

# Can Abenomics Change Japanese Credit Market?

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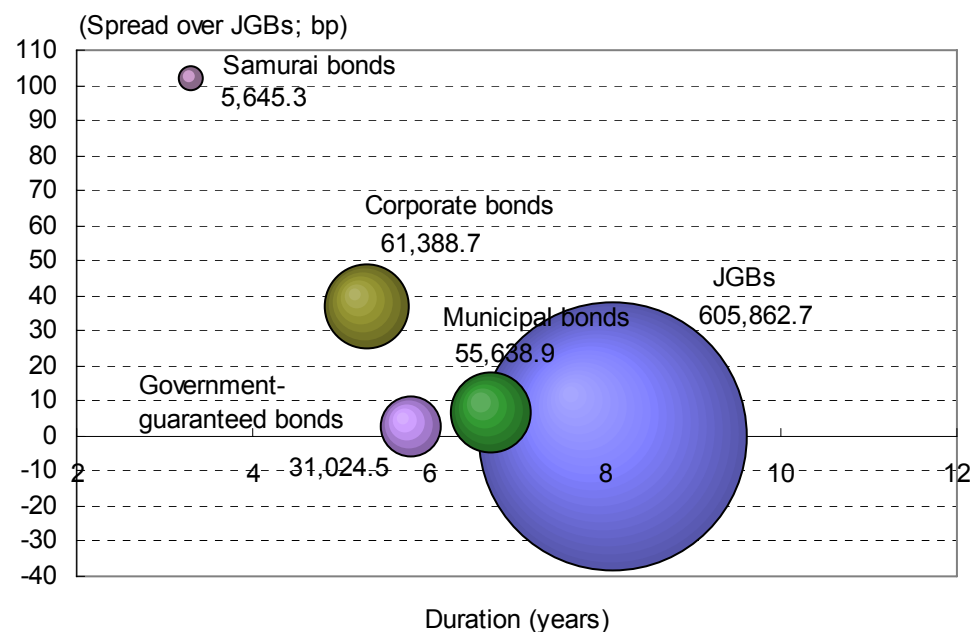
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# Preface: Japanese Credit Market Has Growth Potential

- Japanese bond market dominated by JGBs
- We expect Abenomics to accelerate development of Japanese credit market

## Overview of Japanese Bond Market



Source: Daiwa Bond index as of 10 Oct 2013.

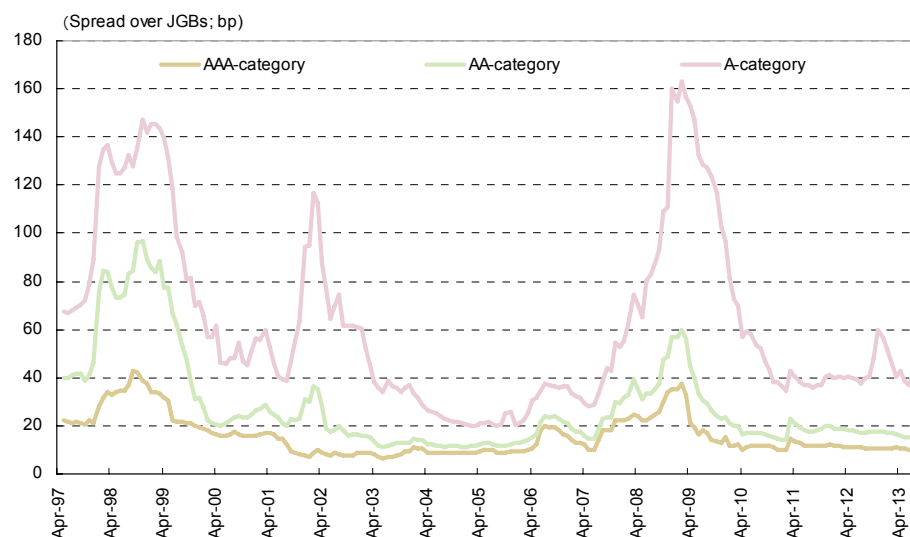
Note: Size of each circle indicates outstanding amount (Y bil).

# Overview and Outlook of Japanese Credit Market

## Japanese Credit Market in Good Condition

- Cash bond market: Investors' risk appetite gradually increasing
- CDS market: End to decoupling of Japanese CDS market from Europe/US

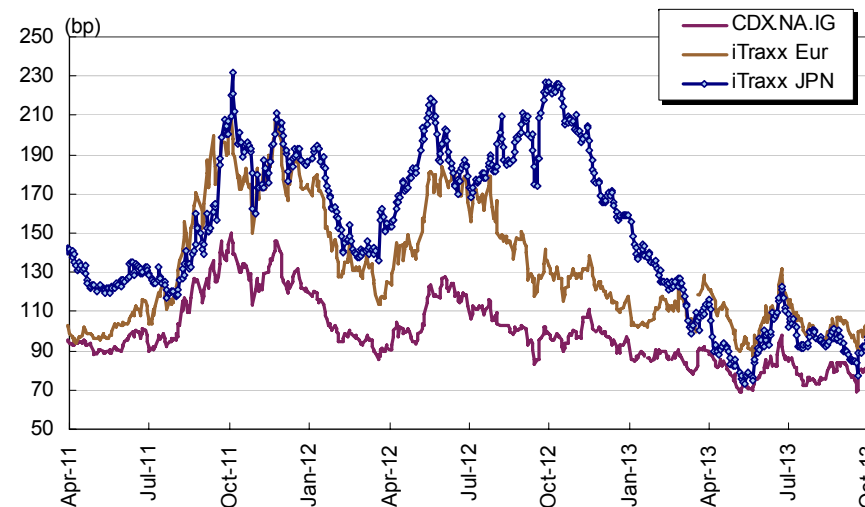
Cash Bond Market in Japan (Avg of bonds with 3-7Y maturities)



Source: Daiwa Securities.

