GlobalCapital

JAPANESE ISSUERS IN THE GLOBAL DEBT CAPITAL MARKETS

April 2015

Lead sponsor:

NOMURA

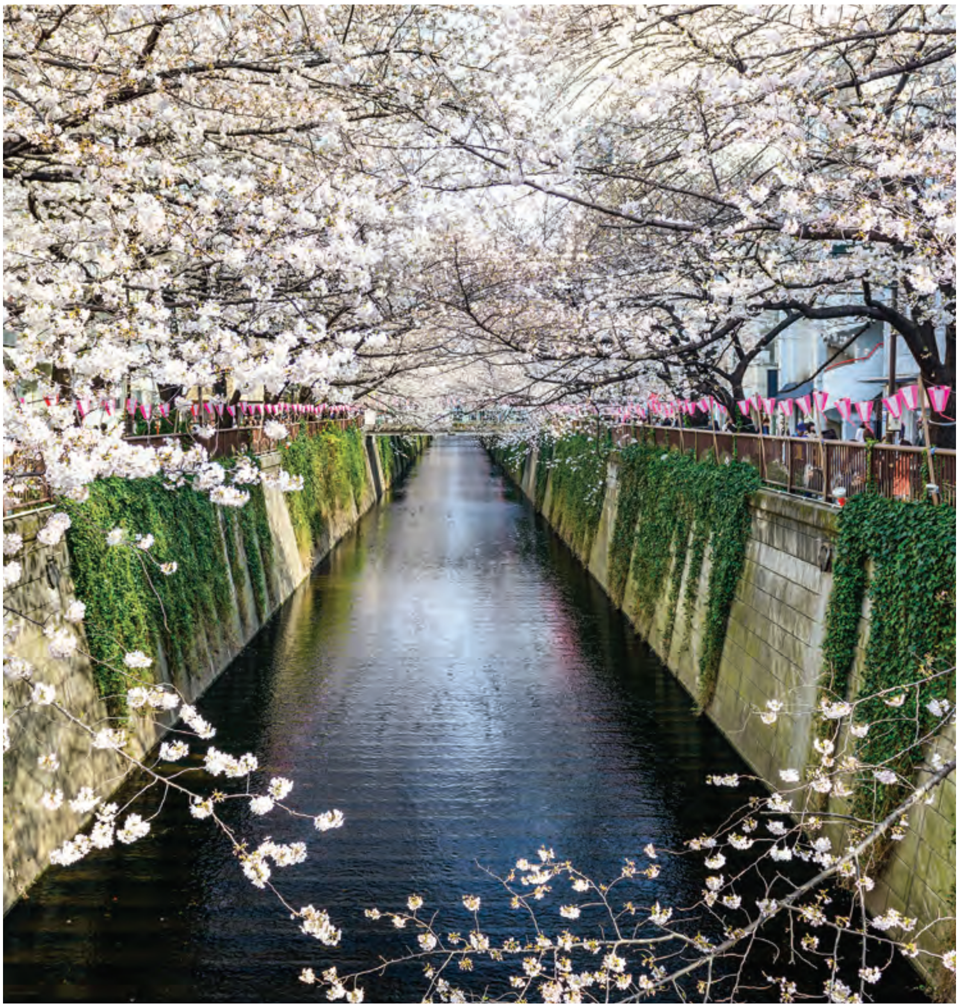
Sponsors:

DBJ Development Bank of Japan

JBIC

JFM

JAPANESE ISSUERS IN THE GLOBAL DEBT CAPITAL MARKETS



GlobalCapital

Group managing director: John Orchard • john.orchard@globalcapital.com
Managing editor: Toby Fildes • toby.fildes@globalcapital.com
Editor: Ralph Sinclair • ralph.sinclair@globalcapital.com
Supplements editor: Ruth Beddows
Contributing editor: Matthew Thomas
People and markets editor: Owen Sanderson
SSA editor: Tessa Wilkie
Deputy SSA editor and MTNs & CP editor: Craig McGlashan
MTNs and CP reporter: Jonathan Breen
Fixed income editor: Graham Bippart
Covered bond editor: Bill Thornhill
Deputy FIG editor: Nathan Collins
Global securitization editor: Will Caiger-Smith
European securitization editor: Tom Porter
Securitization reporter: Ryan Bolger
Loans editor: Dan Alderson
Equity senior reporter: Olivier Holmey
Leveraged loans reporter: Ross Lancaster
Corporate bonds reporter: Richard Metcalf
High yield bonds reporter: Victor Jimenez
Syndicated loans reporter: Elly Whittaker
Emerging markets editor: Francesca Young
IFIS editor: Steven Gilmore
Emerging markets reporter: Virginia Furness
IFIS reporter: Luka Dimitrov
Latin America reporter: Oliver West
Derivatives reporter: Gabriel Suprise
Design and production manager: Gerald Hayes
Deputy design and production manager: Emily Foster
Sub editor: Richard Cosgrove
Events & Project Manager: Sara Posnasky +44 20 7779 7301
Advertising
Publisher: Oliver Hawkins +44 20 7779 7304
Deputy publisher: Daniel Elton +44 20 7779 7305
Associate publisher: Henry Krzymuski +44 20 7779 7303
Subscriptions
Europe
James Anderson +44 20 7779 8338
Katherine Clack +44 20 7779 8612
Mark Goodes +44 20 7779 8605
Philip Huntsman +44 20 7779 8036
George Williams +44 20 7779 8274
Marketing
Clare Cottrell +44 20 7827 6458
Claudia Marquez Reyes +44 20 7827 6428
Customer Services: +44 20 7779 8610
Americas
US Publisher - Capital Markets Group: James Barfield +1 212 224 3445
Advertising and Sponsorship Associate: Kevin Dougherty +1 212 224 3288
Euromoney Institutional Investor plc
8 Bouverie Street, London, EC4Y 8AX, UK
Tel: +44 20 7779 8888 Fax: +44 20 7779 7329
Directors: PR Ensor (chairman), The Viscount Rothermere (joint president), Sir Patrick Sergeant (joint president), CHC Fordham (managing director), D Alfano, A Ballingal, JC Botts, DC Cohen, T Hillgarth, CR Jones, M Morgan, NF Osborn, J Wilkinson

Printed by MethodUK

Stock market gains indicate Abenomics is beginning to work

Prime minister Shinzo Abe and Bank of Japan's govenor Haruhiko Kuroda have made aggressive moves to change the direction of the Japanese economy. Most economists and analysts argue that there is still plenty more work to do. But by one metric, at least, they have already notched up a clear success. **Matthew Thomas** reports.

HARUHIKO KURODA could never be accused of sitting back and being satisfied with past successes. Since Kuroda, a former president of the Asian Development Bank, was picked to become the governor of the Bank of Japan (BOJ) in early 2013, he has taken the fight to deflation, using all of the tools at his disposal to attempt to stimulate the economy. His aggression means that economists and analysts in the country could be forgiven for expecting Kuroda to announce a market-shaking move every other day.

But on October 31, Kuroda proved he still had the ability to shock the market, by announcing that the BOJ would increase its annual holdings of Japanese government bonds (JGBs) by ¥80tr ($671bn) a year: a sharp increase from the ¥50tr ($420bn) it had told investors to expect.

The announcement surprised most bankers and economists, and had an immediate impact on the stock market. But it did not shift the macroeconomic picture.

"We have not seen a huge impact on the macro data, but there was a big depreciation of the Japanese yen," says Yuichiro Nagai, an economist at Barclays Japan. "That supported Japanese companies' profits, especially in the manufacturing centres, and in turn that pushed up the Nikkei further. That is the major impact we've seen so far."

That may well be enough for the government at this point. The key to understanding the Abe administration's approach to the economy, according to market experts, is not to look at the usual datapoints that would be reeled off in a discussion of the US: GDP growth, unemployment, or even inflation, which is at least starting to move up in Japan. These are long-term indicators that are tough to shift. To really improve these indicators, particularly to push up inflation, the government first needs to fuel a burst of confidence. That is why one of the most important considerations for the Abe administration is the performance of the stock market.

