

Daiwa's View

Introductory guide to fiscal finance and JGB issuance

- Structures of JGB issuance plan, front-loading issuance of refunding bonds, annual schedule of budget compilation, and supplementary budgets

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Daiwa Securities Co. Ltd.

Introductory guide to fiscal finance and JGB issuance

Structures of JGB issuance plan, front-loading issuance of refunding bonds, annual schedule of budget compilation, and supplementary budgets

In this report, we explain the basic structures of fiscal finance and the JGB issuance plan. We discuss the JGB issuance plan, front-loading issuance of refunding bonds, the annual schedule of budget compilation, and the structures of supplementary budgets, economic packages, and actual stimulus. As there are many items, please refer to necessary items as needed.

◆ Structure of JGB issuance plan

The basic structure of the JGB issuance plan is shown in the chart below. First, the necessary JGB issuance amount for budget implementation is calculated based on issuance amounts by legal grounds on the left. Next, the method for actually procuring the necessary JGB issuance amounts is determined based on issuance amounts by financing methods on the right.

Basic Structure of JGB Issuance Plan (Y bn)

<Issuance amounts by legal grounds >

| | FY20 Initial | FY20 After 3rd extra budget | FY21 Initial |
|----------------------------------|------------------|--------------------------------|------------------|
| Newly-issued bonds | 32,556.2 | 112,553.9 | 43,597.0 |
| Construction bonds | 7,110.0 | 22,596.0 | 6,341.0 |
| Special deficit-financing bonds | 25,446.2 | 89,957.9 | 37,256.0 |
| Reconstruction bonds | 924.1 | 782.4 | 218.3 |
| FILP bonds | 12,000.0 | 40,700.0 | 45,000.0 |
| Refunding bonds | 107,981.8 | 109,029.2 | 147,192.9 |
| For matured reconstruction bonds | 1,693.2 | 2,725.4 | 2,871.0 |
| Total | 153,462.1 | 263,065.5 | 236,008.2 |

<Issuance amounts by financing methods >

| | FY20 Initial | FY20 After 3rd extra budget | FY21 Initial |
|-----------------------------------|------------------|--------------------------------|------------------|
| Calendar-basis market issuance | 128,800.0 | 212,300.0 | 221,400.0 |
| Non-price competitive auctions II | 7,988.4 | 7,738.0 | 8,230.0 |
| Fiscal year adjustment | 9,673.7 | 37,627.5 | 78.2 |
| Subtotal financed in market | 146,462.1 | 257,665.5 | 229,708.2 |
| Sales to individual investors | 4,800.0 | 3,200.0 | 4,100.0 |
| Public sector (BOJ rollovers) | 2,200.0 | 2,200.0 | 2,200.0 |
| Total | 153,462.1 | 263,065.5 | 236,008.2 |

"Actual procurement methods" in the right chart are formulated to cover "necessary budget amount" in the left chart

Source: Ministry of Finance (MOF); compiled by Daiwa Securities.

<Issuance amounts by legal grounds>

Newly-issued bonds: These include construction bonds for public works and special deficit-financing bonds commonly known as deficit-financing bonds, both of which are issued under the general account. The financial resource of the general account is taxes, which are grant funds. Programs such as social security, public works, and national defense are implemented under this account. The JGB issuance amount is determined by the amount of expenditures, tax revenues, and non-tax revenues.

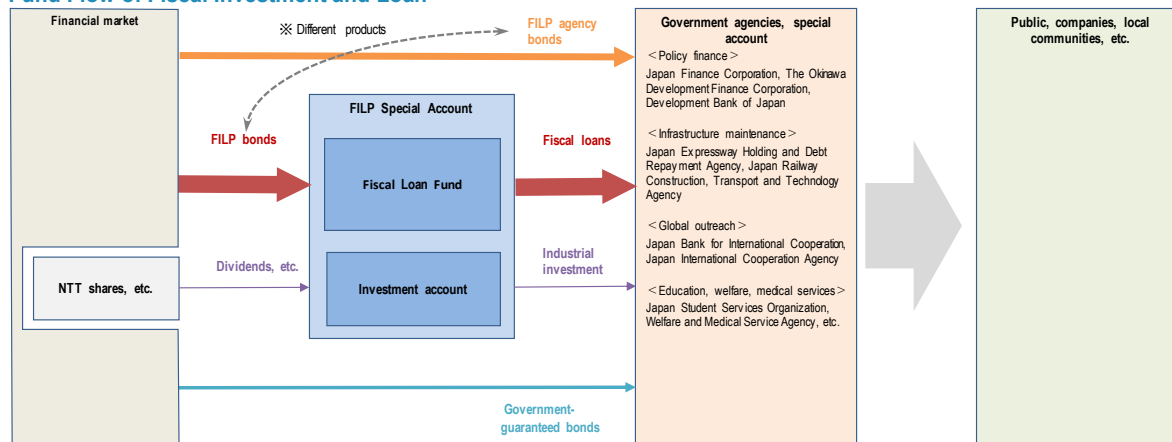
Reconstruction bonds: These are issued under the Special Account for Reconstruction from the Great East Japan Earthquake for reconstruction from the eponymous earthquake. The account is separate from the general account, but the financial resource is also taxes that are grant funds. With more than ten years having passed since the earthquake, the scale of reconstruction work has diminished. Therefore, these bonds have less impact when forecasting the JGB issuance plan.