Note: Data excludes electric utility bonds since March 2011.

CDS Index in Japan, US, and Europe (5Y)



Source: Markit, Daiwa Securities.

# Difficult to Find Risk Factors in Japanese Credit Market

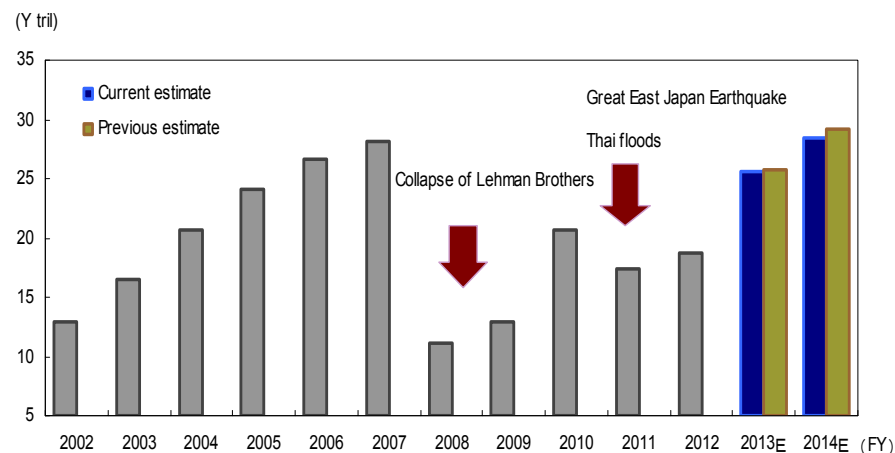
## Seven Supportive Factors in Japanese Credit Market

1. Regarding corporate earnings, profit growth expected for FY13, FY14 (Daiwa 200)
2. Favorable credit fundamentals, given low leverage on balance sheets
3. Market not suggesting signs of overheating yet
4. Eased concerns about creditworthiness of two issuers (TEPCO, Sharp), both of which warranted caution
5. Bank of Japan continuing to purchase corporate bonds
6. Weaker downgrading pressure in terms of rating cycle
7. CDS market calmed down in FY13 after wild gyrations in FY12

## Outlook for Japanese Credit Market in FY2013

- Spread tightening trend to continue on both cash bond and CDS markets

## Recurring Profit Outlook for Daiwa 200



Source: Regular Earnings Survey (September 2013) by Daiwa Securities.

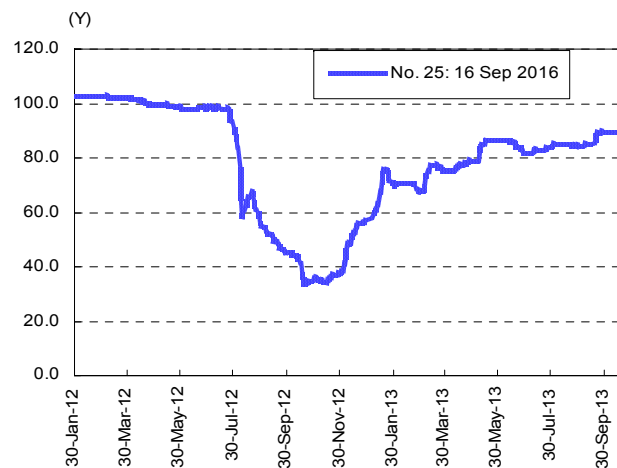
## Credit Outlook by Sector

Sector	2H FY12	1H FY13	2H FY13
Food & beverages	Stable	Slightly positive	Slightly positive
Paper & pulp	Slightly negative	Stable	Stable
Chemicals	Slightly negative	Slightly negative	Slightly negative
Oil	-	Slightly positive	Slightly positive
Glass/ceramics	-	Stable	Stable
Iron/steel	Slightly negative	Stable	Stable
Electrical machinery	Polarized	Polarized	Stable
Automobiles	Slightly positive	Positive	Positive
Trading companies	Stable	Stable	Stable
Retail	Stable	Stable	Stable
Consumer finance	Slightly positive	Slightly positive	Slightly positive
Credit card	Slightly positive	Slightly positive	Slightly positive
Leasing	Stable	Stable	Stable
Major banks	Stable	Stable	Slightly positive
Regional banks	Stable	Polarized	Stable
Construction	Stable	Stable	Stable
Real estate	Stable	Stable	Stable
REITs	Stable	Stable	Slightly positive
Railways	Stable	Slightly positive	Slightly positive
Shipping majors	-	Stable	Slightly positive
Air transport	Stable	Stable	Stable
Electric utilities	Stable (incl. TEPCO)	Stable	Slightly positive
Gas utilities	Stable	Stable	Stable
Telecom	Stable	Stable	Stable
FILP agencies	Stable	Stable	Stable
Municipals	Stable	Stable	Stable

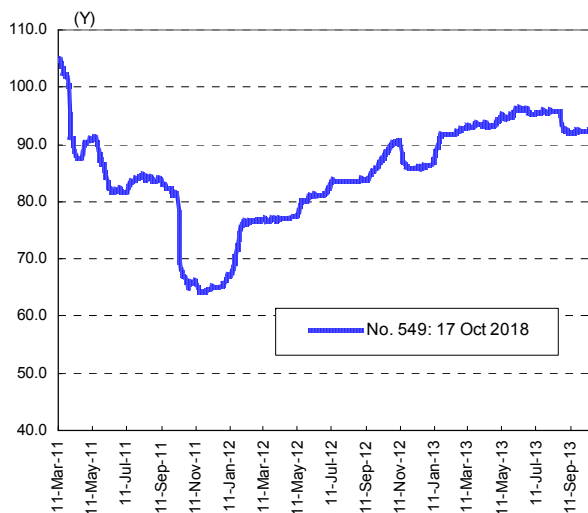
Source: Daiwa Securities.

