



MIC

Local Government Bond System and Market in Japan

**Ministry of Internal Affairs
and Communications**

October 2014

I JLGB as an alternative to JGB

II High credit rating of JLGB

III Topics - Japanese economy -

Appendix

I JLGB as an alternative to JGB

The type and issue amount of the JLGBs and JFM's Bonds (FY2013)

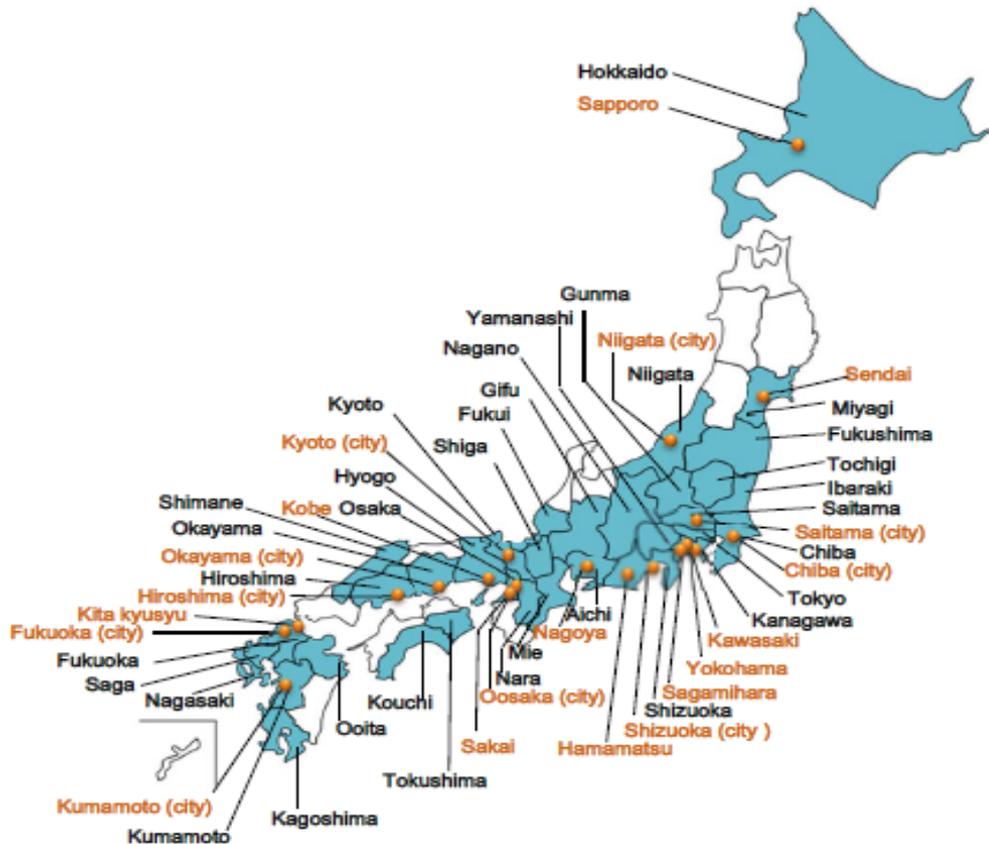
	Denominated in JPY	Denominated in USD
JLGBs	LGB <JPY 5.4 trillion> ≒ USD 49.6 billion Joint local government bond <JPY 1.5 trillion> ≒ USD 13.8 billion	Tokyo Met. <USD 1 billion>
JFM's Bonds	<JPY 2.3 trillion> ≒ USD 21.1 billion	<USD 2.5 billion>
Total	<JPY 9.2 trillion> ≒ USD 84.5 billion	<USD 3.5 billion>

※【Reference】 Issue amount of JGB (FY2013) : JPY 168 trillion ≒ USD 1,543 billion

Note : USD 1 = JPY 108.87 as of 1 October 2014.

I JLGB as an alternative to JGB (diversity of JLGB)

- ◆ A lot of LGs successfully issue public offering bonds underpinned by the solid creditworthiness supported by the local public finance.

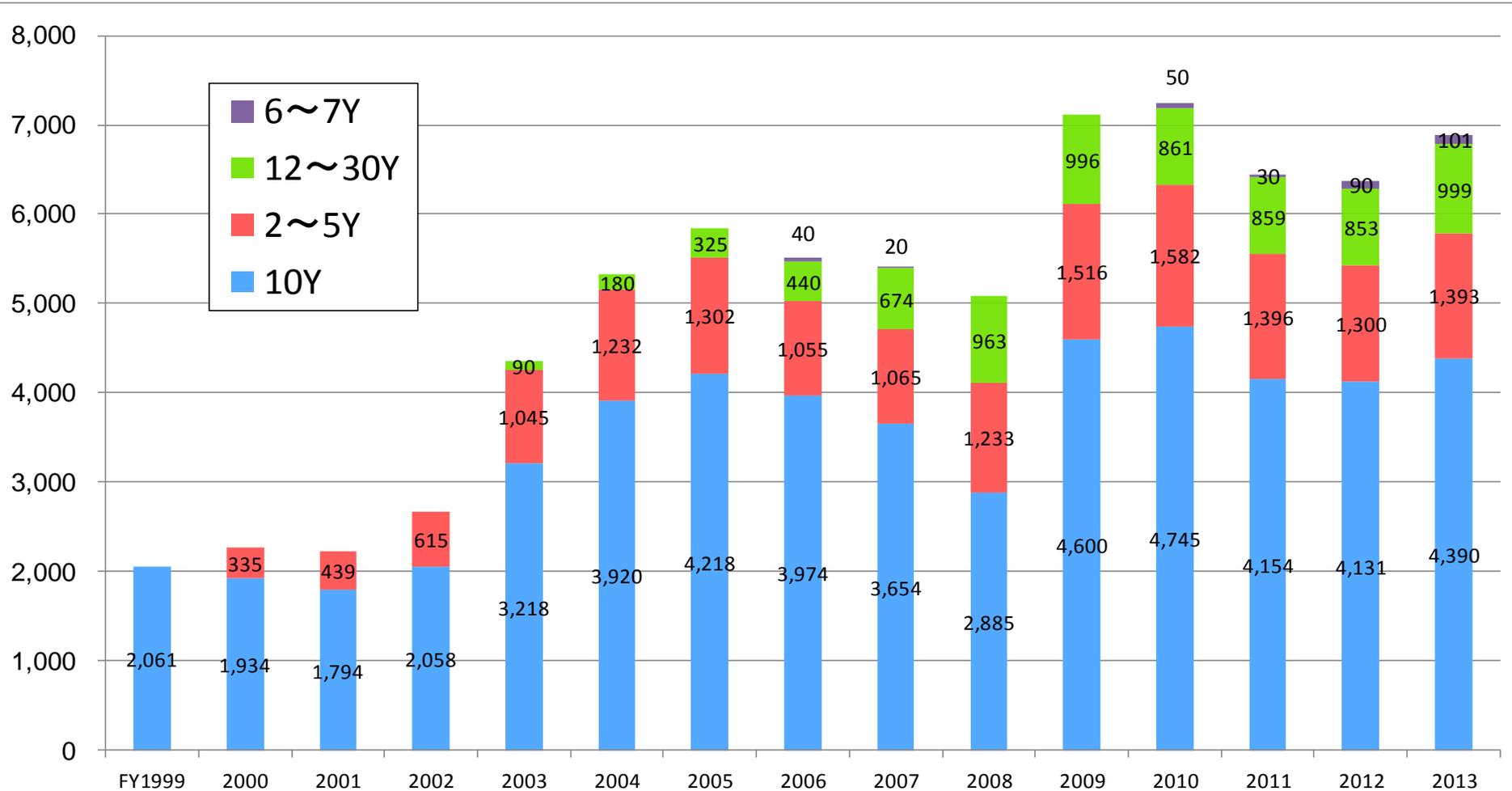


- ◆ 54 LGs issue public offering bonds in FY 2014.
 - ▶ 34 prefectures (shown in black)
 - ▶ 20 designated cities (shown in red)

I JLGB as an alternative to JGB (diversity of JLGB)

◆ Issue amount of public offering LGBs

(Unit: billions of JPY)



II High credit rating of JLGB

- ◆ International rating agencies assign rating levels of JLGB close to JGB thanks to the solid JLGB system.

	Ratings	
	Moody's	S&P
JGB(Central Government)	Aa3/Stable	AA-/Negative
Tokyo	-	AA-/Negative
Niigata Prefecture*	Aa3/Stable	-
Shizuoka Prefecture*	Aa3/Stable	-
Aichi Prefecture*	-	AA-/Negative
Hiroshima Prefecture*	Aa3/Stable	-
Fukuoka Prefecture	Aa3/Stable	-
Sapporo City*	Aa3/Stable	-
Chiba City*	-	A+/Stable
Yokohama City	-	AA-/Negative
Niigata City*	-	AA-/Negative
Shizuoka City*	Aa3/Stable	-
Hamamatsu City	Aa3/Stable	-
Nagoya City	Aa3/Stable	-
Kyoto City*	Aa3/Stable	A+/Stable
Osaka City*	Aa3/Stable	AA-/Negative
Sakai City	Aa3/Stable	-
Fukuoka City*	Aa3/Stable	-
Miyazaki City	-	A/Stable
JFM	Aa3/Stable	AA-/Negative

■ Opinions by the International Rating Agencies

We rate Japanese regional and local governments (RLGs) at Aa3/stable, the same as Japanese government bonds, reflecting the close linkage between the central government and the RLGs, the local allocation tax (LAT) equalization system, and the central government's strong oversight. We believe that it is unlikely that any policy changes would emerge and which would weaken the government's support for the RLGs.

