

# Update on GX economic transition bonds

## I recommend issuance of 5yr and 20yr GX bonds

- GX economic transition bonds will be launched in FY23, amid the expansion in the SDG bond market
- We focus here on discussions at the Meeting of JGB Market Special Participants and the Meeting of JGB Investors
- In my view, issuance of GX bonds in the 5yr and 20yr sectors is recommended
- We should also carefully monitor changes in investors' stance on greeniums

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## GX economic transition bonds will finally be issued in FY23

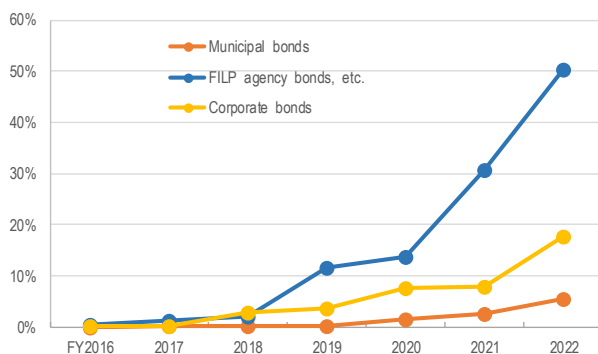
### Update on GX economic transition bonds: Issuance of 20yr and 5yr bonds is recommended

The issuance of SDG and ESG bonds expanded to Y4.5tn in FY22, up 1.5-fold y/y. The increase in issuance, centering on corporate bonds, despite the deterioration in investors' risk sentiment due to monetary policy tightening, once again confirmed the strong demand for investment in ESG-labelled bonds (charts 1 and 2). In FY23, the Japanese government will finally issue GX economic transition bonds (GX bonds). In this report, we confirm discussions at two meetings hosted by the Ministry of Finance (MOF). Furthermore, I recommend the issuance of 20yr and 5yr bonds via the lead management method.

## Points of discussions at Meeting of JGB Market Special Participants and Meeting of JGB Investors

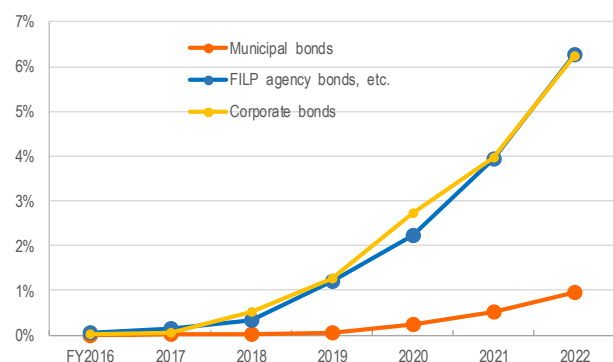
Opinions on GX bonds were submitted to the Meeting of JGB Market Special Participants and the Meeting of JGB Investors, both of which were held on 22 March. The major points of discussion dealt with (1) the issuance method (separate issuance or integrated issuance, auction or underwriting), (2) issuance maturities, (3) whether or not to have external certification, (4), greeniums, and (5) handling liquidity. Firstly, regarding the issuance method, "the integrated method," in which GX bonds are issued together with other regular government bonds, appears to be on its way towards being removed from the topics for discussion. There was a strong desire for the "separate method" from the investor side. Furthermore, there were also many on the dealer side wanting "separate issuance" in light of demand from investors, although some were concerned about liquidity. There was also a lot of desire for external certification, and it was safe to say that both dealers and investors had a desire for separate issuance after obtaining external certification. Furthermore, given that (1) GX bonds will be issued for the first time and (2) green investors should be sought after carefully, most attendants preferred the underwriting method to the auction method. As for issuance maturities, with GX economic transition bonds having the restriction of needing to be paid back in full by FY2050, many wanted 20yr bonds, followed by 10yr bonds, and some investors wanted 5yr bonds.

Chart 1: Ratio of SDG/ESG Bonds to Total Issuance Amount



Source: Japan Securities Dealers Association; compiled by Daiwa.

Chart 2: Ratio of SDG/ESG Bonds to Total Outstanding Amount



Source: Japan Securities Dealers Association; compiled by Daiwa.

## I recommend issuance of 5yr and 20yr GX bonds

Personally, I think that 10yr bonds are desirable in terms of the breadth of the investor base. However, difficult problems would arise under the current yield curve control (YCC) policy. Since the policy revisions in December 2022, there has been upward pressure on yields due to speculation about additional policy revisions (the so-called YCC attack). Between 20 December 2022 and 20 January 2023, the BOJ purchased a total of as much as ¥6.5tn in three 10yr on-the-run issues. Following the monetary policy meetings in January and March, JGB yields declined temporarily, but the yield of new 10yr JGBs issued in April (JB370) was 0.456%, close to the upper limit of 0.50%. With the market having once again lost buyers of 10yr JGBs, there are many concerns, such as (1) whether investors have actual demand for 10yr GX bonds and (2) whether the BOJ will buy GX bonds. Consequently, it would be better to avoid issuing 10yr GX bonds under the current YCC policy. Therefore, I recommend setting the 20yr sector (which appears to have the second largest investor base after the 10yr sector) as the main maturity zone, in combination with 5yr bonds in order to meet the needs of depository financial institutions and overseas central banks. Specifically, I believe that quarterly issuance of GX bonds in which 25% of the annual issuance alternates between 20yr and 5yr bonds would also meet the time dispersion needs of investors.