Note: Indicating credit outlook (not credit level) for each sector's debt redemption capacity.

### Price of Sharp Bond

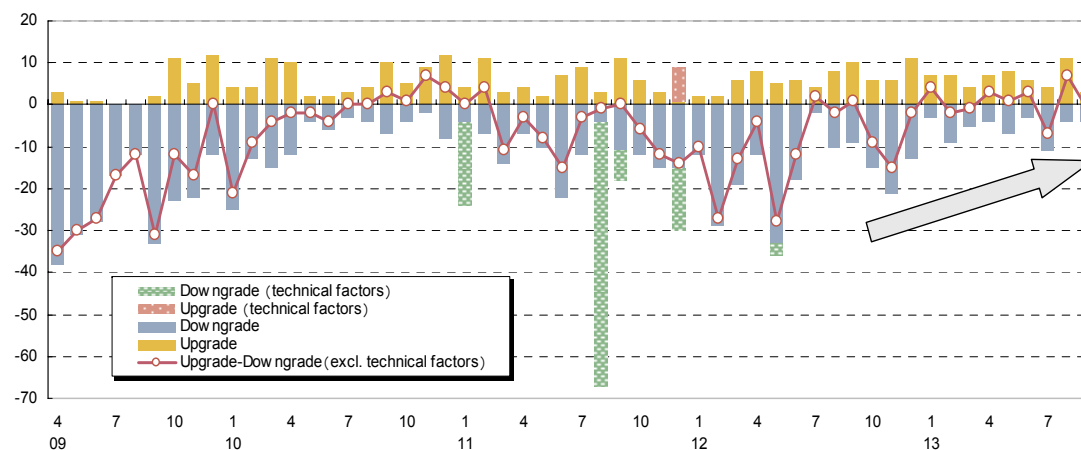


### Price of TEPCO Bond



Source: JSDA, Daiwa Securities.

### Monthly Trend of Rating Actions

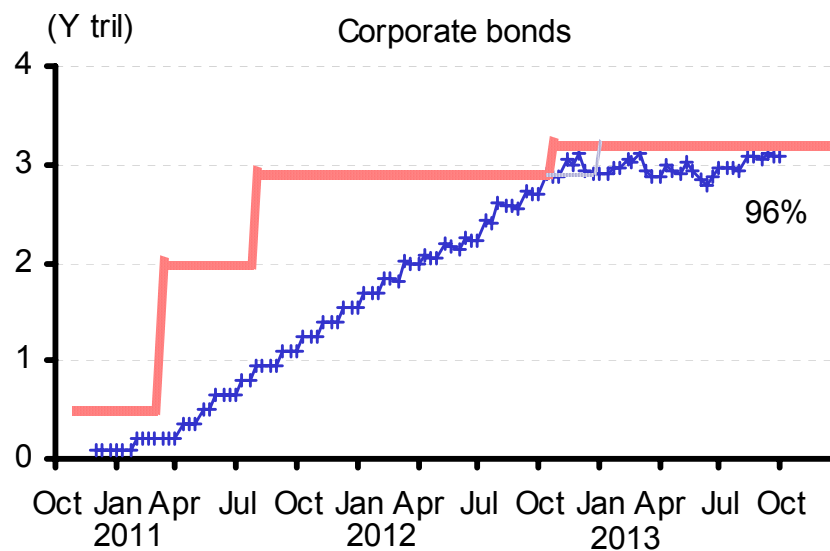


Source: Rating agencies; compiled by Daiwa Securities.

Notes: 1) Downgrades are expressed as negatives.

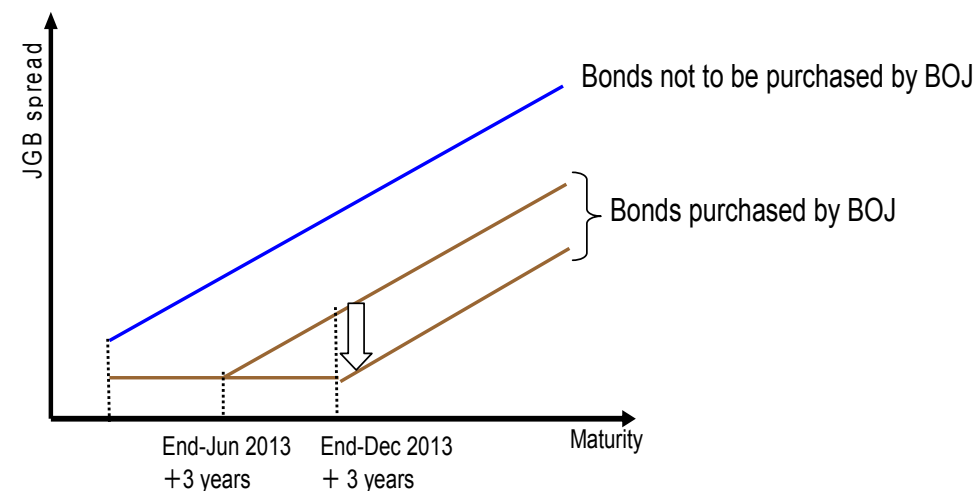
2) Technical factors are rating actions triggered by changes in sovereign ratings or by changes in rating agency's valuation methodology.