The central government primarily provides its strong support through LAT. The latter is designed to reduce fiscal disparities among RLGs and guarantee minimum services for all residents.

(As of 28 September 2012, Moody's)

Passage of the Act on Assurance of Sound Financial Status of Local Governments in 2007 has, in our view, enhanced extraordinary central government support for local and regional governments by providing them with unequivocal permission to access central government funds when faced with a dire shortage of liquidity.

(As of 13 November 2013, S&P)

- 1. Solid support by the central government on redemption**
- 2. Check and control system by the central government**
- 3. Control of fiscal discipline**



Principal and interest of JLGB have been fully paid without default (similar to JGB).

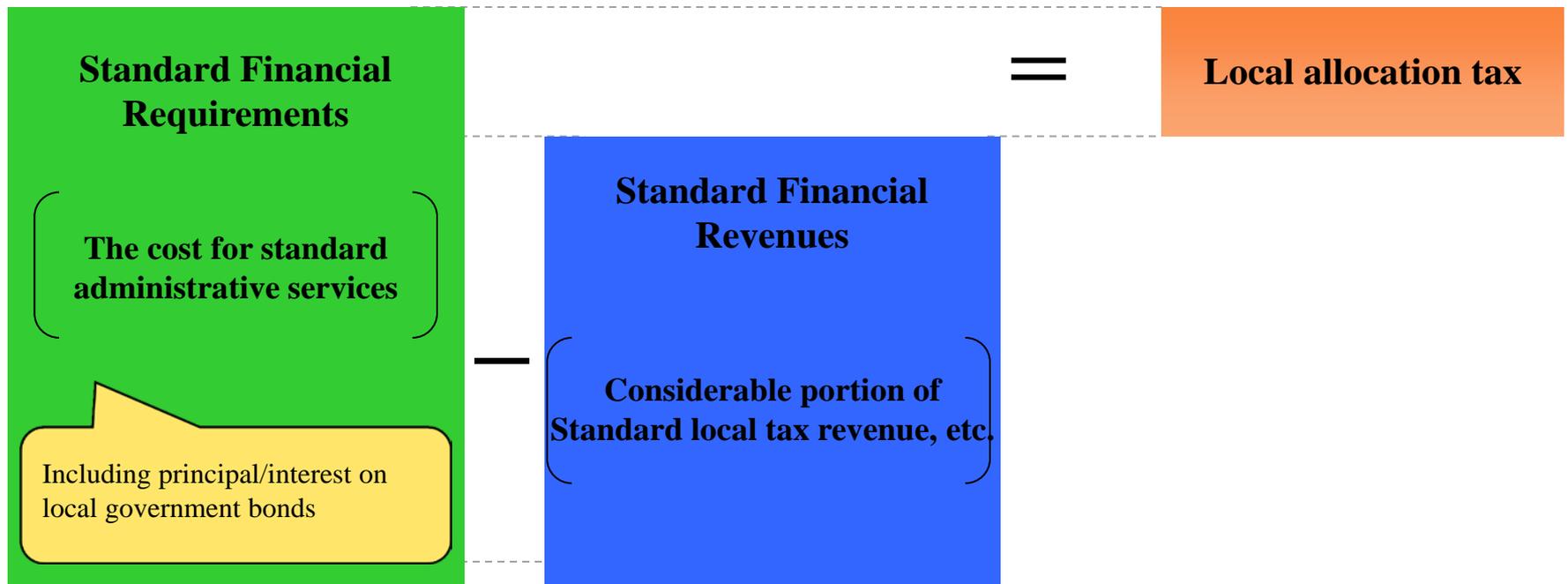
II -1 Solid support by the central government on redemption

The central government secures revenue sources required for principal/interest payment on local government bonds through the local public finance system.

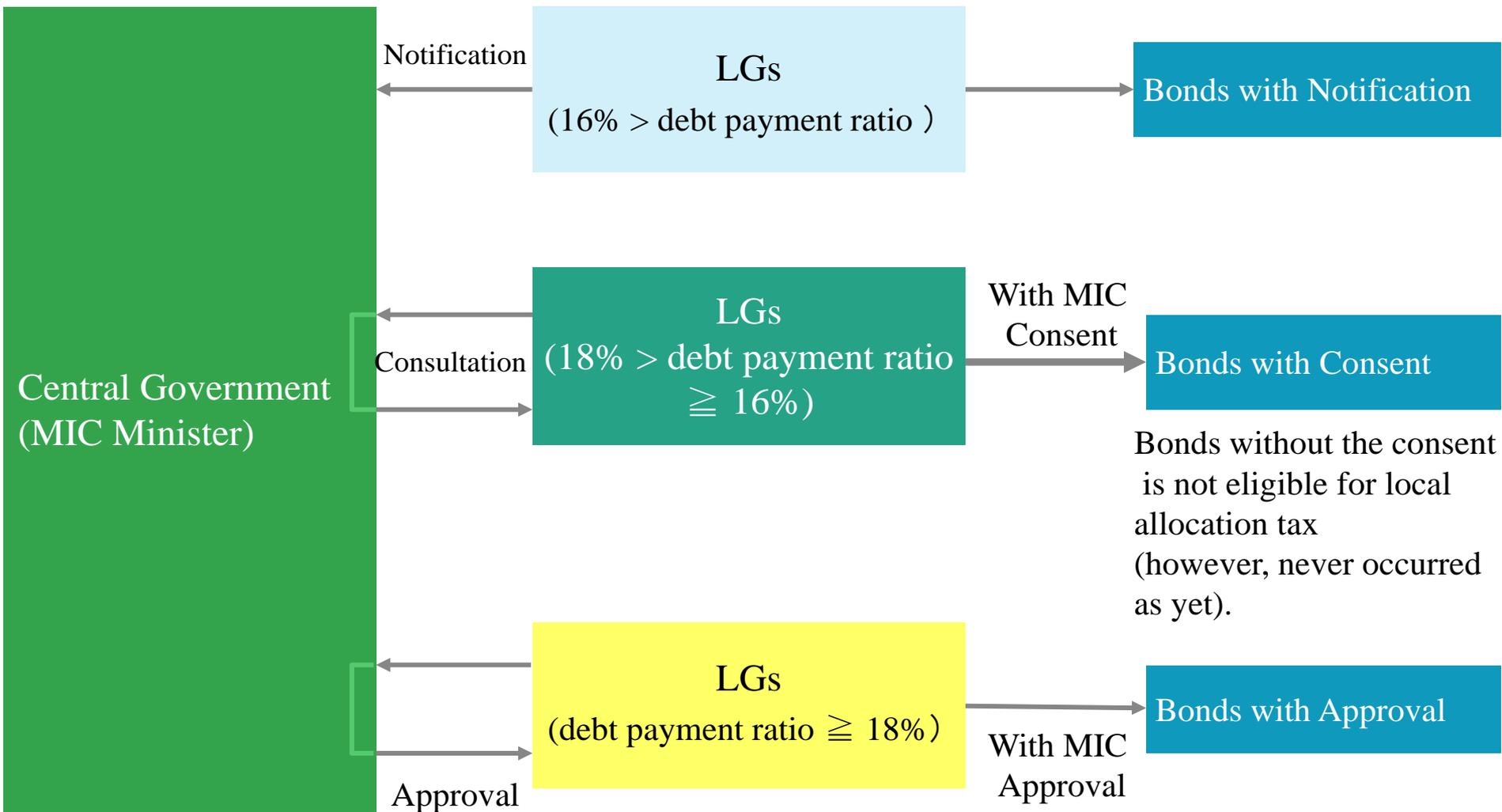
In particular, it is secured through local allocation tax each local government receives from the central government to provide basic social capital and standard administrative services to citizens.

The principal / interest on JLGB is included in the standard fiscal demand amount when calculating local allocation tax.

