

Daiwa's View

Outlook for JGB issuance from viewpoint of FY21 budget

- Already took first step toward return to normal; issuance to peak out from plateau in line with end to pandemic

FICC Research Dept.

Senior Fiscal Policy and
Credit Analyst
Kouji Hamada
(81) 3 5555-8791
kouji.hamada@daiwa.co.jp



Daiwa Securities Co. Ltd.

Outlook for JGB issuance from viewpoint of FY21 budget

Already took first step toward return to normal; issuance to peak out from plateau in line with end to pandemic

On 21 December, the government decided on the FY21 budget, FILP plan and JGB issuance plan. As the COVID-19 pandemic has yet to come under control, a V-shaped economic recovery is not anticipated. Therefore, it is difficult to sharply reduce the JGB issuance amount. Depending on the pandemic situation, a supplementary budget could be compiled several times also in FY21. However, the FY21 budget already took the first step toward a return to normal. Hitting a peak in FY20, JGB issuance is likely to peak out from its plateau in line with an end to the pandemic. In order to prepare for any contingency, the issuance plan includes an extra amount (or extra amount issued), which should serve as a factor to reduce the issuance amount when receiving the change later.

In the FY21 JGB issuance plan by legal grounds, the amount of newly issued bonds is less than the previous estimate, while that of FILP bonds and refunding bonds was more than the estimates.

JGB Issuance Plan by Legal Grounds (actual)

(Y tn)	FY20									FY21		
	Initial Amount	After first extra budget		After second extra budget		After third extra budget			Initial Amount	Second → Initial	Third → Initial	
		Amount	Initial → First	Amount	First → Second	Amount	Second → Third					
Newly-issued bonds	32.6	58.2	25.7	90.2	31.9	112.6	22.4	43.6	-46.6	-69.0		
Reconstruction bonds	0.9	0.9	0.0	0.9	0.0	0.8	-0.1	0.2	-0.7	-0.6		
FILP bonds	12.0	21.4	9.4	54.2	32.8	40.7	-13.5	45.0	-9.2	4.3		
Refunding bonds	108.0	108.0	0.0	108.0	0.0	109.0	1.0	147.2	39.2	38.2		
Total	153.5	188.5	35.1	253.3	64.7	263.1	9.8	236.0	-17.3	-27.1		

Source: MOF; compiled by Daiwa Securities.

Regarding newly issued bonds, the policy to compile the FY21 initial budget has already returned to normal mode. For COVID-19 pandemic response measures and the economic package, only Y5tn is allocated as contingency funds for COVID-19. In real terms, the increase in social security expenditures was limited to that caused by the aging of society. FY19 and FY20 expenditures included Y2tn and Y1.8tn for “temporal and special measures,” but FY21 spending does not include such measures, leading to a decline in public work expenses.

If next year follows the usual schedule, the ordinary session of the Diet ends in June 2021 and there is some time until the next session. As six months will have passed since the compilation of the third extra budget in December 2020, the next policy may be requested at that timing depending on the pandemic and economic situations. We would like to keep in mind that a first extra budget in FY21 worth several trillion yen may be compiled by June.

Meanwhile, the entire amount of FY20 contingency funds for COVID-19 of Y5tn and expenses for pandemic response measures in the FY20 third extra budget may not be used, and therefore a surplus of several trillion yen in the FY20 result may become a new financial source. This may rein in the issuance amount of new JGBs in a supplementary budget to be compiled at the end of FY21 and beyond.