Refunding bonds: These are issued under the Special Account of Government Debt Consolidation Fund, which manages redemption of principal and interest of newly-issued bonds, reconstruction bonds, and refunding bonds, etc. Matured JGBs are rolled over by refunding bonds, or redeemed by cash via money transferred from the general account or the Special Account for Reconstruction from the Great East Japan Earthquake (with the financial resource being taxes that are grant funds). The issuance amount is determined by the amount and maturities of JGBs to be redeemed in the reference fiscal year.

Fiscal investment and loan program (FILP) bonds: These are issued by the Fiscal Loan Fund under the FILP Special Account as financial resources of fiscal investments and loans. FILP is a fiscal policy tool using loan funds on the assumption that such loans are collected. For example, after highways and rental housing are constructed by debt, debt is redeemed via payment from highway tolls and rent. Moreover, redemption is made after providing loans to private companies and medical/welfare facilities, yen loans to developing nations, and scholarship loans to university students. Compared to the general account that relies solely on taxes, FILP enables early implementation of a wide range of programs.

Each program is implemented mainly by government agencies. The government raises funds by issuing FILP bonds via the Fiscal Loan Fund under the FILP Special Account, and then supplies money to government agencies in the form of fiscal loans (chart below). Government agencies issue FILP agency bonds as well, but their funds are mainly raised by fiscal loans. The issuance amount of FILP bonds is determined by the size of fiscal loans and the financing conditions of the Fiscal Loan Fund. FILP bonds are well known in the market as an abbreviated name for FILP agency bonds, but, as described above, they are actually a kind of JGB.

Fund Flow of Fiscal Investment and Loan



Source: MOF; compiled by Daiwa Securities.

Regarding newly-issued JGBs, reconstruction bonds, refunding bonds, and FILP bonds, their accounts and the legal grounds for their issuance are different, and, therefore, their funds are not mutually accommodated.

<Issuance amounts by financing methods>

Calendar-basis market issuance: The amount actually issued at auctions during the reference fiscal year, running from April through March. For the 10-year JGB, for example, one auction for Y2.6tn will be held each month, for a total of Y31.2tn for the year. The point of the JGB issuance plan is to forecast this amount.

Non-price competitive auctions II: Calculated based on the assumption that a certain percentage of calendar-basis market issuance will be successively bid for. For FY21, the percentage is assumed at 5.5%.

Fiscal year adjustment: This consists of front-loaded issuance of refunding bonds and issuance during the treasury adjustment period. We discuss front-loaded issuance later in this report. For details on issuance during the treasury adjustment period, see footnote 1¹.

Sales to individual investors: The amount of planned issuance of JGBs for individual investors.

Public sector (BOJ rollovers): The amount of refunding bonds taken by the BOJ based on the JGBs in its portfolio reaching maturity. The amounts will be negotiated by the MOF and BOJ.

◆ Issuance of front-loaded refunding JGBs

Front-loaded issuance of refunding bonds is that portion of refunding bonds scheduled for issuance the following fiscal year that is moved forward into the current fiscal year. When the amount of newly-issued bonds, FILP bonds, and refunding bonds that must be issued is small, the amount of front-loaded refunding bonds is increased, and likewise when it is large, the amount is decreased, possible to smooth on average changes in the amount of calendar-basis market issuance. See the insert below for our thinking on these increases and decreases.

We assume a world in which the issuance amount of refunding bonds is fixed every year at Y120tn. The amount of calendar-basis market issuance needed at auction from April to March is also Y120tn per fiscal year.

