



Japanese Economy and Debt Management – Recent Challenges –

Ministry of Finance Japan

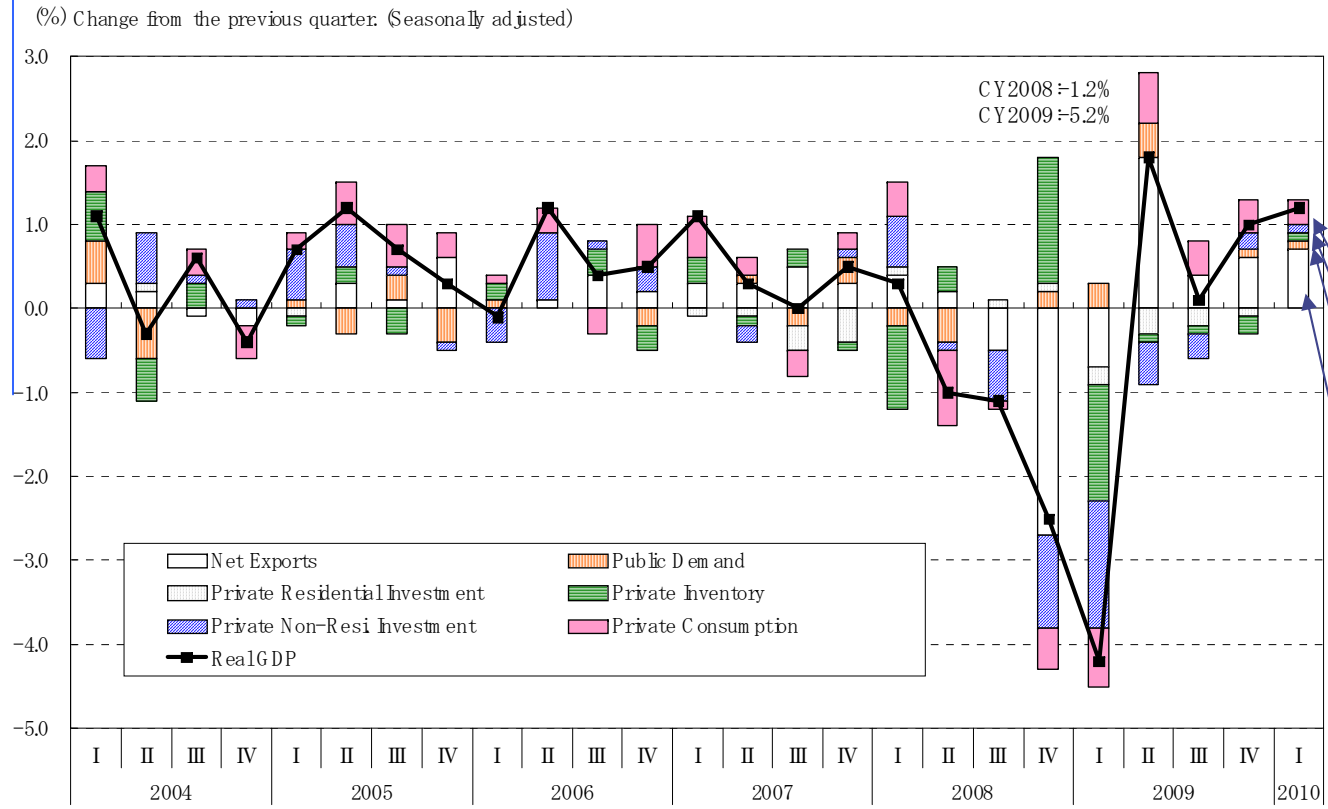
The Japanese Credit Investor Forum
June 21, London



1. Japanese Economy



1-1. Real GDP and Level of Contribution



(Source) Cabinet Office

	2010 1st Quarter	2009 4th Quarter
Real GDP	1.2%	1.1%
(Annualized rate)	5.0%	4.6%
	Growth Rate (contribution)	Growth Rate (contribution)
Private Consumption	0.4%	0.7%
Private Non-Residential Investment	0.3%	0.4%
Private Residential Investment	0.6%	1.1%
Private Inventory	0.1%	0.2%
Public Demand	0.4%	-2.6%
Net Exports	0.0%	-0.1%
	-	-0.2%
	0.3%	0.4%
	0.1%	0.1%
	0.7%	0.7%
Nominal GDP	1.3%	0.3%

Changes of Japanese Real and Nominal GDP (actual figure)						
	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009
Real GDP	2.0	2.3	2.3	1.8	▲ 3.7	▲ 2.0
Nominal GDP	1.0	0.9	1.5	0.9	▲ 4.2	▲ 3.7

(% change from the previous year)

Government-Economic Outlook (January 2010)		
	FY2009	FY2010
Real GDP	▲ 2.6	1.4
Nominal GDP	▲ 4.3	0.4

(% change from the previous year)



1-2. GDP by expenditure

	2008		2009								2010	
	4Q		1Q		2Q		3Q		4Q		1Q	
	Changes from previous quarter	Contributions	Changes from previous quarter	Contributions	Changes from previous quarter	Contributions	Changes from previous quarter	Contributions	Changes from previous quarter	Contributions	Changes from previous quarter	Contributions
Real GDP Growth Rate (Annualized rate)	▲2.5 (▲9.6)	–	▲4.2 (▲15.8)	–	1.7 (6.9)	–	0.1 (0.4)	–	1.1 (4.6)	–	1.2 (5.0)	–
Domestic Demand	0.2	0.2	▲3.4	▲3.5	▲0.1	▲0.1	▲0.2	▲0.2	0.4	0.4	0.6	0.6
Private Consumption	▲0.8	▲0.5	▲1.2	▲0.7	1.0	0.6	0.6	0.4	0.7	0.4	0.4	0.3
Private Residential Investment	3.0	0.1	▲7.1	▲0.2	▲9.8	▲0.3	▲7.3	▲0.2	▲2.6	▲0.1	0.4	0.0
Private Non-Resi Investment	▲6.9	▲1.1	▲9.7	▲1.5	▲3.8	▲0.5	▲2.1	▲0.3	1.1	0.2	0.6	0.1
Private Inventory	–	1.5	–	▲1.3	–	▲0.2	–	▲0.1	–	▲0.2	–	0.1
Government Consumption	1.1	0.2	0.7	0.1	0.1	0.0	0.1	0.0	0.7	0.1	0.4	0.1
Public Investment	0.2	0.0	3.8	0.1	7.5	0.3	▲0.8	0.0	▲0.9	0.0	▲0.5	▲0.0
External Demand	–	▲2.7	–	▲0.7	–	1.8	–	0.3	–	0.7	–	0.7
Nominal GDP Growth Rate	▲1.1		▲4.4		0.2		▲0.3		0.3		1.3	

(source) Cabinet Office

(%)



1-3. Japanese economic outlook

(% Change from the previous year)

		FY2009	FY2010	FY2011
Government - Economic Outlook (January 2010)	Real GDP	-2.6	1.4	-
	Nominal GDP	-4.3	0.4	-
Bank of Japan - Forecast of the Majority of Policy Board Members (April 2010) <small>* the median of the forecasts of Policy Board members</small>	Real GDP	-2.2	1.8	2.0
	CPI (excluding fresh food)	-1.6	-0.5	0.1

(% change from the previous year)

