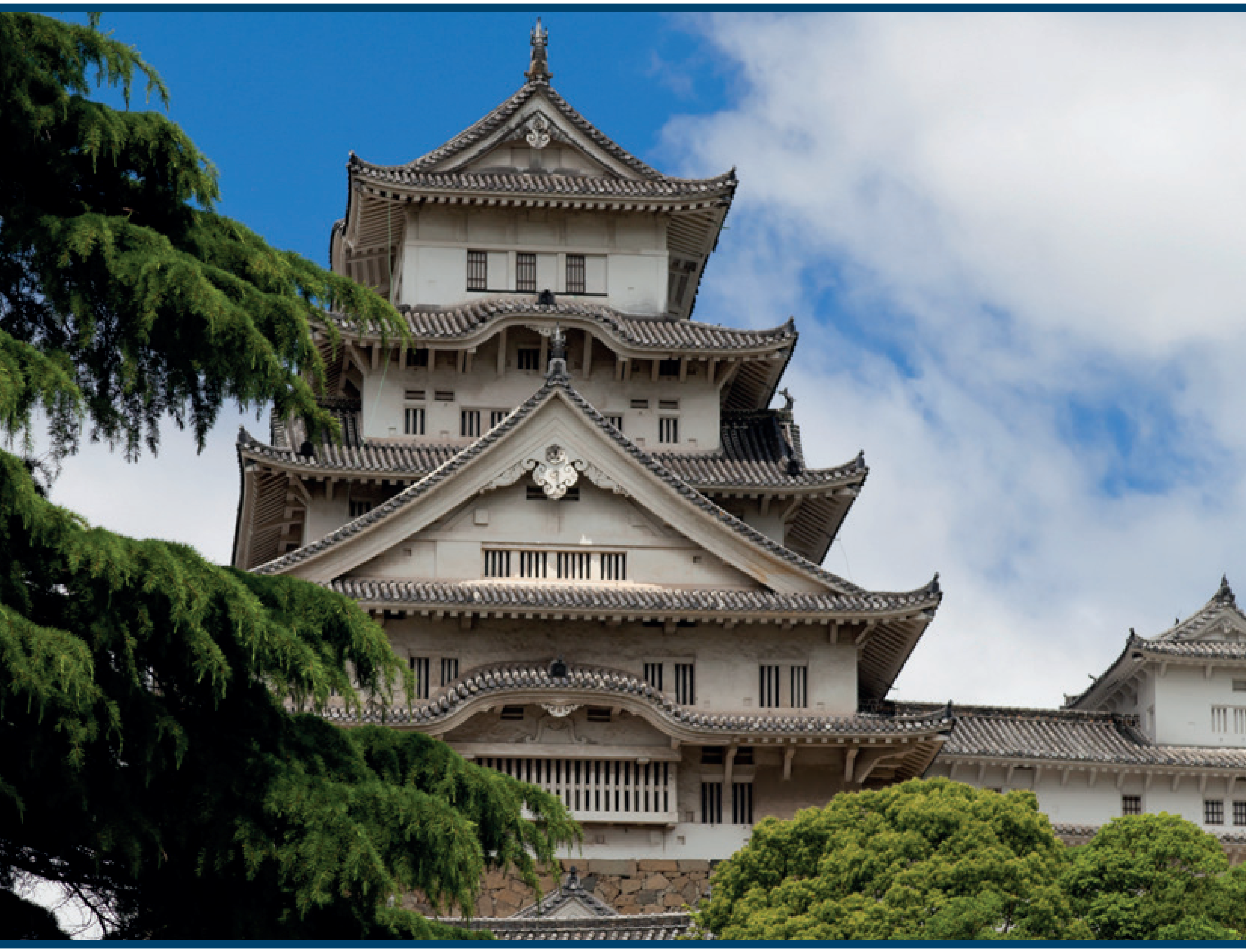
EUROWEEK

Japan's State Agencies in the Capital Markets

April 2012



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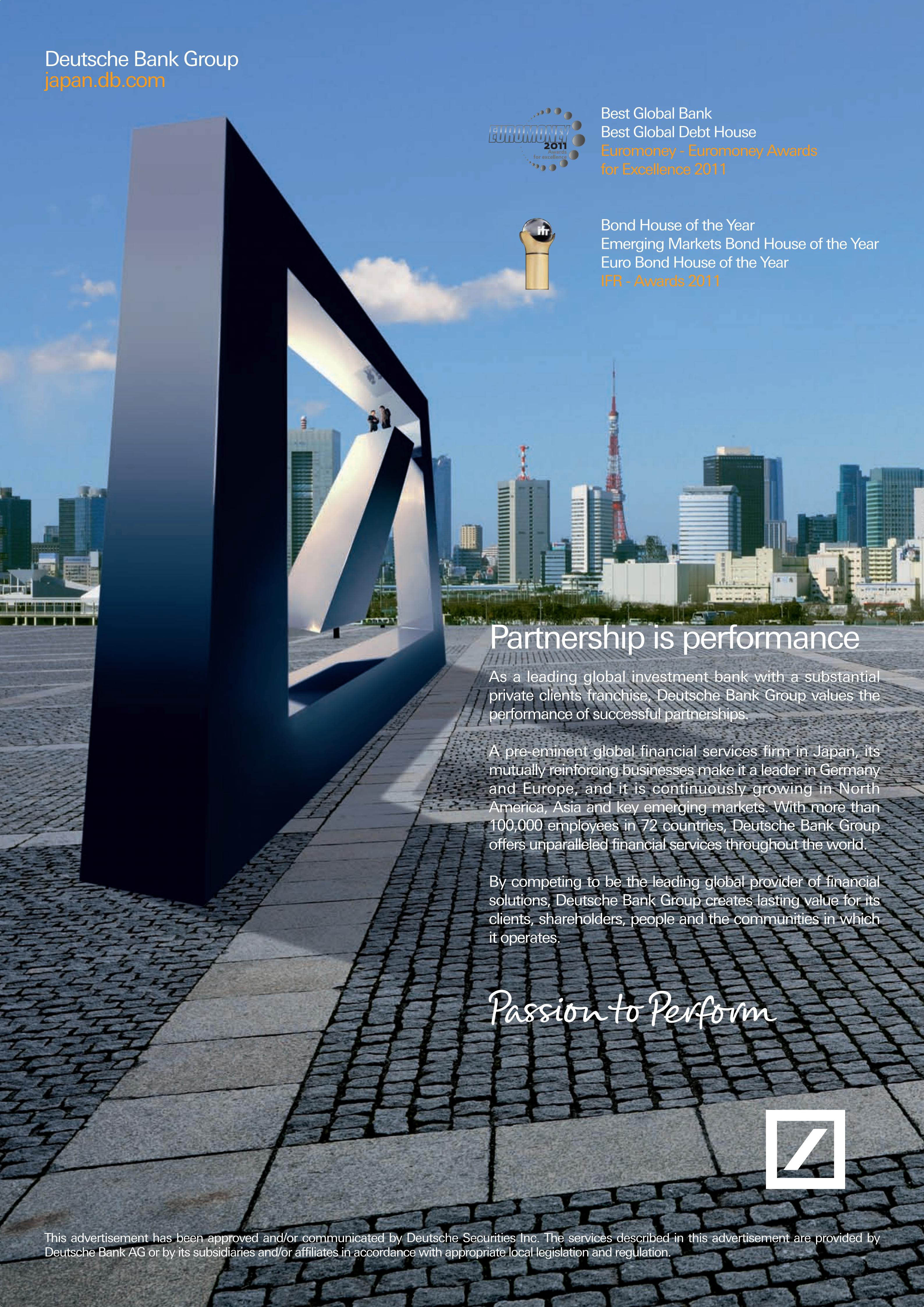
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Against the backdrop of a turbulent and uncertain environment in the global economy and capital market, the credentials of Japanese assets as safe havens have been strengthened over the last 12 months. At the same time, Japan's leading state agencies have continued to work hard to build on their relationships with their existing international investors and explore ways of extending and diversifying their investor bases outside Japan.

The consequence has been that demand for Japanese issuance has remained robust over the last year, with a series of tightly priced transactions in a variety of formats and currencies that the international investor community has warmly received. To discuss the prospects for Japanese state agency issuance in the domestic and international capital markets, four of the country's leading borrowers gathered at the annual *EuroWeek* Japanese roundtable.

Participants in the roundtable, which took place in Tokyo in March, were:

Hiroshi Kiyota, director, finance, **Japan Finance Organization for Municipalities (JFM)**, Tokyo

Tetsuya Kodama, managing director and head of debt capital markets, **Deutsche Securities**, Tokyo

Tomoki Matsuda, director general, treasury department, **Development Bank of Japan (DBJ)**, Tokyo

Takeshi Sakamoto, division chief, capital markets and funding division, treasury department, **Japan Bank for International Cooperation (JBIC)**, Tokyo

Shohei Takahashi, joint head of international debt capital markets, **Nomura Securities**, Tokyo

