Economics & Strategy

DBS Focus

G3 rates outlook for 2020: Part 3 (Japan)

Strategy/economics/fiscal/monetary/rates

Group Research

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- *This is the third of a three-part series that explores how G3 rates will be impacted as policy makers tilt towards a more balanced monetary / fiscal mix*
- *Concerns about overly low rates and overly flat curves suggest that the BOJ has no appetite for further monetary easing*
- *The government has also announced a small-scale stimulus, delaying fiscal consolidation in the process*
- *BOJ will maintain the 10Y yield target at ±0.2%. Trading the range is still the clearest way to handle JPY rates*

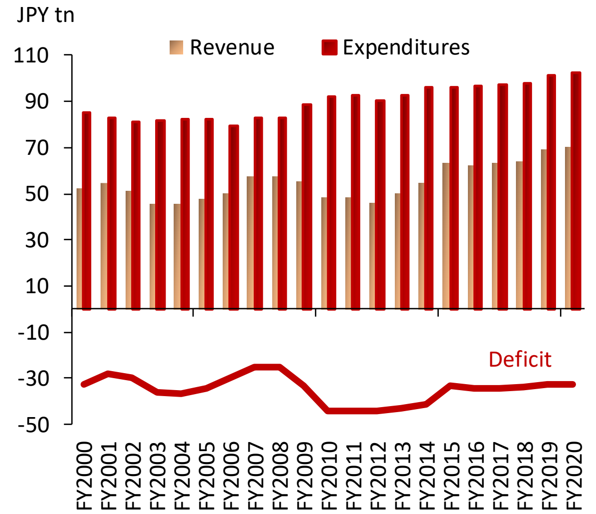
Japan: Fiscal consolidation is slightly delayed

The Japanese government is resorting to small-scale fiscal stimulus to boost the economy, delaying the fiscal consolidation process initially supported by the sales tax reform. **A JPY13tn stimulus package was announced in Dec19** (the first one since 2016), to help the economy recover from the sales tax hike and typhoon disaster, as well as to prevent a slowdown after the 2020 Tokyo Olympics. The headline figures of JPY13tn are inflated by the promised loans and private sector assistance. Funding through the supplementary budget amounts to a small JPY4.5tn, which includes an issuance of deficit-covering bonds worth JPY2.2tn.

The general budget proposed for FY20 is largely neutral. Government revenues and expenditures are projected to increase by a modest 1.9% YoY and 1.2%, respectively. New bond issuance will be kept at JPY32.6tn, roughly unchanged from last year's JPY32.7tn. Including the bonds issued to roll over those reaching maturity, the total amount of bond issuance will increase by JPY4.7tn to JPY 153.5tn. The amount of JGB market issuance through normal auctions will be managed at JPY128.8tn, a JPY0.6tn decline from last year. Note that the government's budget projections imply an optimistic forecast for nominal GDP to grow by 2.1% in FY20, compared to the average of 1.7% in the past six years (after Abenomics was introduced). Given the likelihood of revenue shortfall, the actual size of JGB issuance would exceed expectations by a small margin this year.

More substantial fiscal stimulus remains possible in the next couple of years. The country's next lower house election is required to be held before October 2021. PM Shinzo Abe's term as the LDP leader is scheduled to expire in September 2021. The chance for Abe to call a snap election later this year (after Tokyo Olympics) and seek for an extension of his term as LDP leader should not be ruled out. Whether this will happen and involve a fresh round of fiscal stimulus will be worth watching.

Japan: Fiscal budget (initial)



Sources: CEIC, DBS

Table: JGB issuance plan

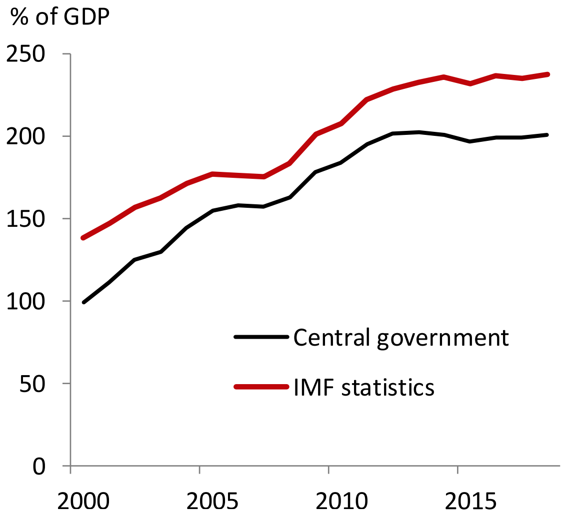
(JPY tn)

	FY20	Changes from FY19
Total	153.5	4.7
- Newly issued bonds	32.6	-0.1
- Refinancing bonds	108.0	4.8
- Market issuance by normal auctions	128.8	-0.6
- Non-price competitive auctions & others	17.7	5.2

Sources: Ministry of Finance, DBS

On the demand side, **the Bank of Japan (BOJ) has been gradually slowing the pace of government bond purchases**. The gross quantity of the BOJ's JGB purchases during the monthly operation plan for Jan20 is calculated to be JPY4.9tn (mid-point of the target range). This translates into an annual pace of JPY59tn, compared to JPY78tn in Jan19 and the peak of JPY109tn in Sep16. The BOJ appears reluctant to allow the long-term yields to stay at the lower-end of its ±0.2% target band for too long, in light of mounting concerns about financial institutions' profit pressures.

Japan: Public debt burden



Sources: CEIC, Bloomberg, DBS

Implications for investors

Global sentiment is still the largest factor driving JGB yields and curve shape. Notably, the BOJ briefly lost control of the 10Y yield during the height of risk aversion in August / September last year as yields dipped below -0.2%.

Assuming that volatility will be more subdued in 2020 and a broadly stable JGB issuance outlook, the ±0.2% range for 10Y yields should hold. Trading the range is still the clearest way to handle JPY interest rates.

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).