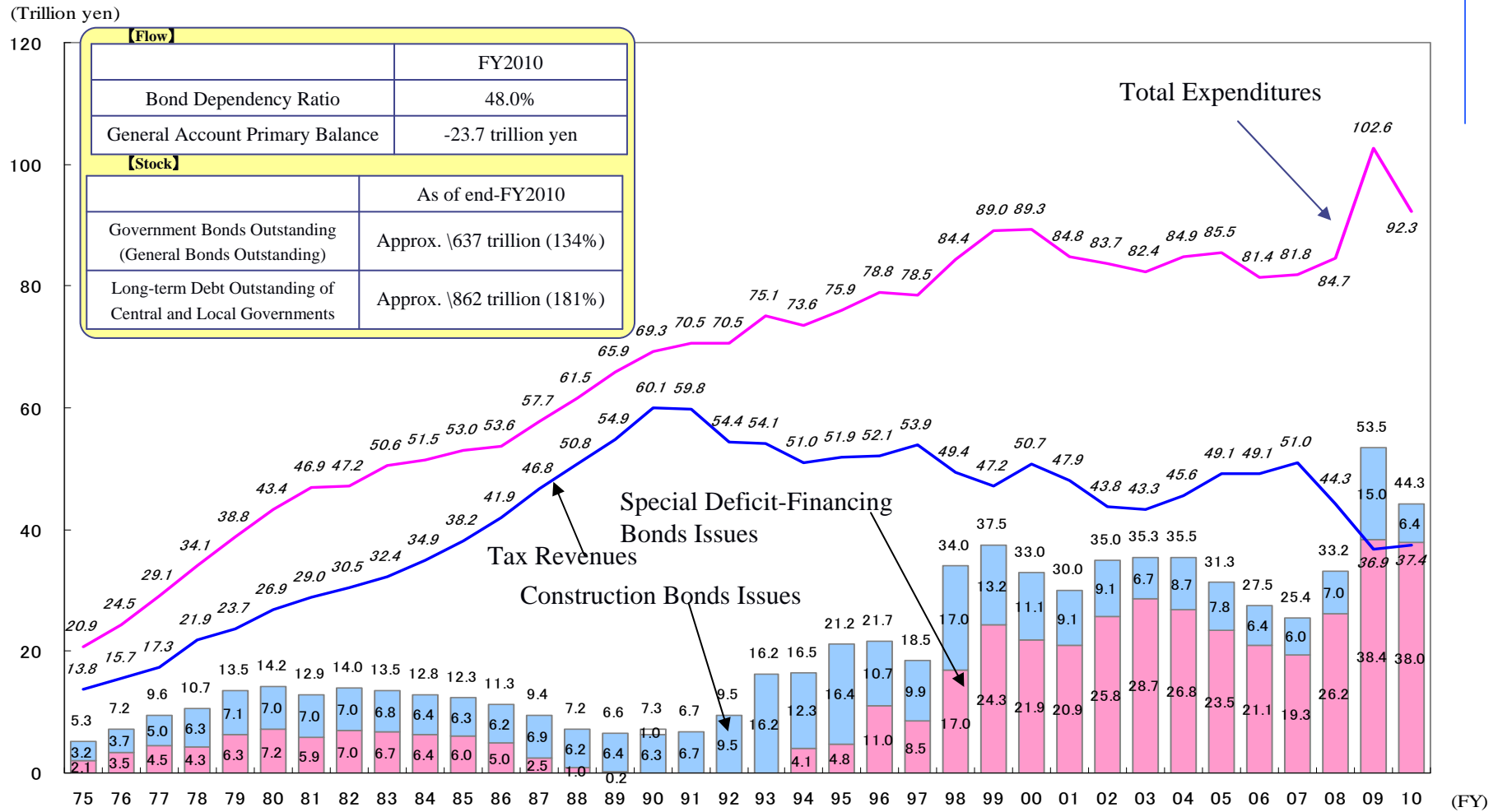
		CY2009	CY2010	CY2011
IMF - World Economic Outlook (April 2010)	Real GDP	-5.2	1.9	2.0
OECD - Economic Outlook (May 2010)	Real GDP	-5.2	3.0	2.0



2. Debt Issuance and Debt Outstanding

2-1. FY2010 Japan's Fiscal Condition

(Trends in General Account Tax Revenues, Total Expenditures, and Government Bond Issues)



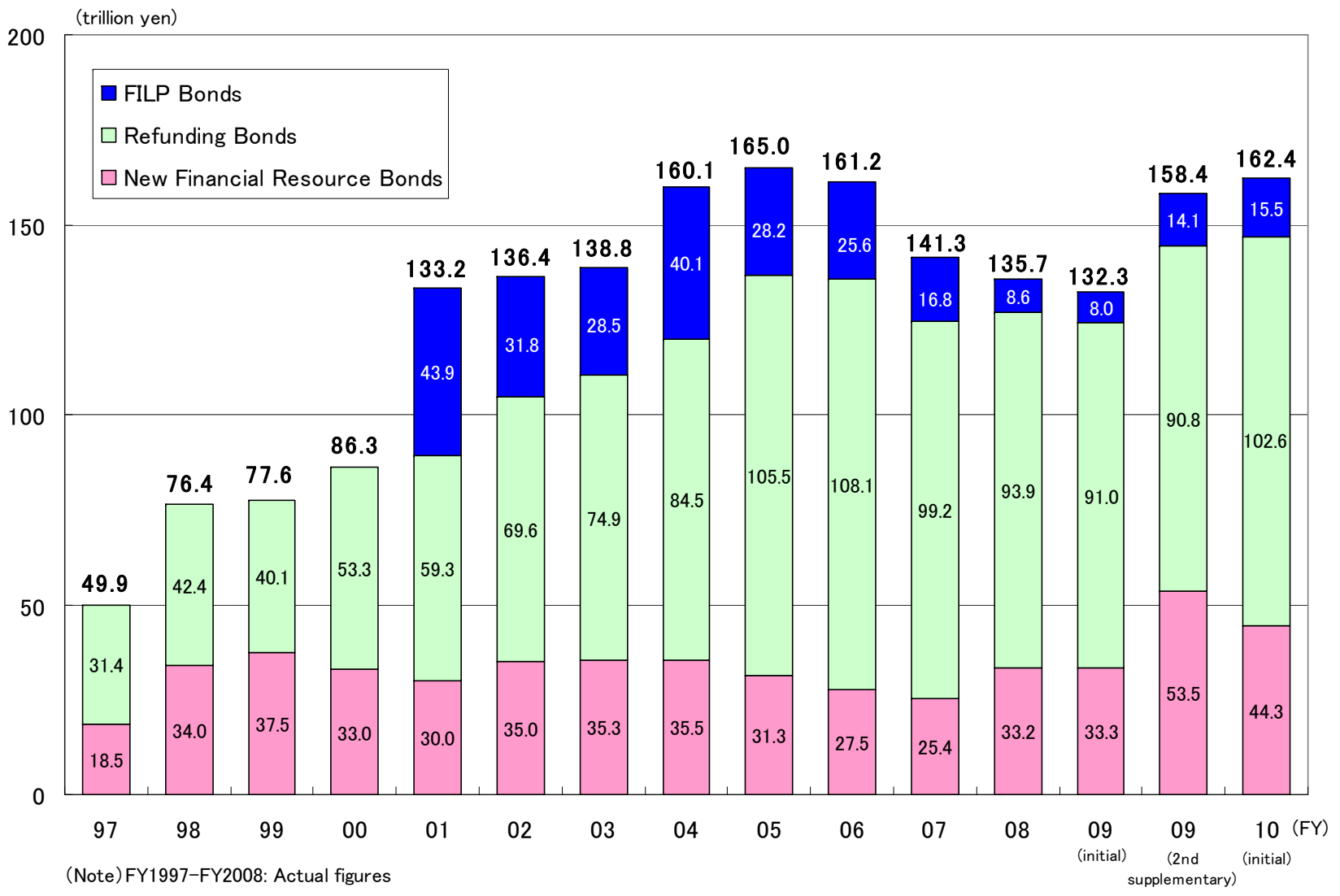
(Note 1) FY1975-2008: Settlement; FY2009: Second revised budget; FY2010: Initial Budget

(Note 2) The special deficit-financing bonds outstanding include refunding bonds for long-term debts transferred from JNR Settlement Corporation, National Forest Service, etc.

(Note 3) General Account Primary Balance is calculated based on the easy-to-use method of National Debt Service minus Government Bond Issues, and is different from the Central Government Primary Balance on an SNA basis.