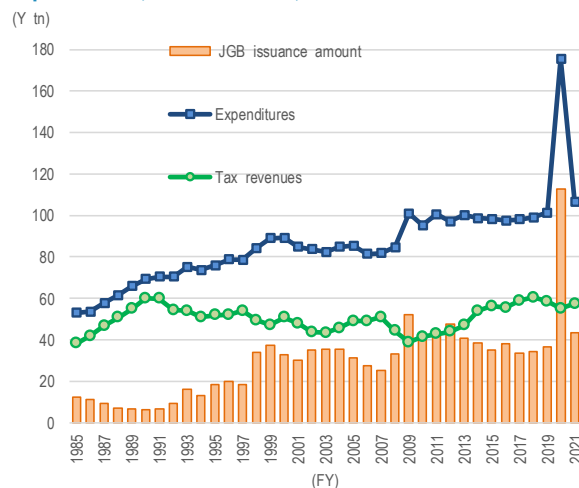
Initial Budget in General Account (actual)

(Y bn)	2017	2018	2019	2020	2021
Expenditures	97,454.7	97,712.8	101,457.1	102,658.0	106,609.7
Social security expenditure	32,473.5	32,973.2	34,059.3	35,740.1	35,842.1
Public works	5,976.3	5,978.9	6,909.9	6,857.1	6,069.5
Other general expenditures	19,559.2	19,593.5	20,494.6	20,400.0	19,490.4
COVID-19 pandemic response measures					0
National debt service	23,528.5	23,302.0	23,508.2	23,351.5	23,758.8
Local allocation tax grants, etc.	15,567.1	15,515.0	15,985.0	15,809.3	15,948.9
Contingency funds for COVID-19					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	106,609.7
Tax and stamp revenues	57,712.0	59,079.0	62,495.0	63,513.0	57,448.0
Other revenues	5,372.9	4,941.6	6,301.6	6,588.8	5,564.7
Government bond issuance	34,369.8	33,692.2	32,660.5	32,556.2	43,597.0

Source: MOF; compiled by Daiwa Securities.

In FY20, the difference between expenditures and tax revenues in the general account widened notably, which led to a state of a “crocodile’s mouth with a dislocated jaw.” In the FY21 initial budget, however, the situation has returned to the state where the mouth is open at a normal level. As witnessed by the fact that tax revenues have long been sluggish and expenditures have been gradually increasing due to the aging of society, the situation remains severe. However, we may manage to avoid a worse situation, where the pandemic turns the crocodile into a monster with a bigger mouth.

Expenditures, Tax Revenues, and JGB Issuance Amount in General Account

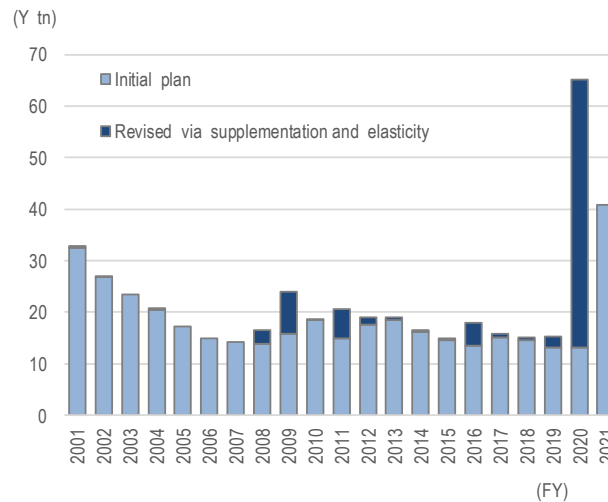


Source: MOF; compiled by Daiwa Securities.

Note: Figures are results until FY19, after third extra budget for FY20, and initial budget for FY21.

I stated that the issuance amount of FILP bonds is larger than expected, but this was caused by financing of fiscal loan funds. The FILP plan itself is in line with our estimate. In FY20, the size expanded to an extraordinary level of Y65.1tn due to an addition of Y51.9tn mainly via extra budgets. Also in FY21, the initial plan is already at a high level of Y40.9tn, whose picture is different from the general account, which has returned to normal mode.

FILP Plan



Source: MOF; compiled by Daiwa Securities.

