

Development of Japan's credit markets

Hibiki Ichiue¹
Bank of Japan

Introduction

This paper examines the development of the corporate bond market in Japan. Other credit products are also reviewed because they are important for understanding the bond market.

The paper is organised as follows. Section 1 considers the corporate bond market. Sections 2 and 3 consider the syndicated loan and securitisation markets, respectively, both of which the Bank of Japan (BOJ) plays a role in developing. Section 4 looks at yen-denominated foreign debt, or the so-called "Samurai bond" market, which offers a solid infrastructure for Japanese investment in Asian companies. Section 5 touches on credit derivatives, and Section 6 provides some conclusions.

1. The corporate bond market

A comparison with bank loans is a useful first step for understanding Japan's corporate bond market. Historically, the credit market in Japan has been dominated by bank loans, and this is true even now, as shown in Graph 1. However, the outstanding amount of bank loans has declined in the last decade, while direct financing through the corporate bond market has more than doubled.

A more detailed analysis will help illuminate the history of the market. Graph 2 shows the net flows of corporate bonds and bank loans. Loans increased in the 1980s, but after the bubble economy burst in the early 1990s, they started to decrease dramatically. The financial crisis in 1997-98 further accelerated the decrease in bank loans because banks faced serious credit problems and could no longer continue lending to firms. Firms had to look elsewhere for finance, with the result that corporate bonds partially took over the role of bank loans - making the financial crisis the turning point for the development of the corporate bond market. The bond market has now levelled off and the credit recovery at banks is enabling bank loans to crowd out corporate bonds.

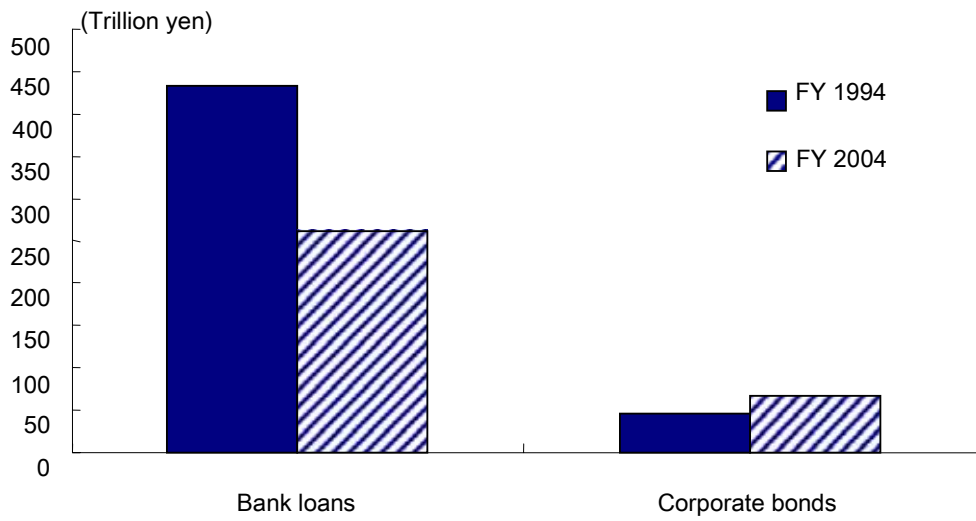
Deregulation is another driving factor behind the development of the corporate bond market. The abolition of the "issue standards" in 1996, under which only limited firms could issue bonds, was a prerequisite for market growth.

Japan's corporate bond market is characterised by the domestic nature of its investor base. Indeed, most investors are Japanese players, such as local pension funds and insurance companies willing to accept the low credit spreads that, historically, foreign investors would not. In other words, domestic demand for credit risk is strong and absorbs the private sector's need for financing.

Credit ratings have also played an important role in the growth of Japan's corporate bond markets. As shown in Graph 3, foreign as well as local agencies cover Japanese issuers, providing multi-credit ratings that help investors to make appropriate decisions.

¹ Deputy Director, Financial Markets Department, Bank of Japan.