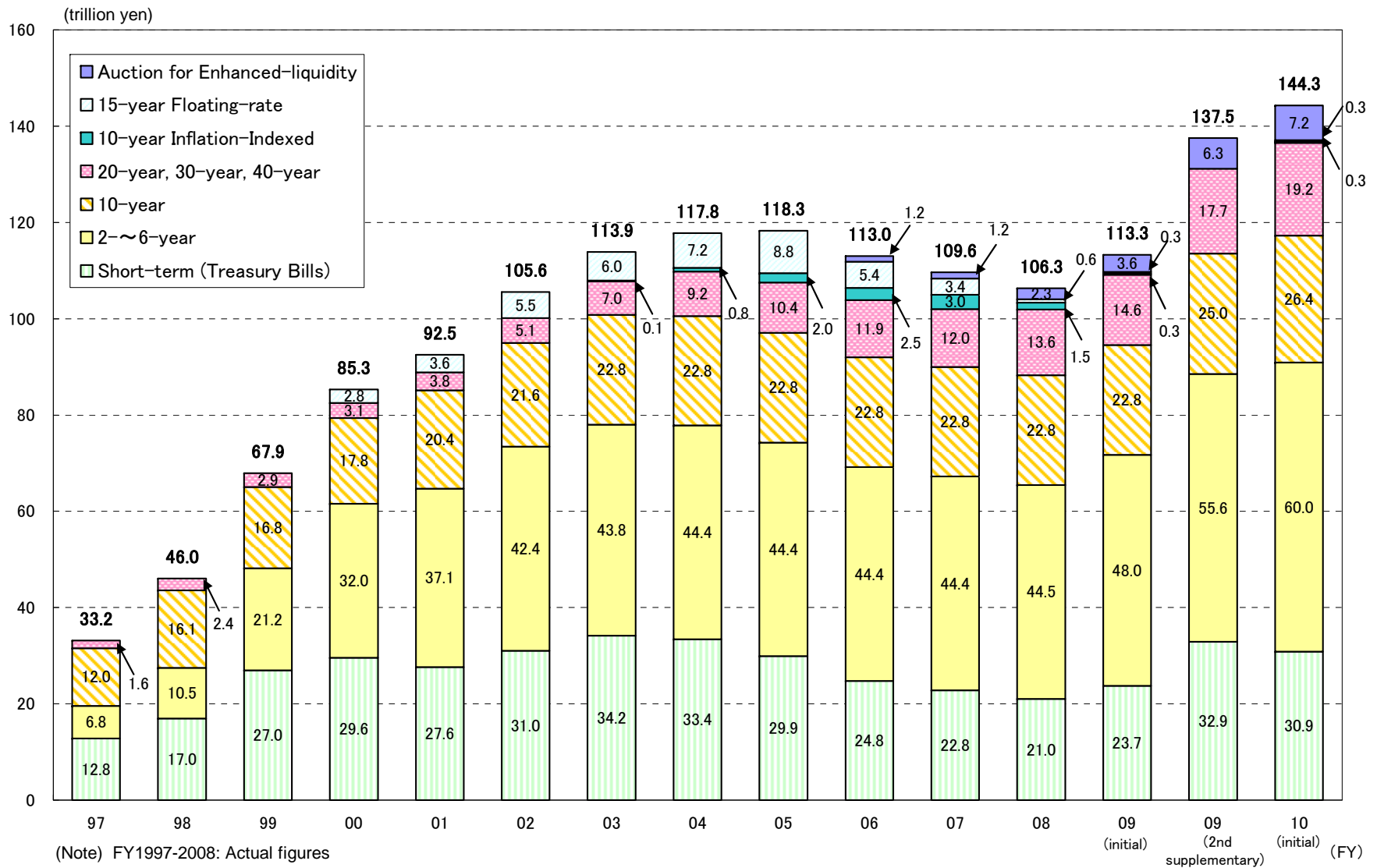


2-2. Historical Changes in JGB Issuance Plan





2-3. Market Issuance Plan by JGB Types





2-4. Market Issuance Plan by JGB Types

(trillion yen)

	FY2009 (initial)		FY2009 (2nd Supplementary budget)			FY2010 (initial)		
	(a)		(b)	(b) - (a)	(c)	(c) - (a)	(c) - (b)	
40-year	0.2 × 4 times	0.8	0.2 × 1 time 0.3 × 3 times	1.1 + 0.3	0.3 × 4 times	1.2 + 0.4	+ 0.1	
30-year	0.5 × 6 times	3.0	0.5 × 2 times 0.6 × 5 times	4.0 + 1.0	0.6 × 8 times	4.8 + 1.8	+ 0.8	
20-year	0.9 × 12 times	10.8	0.9 × 3 times 1.1 × 9 times	12.6 + 1.8	1.1 × 12 times	13.2 + 2.4	+ 0.6	
10-year	1.9 × 12 times	22.8	1.9 × 3 times 2.1 × 5 times 2.2 × 4 times	25.0 + 2.2	2.2 × 12 times	26.4 + 3.6	+ 1.4	
5-year	2.0 × 12 times	24.0	2.0 × 3 times 2.3 × 4 times 2.4 × 5 times	27.2 + 3.2	2.4 × 12 times	28.8 + 4.8	+ 1.6	
2-year	2.0 × 12 times	24.0	2.0 × 3 times 2.4 × 5 times 2.6 × 4 times	28.4 + 4.4	2.6 × 12 times	31.2 + 7.2	+ 2.8	
TBs (1-year)	1.9 × 12 times	22.8	1.9 × 3 times 2.3 × 4 times 2.5 × 5 times	27.4 + 4.6	2.5 × 12 times	30.0 + 7.2	+ 2.6	
TBs (6-month)		0.9		5.5 + 4.6		0.9	— ▲ 4.6	
15-year Floating-rate	0.3 × 1 time	0.3		— ▲ 0.3	0.3 × 1 time	0.3	— + 0.3	
10-year Inflation-Indexed	0.3 × 1 time	0.3		— ▲ 0.3	0.3 × 1 time	0.3	— + 0.3	
Auctions for Enhanced-liquidity	0.3 × 12 months	3.6	0.3 × 3 months 0.6 × 9 months	6.3 + 2.7	0.6 × 12 months	7.2 + 3.6	+ 0.9	
Total to the Market	113.3		137.5	+ 24.2	144.3	+ 31.0	+ 6.8	

Note 1: In addition to the above plan, 40-year, 30-year, 20-year, 10-year, 5-year, 2-year, 15-year Floating-rate and 10-year Inflation-Indexed bonds will be issued via Non-price competitive auction II, which will be held for JGB Market Special Participants after the price-competitive auction (the amount assignable to each Market Special Participant will not exceed 15% of the amount awarded to it in the price-competitive auction).

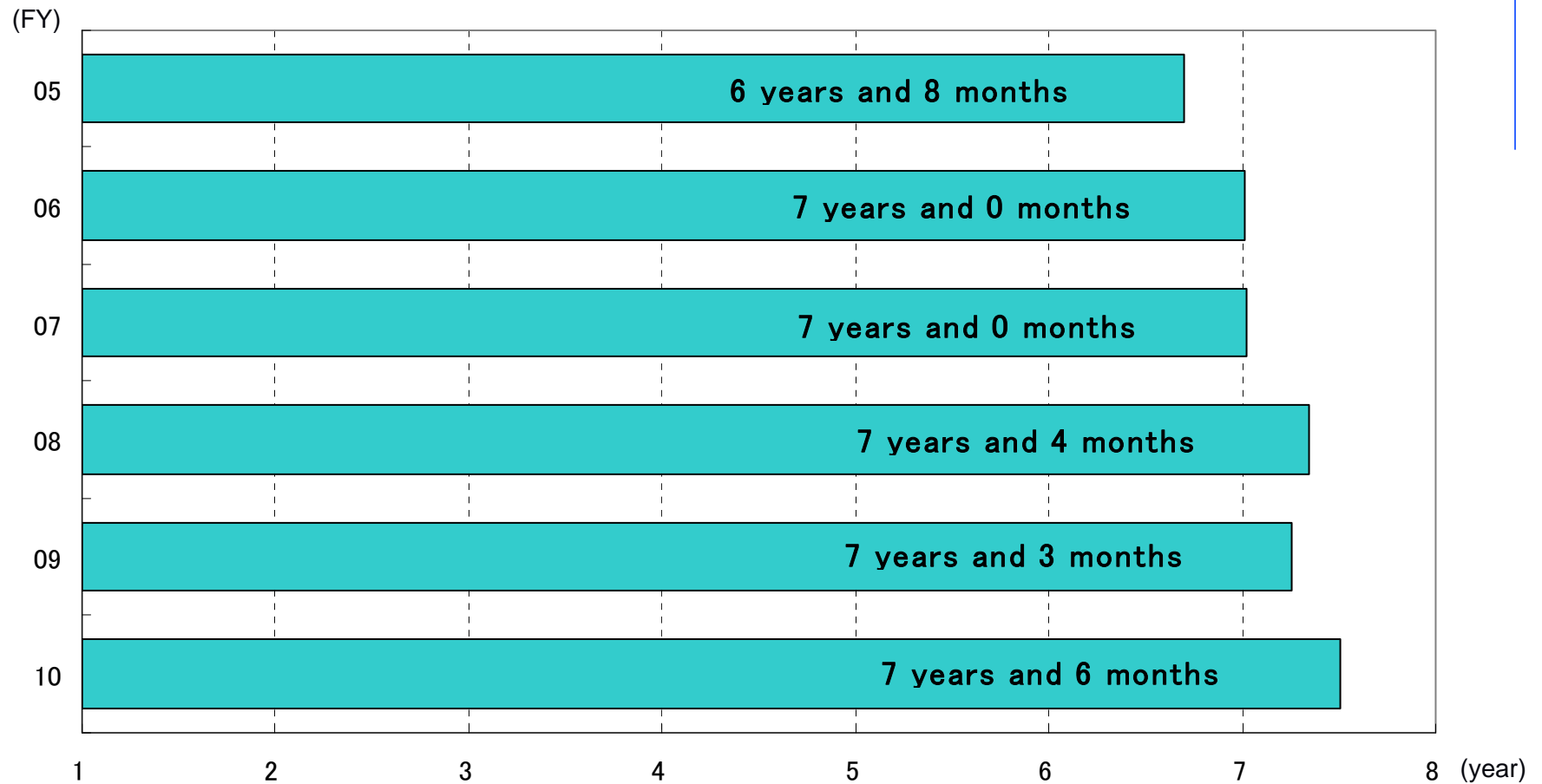
Note 2: With regard to 6-month TBs, only the total amount is listed because TBs and FBs are issued as unified bills (Treasury Discount Bills).

Note 3: 40-year bonds will be issued in May, August, November and February. 30-year bonds will be issued in April, June, July, September, October, December, January and March in FY2010.

Note 4: The issuance of the 15-year Floating-rate bonds and 10-year Inflation-Indexed bonds in FY2010 could be called off, taking in the market conditions.



2-5. Average Maturity



【The Average Maturity of JGB Market Issuance “Calendar Base”】

(Note) FY2005-2008: Actual figures, FY2009: Figures based on 2nd Supplementary budget, FY2010: Figure based on the initial issuance plan



2-6. Basic Philosophy of the JGB Issuance Plan

◆ Predictability

The JGB issuance plan for the fiscal year is to be formulated and announced at the end of the previous year, which provide market participants with the predictability for the market issuance.

