           | 2019      | 2020 (estimate) |
|--|-----------|-----------|------------|-----------|-----------|-----------------|
|  | First Dec | First Oct | Second Dec | First Dec | Third Dec |                 |
| Expenditures                                   | 1,654.7   | 935.6     | 2,709.7    | 3,194.5   | 9,900.0   |                 |
| Restoration from natural disasters, etc.       | 343.6     | 727.5     | 213.6      | 690.7     | 700.0     |                 |
| Disaster prevention/mitigation project         | 913.1     |           | 1,072.3    | 855.7     | 2,000.0   |                 |
| Transfer to Government Debt Consolidation Fund | 189.1     |           | 454.7      |           |           |                 |
| Local allocation tax grants                    |           |           | 510.8      | -734.9    | -1,700.0  |                 |
| Compensation for local allocation tax grants   |           |           |            | 748.1     | 1,700.0   |                 |
| Reduction in stipulated expenses               | -1,191.6  |           | -1,290.9   | -1,290.8  | -1,300.0  |                 |
| Contingency reserves                           | -50.0     | 100.0     |            |           | -6,500.0  |                 |
| Economic measures/other policy costs           | 1,450.5   | 108.1     | 1,749.2    | 2,925.7   | 10,000.0  |                 |
| COVID-19 pandemic response measures            |           |           |            |           | 5,000.0   |                 |
| Revenues                                       | 1,654.8   | 935.6     | 2,709.6    | 3,194.6   | 9,900.0   |                 |
| Tax revenues                                   |           |           | 849.0      | -2,315.0  | -6,000.0  |                 |
| Other revenues                                 | 95.7      | 4.2       | 139.3      | 188.1     | 200.0     |                 |
| Transfer from surplus in previous fiscal year  | 374.3     | 236.4     | 713.1      | 900.1     | 700.0     |                 |
| Government bond issuance                       | 1,184.8   | 695.0     | 1,008.2    | 4,421.4   | 15,000.0  |                 |
|  |           |           |            | ①+②+③+④   | 17,700.0  |                 |

Source: MOF; compiled by Daiwa Securities.

What should be noted in the FY20 third extra budget is the FILP. The initial plan of Y13.2tn was increased to Y63.7tn due to the addition of Y50.5tn via the first/second extra budgets and an elastic clause. Most of the addition was allocated to the Japan Finance Corporation. The FY20 plan for fiscal loans, which entail the issuance of FILP bonds, is Y44.1tn. However, the actual results show that such loans surged only in May and June, and the total up to September is Y12.5tn (chart below). If fiscal loans are used on the pace of Y0.8tn/month during the remaining six months, the amount unused is calculated at around Y27tn. Even if the pace increases to Y5tn/month during the three months, the amount unused is calculated at around Y14tn. Even in the case that the progress of FILP projects is slow, the FILP plan is rarely reduced in the supplementary budgets. However, the actual issuance amount of FILP bonds is adjusted in line with the progress. Accordingly, if the issuance of new JGBs by legal grounds is increased by around Y15tn in the FY20 third extra budget, the total of JGB issuance on a calendar basis may be unchanged because the amount of unissued FILP bonds is estimated at Y15tn.

#### FY20 FILP Plan at Japan Finance Corporation and Actual Results up to Sep 2020

| (Y bn)                | FY20 plan | Apr (actual) | May (actual) | Jun (actual) | Jul (actual) | Aug (actual) | Sep (actual) | Total (actual) |
|-----------------------|-----------|--------------|--------------|--------------|--------------|--------------|--------------|----------------|
| Fiscal loans          | 44,098.0  | 861.9        | 4,051.2      | 5,722.3      | 534.4        | 705.4        | 579.2        | 12,454.3       |
| Industrial investment | 21.4      | -            | -            | -            | -            | -            | -            | -              |
| Government guarantee  | 6,500.0   | -            | -            | -            | -            | -            | -            | -              |
| Total                 | 50,619.4  | 861.9        | 4,051.2      | 5,722.3      | 534.4        | 705.4        | 579.2        | 12,454.3       |

Source: MOF; compiled by Daiwa Securities.

Next, we check the initial budget of the general account in FY21 (chart below). As mentioned, temporal expenditures (such as economic measures, disaster restoration) are generally booked in supplementary budgets, while changes in the initial budget are kept at a minimum level. We would not be surprised if FY21 pandemic response measures are included in the first extra budget at the beginning of the fiscal year. However, there were some additions to expenditures for temporal and special measures (such as public works) in FY19 and FY20, and we assume that the above-mentioned pandemic response measures of Y10tn and the related contingency cost of Y5tn will be included in the initial budget, although this is quite extraordinary. On the premise of the ongoing uptrend of social security expenditures and tax revenues of Y58tn (expected to hit bottom from estimated Y57.5tn after FY20 third extra budget), the issuance amount of new JGBs is estimated at around Y55tn. This can be calculated at around Y40tn if the pandemic-related Y15tn is excluded.