### Corporate Bond Purchases by BOJ



Source: Bank of Japan.

### Effects of Extension of Purchased Assets' Maturities (pattern diagram)

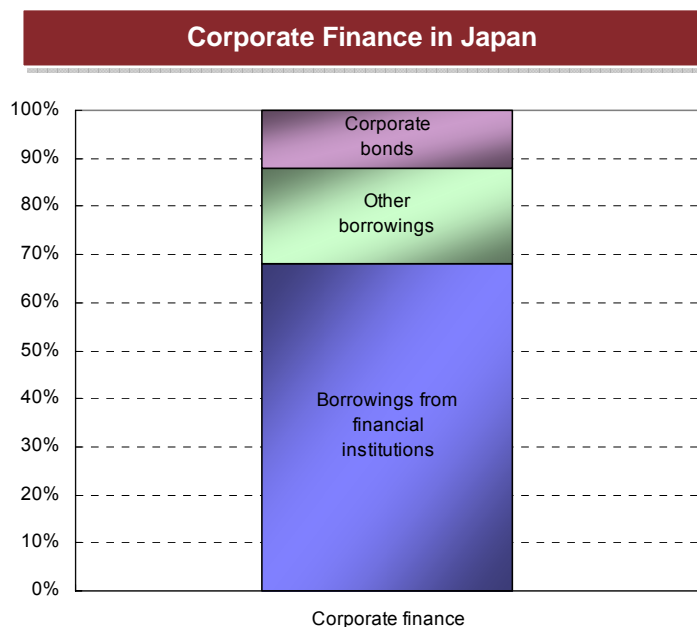


Source: Daiwa Securities

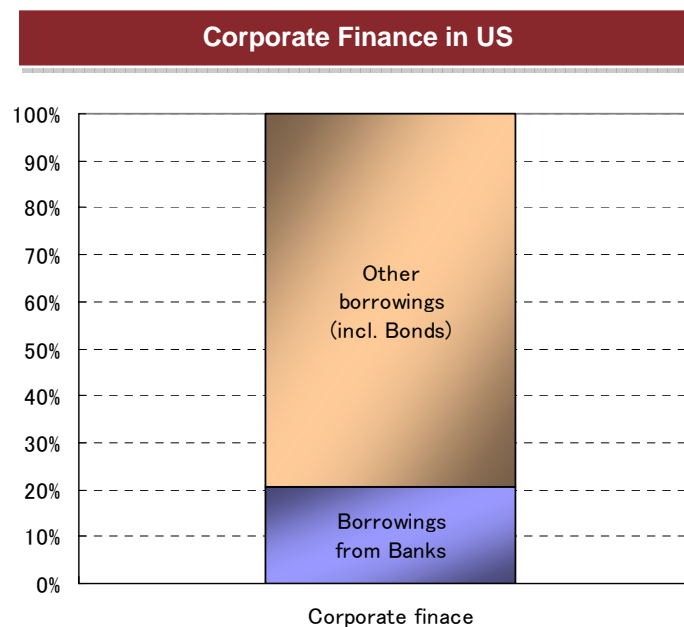


# Uniqueness of Japanese Credit Market

1. Bank loan main source of corporate finance
2. Investment grade (IG) market
3. Default still rare, but recovery rate low
4. Credit spread tight



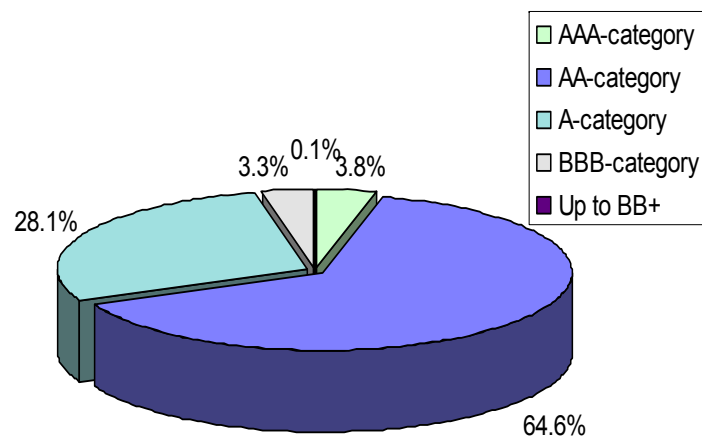
Source: Ministry of Finance.



Source: U.S. Department of Commerce.

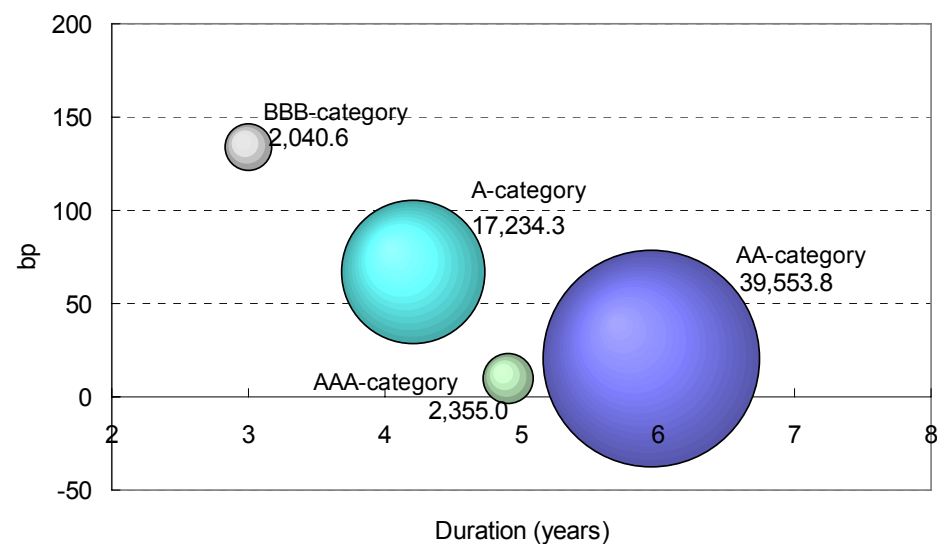
# Investment Grade Market

**Corporate Bond Share by Rating**



Source: Daiwa Securities.  
Note: As of 10 Oct 2013.