Yoshifumi Omura, director, capital markets division, treasury department, **Japan International Cooperation Agency (JICA)**, Tokyo

Moderator: Phil Moore, contributing editor, ***EuroWeek***

Roundtable sponsored by Deutsche Securities and Nomura Securities

EUROWEEK: To what extent has the Japanese economy and capital market recovered from the shock of the Tohoku earthquake and the tsunami?

Tetsuya Kodama, Deutsche Securities: The impact on the Japanese economy of the disaster was not restricted to the harm directly caused by the earthquake and by the damage caused at Fukushima. It also had an indirect impact by leading to a further strengthening of the yen, and more recently the economy has also been put under additional pressure by the sovereign debt crisis.

However, our analysts are more positive on the outlook for the Japanese economy now that the country is making the transition from rescue mode following the earthquake to longer-term reconstruction, which is expected to involve a substantial contribution from the private sector. We expect FY2012 to be a strong year, with momentum picking up after the summer, although in the short term both the public and private sectors will continue to face challenges arising from the Eurozone sovereign crisis and the strong yen.

Shohei Takahashi, Nomura Securities: I share Mr Kodama's views in many ways, but I would also point out that the floods in Thailand as well as the weak global economy have had a negative impact on the Japanese economy. We are optimistic on the longer-term prospects for Japan, with the economy supported by reconstruction following last year's disaster and a weakening yen.

EUROWEEK: How, if at all, were the business models, borrowing requirements and funding strategies of Japan's state agencies affected by the Tohoku earthquake?