◆ Transparency

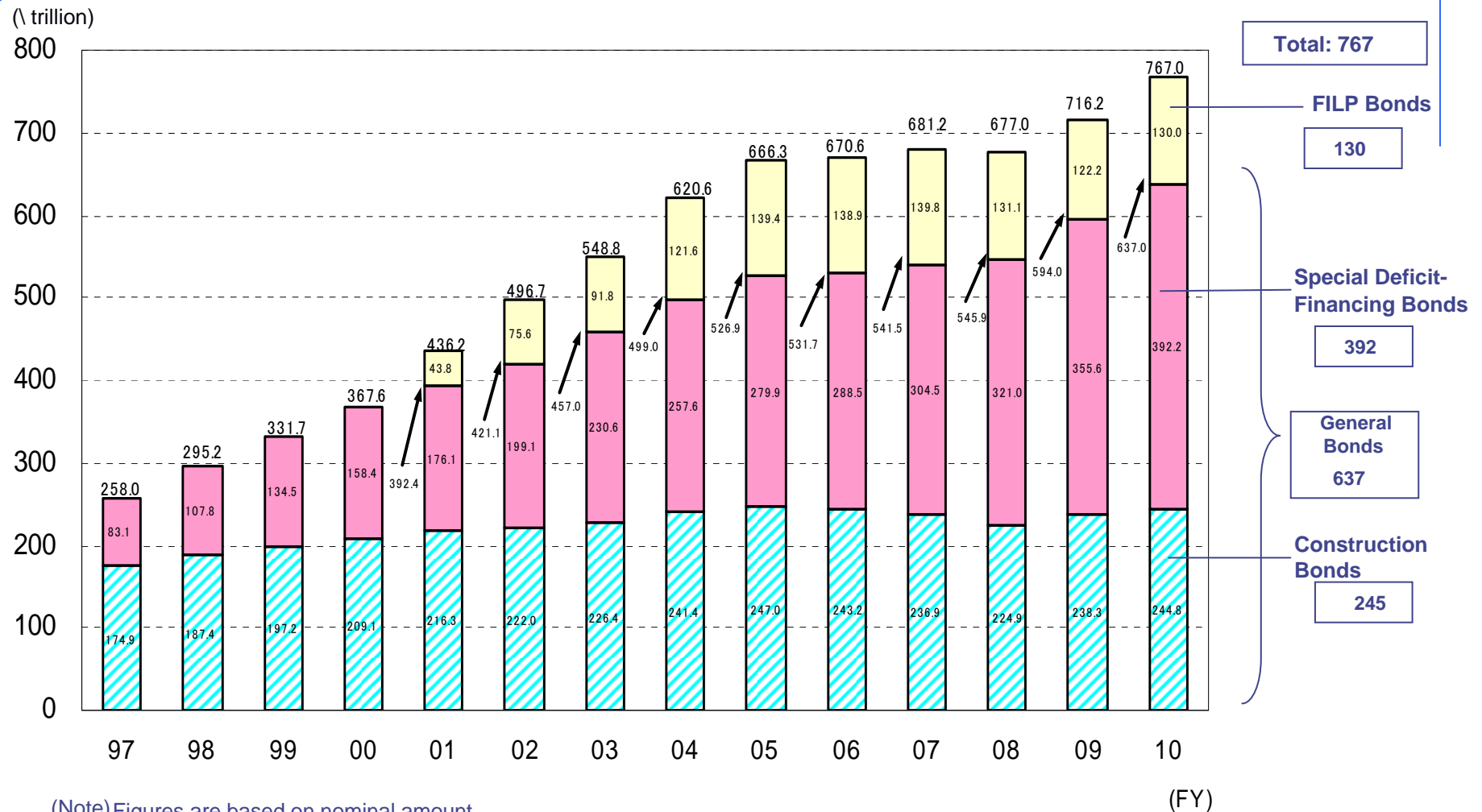
The JGB issuance plan is to be formulated in consultation with the market participants, including primary dealers and investors, so that the plan could reflect market needs properly. The record of such consultation is to be made public on the JGB web-pages.

◆ Flexibility

Responding to the change of the market conditions after formulating the issuance plan, we would flexibly review and revise the plan by conferring with the market participants.



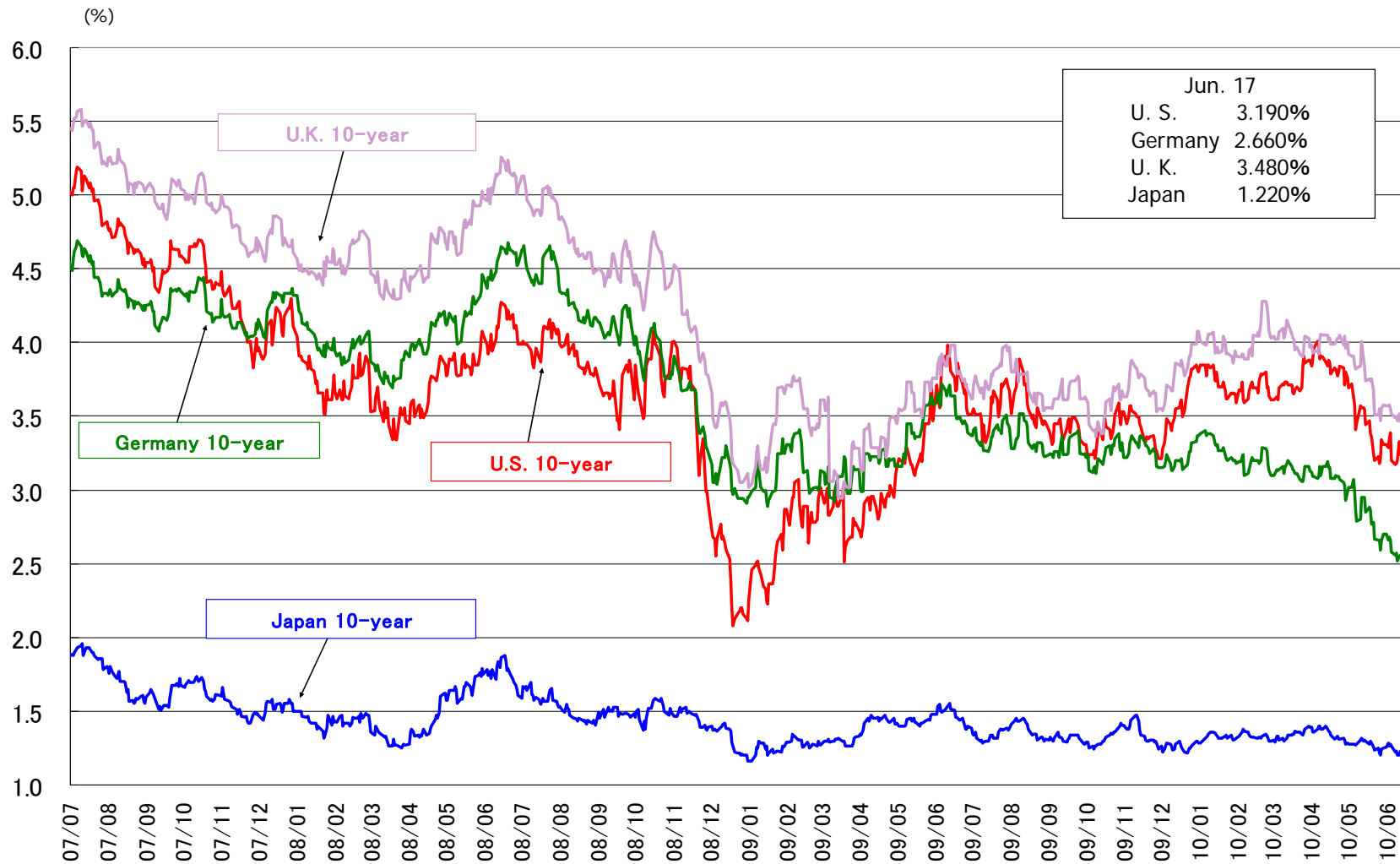
2-7. Outstanding JGBs



(Note) Figures are based on nominal amount.
 FY1997-FY2009: Actual figures, FY2010: initial