## Changes in investors' stance on greeniums

We are also paying attention to investors' stance on greeniums<sup>1</sup>. From the standpoint of investors, a greenium itself is nothing other than a simple decline in returns. According to the minutes of the Meeting of JGB Investors, some were naturally cautious about excessive greeniums, pointing out a possible decline in investment. However, several participants commented that they could buy bonds with greeniums. While excessive greeniums obviously constitute a problem, we may now be in a trend in which greeniums are tolerated to a certain extent in terms of the importance of sustainability investment. In the municipal bond market, each local public body issues bonds at the same spread. However, since 2H FY22, we have seen many cases in which SDG-labelled bonds were issued with greeniums of around 1-2bp (Chart 3). In addition, 10yr German bonds, which took the initiative with global greeniums via the "twin bond" format, have been recently posting a 1-2bp greenium (Chart 4). This may serve as a reference for the issuance of GX bonds in Japan.

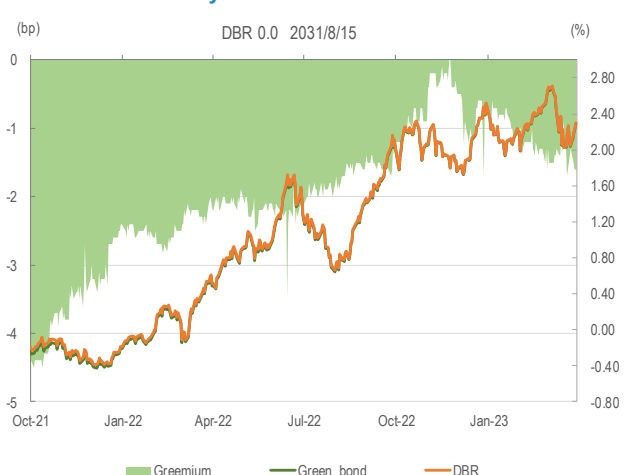
We have provided a summary on GX bonds, which are likely to become the greatest focus of interest in the FY23 SDG bond market, centering on discussions at the Meeting of JGB Market Special Participants and the Meeting of JGB Investors. Under the YCC policy, issuance of 20yr and 5yr GX bonds is recommended. We will continue to monitor future developments.

Chart 3: Greenium of Municipal Bonds

Terms and conditions decided on	Issuer	Type	Issue amount (¥ bn)	Maturity (years)	JGB spread (vs. curve)	JGB spread of latest non-labelled bonds	Greenium (bp)
05-Oct-22	Mie Prefecture	Green	6.5	10	19.0bp	20.0bp	-1.0
07-Oct-22	Nagano Prefecture	Green	10.0	10	19.0bp	20.0bp	-1.0
07-Oct-22	Nagano Prefecture	Green	2.8	20*	24.0bp	-	-
14-Oct-22	Tokyo Metropolis	Green	15.0	30	10.0bp	10.0bp	0.0
14-Oct-22	Tokyo Metropolis	Green	15.0	5	8.0bp	9.0bp	-1.0
20-Oct-22	Kanagawa Prefecture	Green	11.0	5	8.0bp	9.0bp	-1.0
21-Oct-22	Osaka Prefecture	Green	5.0	15	10.5bp	-	-
07-Dec-22	Aichi Prefecture	Green	10.0	5	11.0bp	12.0bp	-1.0
09-Dec-22	Kyoto City	Green	5.0	5	11.0bp	12.0bp	-1.0
09-Dec-22	Yokohama City	Sustainability	8.5	5	11.0bp	12.0bp	-1.0
09-Dec-22	Yokohama City	Sustainability	1.5	30	10.0bp	10.0bp	0.0
26-Jan-23	Osaka City	Green	5.0	5	10.0bp	12.0bp	-2.0
27-Jan-23	Fukuoka City	Green	9.0	10	25.0bp	27.0bp	-2.0
08-Feb-23	Sagamihara City	Green	5.0	10	23.0bp	25.0bp	-2.0
15-Feb-23	Hiroshima Prefecture	Green	5.0	10	23.0bp	25.0bp	-2.0
22-Feb-23	Tokyo Prefecture	Social	30.0	5	11.0bp	12.0bp	-1.0
16-Mar-23	Kochi Prefecture	Green	5.0	5	10.0bp	12.0bp	-2.0

Source: Japan Local Government Bond Association; compiled by Daiwa.  
\*Scheduled redemption.

Chart 4: Greenium of 10yr German Bunds



Source: Bloomberg; compiled by Daiwa.

<sup>1</sup> As indicated by the name of the bonds, the government appears to be intending to issue GX bonds as transition bonds, not green bonds. However, in this report, we use the term greeniums to refer to premiums for all SDG/ESG bonds, not just premiums for green bonds.

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