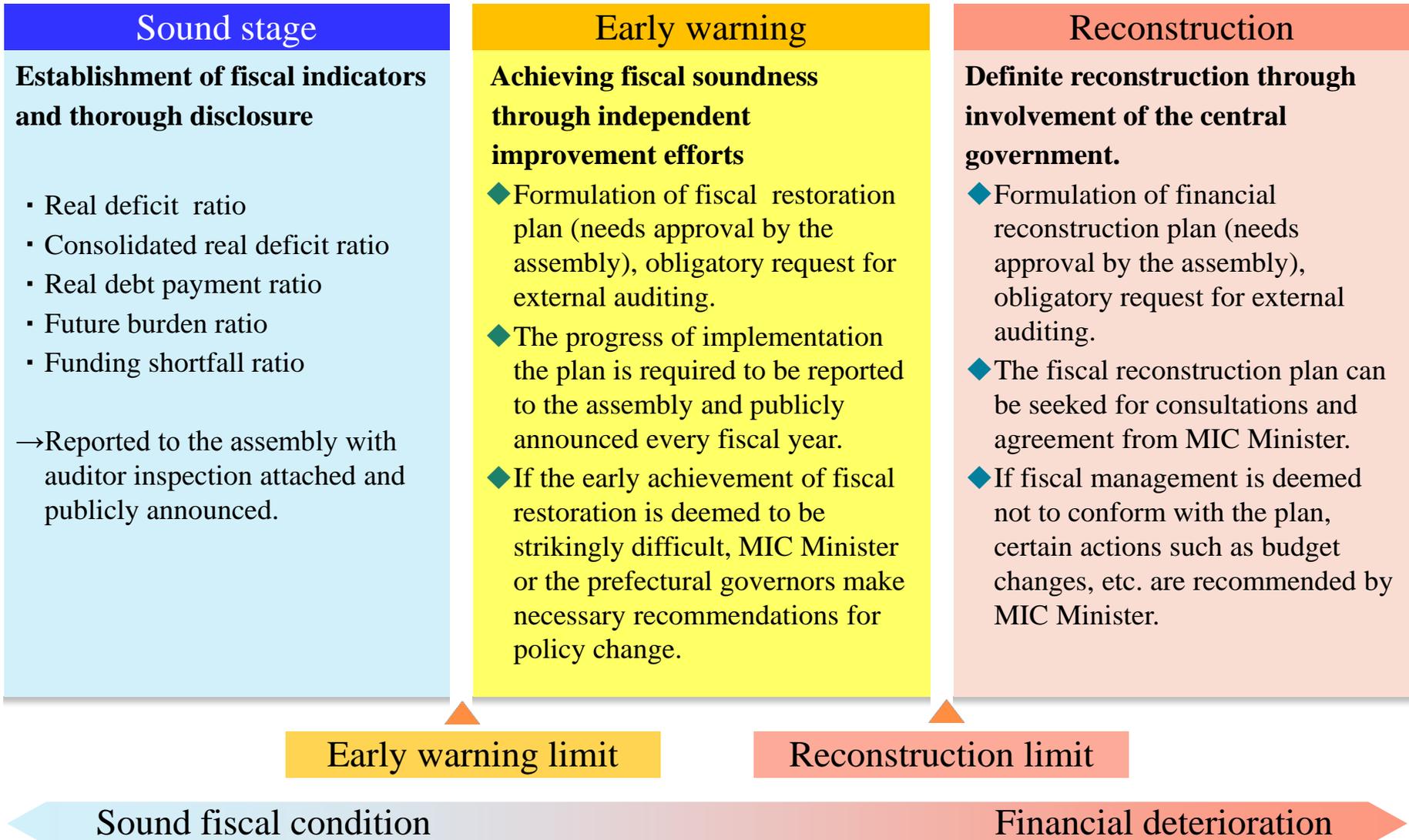
The local allocation tax system has functioned for about 60 years since 1954. The amount of the local allocation tax is around 17 trillion yen.



II -2 Check and control system by the central government



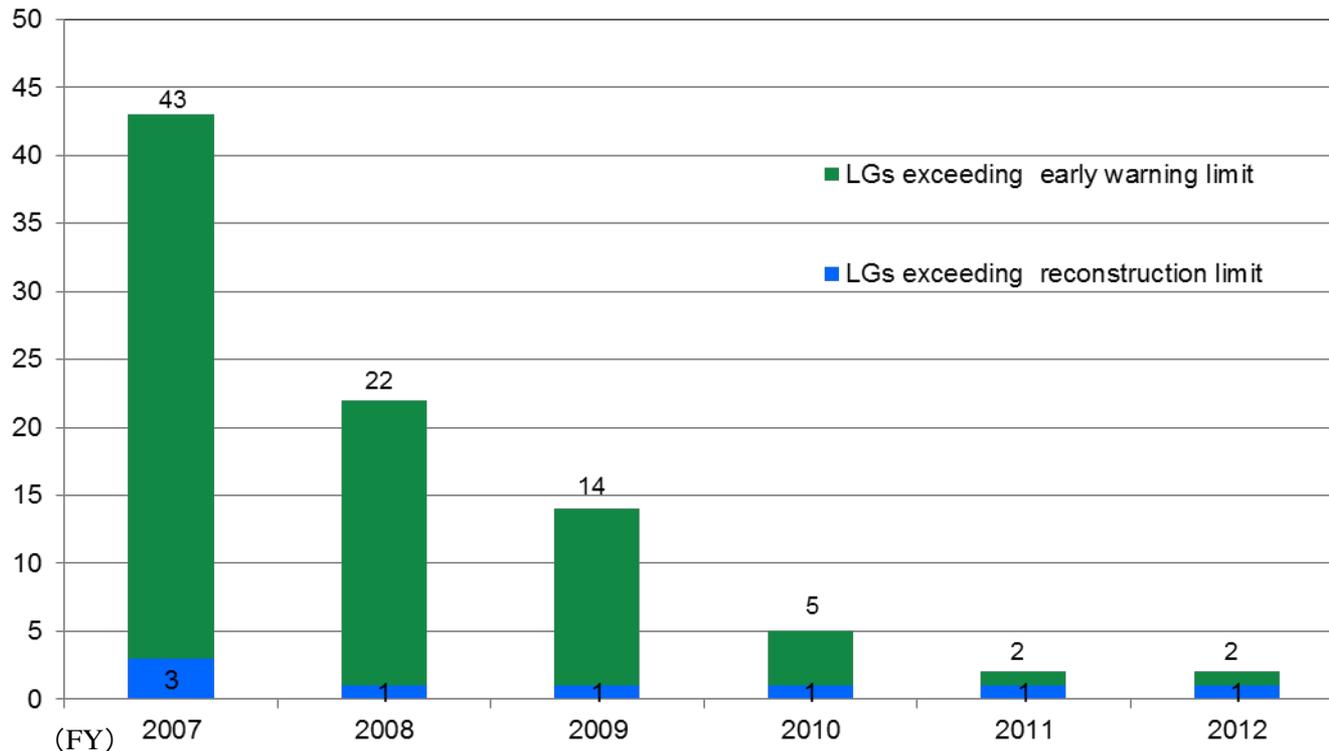
II-3 Control of fiscal discipline



II -3 Numbers of LGs exceeding early warning limit

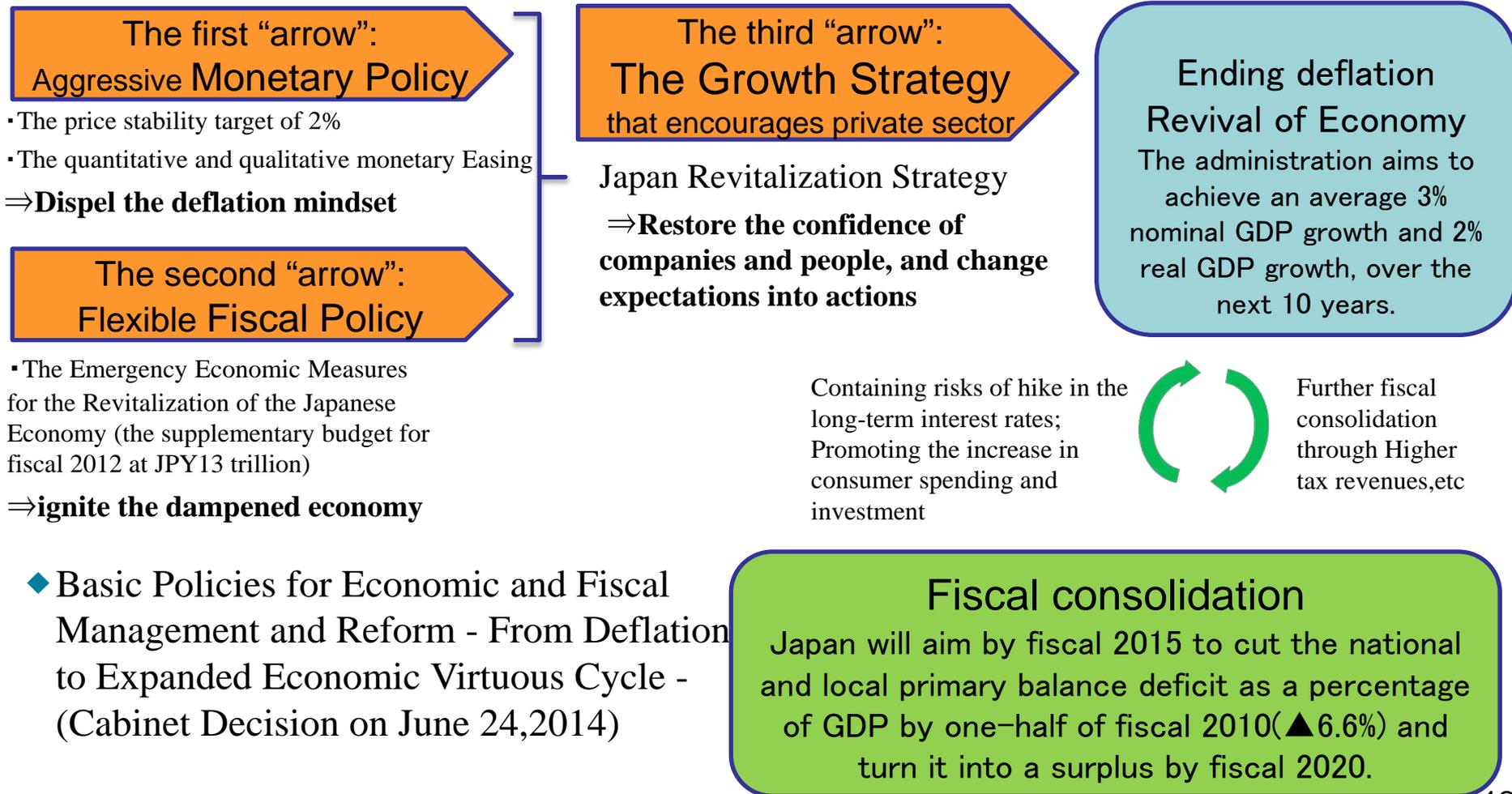
- ◆ In recent years, the numbers of LGs exceeding early warning limit have decreased.

(Numbers of LGs)



III-1 Abenomics

- ◆ The Abe administration has successively implemented the policy mix of the “three arrows”(known as “Abenomics”).