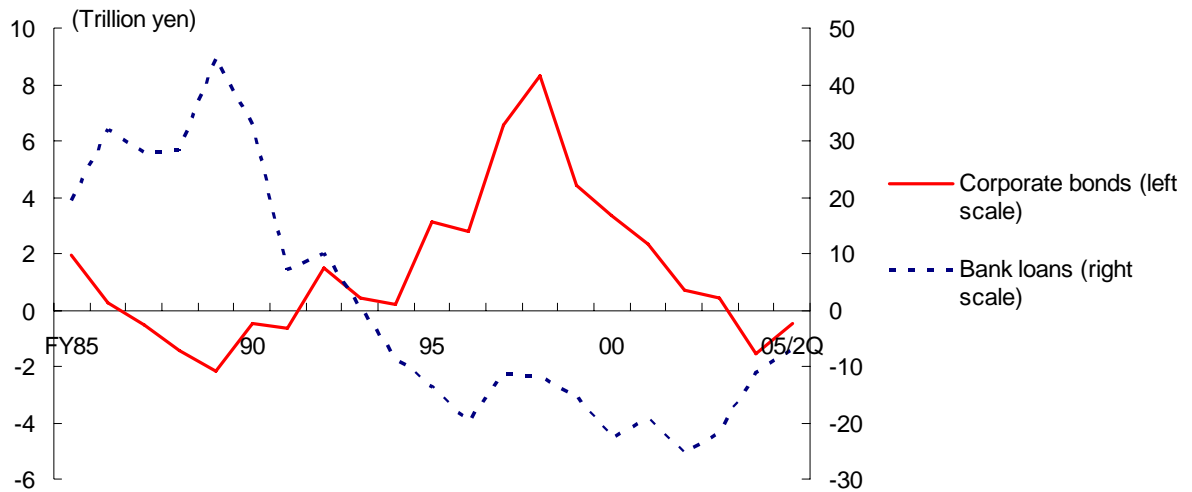
Graph 1
Outstanding amounts of loans/bonds



Note: The outstanding amount of corporate bonds in FY94 has been estimated by the BOJ. Privately issued bonds are excluded from corporate bonds.

Sources: BOJ "Flow of Funds"; IN database; Japan Securities Dealers Association.

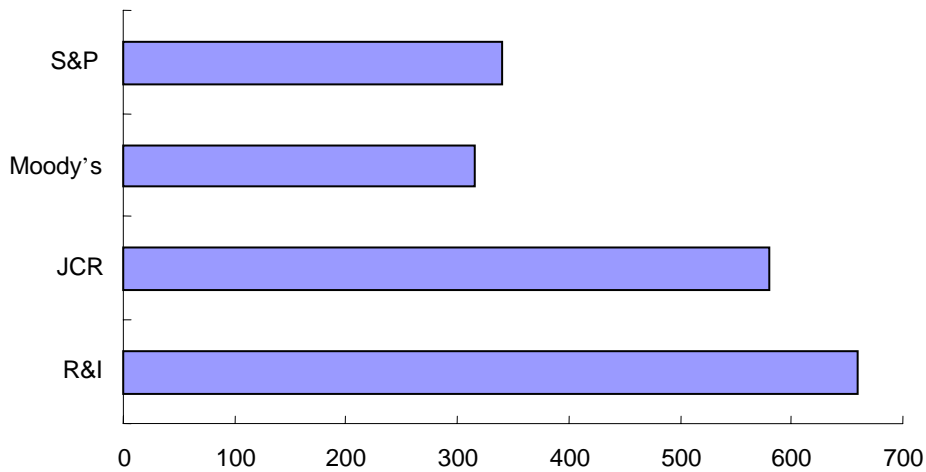
Graph 2
Net flow of corporate bonds



Note: Total net flow of corporate bonds before FY98 has been estimated by the BOJ. Privately issued bonds are excluded.

Sources: BOJ "Flow of Funds"; IN database; Japan Securities Dealers Association.