"Abe's policies since his reelection have been quite straightforward," says Daisaku Fujikawa, head of capital markets origination for Citi in Japan. "He sees the stock price as the important indicator. Abe's team believe that Japanese people must become happier. What else can be the strongest indicator? Is it GDP growth, or the interest rate, or the land price? No. It is the stock price. That, at least, is what they are thinking."

That is understandable given the widespread stock market ownership among Japan's citizens, which makes the stock market important in determining many people's faith in Japan's economic direction.

By that metric, Abe's administration has already been far more successful than any other Japanese government in recent memory. Junichiro Koizumi, the last prime minister of Japan to last more than a year, only saw the Nikkei 225 increase by around 12.43% in his five years in power, which ended in September, 2006.

The six prime ministers that followed him, before Abe's eye-catching election win in December 2012, managed to oversee a collective fall in the Nikkei of 35.3%.

The stock market has increased more than 87% since Abe took power, a return that is thanks in large part to the bazooka approach of Kuroda and its impact on the currency. The Japanese yen has lost around a third of its value against the US dollar since Abe was elected, moving from around ¥85 against the dollar on December 26, 2012, to around ¥119.75 in late March 2015.

The improvement of the stock market and the success of Abe's policies clearly go hand in hand. But there is still plenty of demand that could shift from the government bond market to the stock market. The government can be assured that as long as they continue to convince investors their plans will work, they will see that happiness gauge increase further and further.

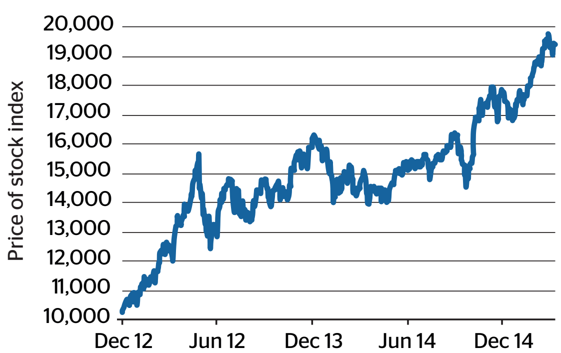
"The next step for the Japanese

"Abe's team believe that Japanese people must become happier. What is the strongest indicator? It is the stock price"

Daisaku Fujikawa, Citi

The happiness indicator

The performance of the Nikkei 225 index since Shinzo Abe became prime minister on December 26, 2012, using unadjusted closing prices



Source: Yahoo! Finance

economy is to start slowing the rate of deflation," says Morifumi Yotsumoto, head of debt capital markets at Barclays Japan. "Japanese investors have already started incorporating that into their investment strategies, moving gradually from buying JGBs to buying more inflation-friendly products, like stock."

Abe's greatest success, however, may have been political, not economic. By keeping power for more than two years and even winning a re-election, an achievement that the previous six prime ministers could barely have imagined, he has given Japan a much clearer narrative. Bankers and economists, much like the rest of the population, might well debate the merits of some of his policies. They may occasionally disagree with him, or want him to turn course. But they surely all acknowledge that the country has now got a focus that it lacked for too long.

There is a certain irony to Abe becoming the figure to turn off the music, finally, on this high-powered game of musical chairs.

Koizumi, a Liberal Democrat leader who was well known overseas, was the last prime minister to keep a tight grip on the seat of power, keeping the job for more than five years. But after Koizumi left office on September 26, 2006, the merry-go round began. There were six prime ministers, none lasting much more a year, and Japan seemed destined for a cycle of ever-changing prime ministers lacking the momentum needed to make the changes the country really seemed to need. And the first prime minister to follow Koizumi, lasting exactly a year before he was replaced? None other than Abe himself.

Abe now has a second chance to get things right. After an ambitious set of policy targets, including the much discussed "three arrows", after a bolder stance in international affairs, after that eye-popping stock market performance and, most crucially, after a resounding re-election win, the prime minister would be well within his rights to feel that he has gotten off to a good start. Bankers will be watching the next few years closely to see what else Abe has up his sleeve. ▲

Dollar rate volatility sparks concern for issuers, investors

Japanese issuers sold more than $26bn of dollar-denominated bonds in the first quarter of 2015, according to Dealogic data. That made the first three months of this year the busiest quarter since the start of the financial crisis. But issuers are not the only ones heading to the dollar market to hit their targets. The miniscule yields available in the domestic bond market are also pushing more and more investors overseas, say bankers — something that will leave them exposed to increasing volatility.