Takeshi Sakamoto, JBIC: As JBIC's lending operations are mainly overseas, there have been no substantial changes in our asset quality, borrowing requirements or funding strategies due to the Tohoku earthquake and the subsequent nuclear accident. However, the stable supply of electricity has been one of the most important priorities on the agenda for Japan since the earthquake, and we are supporting the overseas development and acquisition of natural resources that are strategically important for Japan.

Tomoki Matsuda, DBJ: We responded to the earthquake with three key initiatives. First, on the financing side, we have already provided more than ¥870bn in crisis response business for reconstruction from the damage caused by the disaster. Second, we have set up four investment funds in partnership with regional banks in the disaster-affected area. And third, through our Tohoku branch we have established the Tohoku Revival Reinforcement Office. But since the fund for the crisis response operation is supplied by the Japanese government, the disaster itself has not had a big impact on our total financing requirement, nor on our funding strategy for our ordinary business.

Hiroshi Kiyota, JFM: Most of the projects for restoration and reconstruction in the disaster-struck area were directly financed by the national government. We did not get involved directly by providing lending. But at a nationwide level the earthquake created an increase in demand for disaster preparedness projects and we played a role in providing funding for these initiatives.

Yoshifumi Omura, JICA: JICA's operations were not significantly affected by the earthquake because our assets and offices are mainly abroad. We have been sending our staff and volunteers to the affected region. We have also been cooperating with local municipalities and universities to draw lessons and share information worldwide on how to respond to future catastrophes all over the world.

It has been said that the Japanese economy has been seriously affected by the floods in Thailand that happened six months after the earthquake, and which demonstrated how close the economic links between Thailand and Japan are.

EUROWEEK: How has the Japanese economy and its capital market been affected by the European sovereign debt crisis? Did Japanese public sector borrowers benefit from the flight to quality that gathered momentum towards the end of the year as sentiment towards Europe deteriorated?

Sakamoto, JBIC: The European debt crisis led to a decrease in global demand which affected emerging countries as well as Europe. And the appreciation of the yen resulted in a decline in Japanese exports last year, with the trade balance falling into the red for the first time in 31 years.

Japanese investors have responded to the crisis in a risk averse way, and the bond market has been very strong as a result. Under these circumstances, Japanese public sector issuers have been able to issue bonds in the domestic market at low rates and tight spreads.

Takeshi Sakamoto, JBIC

Matsuda, DBJ: There are two sides to this discussion. On the one hand Europe is of course one of the key drivers of the global economy, so clearly Japanese exports will be affected by a prolonged crisis in Europe. The yen is still too strong, relatively speaking, which also has an adverse impact on the Japanese economy.

On the other hand international investors view Japan as being relatively safe, which is creating a flight to quality. But this demand tends to decline when European investors adopt a risk-off approach to global markets.

The ECB's LTRO initiative has helped to improve sentiment among European investors markedly but there is still uncertainty over the situation in Greece.

Omura, JICA: European sovereigns used to be regarded as zero risk, but this perception has almost collapsed. At the same time we have seen an upgrading in the credit quality of other emerging sovereign borrowers outside Europe.

It is said that we may now see contagion from Europe spreading to Asia and Latin America, which will inevitably have an impact on the quality of our assets in those regions. So we certainly hope that the European debt crisis will be contained.

The worldwide flight to quality has contributed to the reduction in yields on instruments such as JGBs and Japanese agency bonds. This has not necessarily been driven by the belief that Japan is in good shape, but because investors see the Japanese economy as not being in as bad a shape as the US or European economies.

Kodama, Deutsche Securities: It is probably an over-simplification to conclude that the impact of the sovereign debt crisis has been completely positive for Japanese issuers, because it has restricted demand for longer maturities.

EUROWEEK: Turning to the funding strategies of the borrowers around the table, what are your borrowing requirements over the next year? How will this be split between domestic and international funding, and between government-guaranteed and non-guaranteed issuance?

Sakamoto, JBIC: In the government plan for the FY2012 budget, which is being discussed in the Japanese Diet, our funding plan calls for ¥1,344bn equivalent of borrowing from foreign exchange reserves, ¥212bn equivalent in government-guaranteed international bonds, and ¥50bn in non-guaranteed domestic bonds. We are also due to borrow ¥400bn under the government's Fiscal Investment and Loan Programme (FILP).

Omura, JICA: Our total funding need for our Overseas Development Assistance (ODA) account is ¥880bn in 2012. Of this total, only ¥80bn will be raised through JICA agency bonds, which are JICA's main capital market funding instruments, with more than 80% of our borrowing coming from the Ministry of Finance under the FILP.

So far, all JICA's bonds have been yen-denominated. The JICA Act stipulates that we can issue bonds with or without a government guarantee, although we have not issued a government-backed bond since 2008, which was the first year in which we issued a JICA agency bond.

Matsuda, DBJ: Our funding plan for FY2011 was for issuance to total ¥700bn. Of this total, ¥200bn was in local government-guaranteed bonds, with ¥150bn in international government-guaranteed bonds. The remaining ¥350bn is in unguaranteed issuance, including issuance off our EMTN programme which we set up in August 2008.

As to FY2012, the government plan for the year's budget contains ¥200bn of guaranteed domestic bonds, ¥150bn of guaranteed international bonds and ¥400bn of non-guaranteed bonds, in addition to borrowing ¥500bn from the government under the FILP.