**Avg Duration, JGB Spreads and Outstanding Bonds by Rating**

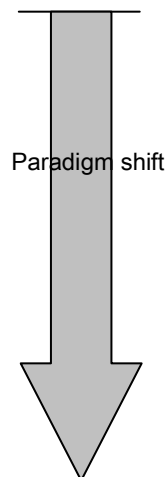


Source: Daiwa Securities.  
Note: Size of each circle indicates outstanding amount (Y bil) as of 10 Oct 2013.

# Default of Corporate Bonds Still Rare, but Recovery Rate Low

Default Cases of Publicly Offered Corporate Bonds and Recovery Rate by Bond Type in Japan

Default timing	Company name (industry)	Applied law	Existence of CCB*	Outstanding bonds (Y bil)	Recovery rate
Dec-98	Japan Land Development (Real estate)	Corporate Reorganization Law	Existed	50	10% (19-year installment repayment) 6% (Lump-sum repayment)
Sep-01	Mycal (Retail)	Corporate Reorganization Law	Existed	243	30% (Retail bonds) 10.2% (Wholesale bonds)
			No	100	Depends on holding amount 5%+ Y5 mil (up to Y2 bil) 4%+ Y25 mil (up to Y10 bil), etc.
Jun-08	Suruga (Real estate)	Civil Rehabilitation Law	No	21	Y30 mil + at least 54.2% of excess amount (Rehabilitation plan)
Jul-08	Zephyr (Real estate)	Civil Rehabilitation Law	No	20	14.7% (Rehabilitation plan)
Aug-08	Urban (Real estate)	Civil Rehabilitation Law	No	20	Around 15% at maximum (Rehabilitation plan)
Oct-08	New City Residence Investment (J-REIT)	Civil Rehabilitation Law	No	17	100% (Rehabilitation plan)
Feb-09	Japan General Estate (Real estate)	Corporate Reorganization Law	No	10	4.0% (Y0.1~1bil) 2.8% (Over Y1 bil) (Rehabilitation plan)
Mar-09	Pacific Holdings (Real estate)	Corporate Reorganization Law	No	37	5.78% (over Y0.1 mil) + Y100,000 + α
May-09	Joint (Real estate)	Corporate Reorganization Law	No	15	7.13% (over Y0.5 mil) + Y500,000 (5-year installment)
Jun-09	ES-CON Japan (Real estate)	Business Rehabilitation ADR	No	8	4-year installment repayment starting in 3.5 years (100%) or immediate purchases at 15%
Jan-10	Japan Airlines (Air transportation)	Corporate Reorganization Law	No	47	12.5% (Rehabilitation plan)
Feb-10	Willcom (Telecom)	Corporate Reorganization Law	No	35	13.3% (over Y10 mil) (Rehabilitation plan) 100% up to Y10 mil
Sep-10	Takefuji (Non-bank)	Corporate Reorganization Law	No	93	3.3% (First repayment) (Rehabilitation plan)
Feb-12	Elpida Memory (Semiconductor)	Corporate Reorganization Law	No	45	17.4% (Rehabilitation plan proposal)



■ Domestic corporate bonds:  
Consensus of expected recovery rate is about 10%

## 【Reference】

According to Moody's, worldwide recovery rate of senior unsecured bonds during 1982-2011 averaged at 36.8%

Source: Moody's Annual Default Study.

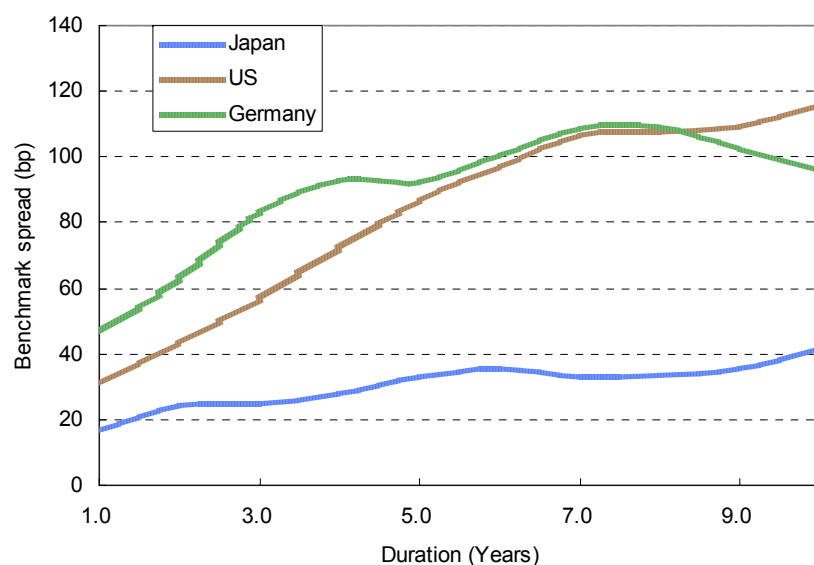
Source: Various materials; compiled by Daiwa Securities.

\*CCB is commissioned company for bondholders.