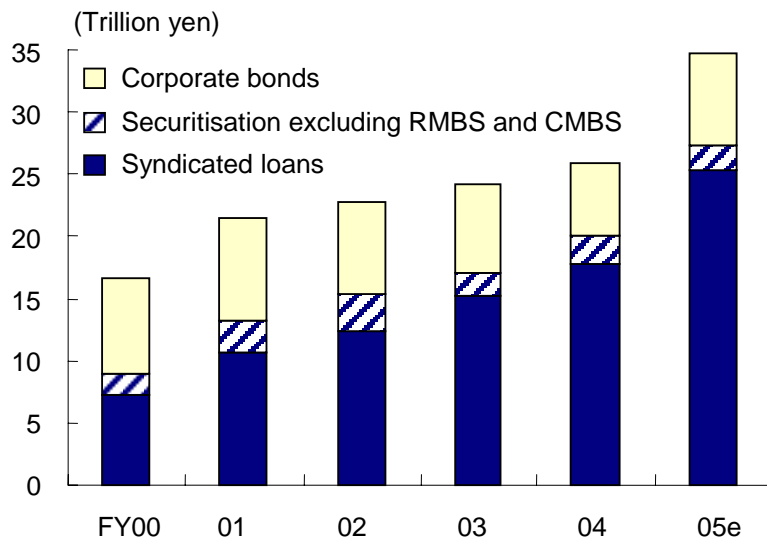
Graph 3
Coverage by rating agencies



Note: The numbers of Japanese issuers rated at end-July 2003 are reported.

Source: Tsutomu Okato, "Credit Ratings in Japan", Chuokeizaisha 2004.

Graph 4
Amount issued and originated in credit markets



Note: 2005e figures are calculated on a year-on-year basis, using available data. RMBS stands for residential mortgage backed securities; CMBS stands for commercial mortgage backed securities.

Sources: BOJ, "The Survey on the Securitisation Market"; Deutsche Securities Limited Securitisation Research; Japan Securities Dealers Association; Thomson Financial.

2. The syndicated loan market

As shown in Graph 4, the corporate bond market has levelled off recently. Securitisation, excluding mortgage-backed securities, provided some funding for firms following the financial crisis, but has been capped in recent years. In contrast, loan syndication is now taking off. This section considers the loan market.

The syndicated loans market started to develop after the financial crisis, because banks needed to liquidate non-performing loans. The primary loan syndication market is driving the recent growth of the loan market, as shown in Graph 5. The BOJ supports the market's growth in various ways. First, it publishes "Statistics on Syndicated Loans", which are useful for analysing the market since the report provides detailed breakdowns of data. (Note that the BOJ acts as a clearing house for information.) Second, the BOJ accepts syndicated loans as collateral for open market operations. Finally, the BOJ supports the activities of industry associations. For example, as a member of a working group, it helped the Japan Syndication and Loan-trading Association (JLSA) devise standard contracts.

As already mentioned, Japan's domestic demand for credit risk is strong, while investment opportunities in Japan's credit markets are very limited. Expansion of cross-border syndicated loans could broaden investment opportunities for Japanese investors, particularly in Asia, where regional companies might benefit from multiple sources of funding.

3. The securitisation market

The securitisation of credit receivables and equipment leases has also served as a substitute for bank loans since the financial crisis, just as the corporate bond and secondary syndicated loan markets have done. Graph 6 shows that mortgage-backed securities have driven recent market growth. This growth has been due in part to deregulation, specifically the revision in 2003 of the Government Housing Loan Corporation Law to accelerate the liquidation of housing loans.

The BOJ commenced a program of outright purchases of asset-backed securities (ABSs) and Asset-back commercial papers (ABCPs) in 2003 to support the transmission mechanism of monetary easing. In particular, the BOJ has tried to smooth the delivery of money to small and medium-sized enterprises, which have the greatest need for credit. To this end, over half of the BOJ's underlying portfolio is restricted to instruments issued by small and medium-sized enterprises. Although the total amount of outright ABS purchases is steadily increasing (Graph 7), the purchases remain small, reaching only around three million yen recently. However, this increase can be interpreted as a good sign for market development since it reflects stronger-than-expected demand from private investors. Indeed, market participants seem to have more confidence in securitisation since the BOJ's announcement of its own purchases.

The BOJ has also contributed to the sound development of the market by holding a workshop on securitisation to discuss market practices with a wide range of professionals. One outcome of the workshop is the "Survey on the Securitisation Market", which increases market transparency as it can be accessed freely on the BOJ's website. (The BOJ started the survey in 2004, and the private sector is planning to take it over.)

4. The Samurai bond market

Graph 8 shows that the issuance of Samurai bonds has increased in recent years. Graph 9 shows that 16% of Samurai bonds in 2005 were issued by Asian institutions. Japanese investors are eager to purchase Samurai bonds, many of which provide them with wider spreads than bonds issued by Japanese firms. This market is a solid means for them to invest in Asian companies.