Sakamoto, JBIC: In FY2012 we plan to issue a ¥50bn domestic bond, which will be a domestic Zaito bond without a government guarantee. The government restricts the provision of guarantees to truly necessary cases, and as most of our funding needs are denominated in foreign currency, we don't think it is necessary for our domestic yen-denominated bonds to be given a government guarantee. Nor do we think this situation is likely to change in the near future.

Kiyota, JFM: Our total funding this year will be slightly higher than ¥2tr. According to our plan, 95% of this will be in the Japanese market. The share of unguaranteed bonds is increasing, and more than half of our issuance is now in unguaranteed format. In the domestic market, most of our issuance is in unguaranteed bonds with 10 year maturities.

EUROWEEK: Why is JFM's issuance of unguaranteed bonds increasing?

Kiyota, JFM: Traditionally, we have been 100% owned by the central government, but the reorganisation of 2008 meant that we are now owned by municipalities and regional governments. Since then, the government-guaranteed bonds that we have been issuing have been to refinance older traditional bonds. In the future the share of JFM's government-guaranteed bonds will be reduced to zero.

Hiroshi Kiyota, JFM

EUROWEEK: How strong is domestic demand for state agency bonds, given their very tight spreads against JGBs? And how has the withdrawal of utilities from the market impacted demand dynamics among institutional and retail investors in the domestic bond market?

Sakamoto, JBIC: Our domestic investor base is entirely institutional. In the Japanese bond market, if high quality issuers come to the market even at a slight spread to JGBs, domestic demand is still very strong.

As we discussed earlier, the risk-averse stance of domestic investors due to the European debt crisis has strengthened demand among these investors for the best Japanese credits. In addition, because domestic bonds have not been issued by electricity companies in the last 12 months because of the nuclear accident, supply of high quality bonds has diminished. This is another reason why government-guaranteed bonds or Zaito agency bonds have been issued at very tight spreads.

Zaito agency and municipal bonds are recognised as high quality credits and the relative pricing and liquidity of the two have not changed much recently.

Matsuda, DBJ: As Mr Sakamoto said, the main trend last year was spread tightening. With the utilities no longer issuing, investors turned their attention to the high-grade agency issuers. More recently, however, we have seen a slight widening in agency spreads as the market has become more stabilised.

Kiyota, JFM: Looking at the development of spreads to JGBs, last year the spread on our 10 year unguaranteed bonds was between 5bp-8bp, but since July this has come down to 2.5bp.

We also issue 10 year bonds with a government guarantee which are also trading at a very tight spread to JGBs. I think local governments are issuing at similar spreads to us.

Omura, JICA: Lower yields have been the product of a flight to quality and a concentration of investor demand on JGBs and their equivalents.

The shortage of utility bonds has led to strong demand for bonds with maturities of between 10-15 years from high quality borrowers such as municipals and agencies. We also saw excess demand for the unguaranteed Zaito domestic bond we issued in September 2011. This was split into a ¥15bn 15 year bond priced at 5bp over the JGB curve, and a ¥5bn 30 year tranche re-offered at 18bp over the 2041 JGB.

EUROWEEK: What is the difference in spreads between guaranteed and unguaranteed bonds?

Matsuda, DBJ: Trading levels for government guaranteed bonds in Japan are very similar to JGBs. While unguaranteed bonds are now trading at around JGBs plus 10bp, the spreads on guaranteed bonds are much lower than this.

EUROWEEK: Omura-san, you mentioned the strength of demand for your Zaito bond. Can you expand on your strategy in the domestic market, and can you tell us about your role in helping to spearhead socially responsible investment in Japan?

Omura, JICA: As we are a relatively new borrower, which has only been issuing since 2008, we have concentrated so far on deepening and expanding our institutional investor base.

We began to issue retail bonds last year. SIF-Japan, a neutral organisation which was launched in early 2001 to promote socially responsible investment in Japan, officially recognised our first retail bond as an SRI issue. Additionally, the issue was recognised by the bookrunner, Daiwa Securities, as an Impact Investment bond, although the proceeds of the bond were not limited to this specific purpose.

We enjoyed a favourable response to our first Zaito bond from retail investors, many of which were attracted by the SRI element of the issue. This has certainly helped to increase our visibility among Japanese retail investors, but although we have ¥11tr of assets and play a key role in providing overseas development assistance, investors are probably still not as familiar with our story as they should be.

In terms of the cost of retail-targeted issuance versus institutional bonds, the regulator demands that the spread we pay is the same for each type of bond, so there is no difference in costs between the two.

EUROWEEK: Have other state agency borrowers been exploring the potential of retail-targeted issuance?

Sakamoto, JBIC: Our issuance is targeted at the institutional market, so we have not looked at issuing retail bonds and we have no plans to do so.

Kiyota, JFM: We have never issued a retail-targeted bond, but we are very interested in this as a potential source of funding diversification. The Nordic local municipal issuers, which have similar business models to us, have been very successful in marketing bonds in Japan to retail investors in currencies such as Australian and New Zealand dollars, South African rand, Brazilian real and Turkish lire.

To diversify our funding sources, it may be worthwhile for us to look at offering bonds to investors in higher yielding currencies. With five year yen-denominated JGBs only paying 0.3%, I understand from the securities firms that there would be strong demand among retail investors for bonds in these currencies.