# Tight Credit Spread in Japan

## Why is Credit Spread Tight in Japan?

### Credit Spread of Single A-category Bonds



Source: Reuters.

### Possible Reasons

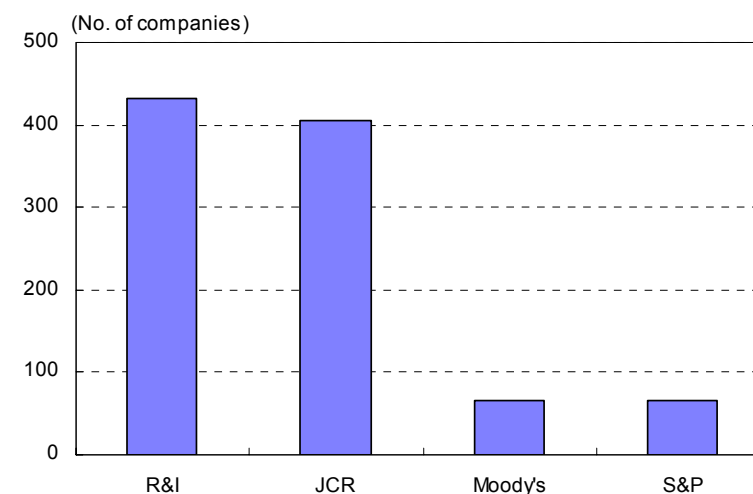
1. Low interest rates and low volatility
2. Severe competition with bank loans
3. Investors' strong home market bias and low risk appetite
4. Homogeneous investors
5. Rare SB defaults in Japanese corporate bond market
6. Rating gap between domestic and overseas rating agencies

## Rating Gap Between Domestic and Overseas Rating Agencies (R&I vs. S&P)

R&I S&P	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-
AA										
AA-		Toyota Motor Tokyo Gas East Japan Railway	Japan Tobacco							
A+			Honda Motor Mitsubishi Estate	Mitsui & Co. Mitsubishi Sumitomo Mitsui Banking						
A				Mitsubishi Electric Sumitomo	Risona Bank					
A-				Asahi Glass	Hitachi	Itochu Orix				
BBB+					Nissan Motor Mitsui Fudosan	Fujitsu Aeon				
BBB					Nippon Steel & Sumitomo Metal	Toshiba Panasonic Sony				
BBB-						NEC				
BB+									Tokyo Electric Power Acom	
BB										

Source: R&I, S&P.

## Rating Universe of Japanese Companies (as of Mar 2012)



Source: Rating agencies.

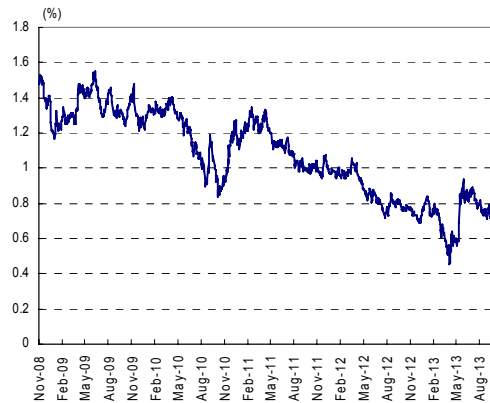
# Can Abenomics Change Japanese Credit Market?

## “First Arrow” May Stimulate Demand for Credit Risk Taking

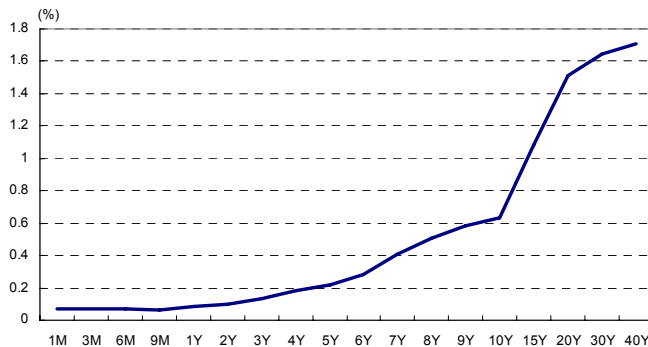


### Bold Monetary Easing

10Y JGB Yield

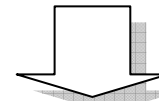


JGB Yield Curve

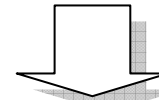


Source: Reuters.  
Note: As of 17 Oct 2013.

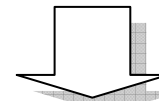
Decline in yields



Portfolio rebalancing effects



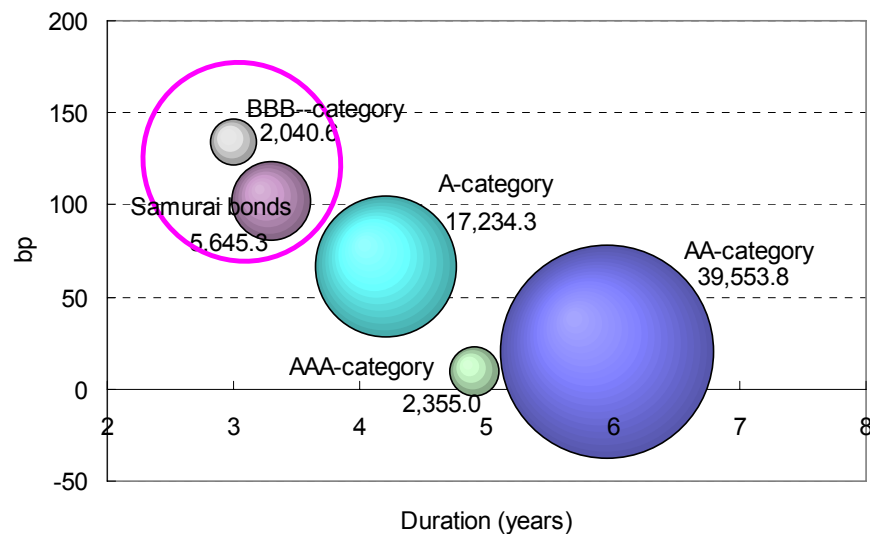
Stronger demand for credit products



Expectations for further issuance of corporate bonds, especially BBB-category ones