ONE OF THE MAJOR talking points among bankers in Tokyo as it is elsewhere, is which direction US interest rates will take this year.

The Federal Open Market Committee, in a March statement touching on the chances of an interest rate hike, removed the word patient from its statement about the timing of such a hike; a small change that had big ramifications for traders, bankers, investors and issuers across the world. That has made analysts work overtime to attempt to predict the timing of a US rate hike, and given issuers pause for thought when reviewing their dollar funding plans.

There is no one recommendation that bankers can give to issuers in a situation like this, says Shohei Takahashi, joint head of international debt capital markets at Nomura (*see public sector roundtable, page 7, for a fuller discussion of this issue*). But dollar-hungry issuers are being warned to prepare for increased volatility later this year.

The same advice, it appears, should be given to Japanese investors, too. Domestic buyers, famously risk-averse, have often relied on their local market to hit their yield targets. But the pressure on yen rates from the Bank of Japan's aggressive easing has forced some of these investors to go overseas. More alarming, it has encouraged some of them to leave themselves open to the increasing risk of volatility.

"Institutional investors are taking more risk than they did five years ago," says a senior debt capital markets banker in Tokyo. "It used to be the case that everything was hedged, but now they are being forced to leave positions unhedged in order to increase their returns."

Those primarily at risk are insurance companies and pension funds, investors with hard yield targets that need to be hit and strict rules on what they can invest in at home. These investors do not tend to stray very far from vanilla bonds, making it hard for them to boost their returns by buying highly structured debt. But the extra risk they are taking on by leaving their positions unhedged in the offshore market is one area of concern to bankers that count these institutions as clients.

There is no easy solution to this. Japanese banks can, of course, offer swaps to their investor clients to reduce the risk of fluctuating currencies and offshore rates. But taking those swaps would hurt the returns pension funds and insurance companies can get, and leave them searching, once again, for an easy way to boost their returns.

Japanese issuers and investors can both see the benefits in the offshore market. Cheap funding levels look attractive to issuers, and a diversity of supply — often paying much more than domestic names — means investors are easily lured offshore too. But both will need to keep a close eye on the volatility of US rates this year.

As much as the Bank of Japan has proved it can play a strong hand, it is still the Federal Reserve that controls the deck. ▲

Japan's MoF talks Abenomics, volatility and downgrades

GlobalCapital sat down with Ministry of Finance officials Kei Kanamori, director of the office of debt management and JGB investor relations, as well as the director of the research office, and Ryo Ishida, deputy director in the office of debt management and JGB investor relations, to discuss the ministry's take on the rapid change in the funding environment over the last two years, driven in large part by seemingly ever-increasing demand from the Bank of Japan.

GlobalCapital: The BOJ's announcement last October that it would expand the monetary base is still one of the key talking points among bankers, investors and issuers in the country. How much did that impact day-to-day trading in JGBs — and are you still feeling the effects of that move?

Kei Kanamori, MOF: The BOJ started its quantitative easing policy in 2013, and expanded it last October. Now they are going to increase their bond purchases by ¥80tr ($667.1bn) a year. They are the biggest buyers of JGBs by far, so that decision has real influence on the market. I can't judge the impact but I would like to refer to statistics.

According to trade data, banks continued to be sellers of JGBs while trust banks in the country switched from buyers to sellers, probably due to the asset allocation shift of Government Pension Investment Fund, Japan (GPIF). Insurance companies and foreign investors are still net buyers of JGBs.

Yields in the JGB market are getting lower and lower, so there is certainly still strong demand in the market.

GlobalCapital: Is the BOJ's demand so big that the impact of other investors reducing demand is almost irrelevant? Can it just absorb any drop in demand from other sectors?

Kanamori, MOF: Though we can still spot adjustments in demand among various sectors and that is something we pay a lot of attention to, there might be various reasons for each investor and we can't say it's all because of the BOJ. The BOJ is certainly a big enough buyer that it is hard for us to see any big problem in the market arising.

