



Media Release

RAM Ratings reaffirms Japan's $gA_1(\text{pi})/\text{Stable}$ rating

RAM Ratings has reaffirmed Japan's respective global- and ASEAN-scale ratings of $gA_1(\text{pi})/\text{Stable}/gP1(\text{pi})$ and $_{\text{sea}}AAA(\text{pi})/\text{Stable}/_{\text{sea}}P1(\text{pi})$. The ratings reflect the country's moderate recovery path, robust external finances and solid institutional framework. These strengths are, however, balanced by a hefty public debt burden, slow progress in structural reforms and inflation that is persistently below target. "The government, by delaying its time frame for achieving a primary balance to beyond its target of FY 2020, demonstrates the difficulties in striking a balance between economic growth and fiscal reform," says Esther Lai, RAM's Head of Sovereign Ratings.

Japan's GDP growth for the latest quarter clocked in its 7th consecutive expansion. Exports surged in 2017 mainly due to stronger global IT-related demand, led by demand for smartphones. Although the consumer confidence index has been trending upwards, the pace of expansion in the consumption of durable goods appears to be dissipating as the effects of 2016's fiscal stimulus wane. Nonetheless, a steady inflow of tourist arrivals, at 18% y-o-y for 10M 2017, provided an uplift to retail trade. Private investment has also contributed positively to growth, with non-residential investment advancing as firms invest in labour-saving machines to overcome labour shortages. In view of a more broad-based recovery, we expect GDP to grow 1.4% in 2018 before moderating in 2019, given a scheduled consumption tax hike that will be a drag on growth.

With a debt-to-GDP ratio of 250%, Japan's government is the world's most indebted. Despite its lofty debt level, refinancing risks are limited as all its debts are denominated in the yen – with domestic investors holding 89% of Japanese Government Bonds (JGBs) and treasury bills as at end-June 2017 – while the average maturities of JGBs are favourable, estimated at 9 years. Japan's fiscal deficit has improved steadily from a peak of -9.0% of GDP in FY 2009 to -4.5% of GDP in FY 2015, given the fiscal discipline observed in terms of limiting growth in expenditure, especially social security spending. Nonetheless, fiscal consolidation has been mild to avoid premature tightening of economic growth and reflation prospects. While the timeline for achieving a primary balance has been extended to beyond FY 2020, which signals a more realistic pace of consolidation, no concrete medium-term fiscal plans have been revealed.

Besides weak government finances, Japan has a host of structural issues to address. On the labour market front, the contracting labour force had seen a reversal since late-2013 with the increased participation of women and older workers, while the rise in the number of full-time employees has exceeded that of part-time workers since 2016. Despite a tight labour market and a higher minimum wage, wage growth has been muted. As such, in FY 2017 tax reforms, the threshold for spousal tax deduction was raised and an additional bonus tax credit of 12% introduced to spur companies to increase salaries. While the government has initiated the Work Style Reform Plan to help address the said issues, implementation is anticipated to be slow. Given the deeply entrenched and complex structural issues, downside risks remain.

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