Expectations for more utilization of domestic corporate bond market by overseas firms and further issuance of samurai bonds

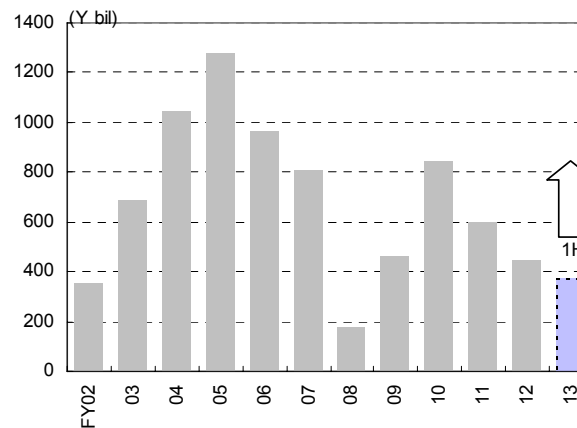
### Market Presence of BBB-category Corporate Bonds and Samurai Bonds



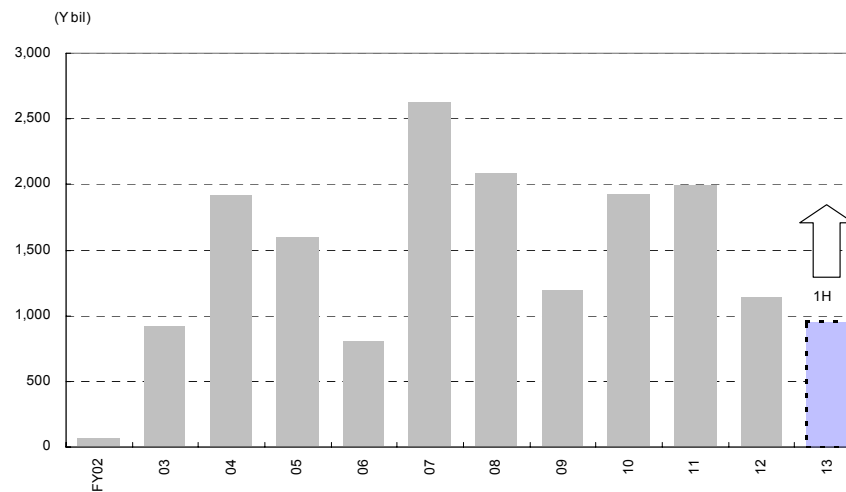
Source: Daiwa Securities

Note: Size of each circle indicates outstanding amount (Y bil) as of 10 Oct 2013.

### Issuance Amount of BBB-category Corporate Bonds



### Issuance Amount of BBB-category Samurai Bonds



Source: Daiwa Securities

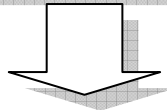
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# Despite “Second Arrow,” Issuance of Municipal, FLIP Agency Bonds Unlikely to Grow



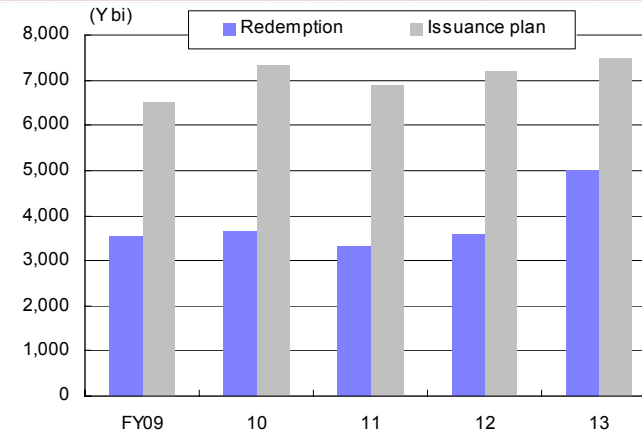
Flexible Fiscal Policy

Flexible fiscal stimulus by government

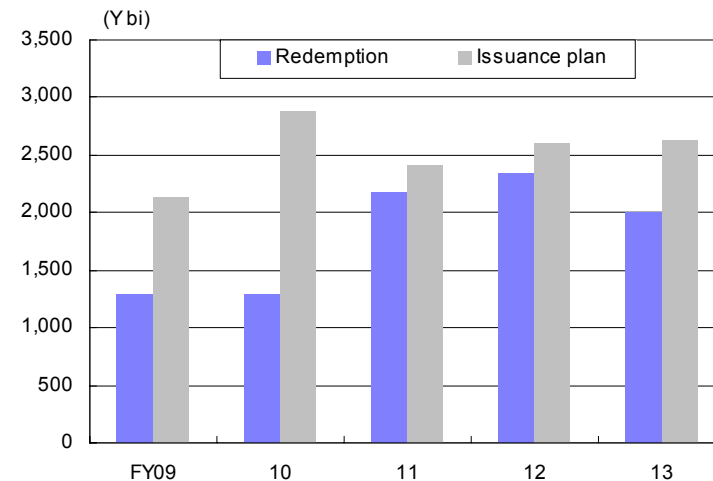


Tends to increase funding needs at municipal governments and quasi-government agencies