GlobalCapital: How surprised were the investors you have spoken to about the October announcement? It seems a lot of market participants did not see this coming.

Kanamori, MOF: For many investors, it was a very big surprise. Before the October decision, there were no news reports hinting that something like that could happen. Governor Kuroda had said not long before the announcement that he was planning to continue the present policies. But then he announced a big increase in monetary easing, so it really caught a lot of people by surprise.

Ryo Ishida, MOF: Volatility surged after the announcement, so that might be a good indication that very few investors predicted that such an expansion of the BOJ's policies was about to happen.

GlobalCapital: Does the rising volatility worry you?

Kanamori, MOF: The kind of volatility we have seen in the JGB market since October is relatively high compared to our usual trading ranges, but when you compare it to the US market or the European market, it is still actually lower. It is important to look at volatility

Kei Kanamori
Ministry of Finance

in the context of the market movement as a whole. There was a big increase in volatility this year, but it seems to be getting stabilised these days. The important point for us is that our auctions have continued smoothly, so the market mood has calmed down a little bit.

GlobalCapital: How long are you expecting the BOJ to provide such large support to the JGB market, and what would the MOF do in the event of a reduction in support by the central bank?

Kanamori, MOF: That is a very difficult question. We can not really talk about the exit policy, and even the BOJ has said that it is far too early to start talking about that. There is, of course, going to be some impact on the market when the BOJ scales back its bond purchases. We know that Mr Kuroda is paying a lot of attention to the market and is trying as much as possible to avoid any confusion. That is going to reduce the impact in the future if and when the BOJ does start to reduce its demand.

We can't predict what will happen in the future. But as long as the market functions well, we do not have to do anything dramatically different. There is still plenty of demand in this market, from many different types of investors with many different views. This range of demand makes it easier for us to deal with any abnormal situations that might arise.

We have experienced moments of market disruption before — after the Lehman Brothers crash, for instance. There was a lot of selling in the inflation-linked market at that time, so we stopped new issuance of inflation-linked bonds and increased our buyback programmes. We know what we can do to respond with necessary measures when things arise that hurt the market function.

GlobalCapital: How strong is demand for inflation-linked bonds and what is the issuance plan for them over the next year or so?

Kanamori, MOF: We resumed the issuance of inflation-linked bonds in 2013, when the Japanese economy started to get out of a deflationary situation. The first auction was for ¥300bn ($2.5bn) but many investors demanded more, so we now sell ¥500bn ($4.17bn) in each auction.

This fiscal year we are planning to sell 10 year inflation-linked bonds worth ¥500bn ($4.17bn) at four different auctions. We have regular meetings with primary dealers and investors, so if the demand among investors increases further, we will consider boosting this amount.

GlobalCapital: The election of Shinzo Abe, and the introduction of his policy reforms that have been billed by analysts as "Abenomics", has dominated discussion among analysts and economists for the last few years. How are investors viewing the Abe administration's policy reforms?

Kanamori, MOF: After Abenomics started two years ago, there were an increasing number of

Ryo Ishida
Ministry of Finance

investors who were very interested in the Japanese economy. They went first to the equity market, where you saw a big increase in foreign demand. But bond buyers also became very interested. Abenomics deals with so many areas of the Japanese economy that it is sometimes very difficult for foreign investors to really understand what is happening. Some foreign investors now say that not much is happening with Abenomics, but actually a lot is. We try to explain to them the bigger picture and everything that has been achieved so far.

GlobalCapital: Those foreign investors are, of course, largely concentrating on the "third arrow" of Abenomics, which is structural reform. What are you telling those investors about the third arrow?

Kanamori, MOF: There are a lot of areas to that third arrow. There have already been some achievements, such as corporate tax reform.

Of course, there are many more reforms that need to be enacted. The agricultural sector is one example. These changes take time. It is important for us to explain to foreign investors that we need to do what we can first while expanding the reforms to the harder areas as we make progress. That is the key to understanding the progress of Abenomics.

GlobalCapital: In the January edition of the MOF's monthly newsletter, there was some discussion of the factors behind a decrease in JGB liquidity, including the possibility that large volatility swings had made it more difficult for in-and-out trading. How much has liquidity of Japanese government bonds decreased over the last year or so?