That said, much of the huge FILP plan consists of safety net loans, i.e., policy finance. Even if the commitment line is set, loans will not be offered unless they are applied for. Therefore, the planned FILP bonds are not issued. In the face of the unprecedented crisis, a considerable amount of leeway was set for the commitment line. In FY20, the actual result of fiscal loans at Japan Finance Corporation as of end-November comes to only Y12.9tn vs. the annual plan of Y44.1tn. In the FY20 third extra budget, new JGBs worth Y22.4tn were needed but calendar-based market issuance remained flat, for which the unissued FILP bonds according to the plan played a role. A similar case is likely to happen again, although, of course, this depends on the pandemic situation. In order to implement a very large amount of loans, the government injected capital to policy financial institutions, and such capital has accumulated. Once the pandemic comes under control, we may hear that such capital will be returned to the national coffers.

It appears that the overshoot in refunding bonds was caused by an increase in the issuance of T-Bills due to the increased amount of JGB issuance. Conversely, if the issuance amount of T-Bills declines due to a decrease in the total issuance amount, this would create a cycle that the future issuance amount of refunding bonds would drop and the total issuance amount would decline further. The FY21 JGB issuance plan has taken the first step toward a decrease in calendar-based issuance of T-Bills.

Explanatory Document of Unregistered Credit Ratings

In order to ensure the fairness and transparency in the markets, Credit Rating Agencies became subject to the Credit Rating Agencies' registration system based on the Financial Instruments and Exchange Act. In accordance with this Act, in soliciting customers, Financial Instruments Business Operators, etc. shall not use the credit ratings provided by unregistered Credit Rating Agencies without informing customers of the fact that those Credit Rating Agencies are not registered, and shall also inform customers of the significance and limitations of credit ratings, etc.

■ The Significance of Registration

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)

How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Unregistered Rating Information" (<http://www.standardandpoors.co.jp/unregistered>) in the "Library and Regulations" section on the website of S&P Global Ratings Japan Inc. (<http://www.standardandpoors.co.jp>)

Assumptions, Significance and Limitations of Credit Ratings

Credit ratings assigned by Standard & Poor's are statements of opinion on the future credit quality of specific issuers or issues as of the date they are expressed and they are not indexes which show the probability of the occurrence of the failure to pay by the issuer or a specific debt and do not guarantee creditworthiness. Credit ratings are not a recommendation to purchase, sell or hold any securities, or a statement of market liquidity or prices in the secondary market of any issues.

Credit ratings may change depending on various factors, including issuers' performance, changes in external environment, performance of underlying assets, creditworthiness of counterparties and others. Standard & Poor's conducts rating analysis based on information it believes to be provided by the reliable source and assigns credit ratings only when it believes there is enough information in terms of quality and quantity to make a conclusion. However, Standard & Poor's does not perform an audit, due diligence or independent verification of any information it receives from the issuer or a third party, or guarantee its accuracy, completeness or timeliness of the results by using the information. Moreover, it needs to be noted that it may incur a potential risk due to the limitation of the historical data that are available for use depending on the rating.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of March 7th, 2017, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of S&P Global Ratings Japan Inc. (<http://www.standardandpoors.co.jp>)

[Moody's]

The Name of the Credit Rating Agencies Group, etc

The name of the Credit Rating Agencies group: Moody's Investors Service ("MIS")

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

How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Unregistered Rating explanation" in the section on "The use of Ratings of Unregistered Agencies" on the website of Moody's Japan K.K. (The website can be viewed after clicking on "Credit Rating Business" on the Japanese version of Moody's website (https://www.moody.com/pages/default_ja.aspx))

Assumptions, Significance and Limitations of Credit Ratings

Credit ratings are Moody's Investors Service's ("MIS") current opinions of the relative future credit risk of entities, credit commitments, or debt or debt-like securities. MIS defines credit risk as the risk that an entity may not meet its contractual, financial obligations as they come due and any estimated financial loss in the event of default. Credit ratings do not address any other risk, including but not limited to: liquidity risk, market value risk, or price volatility. Credit ratings do not constitute investment or financial advice, and credit ratings are not recommendations to purchase, sell, or hold particular securities. No warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such rating or other opinion or information, is given or made by MIS in any form or manner whatsoever.