Tomoki Matsuda, DBJ

Matsuda, DBJ: It is very interesting to hear Mr Kiyota's comments about the potential for this market, which could become an increasingly important source of funding for state agencies. However, we haven't printed retail bonds and have no plans to do so because there are issues that would need to be overcome such as the lack of familiarity with DBJ among individual investors.

EUROWEEK: In the yen market, how much competition has there been from European issuers in the Samurai and private placement markets? Are you seeing signs that domestic investors are becoming more aggressive in their return targets, and are they looking to generate higher returns by investing more in foreign credits?

Sakamoto, JBIC: Last year, Japanese investors demanded a wide spread for bonds issued by European agency and multilateral borrowers relative to comparably-rated domestic borrowers, the credits of which are very familiar to domestic investors. Especially since the surprise downgrade by ratings agencies of Norway's Eksportfinans last November, domestic investors have been very cautious about Samurai bonds with implicit government guarantees.

Kodama, Deutsche Securities: Mr Takahashi is probably better qualified than me to comment on retail investor behaviour. But among institutional investors we are seeing a number of different trends. One of these is that with JGB yields having fallen so far, institutional investors are coming under more pressure to maximise returns. In the past, utility bonds, which were regarded as almost risk-free, were an attractive alternative. But issuance from the Epcos has almost completely stopped since last year's disaster, which has created a big gap in the new issuance market.

On the other hand, concerns about the European debt crisis mean that Japanese institutional investors are reluctant to take on more credit risk, which has more or less forced them to invest in agency and municipal bonds.

To a certain extent investors are looking to compensate for the low yields in the agency and municipal markets by buying Samurai bonds, but they are still cautious about taking international credit risk. Japanese investors have some of their assets denominated in foreign currencies and we have seen some of those assets invested in foreign currency bonds issued by Japanese issuers. We have also seen the banks putting some of these assets into foreign currency deposits.

EUROWEEK: I understand that we have also seen some Samurai bonds, notably one that was issued last year by Poland, being targeted directly at retail investors as an alternative to maturing Japanese Government Bonds (JGBs). Does this suggest that domestic investors are becoming more adventurous in their search for a yield pick-up over Japanese public sector borrowers?

Takahashi, Nomura: My impression is that when we issue a retail-targeted transaction most of the bonds tend to be placed with investors aged over 50 who are reluctant to take any risks. So when we sell Zaito bonds to retail investors we market them as securities that have similar credit qualities to JGBs from issuers that are supporting the broader economy.

In Japan, the retail investor base is very big and diverse, ranging from older generations who are not willing to take risks to the more aggressive retail investors and some of the high net worth individuals. Such high net worth type investors are at the opposite extreme from those that are cautiously investing their retirement savings, mainly in two-year bonds. However, this fiscal year we expect some of the proceeds from maturing JGBs to be invested in riskier instruments, which will be a contributing factor to the product strategies of the major securities brokers.

To come back to your question about the Poland Samurai, I don't know exactly how much of the issue was bought by investors reinvesting from maturing JGBs. But in general it might be true that some money from these bonds is being reinvested in Samurai and Uridashi bonds, albeit on a selective basis.

One of the other important themes we saw last year was the growing importance of socially responsible investment and more of an emphasis on CSR [corporate social responsibility]. In the market for impact bonds, for example, Nomura has managed a number of successful issues by Nordic Investment Bank, which have appealed to retail investors.

EUROWEEK: Has there been any change in the maturity profile of domestic bonds issued by the agencies over the last year?

Sakamoto, JBIC: Our ALM requirements with regard to our yen assets are such that JBIC's bonds in the domestic yen market are issued in five and 10 year maturities. These are the benchmark maturities in the Japanese market and attract strong investor demand.

Since last year's earthquake, low yields and the absence of supply from electricity companies has led to an increase in demand for 10 year bonds. On the other hand, the cost of swapping into floating rate debt currently means that the five year maturity is more attractive to us.

Omura, JICA: We are discussing the appropriate maturity profile of our issuance for the next fiscal year, based on our ALM requirements as well as the all-in cost and our goal of broadening our investor base.

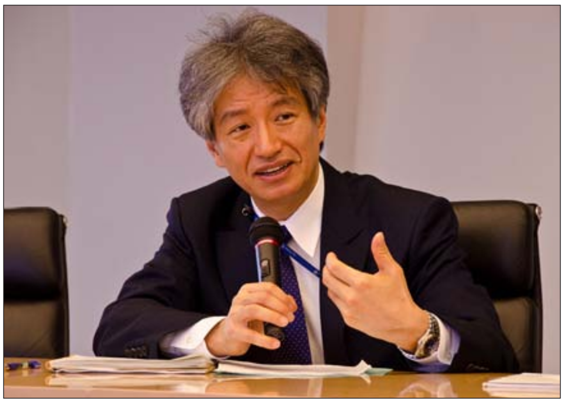
EUROWEEK: Looking at the credit profiles of the state agencies, have there been any notable changes over the last year in, for example, the DBJ privatisation timetable?

Matsuda, DBJ: For DBJ, things changed dramatically after last March's disaster. Before the earthquake, the plan was for DBJ to be privatised within five to seven years from April 1, 2012. But following the Tohoku earthquake and tsunami, the target date has been extended to five to seven years from April 1, 2015. At the end of fiscal 2014, the government is planning a review of DBJ's organisation. The government will continue to hold its shares until then.

