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Media Release

RAM Ratings downgrades Japan's rating to $_{g}A_{1(pi)}$/Stable

RAM Ratings has downgraded Japan's global-scale rating to $_{g}A_{1(pi)}$ from $_{g}AA_{3(pi)}$ while revising the outlook on the rating to Stable from Negative, in view of slower-than-anticipated progress in reforms, persistent inflation target misses and fragile economic recovery. "Slowdown in emerging markets, global financial volatility and low oil prices are some challenges to increase growth and inflation in Japan," says Esther Lai, RAM's Head of Sovereign Ratings. Moreover, a 2.5-year postponement of an 8% to 10% sales tax hike to October 2019 demonstrates difficulties in striking a balance between economic growth and fiscal reform. Nevertheless, Japan's rating on the ASEAN scale remains intact at $_{sea}AAA_{(pi)}$/Stable, supported by the country's exceptional external liquidity and strong institutional framework.

While narrowing budget deficits are a step in the right direction, the sheer size of the Japanese government's debt burden – even though entirely yen-denominated – leaves little room for fiscal stimulus. "Japan's fiscal deficit is wider than its A-rated peers' average as fiscal consolidation has been mild to avoid premature tightening of economic growth," adds Lai. Without revenue enhancing measures, corporate income tax reductions and multiple delays in the consumption tax hike will result in the government missing its primary deficit target of -1.0% of GDP by FY 2018 and primary balance target by FY 2020. Due to the narrower fiscal policy space, Japan's ageing and declining population will continue to exert a strain on public finances despite efforts to contain rising social security spending.

On the monetary front, the Bank of Japan (BOJ) has expanded the scope of asset purchases in its quantitative and qualitative easing programme, with a negative interest rate policy in February 2016 and with yield curve control in September 2016. While BOJ is still committed to its price stability target of 2%, the headline inflation rate of -0.6% in September 2016 underscores the complexity of boosting inflation when oil prices are low and the yen is strong. Supported by an entrenched culture of saving, total deposits in the banking system continued to grow, which inevitably dampened private consumption. In addition, total excess reserves of financial institutions held at the central bank continued to expand as loan growth eased to 2.3% y-o-y in September 2016 from a peak of 3.8% in October 2015.

Japan's GDP growth clocked in at 0.5% y-o-y in 2015 and 9M 2016, mainly cushioned by growth in public consumption. Meanwhile, the growth momentum of non-residential private investment is seen to be dissipating as low confidence in economic growth prospects hold back capital investments and credit demand. The retail trade index continued its slide for the 11th consecutive month, reflective of moderation in the growth of tourist arrivals. A downward-trending industrial production index, persistent weaknesses in the wholesale trade and shipment index, and disappointing machinery orders suggest lacklustre external demand – exports contracted 1.0% in 9M 2016. Although we expect 2016's growth to come in at 0.5% as recovery gradually picks up, risks are increasingly tilted to the downside as global demand moderates and domestic demand stays fragile.

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