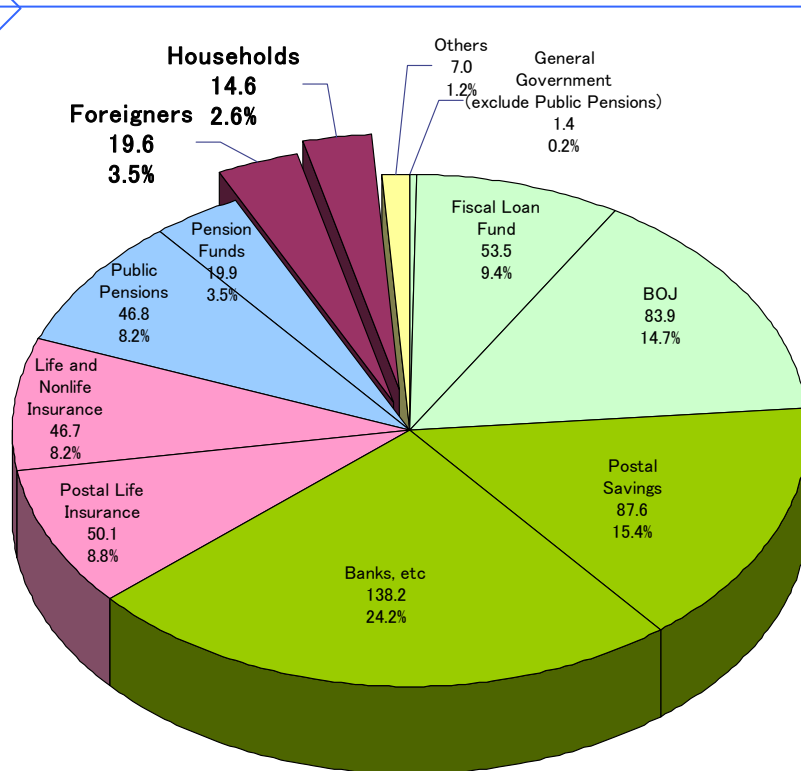
2-8. Long-term Interest Rate



As of
Jun.17

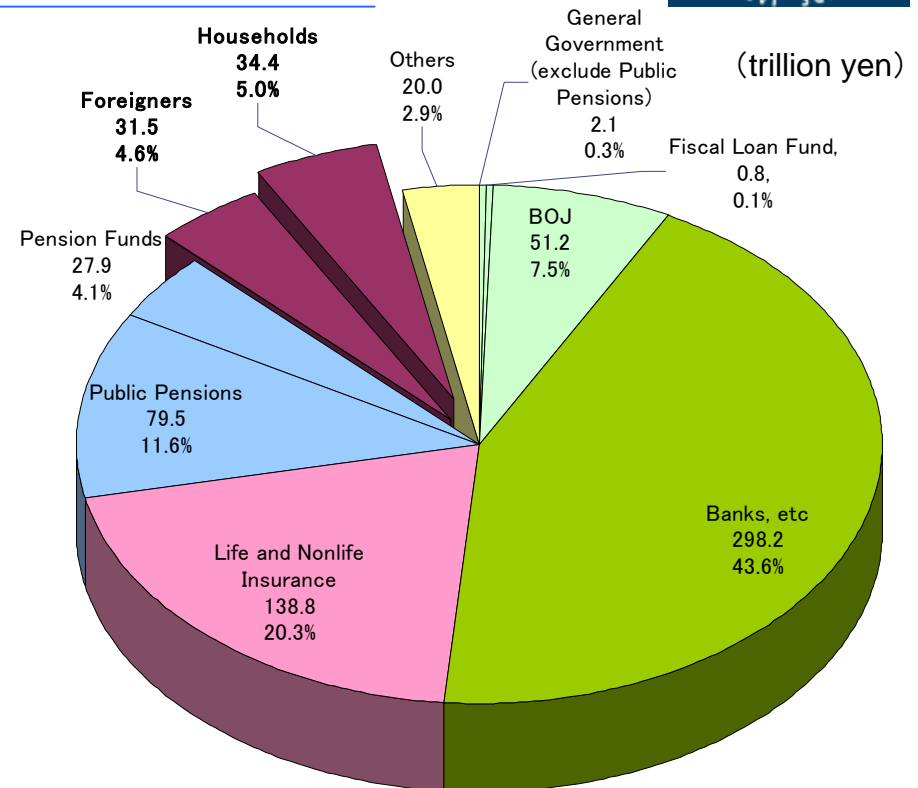


2-9. Breakdown of JGB Holders



Total 569.5 trillion yen

The end of Mar. 2004



Total 684.3 trillion yen

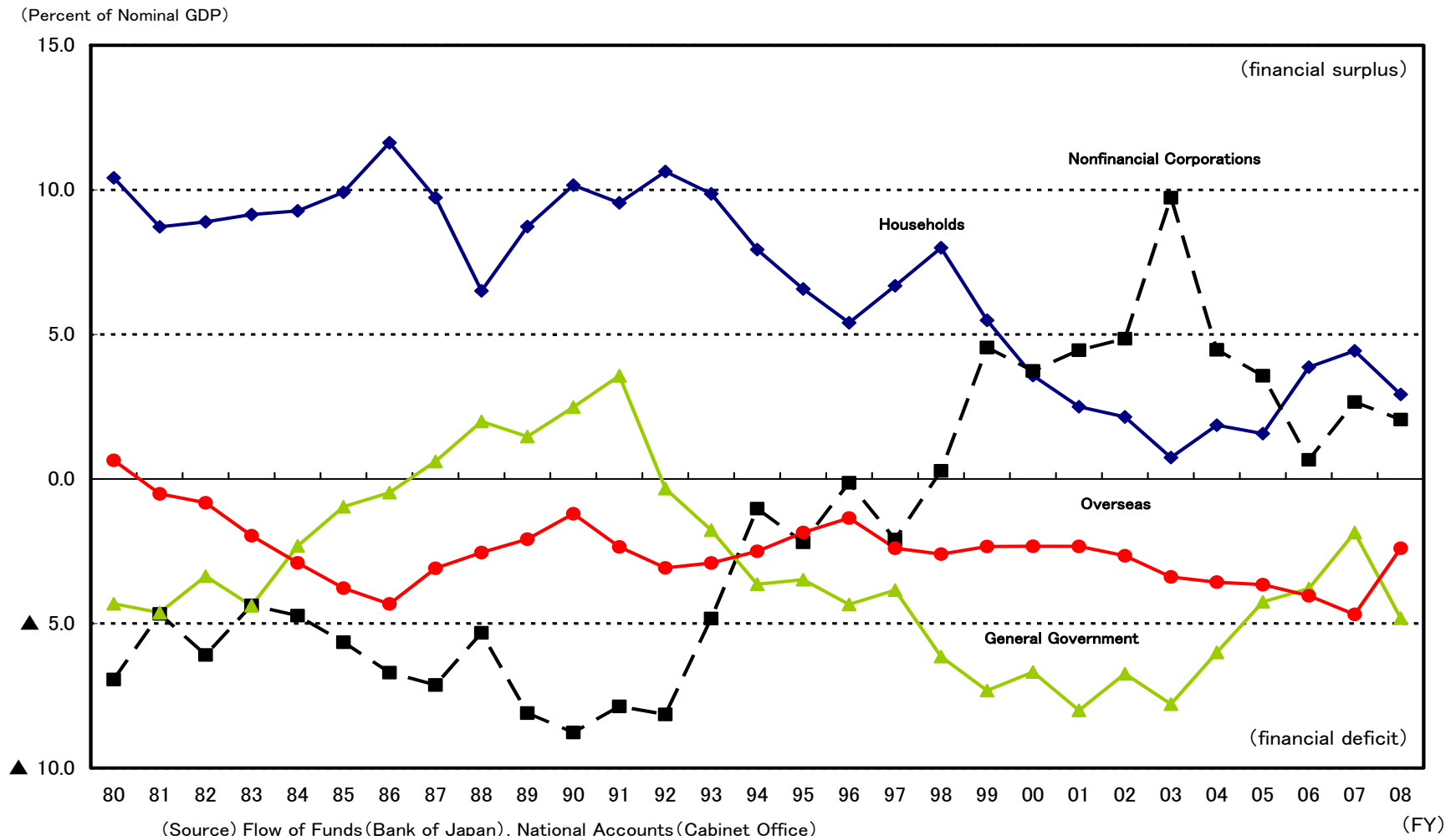
The end of Mar. 2010
(QE)

(Note) "Banks, etc." include "Securities investment trust" and "Securities Companies".
From preliminary figures of the end of December 2007, Banks, etc includes Japan Post Bank. Life and Nonlife Insurance includes Japan Post Insurance.

(Source) Bank of Japan "Flow of Funds"



2-10. Financial Surplus of Deficit per Nominal GDP



2-11. Outline of “Issue brief of the Study Commission of medium-term fiscal management”

(Apr. 6, 2010 National Policy Unit) ①



Provisional translation

I . Basic Concepts ~Emphasize Integrity and be based on prudent economic assumptions~

People are requesting the Government ever more strongly to ensure social safety-net such as employment and the social security systems. In order for the Government to fulfill such roles, fiscal consolidation is essential. It will also contribute to relieve people’s anxieties about the future as well as to gain a foothold in economic growth.

Fiscal consolidation plan must be based on prudent economic assumptions, which is distinct from the targeted growth rates in “The New Growth Strategy.” The government should also emphasize integrity of fiscal management, and should strictly refrain from fiscal management which relies on transfer of funds and/or deficits among different government’s accounts. The government should also ensure strong commitment to fiscal rules, while incorporating flexible mechanisms in order to cope with economic fluctuations.

II . Image of Fiscal Management Strategy ~Set both flow-based and stock-based targets~

Fiscal Consolidation Targets

For example, set a step-by-step targets such as below. Medium- and long-term fiscal consolidation targets should cover not only the central government but also the local governments.

	Goals / Milestones (example)	Target year
↑	IV. Stably reducing public debt to GDP ratio (stock target) = Achieving required primary surplus (flow target)	FY 20XX
	III. Achieving primary balance	FY 20XX
	II. Halving primary deficit (share of GDP or money amount)	FY 20XX
	I. Establishing medium-term fiscal framework for the next three years (FY2011-13)	(FY2013)

(Note) As for the flow target, fiscal balance instead of the primary balance could also be used. (For instance, the EU adopts fiscal deficit to GDP (within minus 3%) as a standard.)