Issuance and Redemption Amount of Municipal Bonds



Issuance and Redemption Amount of FLIP Agency Bonds



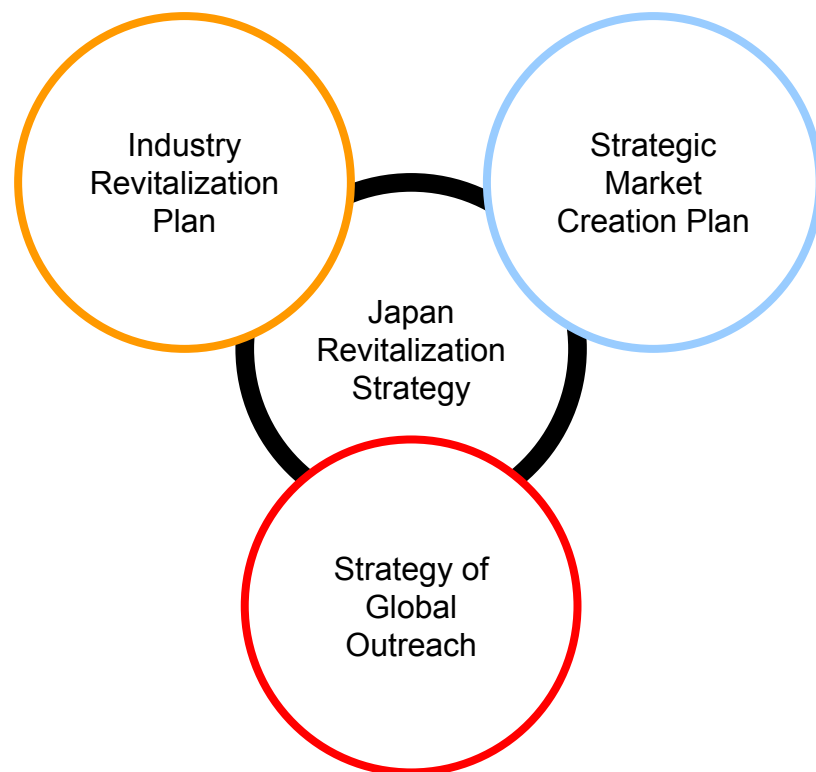
Source: Ministry of Finance, Daiwa Securities.



# “Third Arrow” May Stimulate Supply of Corporate Bonds

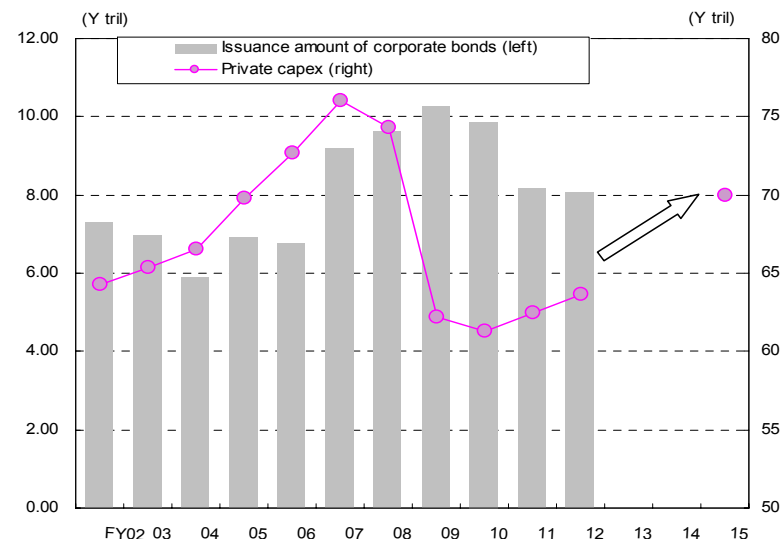


Growth Strategy to Encourage Private Investment

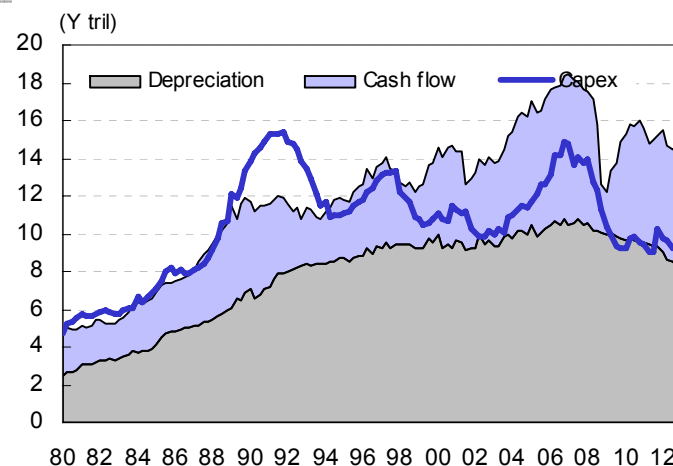


Source: Japanese government.

## Issuance Amount of Corporate Bonds and Capex in Private Sector



## Capex and Cash Flow in Private Sector



Source: Ministry of Finance.

## Notification Items Regarding Advertising etc. (Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law)

If you decide to enter into a business arrangement with our company based on the information described in materials presented along with this cover letter, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission\* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction.

In some cases, our company also may charge a maximum of ¥ 2 million (including tax) per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.

- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

\* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

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Financial instruments firm: chief of Kanto Local The Finance Bureau (Kin-sho) No.108  
Memberships: Japan Securities Dealers Association  
The Financial Futures Association of Japan  
Japan Investment Advisers Association  
Type II Financial Instruments Firms Association