#### Initial Budget in General Account (actual and estimate)

| (Y bn)                              | 2017     | 2018     | 2019      | 2020      | 2021 (estimate) |
|-------------------------------------|----------|----------|-----------|-----------|-----------------|
| Expenditures                        | 97,454.7 | 97,712.8 | 101,457.1 | 102,658.0 | 119,500.0       |
| Social security expenditure         | 32,473.5 | 32,973.2 | 34,059.3  | 35,860.8  | 37,000.0        |
| Public works                        | 5,976.3  | 5,978.9  | 6,909.9   | 6,857.1   | 7,000.0         |
| Other general expenditures          | 19,559.2 | 19,593.5 | 20,494.6  | 20,279.4  | 20,500.0        |
| COVID-19 pandemic response measures | 0.0      | 0.0      | 0.0       | 0.0       | 10,000.0        |
| National debt service               | 23,528.5 | 23,302.0 | 23,508.2  | 23,351.5  | 23,500.0        |
| Local allocation tax grants, etc.   | 15,567.1 | 15,515.0 | 15,985.0  | 15,809.3  | 16,000.0        |
| Contingency funds for COVID-19      | 0.0      | 0.0      | 0.0       | 0.0       | 5,000.0         |
| Contingency reserves                | 350.0    | 350.0    | 500.0     | 500.0     | 500.0           |
| Revenues                            | 97,454.7 | 97,712.8 | 101,457.1 | 102,658.0 | 119,500.0       |
| Tax and stamp revenues              | 57,712.0 | 59,079.0 | 62,495.0  | 63,513.0  | 58,000.0        |
| Other revenues                      | 5,372.9  | 4,941.6  | 6,301.6   | 6,588.8   | 6,500.0         |
| Government bond issuance            | 34,369.8 | 33,692.2 | 32,660.5  | 32,556.2  | 55,000.0        |

Source: MOF; compiled by Daiwa Securities.

Then, we look at the FILP plan in FY21. The budgetary request stands at Y13.9tn, up Y0.7tn vs. the FY20 initial plan. However, the amount of loans unused in FY20 at the Japan Finance Corporation and other agencies cannot be carried forward to the next fiscal year, as mentioned above. Accordingly, rebooking is necessary in FY21 if needed. We think that the addition of about Y20tn to the budgetary request is necessary to prepare for contingencies, although this does not reach Y50.5tn in the additional amount in FY20. Thus far, temporary FILP plans have been generally funded by extra budgets, but this time we assume that the FILP plan in the FY21 initial budget will be Y33.9tn (Y20tn addition to budgetary request), of which around Y30tn is expected to be funded by FILP bonds.

Given the aforementioned factors, as well as the amount of refunding bonds of Y136.5tn shown in the materials at the Advisory Council on Government Debt Management held on 4 November, we have estimated the JGB issuance amount by legal grounds (chart below). Compared to the amounts after the FY20 second extra budget, the total issuance amount after the FY20 third extra budget is expected to increase by around Y15tn (unchanged if we consider unissued FILP bonds), and the figure in the FY21 initial budget is expected to decline by around Y30tn. Our estimate for newly issued JGBs in FY21 is around “Y15tn in pandemic-related measures plus something extra,” larger than the figure in the material at the Advisory Council on Government Debt Management. The size of pandemic response measures is thus one of the things to watch for.

#### JGB Issuance Plan by Legal Grounds (actual and estimate)

| (Y tn)               | FY20    |        |                          |        |                           |        |                                     |        | FY21               |                 |  |
|----------------------|---------|--------|--------------------------|--------|---------------------------|--------|-------------------------------------|--------|--------------------|-----------------|--|
|                      | Initial |        | After first extra budget |        | After second extra budget |        | After third extra budget (estimate) |        | Initial (estimate) |                 |  |
|                      | Amount  | Amount | Initial → First          | Amount | First → Second            | Amount | Second → Third                      | Amount | Second → Initial   | Third → Initial |  |
| Newly-issued bonds   | 32.6    | 58.2   | 25.7                     | 90.2   | 31.9                      | 105.2  | 15.0                                | 55.0   | -35.2              | -50.2           |  |
| Reconstruction bonds | 0.9     | 0.9    | 0.0                      | 0.9    | 0.0                       | 0.9    | 0.0                                 | 0.0    | -0.9               | -0.9            |  |
| FILP bonds           | 12.0    | 21.4   | 9.4                      | 54.2   | 32.8                      | 54.2   | 0.0                                 | 30.0   | -24.2              | -24.2           |  |
| Refunding bonds      | 108.0   | 108.0  | 0.0                      | 108.0  | 0.0                       | 108.0  | 0.0                                 | 136.5  | 28.5               | 28.5            |  |
| Total                | 153.5   | 188.5  | 35.1                     | 253.3  | 64.7                      | 268.3  | 15.0                                | 221.5  | -31.8              | -46.8           |  |

Actual issuance amount in line with progress is minus Y15tn from here

Source: MOF; compiled by Daiwa Securities.

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