Based on the information received from issuers or from public sources, the credit risks of the issuers or obligations are assessed. MIS adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MIS considers to be reliable. However, MIS is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of April 16th, 2018, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of Moody's Japan K.K. (https://www.moody.com/pages/default_ja.aspx)

[Fitch]

The Name of the Credit Rating Agencies group, etc

The name of the Credit Rating Agencies group: Fitch Ratings ("Fitch")

The name and registration number of the Registered Credit Rating Agency in the group: Fitch Ratings Japan Limited (FSA commissioner (Rating) No.7)

How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Outline of Rating Policies" in the section of "Regulatory Affairs" on the website of Fitch Ratings Japan Limited (<https://www.fitchratings.com/site/japan>)

Assumptions, Significance and Limitations of Credit Ratings

Ratings assigned by Fitch are opinions based on established criteria and methodologies. Ratings are not facts, and therefore cannot be described as being "accurate" or "inaccurate". Credit ratings do not directly address any risk other than credit risk. Credit ratings do not comment on the adequacy of market price or market liquidity for rated instruments. Ratings are relative measures of risk; as a result, the assignment of ratings in the same category to entities and obligations may not fully reflect small differences in the degrees of risk. Credit ratings, as opinions on relative ranking of vulnerability to default, do not imply or convey a specific statistical probability of default.

In issuing and maintaining its ratings, Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The assignment of a rating to any issuer or any security should not be viewed as a guarantee of the accuracy, completeness, or timeliness of the information relied on in connection with the rating or the results obtained from the use of such information. If any such information should turn out to contain misrepresentations or to be otherwise misleading, the rating associated with that information may not be appropriate. Despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

For the details of assumption, purpose and restriction of credit ratings, please refer to "Definitions of ratings and other forms of opinion" on the website of Fitch Rating Japan Limited.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of September 27th, 2019, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of Fitch Rating Japan Limited (<https://www.fitchratings.com/site/japan>)

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Securities Co. Ltd. retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.

Conflicts of Interest: Daiwa Securities Co. Ltd. may currently provide or may intend to provide investment banking services or other services to the company referred to in this report. In such cases, said services could give rise to conflicts of interest for Daiwa Securities Co. Ltd.

Daiwa Securities Co. Ltd. and Daiwa Securities Group Inc.: Daiwa Securities Co. Ltd. is a subsidiary of Daiwa Securities Group Inc.

Other Disclosures Concerning Individual Issues:

- 1) As of 26 April 2016, Daiwa Securities Co. Ltd., its parent company Daiwa Securities Group Inc., GMO Financial Holdings, Inc., and its subsidiary GMO CLICK Securities, Inc. concluded a basic agreement for the establishment of a business alliance between the four companies. As of end-December 2017, Daiwa Securities Group Inc. owned shares in GMO Financial Holdings, Inc. equivalent to approximately 9.3% of the latter's outstanding shares. Given future developments in and benefits from the prospective business alliance, Daiwa Securities Group Inc. could boost its stake in GMO Financial Holdings, Inc. to up to 20% of outstanding shares.
- 2) Daiwa Real Estate Asset Management is a subsidiary of Daiwa Securities Group Inc. and serves as the asset management company for the following J-REITs: Daiwa Office Investment Corporation (8976), Daiwa Securities Living Investment Corporation (8986).
- 3) Samty Residential Investment became a consolidated subsidiary of Daiwa Securities Group Inc. effective 10 September 2019.
- 4) On 30 May 2019, Daiwa Securities Group Inc. formalized an equity/business alliance with Samty, and as of 14 June 2019 it owned 16.95% of shares outstanding in Samty along with convertible bonds with a par value of ¥10bn. Conversion of all of said convertible bonds into common shares would bring the stake of Daiwa Securities Group Inc. in Samty to 27.28%.
- 5) Daiwa Securities Group Inc. and Credit Saison Co., Ltd. entered into a capital and business alliance, effective 5 September 2019. In line with this alliance, Daiwa Securities Group Inc. is to acquire up to 5.01% of Credit Saison's total common shares outstanding (excl. treasury shares; as of 31 Jul 2019).

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

(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)

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 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.

Corporate Name: Daiwa Securities Co. Ltd.

Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108

Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association