

11-I-050
October 28, 2011

JCR Affirmed AAA/AAA (FC/LC) ratings on Japan

Japan Credit Rating Agency, Ltd. (JCR) announces the following credit ratings.

Rationale

- (1) JCR conducted annual review of the ratings following the credit opinion on August 29. The ratings continued to be constrained by prolonged deflation and the country's sizable government debt stemming from chronic fiscal deficits, both of which show no obvious signs of improvement. On the other hand, factors that supported the ratings remained unchanged including Japan's solid external position, stable structure of domestic holding of government bonds backed by huge household savings, its relatively low tax burden that leaves ample room for tax increases and highly advanced and competitive economy. Prime Minister Yoshihiko Noda showed further concrete plan including tax increases for fiscal consolidation. All these considered, we affirmed the ratings and keeps stable rating outlook.
- (2) Barring significant electric power supply constrains, the Japanese economy seemed likely to grow more than 2% in FY2012 mainly on full-fledged implementation of the reconstruction programs for the Great East Japan Earthquake (under three FY2011 supplementary budgets totaling JPY19 trillion). The programs are to be funded with temporary tax increases and non-tax revenues, but front-loaded reconstruction will force the government to issue additional bonds worth around JPY 11 trillion in the short run. The fiscal position continues deteriorating as new issue amount of annual government bond surpassed the tax revenues of the central government and the general government debt exceeded 200% of GDP. For fiscal consolidation, Prime Minister Noda is committed to the earlier government target to achieve a central and local government primary balance surplus by FY2020 and plans to send to the Diet bills on "*Integrated reform of social security and tax*" by the end of FY2011 in conformity to the supplementary provision of the FY2009 Tax Reform Act. The "*Integrated reform of social security and tax*" specifically calls for the consumption tax rate to be gradually raised to 10% by the middle of the 2010s. The Noda administration may have twists and turns in the process of implementing tax hikes as it will have to adjust differences with the adversary not only in the opposition parties but within his own ruling party. However, JCR considers that its realization will prove an initial step forward to fiscal consolidation.
- (3) The environment surrounding the Japanese economy is deteriorating amid a sharp appreciation of the Japanese yen and a downturn of the overseas economies stemming from the deepening European sovereign debt crisis. Prolonged sharp appreciation of the Japanese yen may accelerate the hollowing out of Japanese industry and harm Japan's international competitiveness. Should increased bond issues continue without meaningful fiscal consolidation, the stable bond holding structure could be marred by a further decline in the household savings rate that may result from the aging population in the medium to long run. Given the flattening balance of household savings and growing general government debt, the time left to work for fiscal consolidation is getting steadily shorter. Japan's national burden rate is relatively lower as compared with those in other developed countries. JCR expects the government to act swiftly in pushing ahead with fiscal consolidation, in particular tax increases.

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Rating

Issuer: Japan

<Affirmation>

Issues	Rating	Outlook
FC (Foreign Currency Long-Term Senior Debts)	AAA	Stable
LC (Local Currency Long-Term Senior Debts)	AAA	Stable

Outline of the method for the determination of Credit Ratings is posted as "Rating Methodology (Sovereign & Supranationals)" on JCR's home page (<http://www.jcr.co.jp>). The rating methodology is subject to additions and changes. In such cases, however, these additions and changes are shown in chronological order. Please check the release date of this press release against that of the rating methodology (i.e., the date when such methodology became effective) and then refer to the rating methodology above.

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