

Daiwa's Economic View

How agreement to invest \$550bn in US will impact JGB issuance

- Agreement to invest \$550bn in US: Japanese government allocating same amount of financial support to JBIC and NEXI to encourage Japanese companies to invest in US
- \$550bn (approx. ¥80tn) over 3.5 years is extremely high hurdle considering past results, cautious management stance of Japanese firms
- Impact on JGB issuance: Initially be limited to ¥1-2.0tn in construction bonds to strengthen financial bases for JBIC and NEXI; afterwards, if investment increases, issuance of FILP bonds will increase

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The agreement to invest \$550bn in the US involves the Japanese government providing the Japan Bank for International Cooperation (JBIC) and the Nippon Export and Investment Insurance (NEXI) with a maximum of \$550bn in support to enable Japanese firms to proceed with their investment in the US. As for the feasibility of the investment, considering both past results and the cautious management stance of Japanese firms, the hurdle (investing roughly ¥80tn over three and a half years) will be extremely high. As for the impact on JGB issuance, for now, ¥1.0 to ¥2.0tn in construction bonds will likely be issued to strengthen the financial bases for JBIC and NEXI. Then, if investment in the US increases in line with the agreement, that would lead to an increase in the issuance of FILP bonds, which will serve as a source of funding for JBIC loans.

Details of \$550bn investment agreement with US

Prime Minister Shigeru Ishiba revealed details of the agreement to invest \$550bn in the US at a press conference on 23 July.

Investors: Japanese companies

Investment objectives: Build supply chains in US for important fields in terms of economic security, such as pharmaceuticals and semiconductors

Role of Japanese government: Support investment by Japanese companies through JBIC and NEXI with the provision of up to \$550bn (approx. ¥80tn) in investment, loans, and guarantees.

The most important point is that the investors are global Japanese companies. The Japanese government has not committed to any specific investment or fiscal spending amounts, but it will provide JBIC and NEXI with a \$550bn corporate support facility. The actual amount of investment in the US will depend on Japanese companies.

Is \$550bn in investment in US feasible?

As for the feasibility of investing \$550bn (approx. ¥80tn or just over ¥20tn each year for 3.5 years), our conclusion is that the hurdles to achieving that objective are extremely high.

First, the scale of investment in the US must be increased by roughly 2.0 to 2.5X the current level. Japan's annual foreign direct investment from 2021 to 2024 was between just over ¥20tn and just over ¥30tn worldwide. Of that amount, direct investment in the US came to roughly ¥9.0-13.0tn, or about 40% of the total. Global Japanese companies place a strong emphasis on the US, which is the world's largest and fastest-growing market. Still, there is a considerable gap between the current level of investment and the target.

Next, regarding the management stance of most global Japanese companies, a rapid expansion of investment in the US seems unlikely. Global Japanese companies have enjoyed significant improvements for their business results due to the economic growth and yen depreciation that followed the introduction of “Abenomics.” That said, Japanese companies remain cautious about increasing leverage. Some of the top companies in each industry have started to invest more, but they are keeping leverage increases within the range necessary to maintain their credit ratings. Also, after making an investment, there is a tendency to refrain from further investing until the debt-to-equity ratio returns to its original level.

Furthermore, Nippon Steel's large-scale acquisition of US Steel can demonstrate the scale of the overall planned investment in the US, which is set to reach roughly Y80tn (\$550bn). Nippon Steel's total investment, including the acquisition of shares and additional capital investment, will come to roughly Y3.6tn. In order to reach roughly Y80tn investment objective, more than 20 large-scale M&A deals with the same scale as the US Steel deal will be necessary.

In recent years, M&A has been the main focus of foreign direct investment by global Japanese companies. Existing facilities, employees, and customers can be acquired in a short period of time, reducing investment risk. If the US government requests new investment rather than M&A, the hurdles to achieving the target will become even more challenging.

Government fiscal spending required so that JBIC and NEXI can provide support?

JBIC supports exporting by Japanese companies, overseas infrastructure projects, manufacturing, and sales through financing, investment, and guarantees. The capital for such investment comes from the government's industrial investments, which are funded by dividends from NTT and JT shares held by the government. The source of financing is fiscal loans from the government and the issuance of government-guaranteed foreign bonds. The source for fiscal loans is FILP bonds, which require the issuance of JGBs.

NEXI provides Japanese companies with insurance for risks that cannot be covered by normal insurance, such as trade transactions and overseas investments.

Amount of JGB issuance needed to finance \$550bn investment in US?

In the first place, will Japanese companies actually accelerate their investment in the US based on an agreement between the Japanese and US governments? It is also difficult to predict the extent to which support from JBIC and NEXI will be utilized. For now, the government will probably make an additional investment of Y1.0 to 2.0tn and see how developments unfold. If necessary, it may increase the amount of FILP bonds issued. According to a 25 July report in the *Asahi Shimbun*, the actual amount to be provided by the government is expected to be “around several trillion yen.”

JBIC's investing/financing balance at the end of FY23 came to Y18.3tn. The portion of that balance applied to the US accounted for about 20% of all investment, at Y3.4tn. Investment by the government came to Y2.2tn. NEXI's insurance balance was Y15.5tn. The figure for North America was Y1.1tn, accounting for approximately 7% of the total. Investment by the government was Y0.2tn. If the full Y80tn in investment support for the US is implemented, the scale of business for both institutions (JBIC and NEXI) will expand several times over and their business domains will become extremely skewed toward the US. It is hard to imagine what that will look like.

If JGBs are issued, one use would be to strengthen the financial bases for JBIC and NEXI in preparation for business expansion. Economic Revitalization Minister and lead-tariff negotiator Ryosei Akazawa said that only “1% to 2%” of its recently agreed upon \$550bn US fund will be in the form of actual investment. As early as the FY25 supplementary budget, there could be a Y1.0 to Y2.0tn increase in construction bonds to provide additional contributions to both institutions.

Another issue is the procurement of funds for JBIC loans. The financial resources will come from FILP bonds or government-guaranteed foreign bonds. However, if FILP bonds are booked as the source of funds, that would impact calendar-based market issuance (of JGBs) within the JGB issuance plan. The portion for which issuance is certain due to increased support will also be financed through FILP bonds. It seems reasonable to book the uncertain portion as government-guaranteed foreign bonds, which would allow for flexible reductions in the amount issued.

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