5. The credit derivatives market

As can be seen in Graph 10, the size of Japan's credit derivatives market remains small compared with the global derivatives market. However, the Japanese market has expanded rapidly. It is not clear, though, whether credit derivatives help stabilise financial markets, and this will be an important topic to consider in the coming years.

6. Conclusion

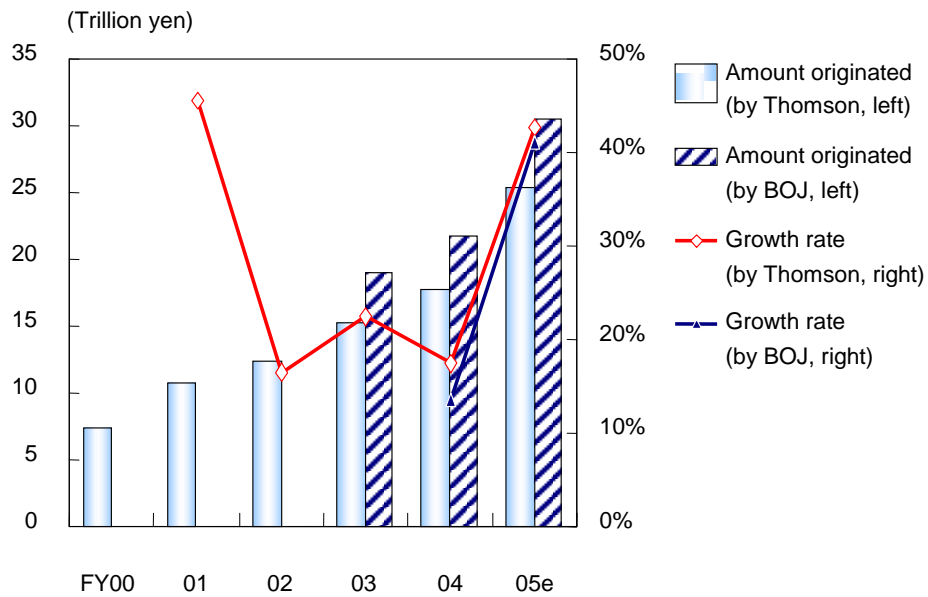
This paper can be summarised by the following three points.

First, although bank loans have dominated the Japanese credit market, the corporate bond market, along with the secondary syndicated loan market and securitisation of credit receivables and equipment leases, has played an important role since the financial crisis. The infrastructure of the credit market is reasonably well developed, and is expected to support the Japanese economy during the next credit down-cycle.

Second, investment opportunities in Japan's credit market are limited. The Samurai bond market is enabling Japanese investors to invest in Asian companies, and cross-border syndicated loans may play a greater role in future.

Finally, deregulation, such as the abolition of bond issue standards, was a prerequisite for the development of the credit market. Measures by the BOJ, such as outright purchases of ABSs and ABCPs and publishing statistics and surveys on credit markets, have helped to enlarge the investor base, as well as develop a new financing channel for companies, particularly small and medium-sized enterprises.

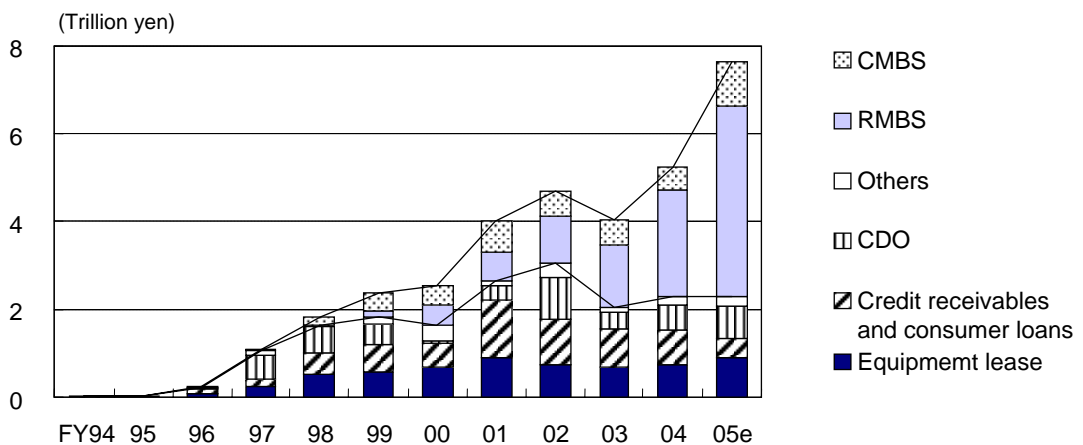
Graph 5
Origination of syndicated loans



Note: 2005e figures are calculated on a year-on-year basis, using available data for April-September.

