5 October 2023
Japanese report: 28 September 2023 (DSTR1366)

How new economic measures may impact JGB issuance

Daiwa Securities

Calendar-based market issuance basically unchanged, but on guard for increase

- Formulation of economic measures in late Oct with supplementary budget compiled in Nov
- LDP's secretary-general Seko says regarding scale of new economic measures, "We may need Y15 trillion or around Y20 trillion if possible" (seen as upper limit at this point)
- Calendar-based market issuance could remain unchanged if government expenditures for economic measures in mid to upper Y10tn range, but increase likely insight if figure close to or exceeds Y20tn; must first focus on scale of economic measures

Strategic Memorandum DSTE488
FICC Research Dept.

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

Daiwa Securities Co. Ltd.

On 26 September, Prime Minister Fumio Kishida officially instructed his cabinet to prepare a package of economic measures by the end of October. In November, a supplementary budget will be compiled to secure financial resources for these measures and JGB bond issuance plans will be revised. LDP secretary-general Hiroshige Seko, who is known within the party as favoring fiscal expansion, said on 19 September in regards to the scale of the economic measures, "We may need Y15 trillion or around Y20 trillion if possible." At this juncture, we view those figures as the upper limit.

There is a good chance that calendar-based market issuance of JGBs will not change provided that government expenditures for the economic measures do not exceed the mid to upper Y10tn range. That said, apparently an increase in such issuance cannot be ruled out if the figure approaches or exceeds Y20tn. If the increase in issuance is on that scale, it would probably be covered mainly by the issuance of more T-bills. For now, we must first focus on the scale of the economic measures.

General account resources roughly Y3.5tn?

The next supplementary budget associated with the economic measures is likely to be compiled in November. The annual year-end spending and revenue items, such as revised tax revenue projections and reductions in existing expenditures, will probably be recorded together.

Chart 1: Expenditure/revenue Items in FY23 General Account Supplementary Budget Other Than Economic Stimulus Measures and New Bonds (Y tn, Daiwa estimates)

Upward revision of tax revenues	2.5
Increase in local allocation tax due to upward revision of tax revenues	-0.7
FY22 surplus	2.6
Transfers to Government Debt Consolidation Fund	-1.3
Transfers to funds for bolstering defense	-1.3
Decrease in existing expenditures	1.0
Increase in non-tax revenue	0.7
Total funding for supplementary budget	3.5

Source: MOF; compiled by Daiwa Securities.

.

Tax revenues were Y2.8tn higher in the FY22 settlement versus the forecast as of last November. It would not be surprising for the FY23 forecast to be revised upward by around the amount of this upside. However, since there have been slight delays as of July, we have revised our forecast upward to Y2.5tn at this juncture. We should note that when tax revenues increase, about 30% of the increase is automatically earmarked for increased local allocation tax grants. So, the actual increase in revenue is Y2.5tn x 70% = Y1.8tn.

There is the stipulation to transfer at least half of the Y2.6tn net surplus in the general account settlement for FY22 to the Government Debt Consolidation Fund. The other half is used to finance supplementary budgets. The system is currently designed to transfer the funds to the Defense Enhancement Fund as part of defense financing. How much money to transfer is, of course, a political decision. Still, in order to delay the start of a tax hike, the entire remaining amount will probably be used to finance defense spending. This money is not expected to be a source of funding for economic measures.

The reduction in existing expenditures and the increase in non-tax revenues are expected to total Y1.7tn, although there are large fluctuations from year to year. Taking the above points into account, the total amount of expenditure and revenue items that could be used to finance economic measures is estimated at around Y3.5tn (Chart 1). If the economic measures place a burden of Y15-20tn on the general account, the increase in new JGBs would come to Y11.5-16.5tn.

Total JGB issuance could increase by Y7-12tn

If new JGB issuance increases by Y11.5-16.5tn as a result of the economic measures, we imagine the total issuance, including other JGBs, to increase by around Y7-12tn (Chart 2).