Next, assuming Y10tn of new front-loaded issuance in a given fiscal year would mean that calendar-basis market issuance would have to be the Y120tn plus another Y10tn, for a total of Y130tn. A negative amount of Y10tn is recorded as a fiscal year adjustment in the JGB issuance plan, creating Y10tn of cash in the Government Debt Consolidation Fund.

If the amount of front-loaded bonds is kept at the same amount of Y10tn the following fiscal year, calendar-basis market issuance would be the actually required amount of Y120tn. Because Y10tn of refunding bonds had already been issued in advance the previous fiscal year (i.e., Y10tn was carried over from the previous fiscal year), that would be covered by the Y110tn of refunding bonds remaining in that fiscal year plus the following year's Y10tn of front-loaded bonds. The fiscal year adjustment in the issuance plan becomes zero and the cash in the Government Debt Consolidation Fund is unchanged at Y10tn.

In the next fiscal year, assuming Y5tn is added to bring front-loaded issuance up to Y15tn, calendar-basis market issuance would have to be the Y120tn actually needed plus another Y5tn, for a total of Y125tn. Because Y10tn of refunding bonds had already been issued in advance the previous fiscal year (i.e., Y10tn was carried over from the previous fiscal year), that would be covered by the Y110tn of refunding bonds remaining in that fiscal year plus the following year's Y15tn of front-loaded bonds. The fiscal year adjustment in the issuance plan becomes -Y5tn and the cash in the Government Debt Consolidation Fund increases to Y15tn.

In the following fiscal year, assuming front-loaded bonds are Y8tn less at Y7tn, calendar-basis market issuance would be Y112tn, Y8tn less than the Y120tn actually needed. Because Y15tn of refunding bonds had already been issued in advance the previous fiscal year (i.e., Y15tn was carried over from the previous fiscal year), that would be covered by the Y105tn of refunding bonds remaining in that fiscal year plus the following year's Y7tn of front-loaded bonds. The fiscal year adjustment in the issuance plan becomes +Y8tn and the cash in the Government Debt Consolidation Fund declines to Y7tn.

¹ The special deficit JGBs in a given fiscal year are issued during the treasury adjustment period in Apr-May of the following fiscal year. By establishing this treasury adjustment period, if the corporate taxes owed by a company with a March fiscal year-end are collected by May they can be treated as tax revenue in the preceding fiscal year. For example, if Y2tn of special deficit JGBs are carried over into Apr-May of the following fiscal year, calendar-basis market issuance (the amount auctioned from April to March) would be Y2tn less than the actual amount needed and that Y2tn would be added to the fiscal year adjustment in the issuance plan.

Conversely, if Y4tn of special deficit JGBs from the preceding fiscal year are carried over into Apr-May of the current fiscal year, calendar-basis market issuance would be Y4tn more than the actual amount needed and that Y4tn would be subtracted from the fiscal year adjustment.

The actual amount of front-loaded bonds carried over to FY20 was ¥45.1tn. The FY20 JGB issuance plan has a fiscal year adjustment of +¥37.6tn after the third supplementary budget and the rapid expansion of total JGB issuance necessitated by the pandemic is ameliorated by a major drawdown of front-loaded bonds. If this goes according to plan, the refunding bonds carried over to FY21 will be ¥45.1tn - ¥37.6tn = ¥7.5tn, substantially reducing the amount that could be drawn down in FY21.

◆ **Annual schedule for budget formation**

The process the government follows in forming the budget begins with creation of the basic policies, followed by the summary of budget request criteria, the summary of budget requests, the initial budget, supplementary budget, and the results. We show the schedule in a typical year below, but this can be delayed sometimes depending on the political situation and other factors.

Basic policies: The Cabinet Office's Council on Economic and Fiscal Policy submits its Basic Policies for Economic and Fiscal Management and Reform (usually abbreviated to "Basic Policies") for Cabinet approval. This indicates the government's basic policy direction. This cabinet decision is normally made in June.

Summary of criteria for budget requests: Before requesting summary budgets from each ministry and agency, the basic thinking on budget formation and maximum request amounts for each major item are indicated and approved by the Cabinet. For example, the document states that the FY21 budget for pensions and healthcare must increase naturally by no more than ¥530bn over the FY20 budgeted amount to reflect demographic aging. This cabinet approval is normally made at the end of July.

Summary of budget requests: Each ministry and agency submits its summary budget request based on the summary of budget request criteria. Although this is an initial benchmark for the size of the budget, the amount could change after a subsequent review by MOF and political negotiations. There will also be a request for the FILP budget, but its amount could change, as well. The deadline for submission is normally end-August.