Sources: BOJ; Thomson Financial.

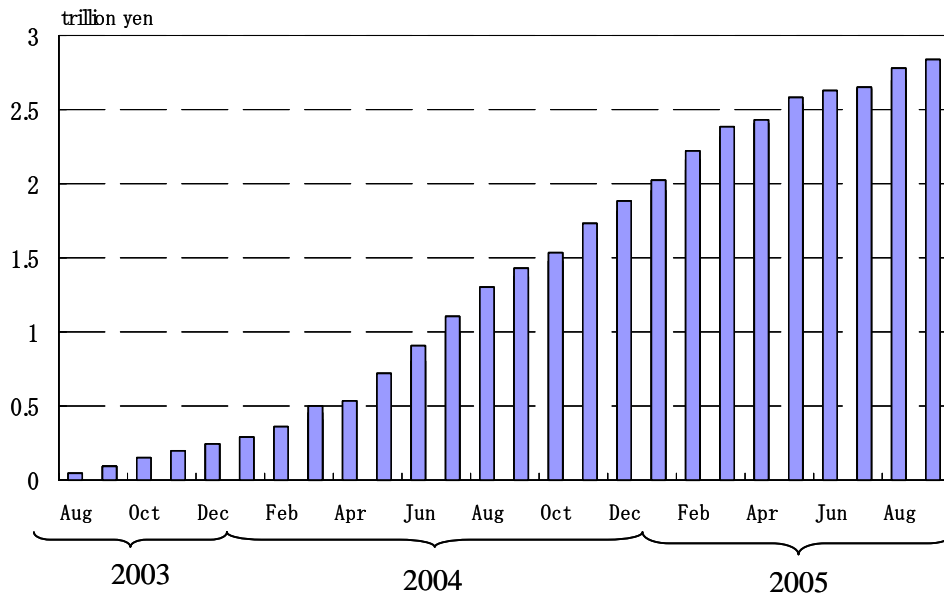
Graph 6
Amount issued in securitisation markets



Note: 2005e figures are calculated on year-on-year basis, using available data for April-September. CDO stands for collateralised debt obligations.

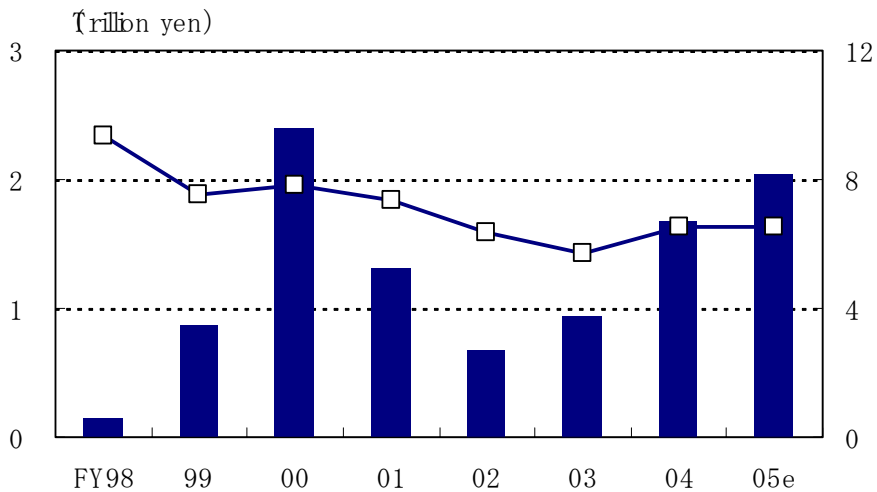
Sources: BOJ "The Survey on the Securitisation Market" (from FY04); Deutsche Securities Limited Securitisation Research (to FY03).

Graph 7
Total amount of ABS and ABCP outright purchases



Source: BOJ.