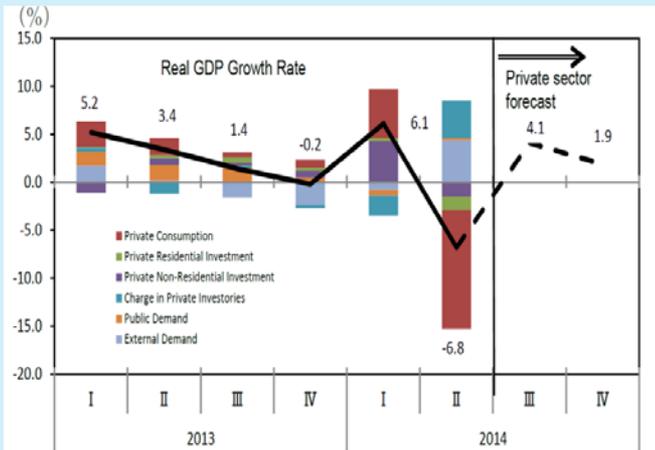


- ◆ Basic Policies for Economic and Fiscal Management and Reform - From Deflation to Expanded Economic Virtuous Cycle - (Cabinet Decision on June 24,2014)

1. Recovery of Real GDP Growth Rate

The economy is expected to continue its moderate recovery.

- ◆ Real GDP has been on a recovery track since the start of the Abe administration. The growth was ▲6.8% for the April-June quarter of 2014, mainly because of a reaction after a last-minute rise in demand before a consumption tax increase. According to average figure of January-March period and April-June period, it exceeds for the same period of the previous year.

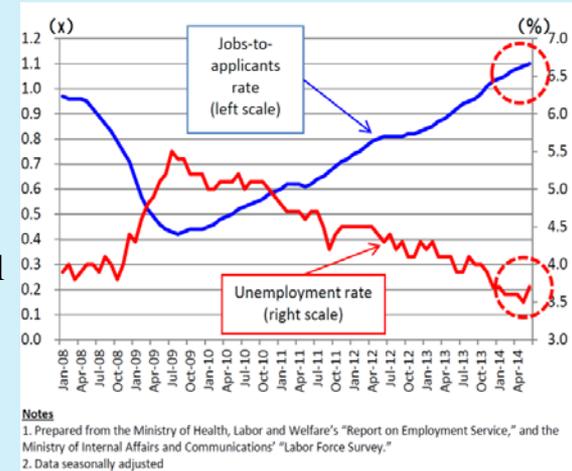


Note: Prepared based on "National Accounts Statistics" from the Cabinet Office, and the "ESP Forecast" from the Japan Center for Economic Research (August 12, 2014)

2. Improved employment conditions

Employment situation is improving steadily.

- ◆ The ratio of jobs offers-to-applicants has risen to 1.10 (June 2014), the highest level in 22 years.
- ◆ The unemployment rate has declined to the 3% range for the first time since October 2008.

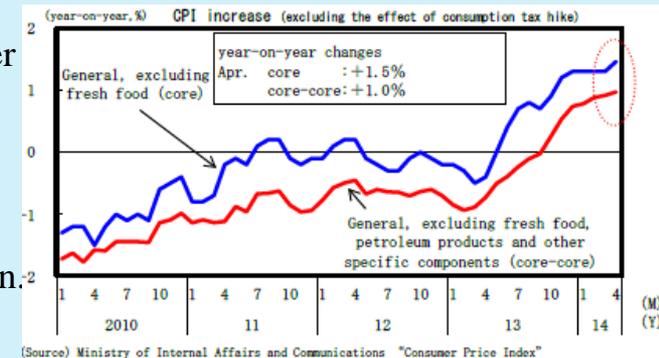


Notes
1. Prepared from the Ministry of Health, Labor and Welfare's "Report on Employment Service," and the Ministry of Internal Affairs and Communications' "Labor Force Survey."
2. Data seasonally adjusted

3. Moderate rising of CPI

CPI is rising at a moderate pace.

- ◆ Price trends are no longer pointing to deflation. The economy is making steady steps forward to break free from deflation.

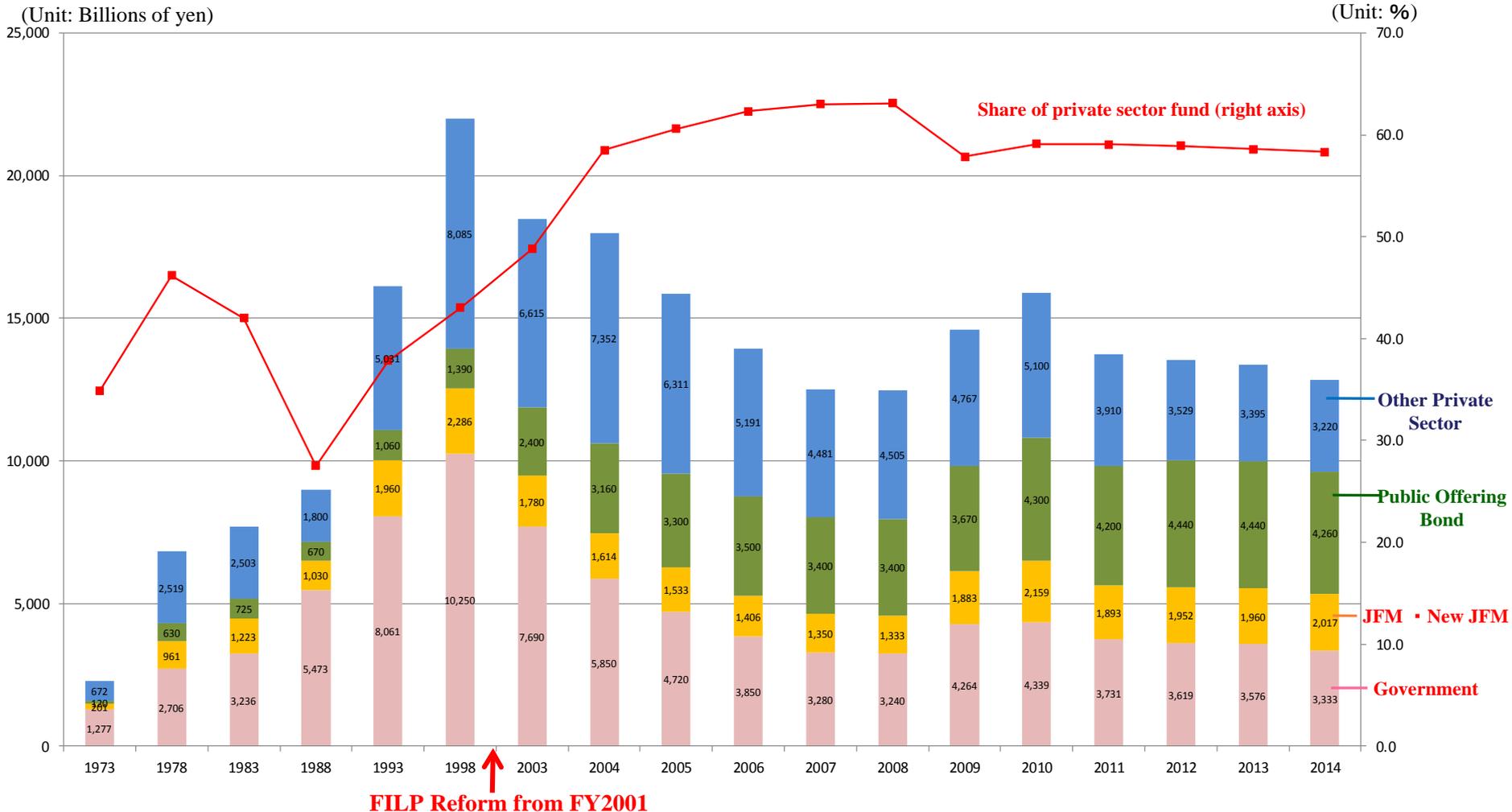


(Source) Ministry of Internal Affairs and Communications "Consumer Price Index"

Appendix

Historical changes of annual issue amount

- ◆ Reduction in government funding due to FILP (Fiscal Investment and Loan Program) Reform to minimize government funding role from FY2001.