The risks in the system that were exposed by the Lehman crisis originally led to the privatisation of DBJ being postponed by three years, and the more recent crisis caused by the Tohoku disaster has led to another three year postponement. But the change to the privatisation schedule has not had any direct impact on our funding requirement, nor on our strategy.

Kodama, Deutsche Securities: It is difficult to assess what impact if any the change in the privatisation schedule will have on DBJ's spreads over the longer term. But the feedback I have had so far from investors does not suggest that they will require a higher spread because they do not perceive any change in DBJ's credit quality.

If anything, last year's disaster led to an even stronger recognition on the part of the government of the importance of DBJ to the Japanese economy.



Tetsuya Kodama, Deutsche Securities

EUROWEEK: What about JBIC? In April 2011, the legislative bill to spin off JBIC from JFC was passed into law and from April 2012 this will come into effect. From the perspective of investors, will the 'new' JBIC that comes into being have a materially different credit profile from the 'old' JBIC?

Sakamoto, JBIC: As you said, in April we will be spun off from JFC and become the new JBIC. JBIC contributes to the sound development of the Japanese and international economy, and will continue to be supported strongly by the government. The budget will continue to be approved by the Japanese government, and our board members will continue to be appointed by the government. So there will be no change to our integral relationship with the government.

As of today, none of the agencies has expressed a ratings opinion on the new JBIC, but I believe they will continue to recognise the importance of the new entity to the Japanese government.

With regard to the international capital market, JBIC has issued — and will continue to issue — bonds with an explicit government guarantee, and we don't believe that the reorganisation process will make any difference with regard to JBIC's creditworthiness.

I would like to emphasise that in its current form JFC consists of several domestic operations alongside JBIC's international activities. JBIC's independence from JFC will make its organisational structure clearer and easier for foreign investors to understand.

Takahashi, Nomura: I agree. Both in the case of DBJ and JBIC I don't believe there will be any change in terms of credit quality arising from changes in their legal status. If anything, transparency will be improved following the spin-off of JBIC from JFC, especially for overseas investors.

EUROWEEK: Presumably there has been no change in the credit metrics of JFM?

Kiyota, JFM: Concerning financing in the international capital market, as I explained earlier our issuance of non-government guaranteed bonds has been increasing. We set up our Euro MTN programme last year, which is also a non-government guaranteed shelf, so there has been some reorganisation in that respect.

But in terms of our relationship with central government, this has not changed, and the ratings agencies continue to regard our credit profile as very similar to that of the central government.

We only provide loans to local governments. Total local government borrowing in the next fiscal year is expected to be ¥14tr, of which about ¥2.2tr will be provided by JFM. Local government funding requires approval from the central government, so we continue to have a very close relationship with the central government. But although nothing has changed in our organisational structure, we need to continue to explain the high quality of our assets through our intensive international investor relations programme.

EUROWEEK: Let's focus on the landmark international transactions from Japan's state agencies in 2011. One banker said JBIC's $2bn global bond last May was: "arguably one of the most successful Japan government-guaranteed issues as far as the quality and size of the order book is concerned". The deal generated demand of $5bn from more than 100 investors, with pricing set at 45bp over swaps, which was well below original guidance. Also, 40% of the bonds were sold outside Asia. Sakamoto-san, would you like to comment on this deal?

Sakamoto, JBIC: In the unstable environment following the Great East Japan earthquake and the uncertainty caused by the crisis in Europe and the political turmoil in the Middle East, until mid-April of last year, international investors focused on highly liquid short or medium-term bonds from the best quality borrowers. So the objective of our $2bn global was to attract some of the cash that had been accumulated by investors in those difficult circumstances.

In April S&P changed the rating outlook on Japan to negative, and we were concerned that investors would still be very cautious about Japan following the earthquake and tsunami. It was therefore very important to pre-market the transaction carefully to ensure an appropriate pricing level. Marketing also involved a series of one-on-one investor relations meetings, especially in Asia, to explain the Japanese situation after the earthquake.

The result was that we ended up with a very successful issue. But as it was the first issue after the Great Earthquake it also had positive implications for the whole Japanese market.

Phil Moore, *EuroWeek*

EUROWEEK: So would it be accurate to say that the JBIC benchmark last May was a very important transaction because it was the first to demonstrate very clearly to international investors that Japan was open for business again after the March disaster?

Sakamoto, JBIC: As you say, we may have made a contribution to re-opening the market.

EUROWEEK: Another notable recent issue from JBIC was the $1.25bn transaction, which had a seven-year maturity, making it JBIC's longest-ever global bond. What was the rationale behind this longer maturity?

Sakamoto, JBIC: From an ALM perspective, the average tenor of JBIC's assets is over five years. So having issued bonds with a maturity of five years or shorter over the last six years, we have been looking for an opportunity to issue longer-dated bonds. Given the changes in the market environment, the lead managers explained to us that we might have a chance to generate sufficient demand at a fair price for a seven year benchmark, and we are pleased that with this transaction we have extended our credit curve and expanded our investor base.

Last autumn the ADB also issued a seven year bond but there has been very limited supply in this maturity since then*. By issuing in the seven year maturity we were able to acquire some totally new investors.

EUROWEEK: JFM started 2011 with a very successful $1bn 10 year global. What has JFM's strategy been in the international market recently and what have been the highlight deals of the last 12-18 months?