Fiscal Management Rules

In order to securely achieve fiscal consolidation targets, combining multiple fiscal management rules such as below is desirable.

- I. Politically-led/Top-down budget formulation system
- II. Pay-as-you-go principle : to cover permanent increase in expenditures or tax cuts by permanent expenditure cuts and/or revenue measures
- III. Fiscal deficit (or structural fiscal deficit) reduction rules : improving fiscal deficit (or structural fiscal deficit, which excludes cyclical factors) at consistent pace until the fiscal consolidation target is achieved.

2-11. Outline of “Issue brief of the Study Commission of medium-term fiscal management”

(Apr. 6, 2010 National Policy Unit) ②



Provisional translation

III. Image of Medium-term Fiscal Framework ~Binding overall expenditure framework, while maintaining flexibility of budget allocation within the framework~

Medium-term fiscal framework would include binding framework of expenditures for the next three years (initially, from FY2011 to FY2013), and the government will formulate each year’s budget request and budget plan in line with the Framework.

It is important to combine binding force of macro-level expenditure frameworks with flexibility of micro-level budget allocation. At a minimum, the government should consider to introduce “Pay-as-you-go” principle, whereby covering permanent increase in discretionary expenditures, including the social security expenditures, by permanent expenditures cuts and/or tax measures.

The Government should demonstrate its strong commitment to contain runaway government bond issuance.

IV. Other

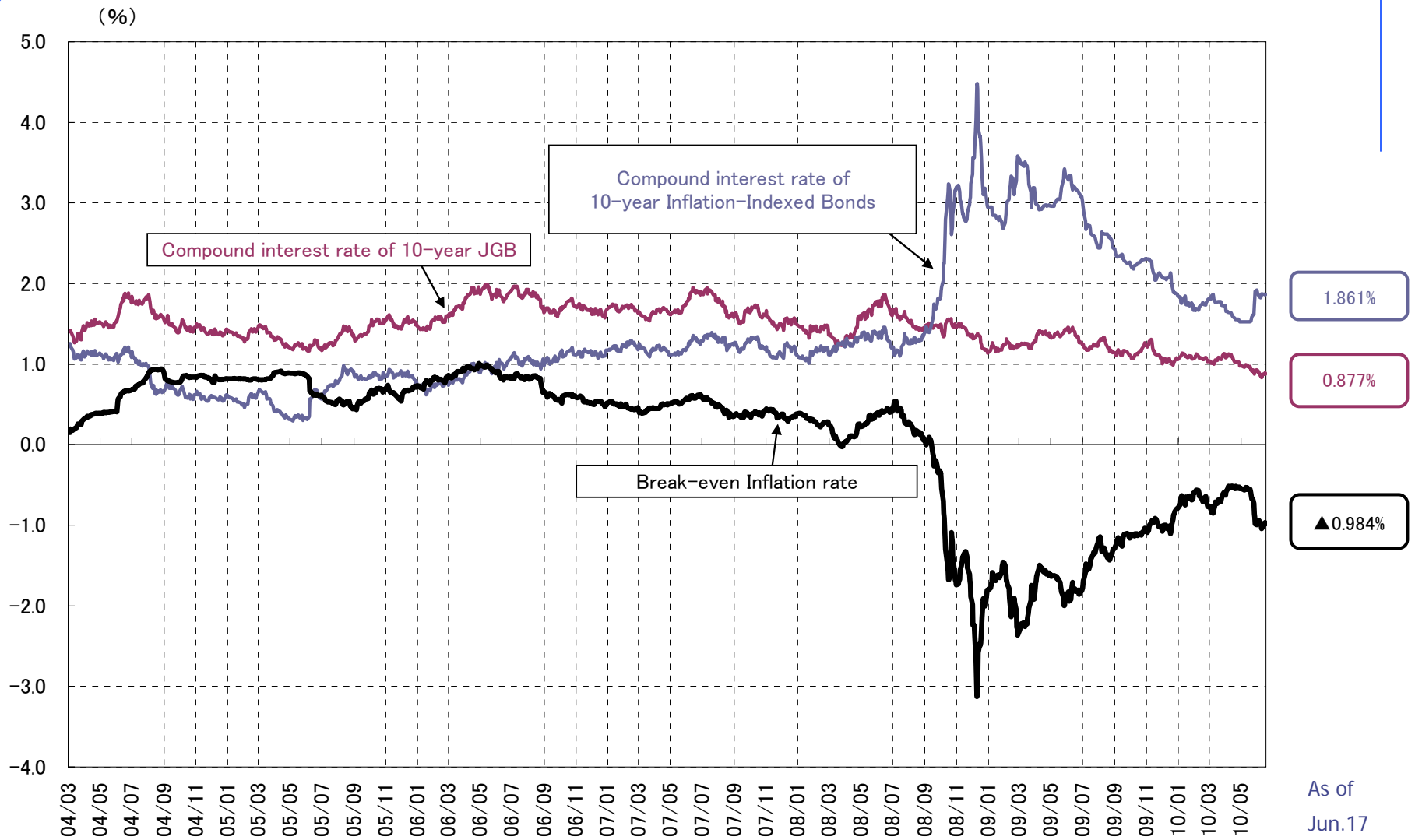
To ensure necessary public services for the people, the government should make thorough discussions for realizing fundamental tax reform in addition to comprehensive expenditure reforms. Fiscal consolidation is our common and long-term challenge, and therefore supra-partisan efforts are called for.



3. Inflation-Indexed Bond



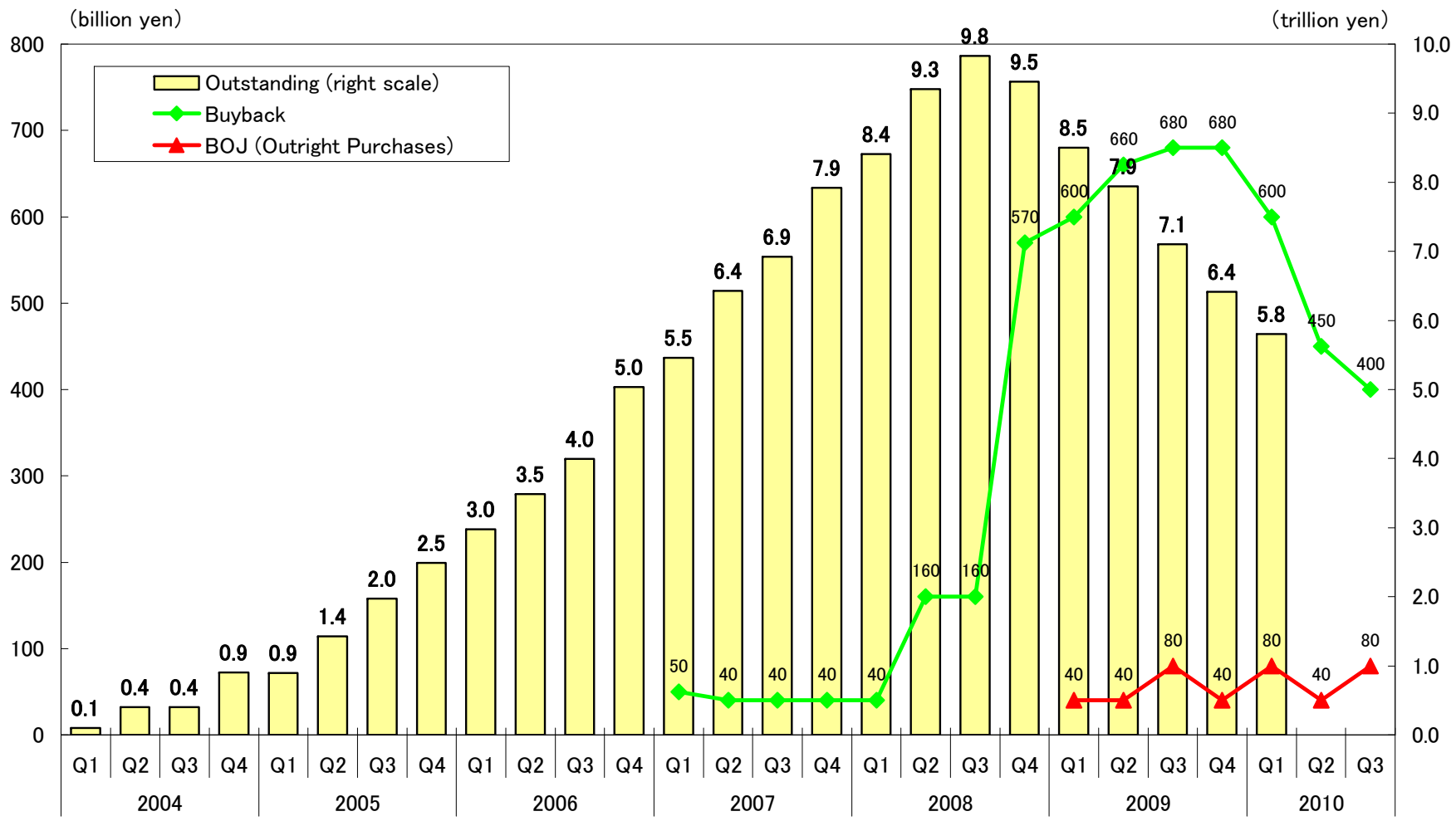
3-1. Interest Rate of 10-year Bonds and 10-year Inflation-Indexed Bonds, and the BEI rate