Chart 2: Projected Increase/Decrease in JGB Issuance Plans by Issuance Governing Law in Conjunction with FY23 Supplementary Budget (Y tn, Daiwa estimates)

Newly-Issued bonds	11.5	-	16.5
GX economy transition bonds			0.0
Reconstruction bonds			0.0
FILP bonds			0.0
Refunding bonds			-4.5
Total	7.0	-	12.0

Source: MOF; compiled by Daiwa Securities.

FILP bonds are not an abbreviation for FILP agency bonds, but rather they are bonds issued by the government. The raised funds are loaned by the government to FILP agencies and used as project funds for fiscal investment and loans.

There has been a significant reduction in FILP bonds within supplementary budgets over the past few years, partially offsetting a large increase in new JGBs. A substantial line of credit from government financial institutions was set up to support private companies that were facing financial difficulties due to the coronavirus disaster, but not much of that financing was actually used. This is because raising funds through FILP bonds was no longer needed.

The amount of FILP bonds to be issued in FY23 has already been determined based on the assumption of acting as a credit line during normal times. There is little room for reductions in the supplementary budget.

Refunding bonds are likely to be reduced by Y4.0-5.0tn in the supplementary budget. This is because some of the T-bills that were scheduled to be issued under the FY22 bond issuance plan were not actually issued, which in turn eliminates the need for refinancing.

Unchanged calendar-based market issuance as main scenario, but eyes on possible increase

We will repeat this one more time, total JGB issuance for the next supplementary budget is expected to increase by Y7-12tn. That said, our main scenario assumes that calendar-based market issuance will remain unchanged as the government will utilize front-loaded JGBs.

If the size of the economic measures expands to the assumed Y20tn ceiling or beyond, we would assume that the amount of calendar-based market issuance could potentially increase. In that case, the government would again hold hearings with market participants to determine which maturities should be targeted for increased issuance. However, considering the current market environment, the 6-month T-bill would be the most likely candidate for increased issuance.

To what extent can front-loaded JGBs be utilized? We recognize that there are no consistent rules on this issue, even among the fiscal authorities, and that decisions have been made on a case-by-case basis from time to time. However, over the past few years, there seems to have been a trend of utilizing roughly the most recent increase portion.

The current front-loaded JGBs for FY23 is Y15.5tn. Of this amount, it is estimated that Y10-11tn has increased since the FY23 budget was completed. We honestly do not know if this is the amount that the fiscal authorities are currently willing to spend. However, if that Y10-11tn is used to help finance the economic measures, the amount of calendar-based market issuance would likely remain flat, provided that the scale of the economic measures does not come close to or exceed Y20tn.

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.

Ratings
Issues are rated 1, 2, 3, 4, or 5 as follows:
1: Outperform TOPIX/benchmark index by more than 15% over the next 12 months.
2: Outperform TOPIX/benchmark index by 5-15% over the next 12 months.
3: Out/underperform TOPIX/benchmark index by less than 5% over the next 12 months.
4: Underperform TOPIX/benchmark index by 5-15% over the next 12 months.
5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

Benchmark index: TOPIX for Japan, S&P 500 for US, STOXX Europe 600 for Europe, HSI for Hong Kong, STI for Singapore, KOSPI for Korea, TWII for Taiwan, and S&P/ASX 200 for Australia.

Target Prices
Daiwa Securities Co. Ltd. sets target prices based on its analysts' earnings estimates for subject companies. Risks to target prices include, but are not limited to, unexpected significant changes in subject companies' earnings trends and the macroeconomic environment.

Disclosures related to Daiwa Securities
Please refer to https://lzone.daiwa.co.jp/l-zone/disclaimer/e_disclaimer.pdf for information on conflicts of interest for Daiwa Securities, securities held by Daiwa Securities, companies for which Daiwa Securities or foreign affiliates of Daiwa Securities Group have acted as a lead underwriter, and other disclosures concerning individual companies. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings
This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: https://lzone.daiwa.co.jp/l-zone/disclaimer/creditratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

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, Japan Security Token Offering Association