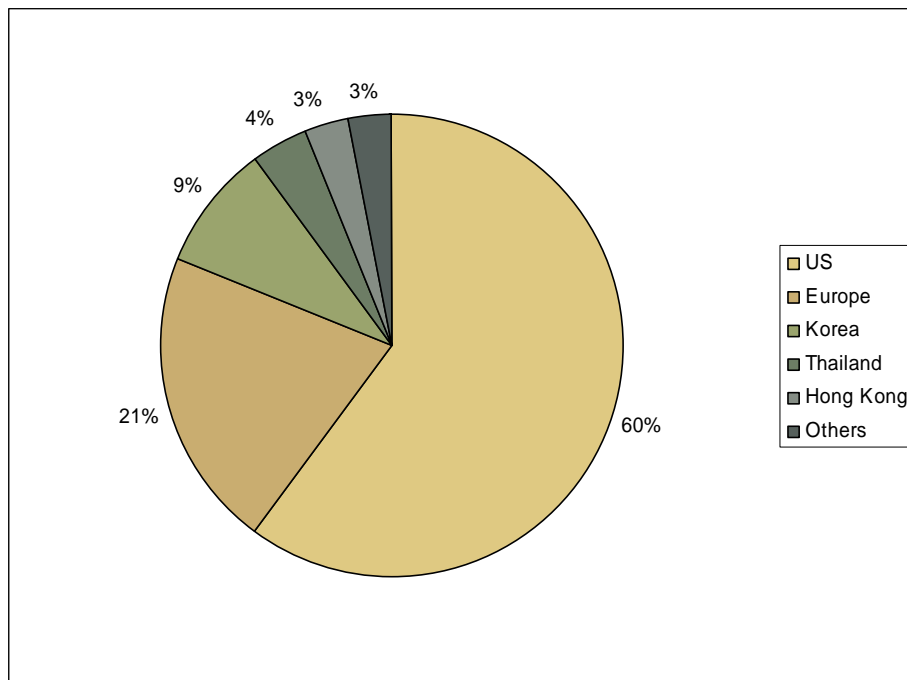
Graph 8
Amount of Samurai bonds issued and outstanding



Note: The bar and the line correspond to issuance and outstanding amounts respectively. 2005e figures are calculated on a year-on-year basis, using data available for April-August.

Source: Japan Securities Dealers Association.

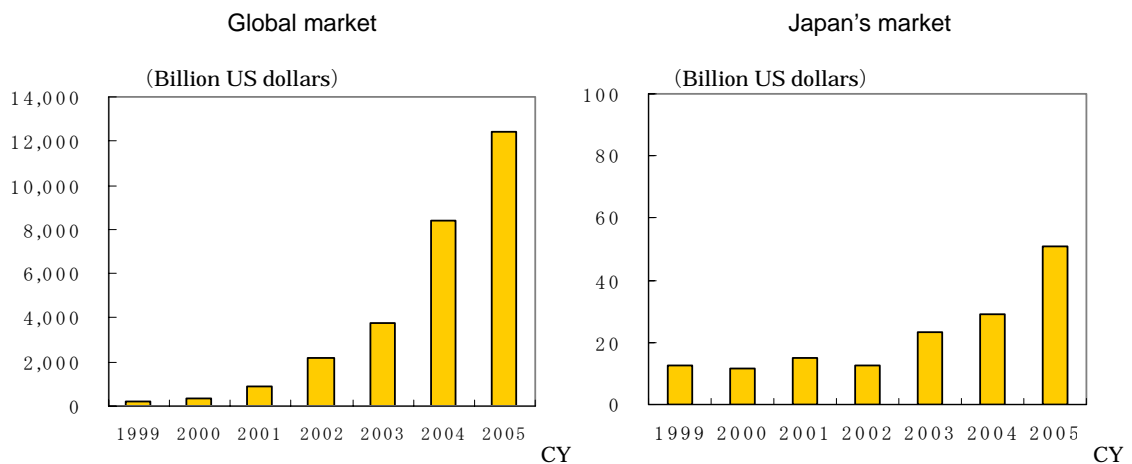
Graph 9
Nationalities of Samurai bonds



Note: Between January and September 2005.

Source: Japan Securities Dealers Association.

Graph 10
Outstanding amount of credit default swaps



Note: CY: calendar year. Some of the figures are estimated by the BOJ. 2005 figures are as of the end of the first half. There is a break in the Japanese data due to statistical processing at the end of June 2005.

Sources: British Bankers' Association; ISDA; BIS.