As of Jun.17



3-2. Outstanding and Buyback Amount of 10-year Inflation-indexed Bonds



(note) Figures based on the initial plan

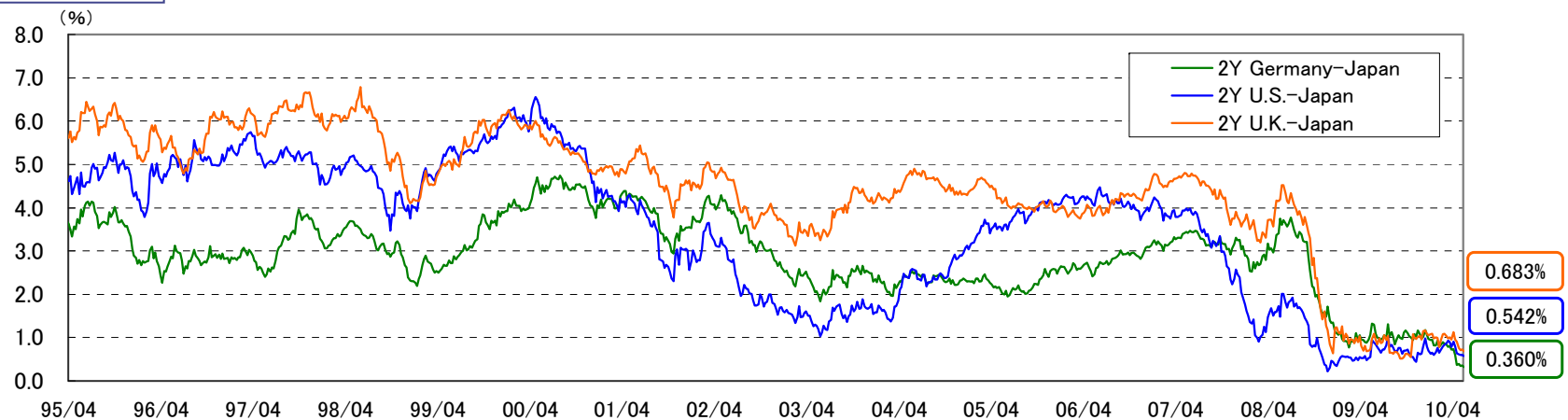


4. Others



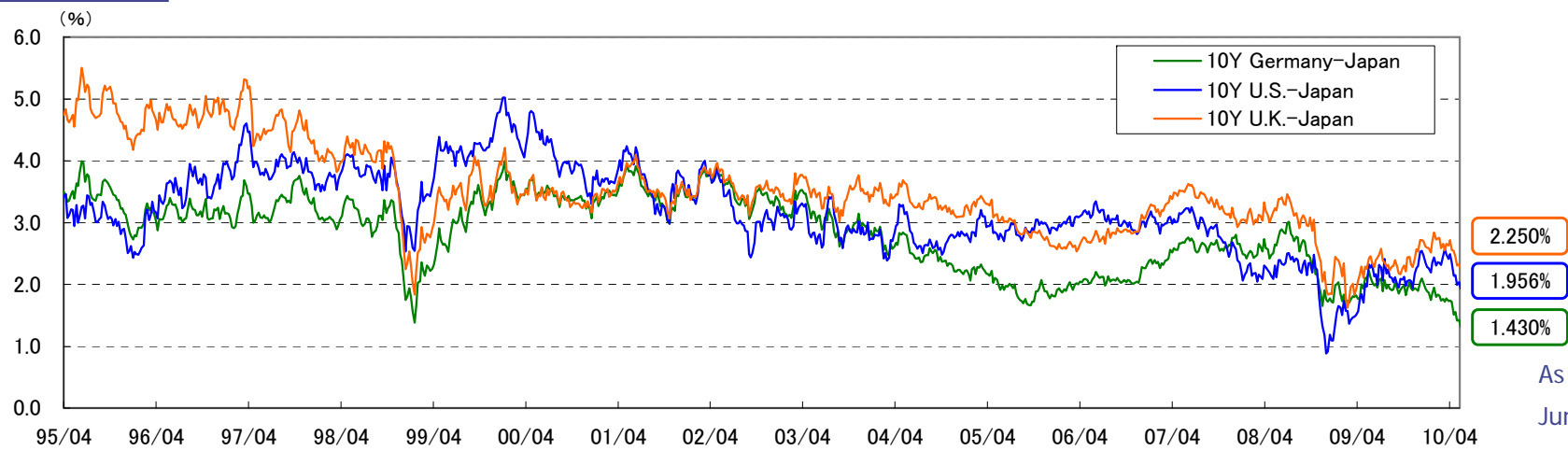
4-1. Yield Spread between JGBs and Other Government Bonds

2-year



(Note) 09/11/12 Bloomberg changed 2year - current Gilt (3.25% 12/7/11 → 4.25% 3/7/11)

10-year

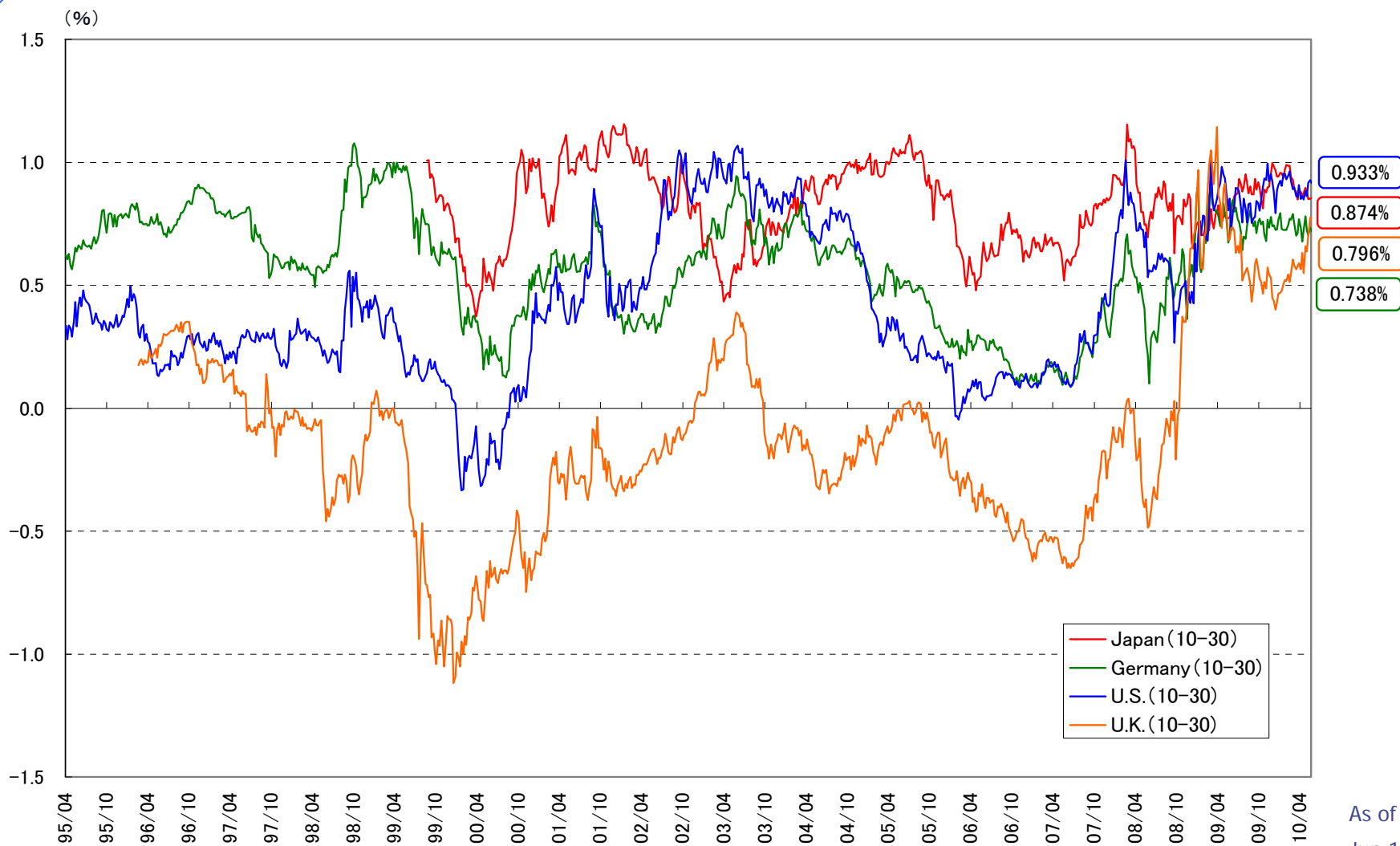


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(Source) Bloomberg



4-2. Comparison of Yield Spread (10-30 year)