Initial budget: The MOF conducts an assessment based on the summary of budget requests, and after political negotiations the cabinet decides on an initial draft budget. The FILP plan, JGB issuance plan, and municipal bond program are released at the same time, at which point the accuracy of JGB issuance plan forecasts become evident. The cabinet decision often occurs after 20 December in a typical year. The initial draft budget is submitted to the regular session of the Diet that starts from January of the following year and can be implemented once it is passed. The amounts and number of JGB auctions are in principle changed from April based on the JGB issuance plan for the new fiscal year.

Supplementary budgets: Details are outlined below.

Results: The outlook for the summary of results is announced in early July in a typical year. If the results show that revenues exceeded expenditures and there is a net surplus, at least half of that must be carried forward into the Government Debt Consolidation Fund until the fiscal year following the next fiscal year (either in a supplementary budget for the fiscal year when results are announced or in the initial budget or supplementary budget for the following fiscal year) and allocated to the redemption of government debt. Because any remaining amounts can be used as revenue starting with supplementary budgets in the fiscal year when results are announced, it reduces the amount of special deficit JGBs.

In contrast, if results show that expenditures exceeded revenues, the shortfall is initially covered by the Government Debt Consolidation Fund via the settlement adjustment fund, but by the fiscal year after the following fiscal year (in the supplementary budget of the fiscal year when results were announced or in the initial budget or supplementary budget of the following fiscal year) it must be covered by the general account and returned to the Government Debt Consolidation Fund via the settlement adjustment fund, which increases spending and therefore increases the amount of special deficit JGBs.

◆ **Supplementary budgets, economic packages, and actual stimulus**

After the fiscal year has begun, supplementary budgets are compiled as necessary and both revenues and expenditures are revised. If JGB issuance is raised or lowered, the JGB issuance plan is also revised.

December supplementary budget: Barring any major event, there is always at least one supplementary budget each fiscal year. Revenues are adjusted either higher or lower depending on progress in collecting taxes. Expenditures are lowered depending on the amount spent thus far, and disaster recovery expenses are added depending on the disasters that occurred. In some cases this could be accompanied by economic stimulus. The cabinet decision on the supplementary budget is typically made after 20 December and around the same day that the initial budget for the following fiscal year is decided.

Time frame for deciding supplementary budgets other than the one in December:

When the economy deteriorates or when there is a major natural disaster like the 2011 earthquake & tsunami, a supplementary budget that adds spending and/or cuts taxes is compiled. This supplementary budget must be submitted to the Diet after the cabinet decision and cannot be implemented unless it is passed, however. Consequently, in some cases the cabinet decision itself is made ahead of time and submitted for debate after the Diet begins its session (the December supplementary budget noted above is submitted to the regular session of the Diet in January), but in most cases the supplementary budget is formed while the Diet is in session.

The Diet holds two sessions each year, its core regular session every year from January until June and an extraordinary session, which starts in September or October and often runs until December. The Diet's regular session can be extended up to one time and its extraordinary session can be extended up to two times.

When the JGB issuance plan is revised in conjunction with a supplementary budget, a certain amount of time must elapse before the amount and number of auctions is changed in anticipation of budget passage and the notice to markets.

The relationship between economic stimulus and supplementary budgets: In some cases an economic package with various measures is compiled, but for those measures to be enacted following their announcement a supplementary budget must be compiled and passed by the Diet. Consequently, the timing of implementation is affected by when the Diet is in session. In some cases a supplementary budget is formed without compiling an economic package.

Definition of actual stimulus: The amount of actual stimulus in an economic package is subject to debate. Originally, based on the thinking that the size of the economic package announced by the government is inflated by projects that do not provide much of a boost to the economy, the private sector started looking separately at the public works, tax cuts, and other elements that would have a direct upward impact on GDP. Because actual stimulus is not formally defined by the government and there is no consensus in the private sector regarding exactly what it consists of, analysts differ in their assessment of which spending items should count as actual stimulus.

Recently, this has often been considered to be spending in the government's general account or the total spending in the government's general account, special accounts, and local governments.

Because of differences in what people consider actual stimulus, it is necessary to look closely at the statements made by politicians and high-ranking government officials to determine exactly what they are saying. What affects the JGB issuance plan is the size of the government's general account for newly-issued bonds and that of the fiscal loans in the FILP program for FILP bonds.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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[Fitch]

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- 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).

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- 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.

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