Kiyota, JFM: As I pointed out earlier, our focus has been on a shift towards unguaranteed bonds. In the international market, all our issuance is now in unguaranteed format, which is why we set up our EMTN programme at the beginning of 2010. Deutsche Bank is the arranger of this programme, which had an initial size of ¥500bn.

At the start of this year we began to issue a lot more private placements, issuing a total of about $800m between January and March alone, in response to strong investor demand.

EUROWEEK: DBJ amended its MTN documentation in August 2010 to include 144A language and therefore to allow it to reach into demand among qualified institutional investors in the US. How successful has DBJ been in building up its US investor base?

Matsuda, DBJ: In our case, overseas funding is in the form of government-guaranteed bonds on the one hand and unguaranteed issuance on the other, both off our MTN programme.

As to the documentation, as you mentioned, 144A language was introduced last year, so that we now can access qualified institutional investors in the US only with the guaranteed bonds. In October 2011, we issued a $1bn five year transaction, of which 27% was placed in the US, with 23% sold to Europe, 9% in the Middle East and 41% in Asia. So the use of the 144A language has definitely helped us to diversify our investor base further.

Total demand for the five year dollar deal was about $1.25bn, and the book was also well diversified and balanced by investor type, comprising central banks, official institutions, banks and asset managers.

EUROWEEK: DBJ was most recently in the market in early March, with a $500m Reg S five year transaction priced at the tight end of its guidance range of 43bp-45bp over US Treasuries. Matsuda-san, can you comment on how this deal went?

Matsuda, DBJ: Market sentiment had become relatively stable by early March, so we thought it was optimal timing to come to the market, which turned out to be the case because demand reached about $1bn. The relative stability of the Japanese credit was very highly appreciated by high quality international investors. As this was a Reg S transaction, 74% was distributed in Asia and 26% in EMEA.

EUROWEEK: Given this very encouraging demand, were you tempted to increase the size of the five year issue in March?

Matsuda, DBJ: Because our budget sets the upper limit, it would not have been possible to increase the issue.

EUROWEEK: How would the intermediaries around the table summarise the strategies of the state agencies in the international market over the last year or so? Have you detected any meaningful change in the composition of their funding or in the geographical distribution of demand for these borrowers' bonds?

Kodama, Deutsche Securities: Concerning funding in overseas markets, one trend has been the issuance of highly liquid benchmarks, and the other has been more opportunistic use of private placements. The benchmark issuance from the Japanese agencies such as DBJ and JBIC met the requirements of international investors at a time of widespread uncertainty and negative sentiment because the credit quality of these issuers is regarded as being the same as the Japanese government. Longstanding investors have been supportive of these issues, but so too have totally new investors as we saw in the case of the JBIC seven year bond. So these issuers' strategies have been perfectly aligned with current investor sentiment.


Shohei Takahashi, Nomura

Takahashi, Nomura: Issuers throughout the world have been affected by the recent crisis, and some key words have emerged to describe their funding strategies over the last year. One such word is "diversification" of investor bases and funding sources. Another is "flexibility", as issuers recognise they need to move quickly to take advantage of windows of opportunity when they open.

The three issuers around the table today all have different strategies but I think each of them has responded well to the opportunities that have arisen for them to continue diversifying their investor bases over the last year. JBIC has focused mainly on benchmarks as well as reaching out to new investors by extending its yield curve to seven years. DBJ has also been successfully increasing the scope of its investor base in the US through 144A language, while JFM has been doing the same in the private placement market. So there is no uniform approach and each has adopted a strategy that is best suited to its circumstances and funding needs.

Over the last year we've acted as lead manager for a number of the Japanese agencies and the one thing that has become very clear is that with this turbulence in global markets, international investors have seen Japanese credits as stable and dependable investments. This has been especially true of North American investors which have historically invested in European agencies. But the turbulence in the Eurozone is leading them to reduce their exposure to European sovereign debt and to increase their exposure to Japan.

EUROWEEK: That's a very interesting point. Have the borrowers around the table also been aware of investors switching out of some European SSA issuers and into non-European names instead?

Matsuda, DBJ: As I said before, we have certainly seen an increase in demand from US investors, but I don't know if this has been because they have been shifting away from Europe.

EUROWEEK: Do the borrowers around the table expect to increase their issuance of international bonds?

Omura, JICA: We have been consulting with the Japanese government about ODA reforms allowing for the development of foreign currency-denominated products. Although we don't yet know when the government will give us its sign-off on this, offshore borrowing may be one way of funding these products. Currency selection will depend on the financial needs of the borrowers, but in the initial stages the most likely denomination of such new products would be US dollars. It also remains to be determined whether this would be on a guaranteed or non-guaranteed basis.

Sakamoto, JBIC: Based on our funding needs, the balance and relative costs of our funding tools, and the government's guarantee policy, we don't foresee a drastic increase in our international issuance. However, Japanese issuers will continue to benefit from their safe haven credentials and their scarcity value.

EUROWEEK: Our focus so far has been on the dollar market. Are Japan's state agencies considering issuance other currencies?

Sakamoto, JBIC: JBIC considers issuance in local currencies if this matches customers' demand for loans in those currencies, and if the cost and other conditions of issuance are more favourable than the funding we could achieve by swapping. In the event of Japanese companies bidding for big infrastructure projects in Europe, for example, we might look to issue in European currencies. Because we are extending the scope of our international infrastructure lending, we could theoretically issue sterling bonds, for example, to finance sterling-denominated projects.