Source: Ministry of Internal Affairs and Communications



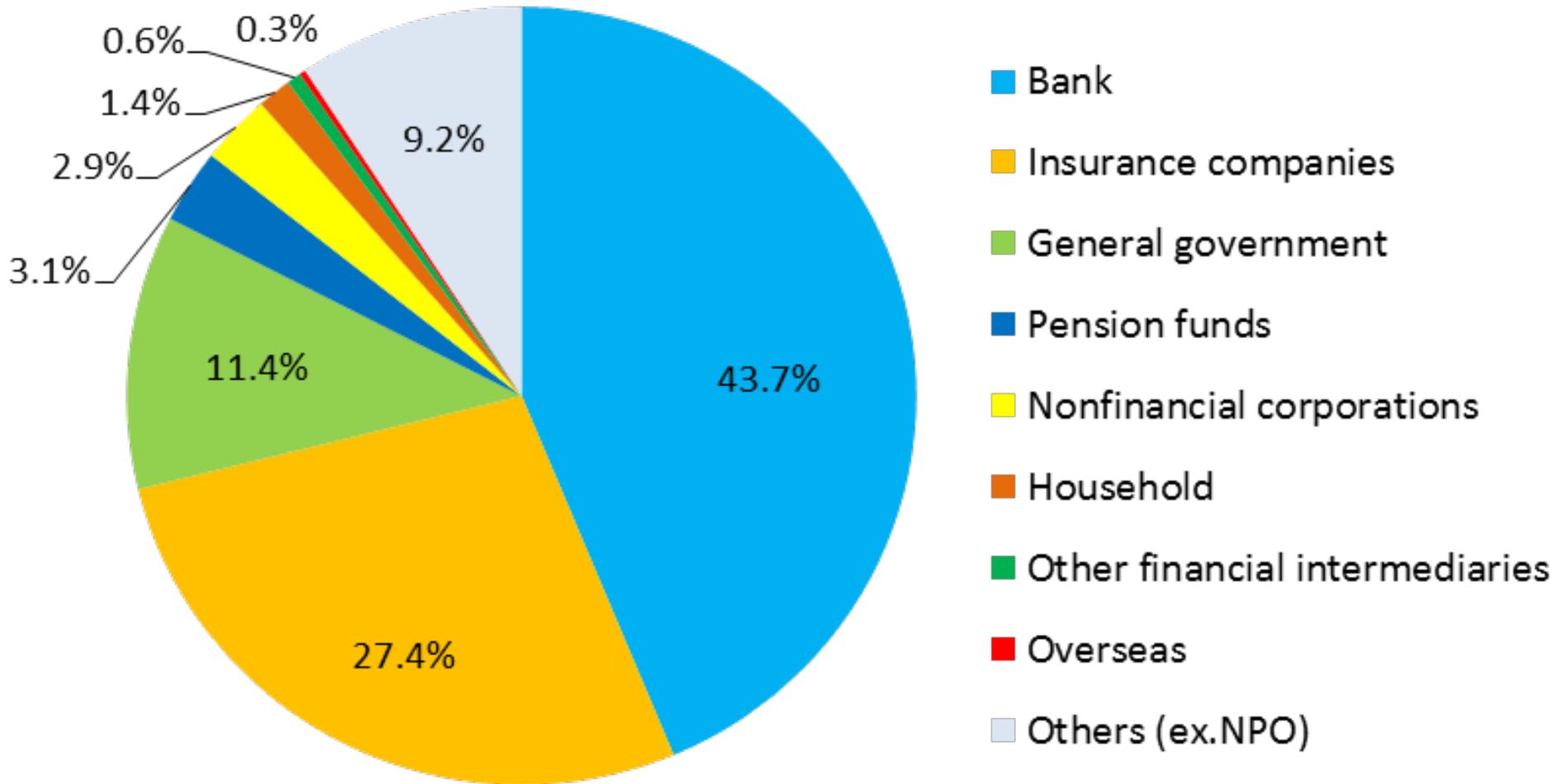
Planned Issuance for Nationwide Public Offering LGBs in Fiscal-Year 2014

(Unit: Hundred Million Yen)

Local government	total	2y or 3y 5y or 7y	10y	15y or 20y or 30y	joint-LGB	other	Local government	total	2y or 3y 5y or 7y	10y	15y or 20y or 30y	joint-LGB	other
Hokkaido	3,300	1,100	1,200	-	800	200	Kochi	100	-	100	-	-	-
Miyagi	1,300	400	300	-	600	-	Fukuoka	2,500	500	1000	600	-	400
Fukushima	600	100	200	-	300	-	Saga	100	-	100	-	-	-
Ibaraki	400	100	-	-	300	-	Nagasaki	100	-	100	-	-	-
Tochigi	100	-	100	-	-	-	Kumamoto	500	100	100	-	300	-
Gunma	400	100	200	100	-	-	Oita	300	-	100	-	200	-
Saitama	3,800	400	1,800	400	600	600	kagoshima	800	100	-	-	700	-
Chiba	2,800	400	1,400	300	500	200	Sapporo City	1,100	200	300	-	300	300
Tokyo	6,600	400	4,400	600	-	1200	Sendai City	480	150	-	-	330	-
Kanagawa	3,500	800	1,600	600	500	-	Saitama City	100	-	100	-	-	-
Niigata	1,000	-	400	-	600	-	Chiba City	600	-	300	-	300	-
Fukui	400	-	200	-	100	100	Yokohama City	2,000	200	900	200	-	700
Yamanashi	200	-	200	-	-	-	Kawasaki City	1,040	280	100	300	260	100
Nagano	800	200	-	-	600	-	Sagamihara City	100	-	100	-	-	-
Gifu	350	-	150	-	200	-	Niigata City	200	-	100	-	100	-
Shizuoka	3,300	400	1,300	300	600	700	Shizuoka City	200	-	100	-	100	-
Aichi	3,700	200	2,400	200	400	500	Hamamatsu City	100	-	100	-	-	-
Mie	200	-	100	-	100	-	Nagoya City	1,600	200	600	200	-	600
Shiga	100	-	100	-	-	-	Kyoto City	1,200	200	200	100	400	300
Kyoto	2,200	500	500	200	600	400	Osaka City	3,200	800	400	300	800	900
Osaka	7,700	3,300	2,400	-	800	1200	Sakai City	200	-	100	100	-	-
Hyogo	3,100	400	400	700	800	800	Kobe City	1,100	200	200	200	300	200
Nara	300	100	-	-	200	-	Okayama City	100	-	100	-	-	-
Shimane	400	300	100	-	-	-	Hiroshima City	600	100	200	-	300	-
Okayama	300	-	200	-	100	-	Kita-Kyushu City	1,050	150	200	200	400	100
Hiroshima	1,700	100	900	100	600	-	Fukuoka City	1,600	600	200	200	400	200
Tokushima	350	-	100	-	250	-	Kumamoto City	100	-	100	-	-	-
							Total	69,970	13,080	26,550	5,900	14,740	9,700

※This is based on the figures of domestic bonds announced by Ministry of Internal Affairs and Communications in Apr 2014.

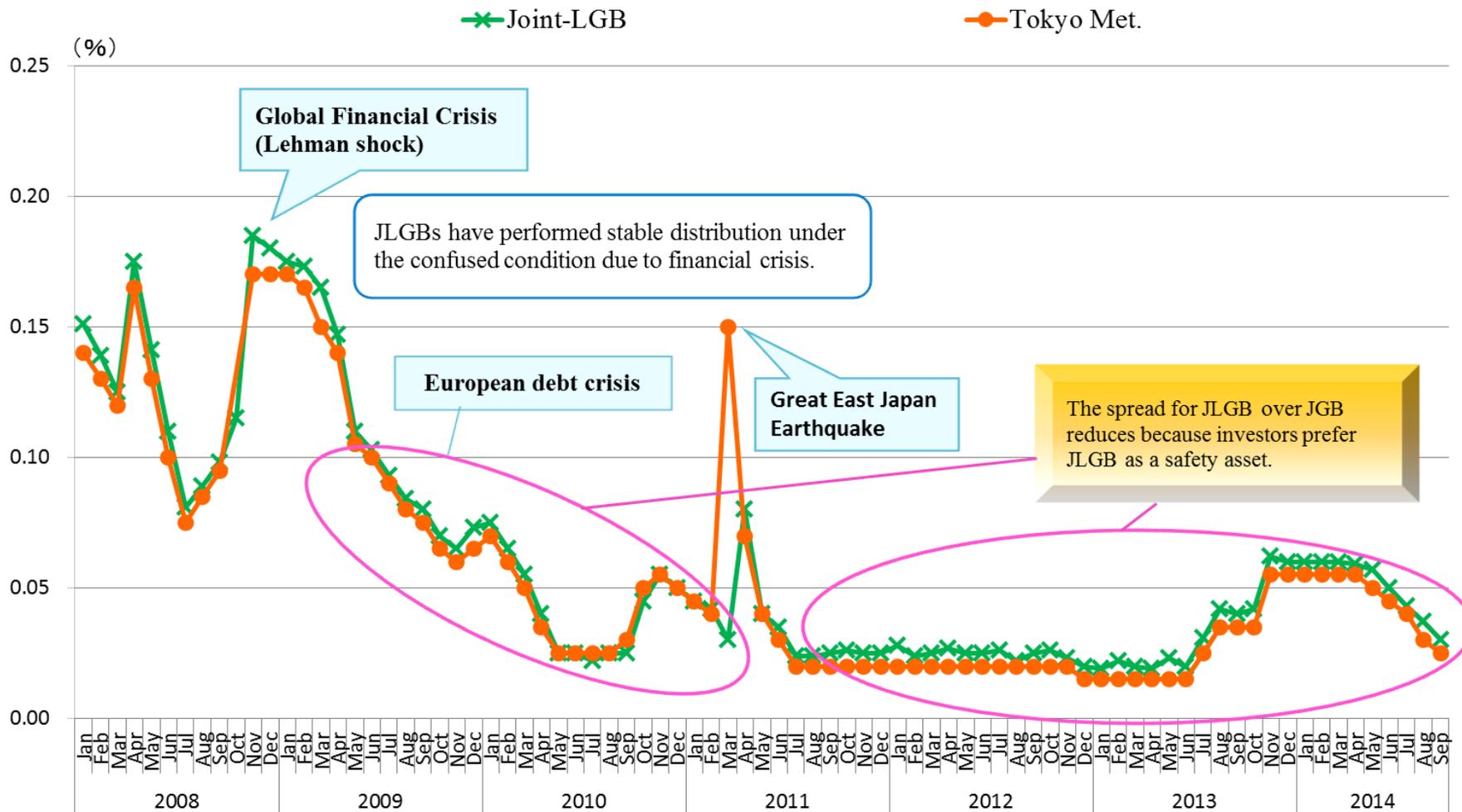
Distribution of JLGB holders (2014/March end)



Source: Bank of Japan “Flow of funds accounts”

