



Media Release

RAM Ratings revises outlook on Japan to negative as narrower policy space challenges sustained recovery

RAM Ratings has revised the outlook on Japan's $gAA_{3(pi)}$ global-scale rating to Negative from Stable, in view of the recent introduction of negative interest rates which signals increasingly limited policy options to stimulate the economy. We are increasingly concerned over the inability of reforms to spur investments, persistently weak price trends and the waning momentum of rising nominal wages to boost consumption. On the ASEAN-scale, Japan's rating remains intact at $seaAAA_{(pi)}$ /Stable, supported by the country's exceptional external position and strong institutional framework. Nonetheless, as inflationary expectations subside and private consumption falters, risks to economic growth are increasingly tilted to the downside.

While Japan's fiscal consolidation efforts are a step in the right direction, the sheer size of its debt burden – even though entirely yen-denominated – leaves little room for fiscal stimulus and makes it challenging to strike a balance between economic stimulus and fiscal reform. While monetary policy easing has improved financing conditions, translation into inflation has been muted as demand for loans stayed subdued. "We do not expect negative interest rates to spark a significant revival in bank lending," says Esther Lai, RAM's Head of Sovereign Ratings. The negative interest rate in Japan is marginal at only -0.1% of excess reserves held by financial institutions at the central bank. The yen has appreciated and the stock market has slowed subsequent to the introduction of the negative interest rate policy, contrary to the European experience. Given the economic challenges, the government's mid-term primary deficit target of -1.0% of GDP by FY 2018 (-4.4% of GDP in FY 2014) is rather optimistic at this juncture.

Although Japan's GDP grew 0.5% in 2015 in line with RAM's forecast, growth was mainly driven by an uptick in public consumption. This is not deemed sustainable as private consumption, investments and exports have markedly deteriorated. Consumer sentiment is weak, with retail spending observed to have declined. Despite a tighter labour market, the surging number of inbound tourists, and low energy prices that free up purchasing power, private consumption contracted by 1.1% y-o-y in 4Q 2015. Enterprises across all industries expect business sentiment and sales to drop, with this trend continuing into 1Q 2016. Although volatility is anticipated in the lead-up to the sales tax hike in April 2017, we do not foresee the

front-loading of durable goods purchases to be as strong as it was prior to the previous sales tax hike.

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