We have issued in emerging market currencies in the past. For example, in 2005 JBIC issued a five year bond in Thai baht as part of the Asian Bond Markets Initiative, which is promoted by the Japanese government. The proceeds were used to finance Japanese companies conducting business operations in Thailand through the Bangkok branches of Japanese banks.

In emerging markets, there is clearly demand from a number of our business partners for local currency financing. In those instances, if market conditions are favourable, it might be advantageous for us to issue in local currency.

Also, last December the Japanese and Chinese governments agreed to cooperate on the development of the Chinese financial market. Under this programme, JBIC will consider the possibility of issuing RMB-denominated bonds in the Chinese domestic market.

EUROWEEK: It may not be the best time to raise the potential of issuance in euros. But DBJ issued a successful 20 year euro-denominated bond in November 2007. Is this a market that DBJ would consider returning to in the foreseeable future?

Matsuda, DBJ: When we're considering which currencies to issue in, we need to take into account the asset side, where although we have a requirement for foreign currencies, our needs aren't as large as JBIC's.

Looking ahead, we may look at other currencies to expand our investor base and to extend maturities, because infrastructure projects call for the issuance of longer-dated bonds. But we will only consider diversification in terms of currency and maturity if the market conditions are favourable.

In emerging market currencies, we are still considering the possibility of issuing in the offshore RMB market. We believe we are a flexible and agile borrower, which means that if opportunities arise in markets such as the RMB, we can respond very quickly to take advantage of them.

Kiyota, JFM: On the asset side, as our long term borrowers are Japanese municipal borrowers our foreign currency budget depends purely on conditions in the swap market. So we make our decisions on a case-by-case basis.

In terms of currencies, at the moment the dollar market is the most suitable and will continue to form the basis of our issuance.

As to maturities, in the Japanese market our issuance is mainly in 10 and 20 year maturities. Overseas markets can be more flexible in terms of maturities and most of our issuance off our EMTN programme has been in the five year maturity.

EUROWEEK: What are roundtable participants' thoughts about the fiscal and demographic challenges facing Japan? How will expected long term economic and social trends in Japan shape participants' funding programmes?

Sakamoto, JBIC: Although Japan recently posted a trade deficit for the first time in 31 years, we think the current account balance will stay in the black for a while.

Also, the share of JGBs held by domestic investors is very high, and the fiscal deficit can be self-financed. The major political parties all agree on the need for tax and social welfare reform, which is a high priority of the government, so I believe Japan's fiscal situation will not worsen. Accordingly, we do not think that the funding conditions for JBIC will materially deteriorate in the near future.

Omura, JICA: Although we are in a severe situation and face a lot of economic and fiscal challenges including recovery from the earthquake, we believe accelerating economic growth through supporting and strengthening global partnerships will contribute to addressing some of these difficulties. We also believe JICA will play an important role in helping with this objective.

For example, in the Strategy for the Rebirth of Japan, endorsed by the Cabinet last December, several strategies were established in which JICA will play a key role. These include programmes named "Supporting SMEs' Overseas Business Activities", "Enhancing Overseas Deployment of Integrated Infrastructure Systems", "Developing resilient Infrastructure in Developing Countries", "Fostering Japan as one of the core Industrial Hubs in Asia" and "Contributing to the Shift to a Green Economy".

JICA is responsible for implementing these government policies, integrating all aspects of ODA from financial to technical assistance.

In response to supporting new activities and trade and investment in developing countries by Japanese private companies, we have also supported a number of initiatives. These include public-private partnerships (PPP), as well as infrastructure projects and base of the pyramid (BOP) businesses under the Japanese government's Public-Private Co-Operation for Accelerated Growth announced in April 2008 and the New Growth Strategy announced in June 2010.

Yoshifumi Omura, JICA

EUROWEEK: Looking at some of the expected longer-term developments in the Japanese capital market, DBJ has led the research into the benefits of a covered bond market in Japan. Why is DBJ interested in covered bonds? What would be the pros and cons of a Japanese covered bond market?

Matsuda, DBJ: From the perspective of investors, one very clear attraction of covered bonds is that they provide recourse both to the issuer and to the cover pool which is why they are recognised throughout the world as very stable instruments. European issuers have used covered bonds very efficiently as a long term financing tool, and since the Lehman shock covered bonds have proved their resilience by remaining relatively unaffected by the crisis.

Maybe in Japan the day will come when we will need to develop covered bonds, and perhaps we at DBJ are ahead of other Japanese issuers in assessing the potential of this market. As you say, we formed a Covered Bond Study Group in February 2011 and published a report last July summarising issues and recommendations raised by financial market practitioners on covered bonds in Japan.

As our mission is to fund infrastructure replacement, we require very long term funding, so we feel that products like covered bonds may one day be an interesting option for DBJ.

But the reality is that there is still excess liquidity in Japan. So even without covered bonds, financial institutions in Japan are still able to fund themselves at extremely low rates so there is little recognition that covered bonds are necessary.

Also, for investors to be able to buy covered bonds we need to change the legal system in Japan. So, frankly speaking, it will take some time for covered bonds to be introduced in Japan.

**ADB returned to the dollar market with a seven year $1bn global issue shortly after this roundtable.* D

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