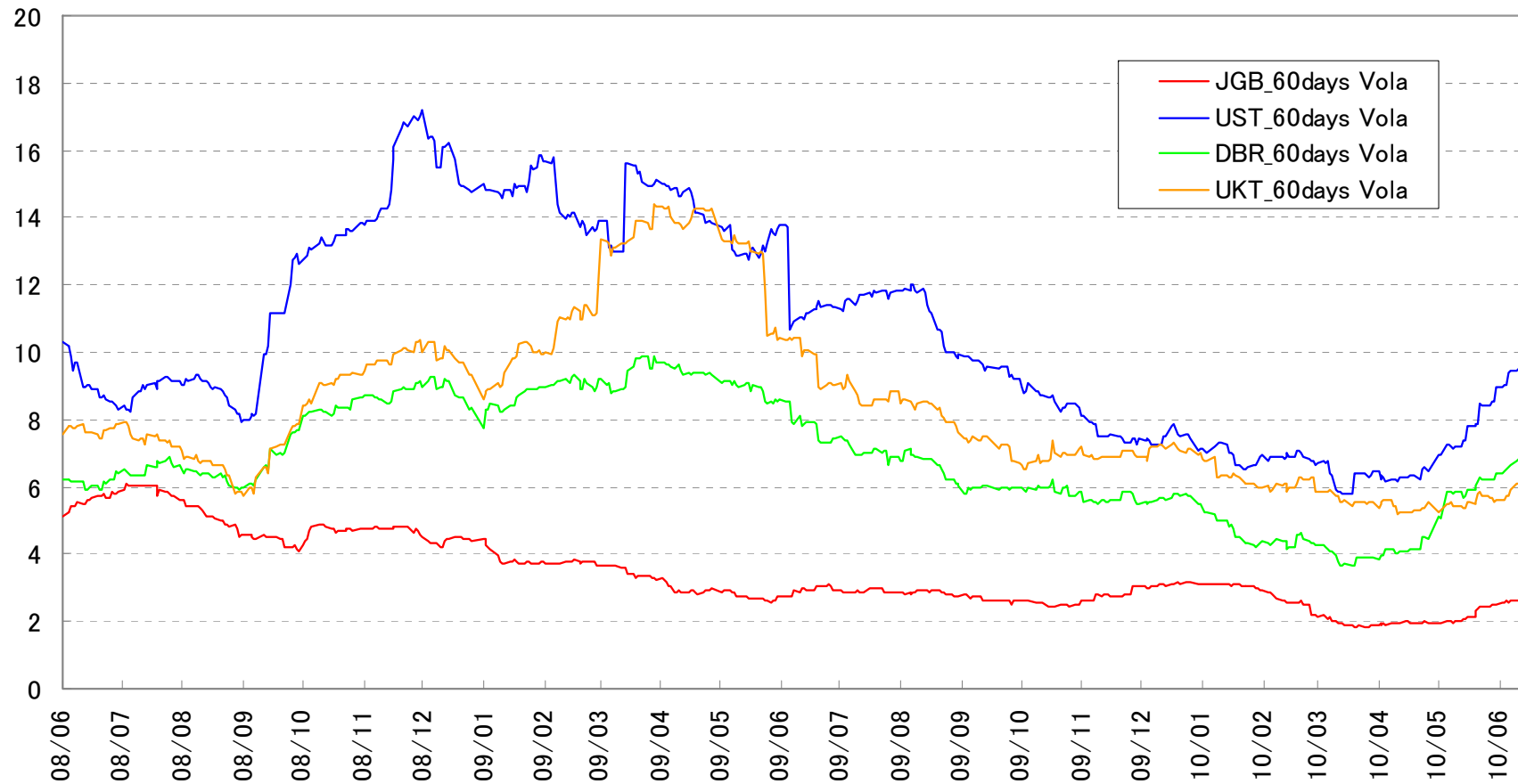


(Source) Bloomberg

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4-3. Historical Price Volatility

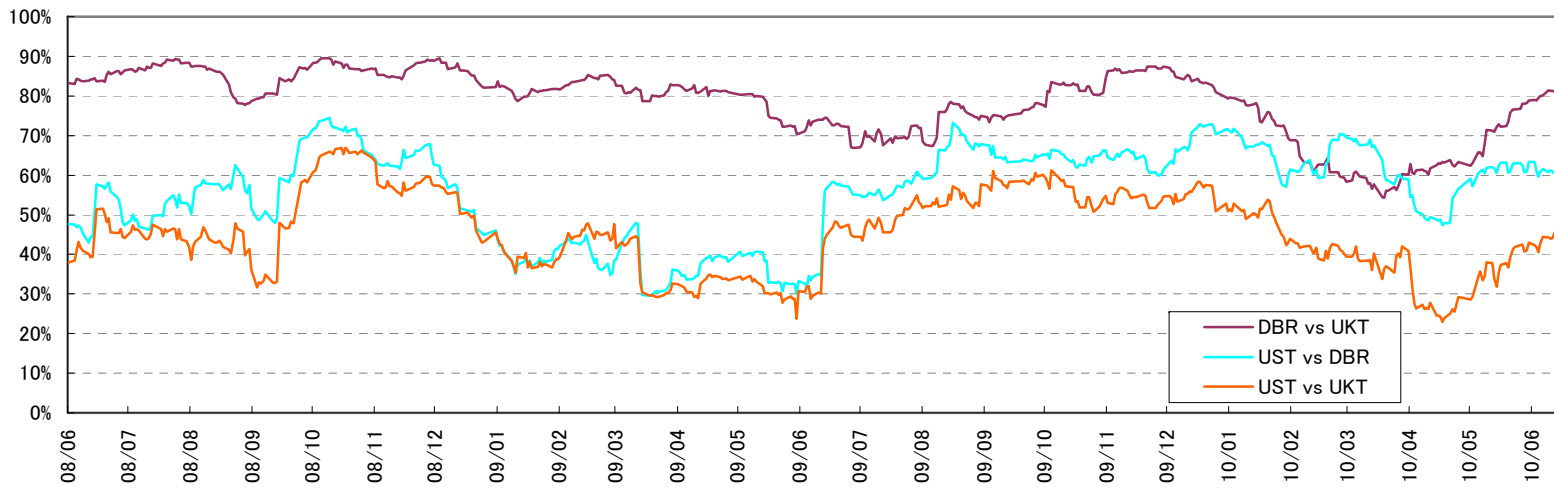
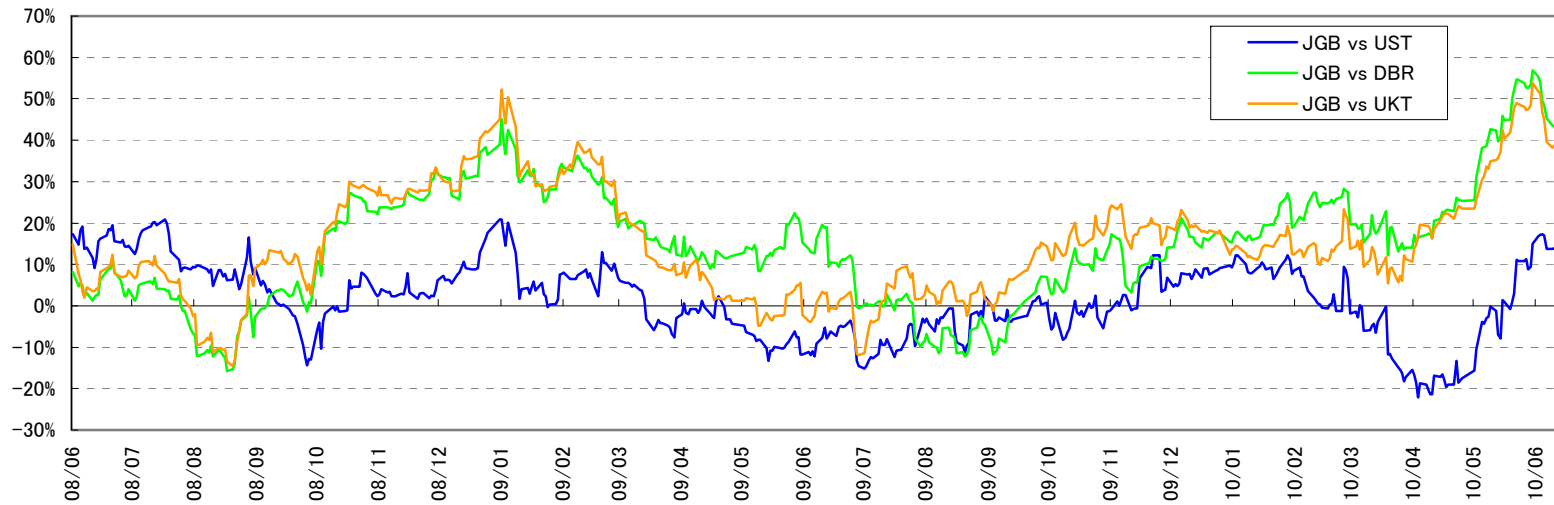


Source : Bloomberg, MOF

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4-4. Correlation between JGBs and other Government Bonds



Source : Bloomberg, MOF

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