Spread for public offering JLGB over JGB

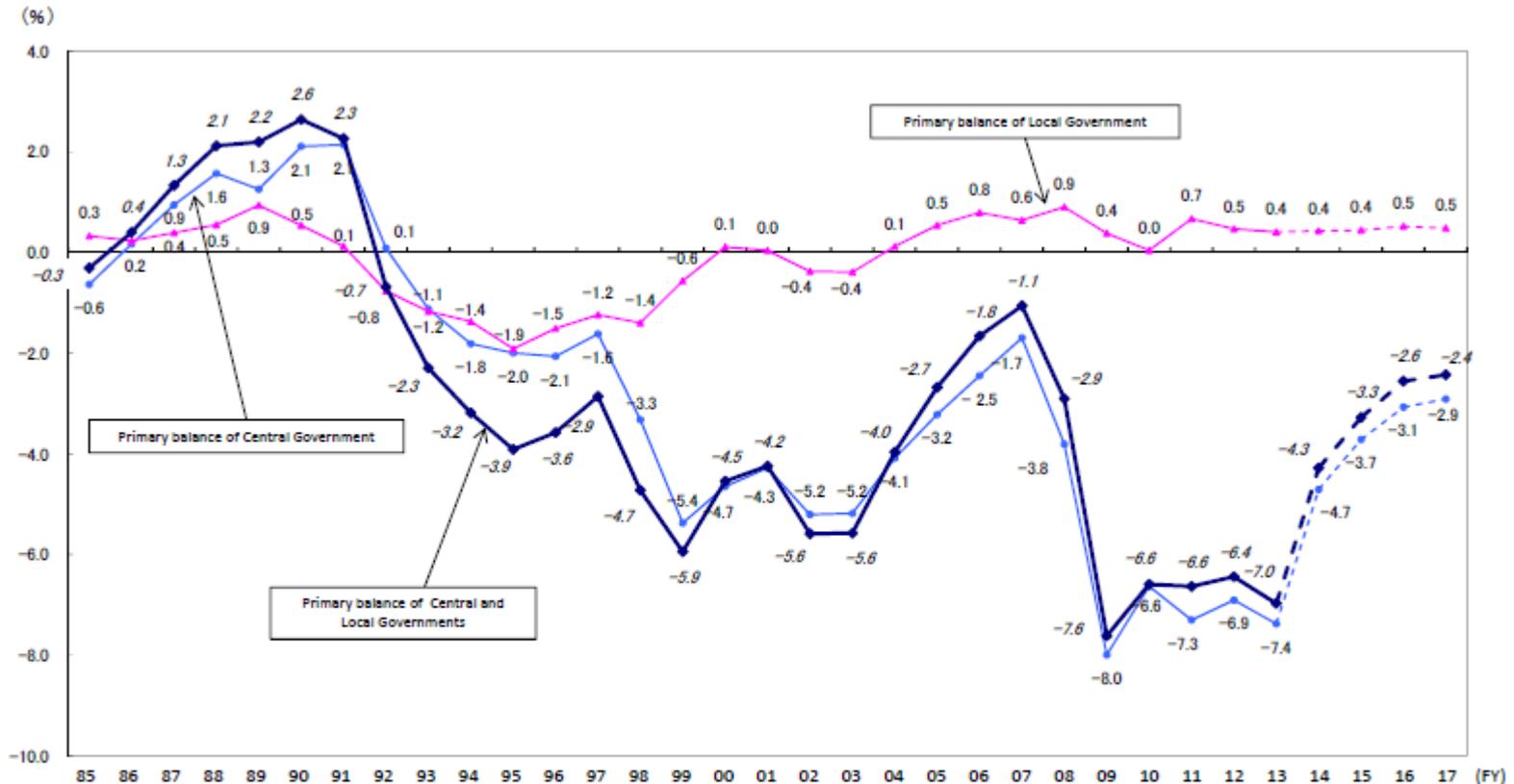
◆ The spread for public offering JLGB (10year) over JGB (10year)



※ Issuance Yield(Jan2008-Sep2014)

Trends in Primary Balance of Central and Local Governments to GDP Ratio

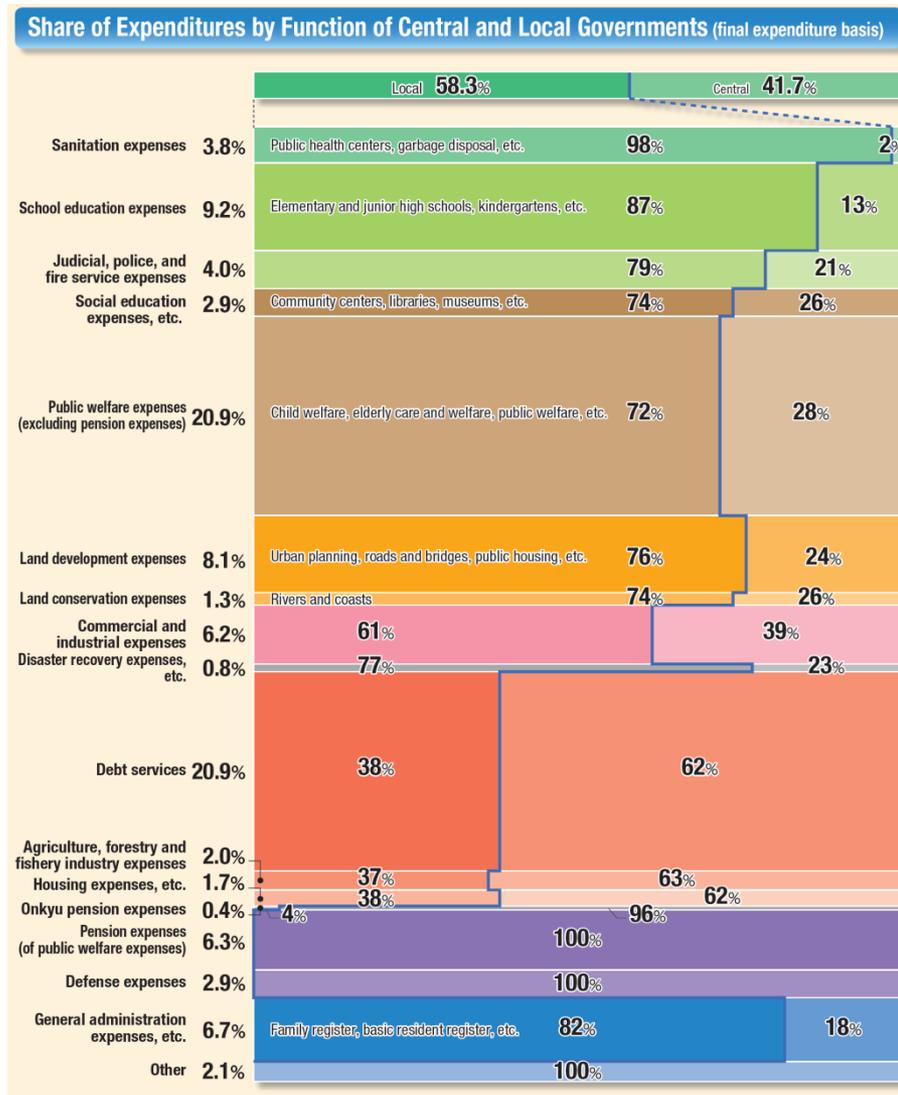
◆ In recent years, Primary Balance of LGs has achieved surplus.



(Source) FY1985-2010: Cabinet Office "Annual Report on National Accounts"
 FY2011-2017: Cabinet Office "Economic and Fiscal Projections for Medium to Long Term Analysis"

(Note 1) The long-term debts of Japan National Railways and the cumulative debts of national forests are excluded for FY1998, the Fiscal Loan Fund of the special account for the fiscal investment and loan program (the special account for the Fiscal Loan Fund for 2006) transferred to the special account for the Government Debt Consolidation Fund or the general account are excluded for 2006, 2008, 2009, 2010 and 2011, the debts transferred from Japan Expressway Holding and Debt Repayment Agency to the general account are excluded for 2008, and the debts transferred from Japan Railway Construction, Transport and Technology Agency to the general account are excluded for 2011.

(Note 2) Excluding the expenditures for the recovery and reconstruction measures from FY2011 to FY2017.

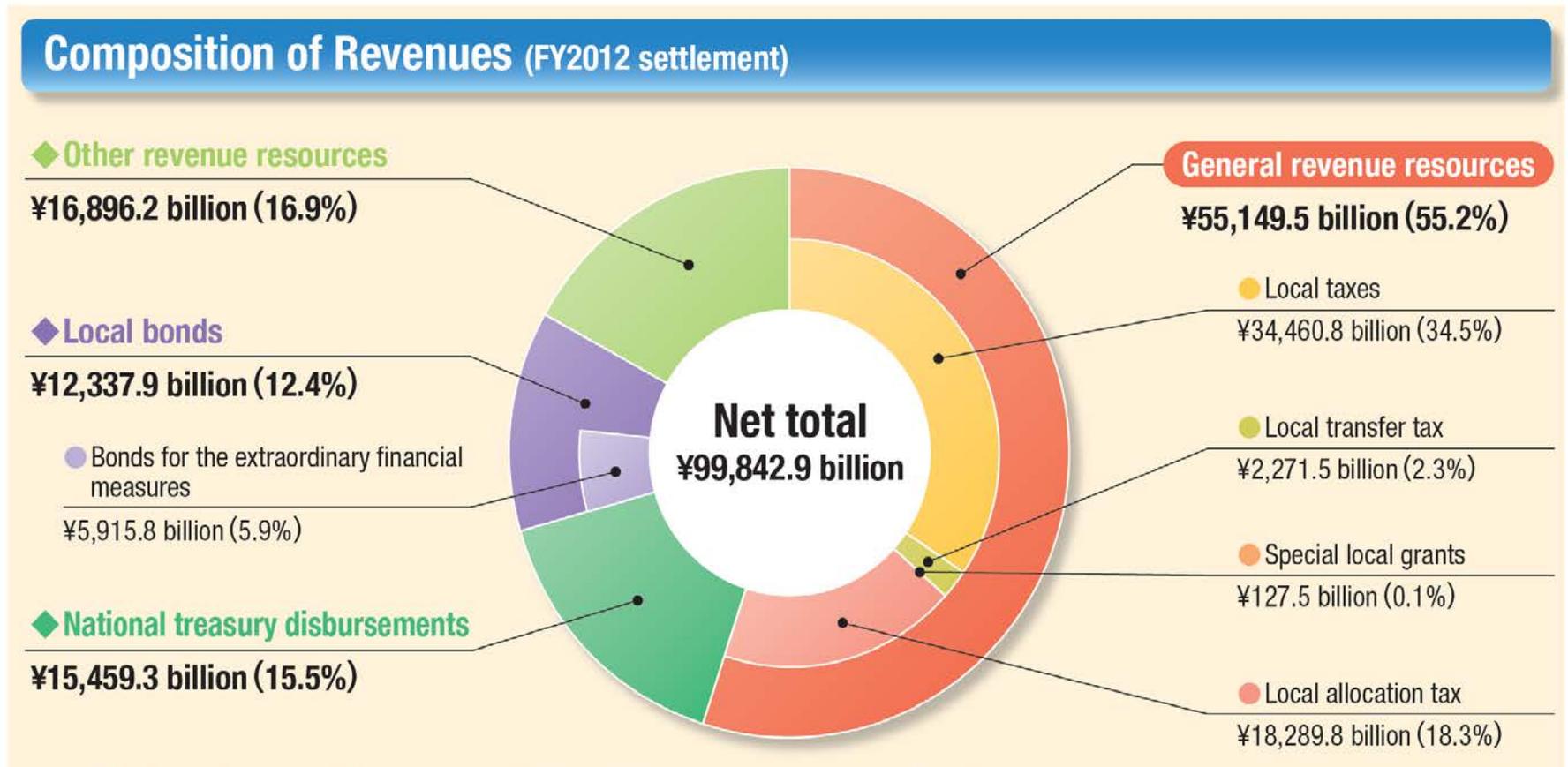


- ◆ LGs have relatively large responsibilities & functions.
- ◆ The greatest portion of local government annual expenditures is directed toward supporting everyday public services: public health and sanitation, education, social education, and police and fire prevention, etc.

Source: White Paper on Local Public Finance, 2014 “FY2012Settlement” by Ministry of Internal Affairs and Communications

The revenue of LGs

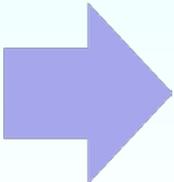
- ◆ The revenue of LGs comes mainly from local taxes, local allocation tax, national treasury disbursements, and local bonds.



Source: White Paper on Local Public Finance, 2014 “FY2012 Settlement” by Ministry of Internal Affairs and Communications

Check and control system by the central government

- Local governments (LGs) are required to consult with the Minister of MIC (or the prefectural governor) at the time of issuance of Local Government Bond (LGB).
- LGB issuance without the consent of the Minister of MIC (or prefectural governors) is not eligible for public funds nor for local allocation tax system (Although LGs can issue LGBs without the consent, there are no such case.).
- In addition, LGs with deteriorating fiscal conditions are required to obtain an approval of the Minister of MIC (or the prefectural governor) in their issuance. LGB issuance without the approval shall not be issued in this case with LGs with relatively weak fiscal conditions.

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- The central government(or prefectures) check all the LGBs.
 - The central government secures the redemption of LGBs as a form of a consent after a consultation.
 - Issuance of LGBs by LGs with deteriorating fiscal conditions is restricted.
(the number of LGs necessary to obtain the approval FY2012 : 63(total LGs : 1,789))

Consultation system for the issuance of JLGB

- ◆ JLGB system changed from approval system to consultation system in FY2006 due to decentralization. Moreover, notification system was introduced in FY2012 limited to Private Fund from the perspective of enhancement of LGs' autonomy.

1. Consultation

LGs are required to consult with the Minister of MIC(prefectures and government designated cities) or the prefectural governor (in the case of municipalities) before debt issue.

2. Allocation of public funds for LGB with the consent

Only LGB with the consent by the Minister of MIC or the prefectural governors may borrow public funds [Government funds, JFM funds].

3. Debt payment for bonds with the consent included in Local Allocation Tax system

Debt payment for LGBs with the consent by the Minister of MIC or the prefectural governors is included in Local Allocation Tax system.

4. LGs are required to report issuance of the bond without the consent to the assembly

In order to issue LGBs without the consent, the head of the LG is required to report issuance of the bond without the consent to the assembly.

5. Standard for consent

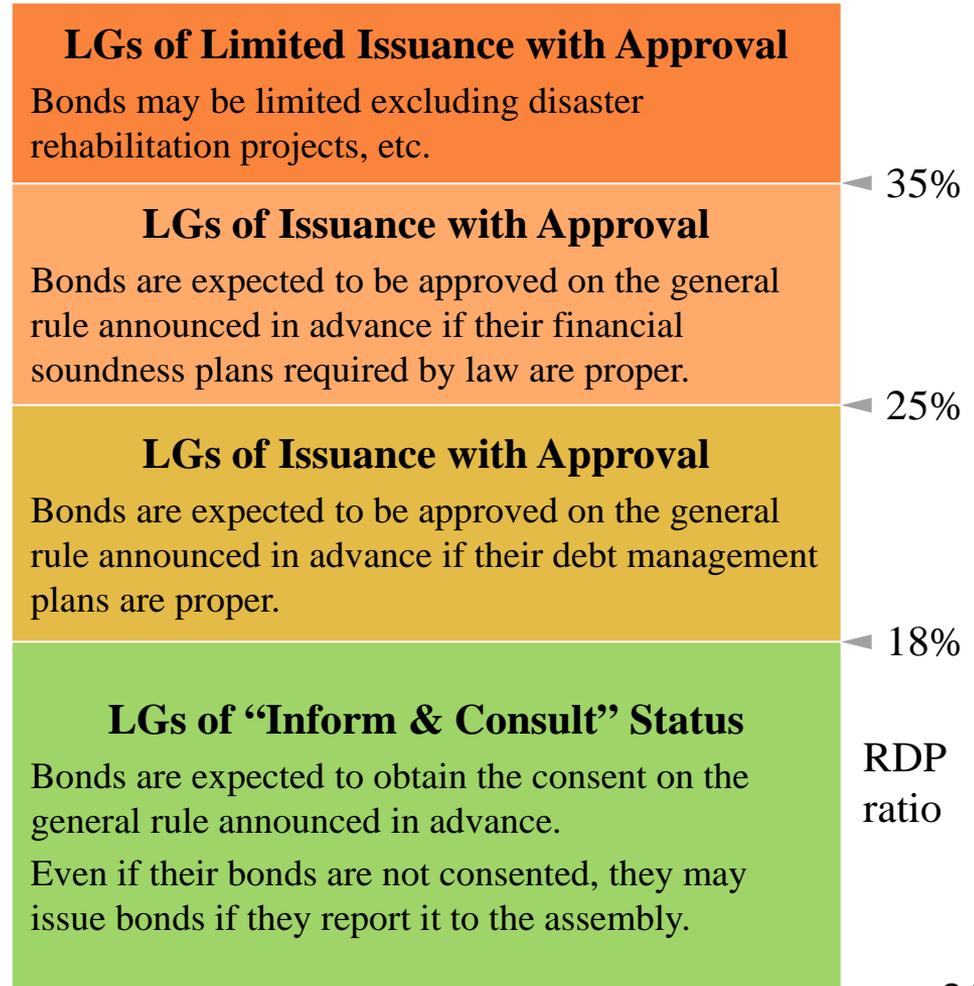
The Minister of MIC releases the standard for the consent every fiscal year. Issuers in high deficit, issuers with high real-debt-payment-ratio, and public enterprises in high deficit, etc. are required to obtain the approval of issuance from the Minister or the governor.

Consultation system for the issuance of JLGB (2)

- ◆ In order to secure fiscal soundness, LGs with higher real-debt-payment-ratio or higher deficit than a set limit are required to get the approval for bond issue instead of the consultation.

Approval required if real-debt-payment-ratio(RDP) is 18% or more

- ◆ Issuers with RDP between 18% ~ 25% must draft the debt management plan and obtain the approval of the MIC minister (or the prefectural governor), based upon the general approval standard.
- ◆ Issuers with the ratio between 25% ~ 35% must draft the financial soundness plan required by law and obtain the approval of the MIC minister (or the prefectural governor), based upon the general approval standard.
- ◆ Issuers with the ratio of 35% or more must draft the financial rebuilding plan and obtain the approval of the MIC minister. Otherwise, Issuers are prohibited from debt issue excluding disaster rehabilitation projects, etc.



Control of fiscal discipline

- In Japan, there is a system of maintaining fiscal discipline by checking the fiscal conditions of LGs through the disclosure of relevant information, and taking measures for early-stage improvement of fiscal conditions before they seriously deteriorate.
- Under this system, local residents, local assemblies and auditors are to examine latent risks of relevant local public corporations and third-sector companies in addition to LGs.
- These examinations are designed to confirm both flow and stock indicators from the perspective of ensuring the medium- and long-term improvement of fiscal management.
- In addition, if the rehabilitation by LGs on their own is deemed difficult, the central government will play a role to ensure their rehabilitation.

- 
- The fiscal conditions of local governments are checked in detail in terms of both flow and stock.
 - The fiscal conditions of related entities are also checked in order to prevent unforeseen liabilities.
 - As of the end of FY2012, only 2 LGs exceed the early warning limit, and 1 of those 2 LGs exceeds the reconstruction limit(out of a total of 1,789 LGs).

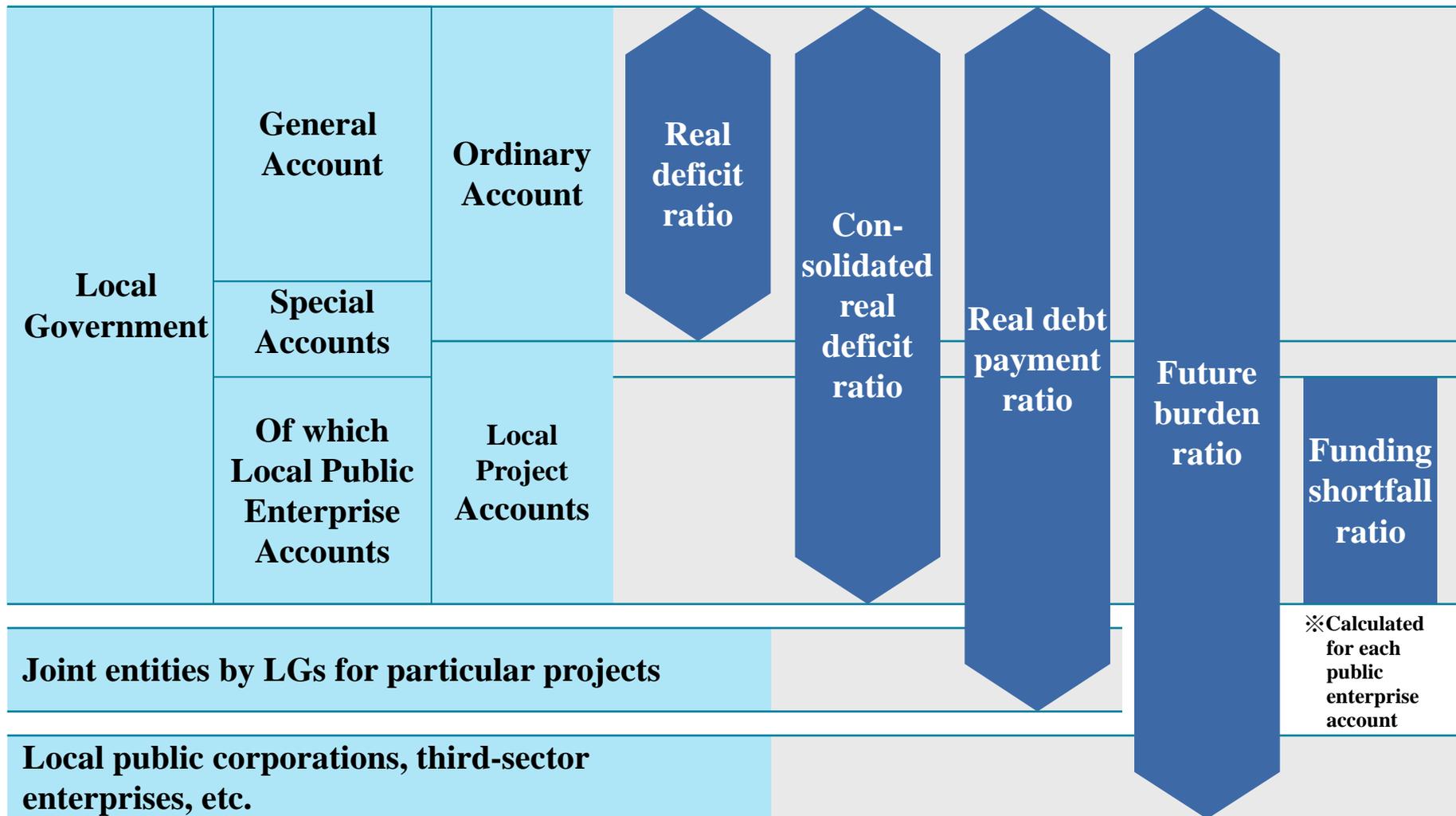
- ◆ LGs are required to report the following ratios to the local assembly every fiscal year after receiving an assessment by the auditor, and to disclose those ratios to the public.

Fiscal indicator	Definition
1. Real deficit ratio	The ratio of deficit to the standard financial scale.
2. Consolidated real deficit ratio	The ratio of consolidated deficit in the all accounts to standard financial scale.
3. Real debt payment ratio	The ratio of debt payment by general revenue to standard financial scale.
4. Future burden ratio	The ratio of outstanding debt as well as contingent liabilities of public enterprises and government affiliates, to standard financial scale.
5. Funding shortfall ratio at Public Enterprises	The ratio of the previous fiscal year's shortfall in funds for each public enterprise to the previous fiscal year's business scale.

Limits for Early warning and reconstruction

	Early warning limit	Reconstruction limit
1. Real deficit ratio	Prefectures: 3.75%	Prefectures: 5%
	Municipalities, depending on fiscal size: 11.25 ~ 15%	Municipalities: 20%
2. Consolidated real deficit ratio	Prefectures 8.75%	Prefectures: 15%
	Municipalities, depending on fiscal size: 16.25 ~ 20%	Municipalities: 30%
3. Real debt payment ratio	Prefectures, and Municipalities: 25%	Prefectures, and Municipalities: 35%
4. Future burden ratio	Prefectures and government-designated cities: 400%	
	Municipalities: 350%	
Management Improvement limit		
5. Funding shortfall ratio at public enterprises	20%	

Scope of fiscal indicators in the Law



Revision of consultation system for the issuance of LGB

- ◆ Notification system for the issuance of LGB was introduced from FY2012 by revising the part of consultation system in order to enhance the independence and autonomy of LGs.

1. Conditions of LGs that don't need consultation when they issue LGBs

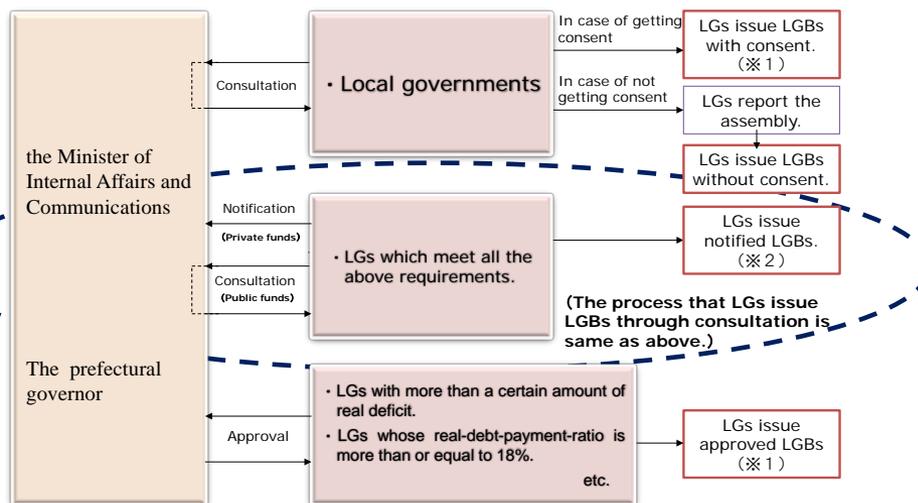
If they meet the following requirements, LGs can issue LGBs[※] without the consultation with the Minister of Internal Affairs and Communications or the prefectural governor. [※]LGBs by private funds only.

- ① Real-debt-payment-ratio is less than 16%.
- ② Real deficit is 0.
- ③ The total amount of LGBs after the consent or the approval is less than or equal to 25% of the previous three year average of the total amount of the standard fiscal scale and the scale of the business of public enterprise.

etc.

2. Local Allocation Tax system

Debt payment for notified LGBs which are approved that LGs could issue with the consent if they consult with the Minister of Internal Affairs and Communications or the prefectural governor is included in Local Allocation Tax system.



※1 LGBs with the consent(or the approval) are approved to be allocated public funds and debt payment for LGBs with the consent(or the approval) is included in Local Allocation Tax system.

※2 Debt payment for notified LGBs which are approved that LGs could issue with the consent if they consult with the Minister of Internal Affairs and Communications or the prefectural governor is included in Local Allocation Tax system.

Japan Local Government Bond Association Website

(<http://www.chihousai.or.jp/english/07/investor.html>)

English Publications on JLGBs

English Publications on JLGBs	
Presentation Materials	Local Government Bond System and Market in Japan
	Public Offering Joint Local Government Bond
	Japan Finance Organization for Municipalities
	Kawasaki City
Other issuers	Tokyo Metropolitan Government (TMG), Chiba Prefecture, Fukuoka Prefecture, Sapporo City, Kyoto City, Kobe City, Fukuoka City
White Paper	FY2012 Settlement White Paper on Local Public Finance, 2014
Laws and Ordinances	Law on the Fiscal Consolidation of Local Governments
	Local Autonomy Law
	Local Finance Law
	Local Allocation Tax Law
Others	Issue Outline of Joint Local Government Bond
	Terms and conditions of Tokyo Metropolitan Government Bond

- **Japan Local Government Bond Association**

Website <http://www.chihousai.or.jp/english>

(This includes most comprehensive information in English)

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