Kanamori, MOF: It is very difficult to show the liquidity situation in numbers. Some of our primary dealers say a liquidity shortage is happening in the market, but if we look at trading volumes there is still a lot of trading in the market every day. Perhaps a liquidity shortage actually appears in spots. We do not have any clear figures on this, but we have had that opinion from the market and we do pay attention to that. That is why this year we are going to increase the amount of liquidity enhancement auctions. Usually, when we make an issuance plan, we set how much will be issued in each term.

There is sometimes a shortage in the secondary market in particular sectors, however, which is why we have budgeted for certain parts of our auction to boost liquidity. These auctions will not have a set maturity in advance; they will be determined by primary dealers' bids at each auction about which parts of the curve to be supported.

GlobalCapital: Moody's downgraded Japan at the end of last year, cutting the rating from Aa3 to A1. How much impact did that have on your investors, or even on your conversations with investors?

Kanamori, MOF: There was actually no market impact that we saw from the downgrade, but it was a warning for us.

The government is determined to improve our fiscal situation. We have already set a fiscal consolidation target to make our primary balance into a surplus by 2020 and even though the consumption tax hike was postponed [in November 2014] the government has already started discussions about the next fiscal consolidation plan which will be unveiled in the summer.

The impact of the downgrade was not significant when you look at the market, but it was a reminder of what we still need to do. ▲

Japan's top issuers mull next steps in global debt markets

There are few issuers better placed to generate broad demand for bonds than Japan's public sector issuers. These borrowers appear to tick all the right boxes: highly rated, well known, and with reputations for the skillful management of their curves. But that does not mean that funding in the global markets is simple for these issuers, especially given the often mammoth size of their funding targets. Funding officials at the top public sector institutions not only need to pay close attention to timing, but they also need to continually work to make sure that their investor base is growing every year.

GlobalCapital sat down with senior officials from some of the biggest public sector issuers in Japan to find out how the changing fortunes of the country are affecting their borrowing plans, and to get a sense of the funding challenges facing a group of borrowers that are planning a combined issuance of more than $25bn over the coming year.

Participants in the roundtable were:

Shohei Takahashi, joint head of international debt capital markets, Nomura

Masanori Kazama, vice president, international DCM, Nomura

Akihito Nagata, director, capital markets, treasury department, Japan International Cooperation Agency (JICA)

Yasuhiro Matsui, director, treasury department, Development Bank of Japan (DBJ)

Hiroyuki Nakashima, director, capital markets and funding division, treasury department, Japan Bank for International Cooperation (JBIC)

Takahisa Nakagaito, director, finance department, Japan Finance Organization for Municipalities (JFM)

Atsuko Inagaki, director, bond section, budget division, Bureau of Finance, Tokyo Metropolitan Government (TMG)

Matthew Thomas, moderator, *GlobalCapital*

GlobalCapital: **Japan's public sector issuers are a big source of supply in both the foreign and domestic markets. It may be best to start by getting a sense of just quite how large that supply is going to be. How much are you planning to issue in this fiscal year, and what areas will you focus on?**

Akihito Nagata, JICA: We are planning to issue up to ¥60bn ($500m) of FILP (fiscal investment and loan programme) bonds in the domestic market in the next fiscal year, down from ¥80bn ($670m) budgeted this year. The reason we have reduced the budget is because, even though we had annually budgeted ¥80bn for the past few years, we actually only issued ¥50-¥60bn ($420m-$500m) every year. In the next fiscal year, we are also planning to issue up to ¥60bn-equivalent of government-guaranteed bonds in the offshore market, which is the same as this year.

Yasuhiro Matsui, DBJ: We were under review concerning our privatisation process by the government this fiscal year. This discussion is almost finalized, but over the past several years this has been an important topic for us when tapping into the bond markets.

As for the budget for the next fiscal year starting this April, we are planning exactly the same size as this fiscal year: ¥150bn ($1.25bn) of foreign bonds, ¥250bn ($2.09bn) of domestic bonds, and ¥400bn ($3.34bn) of FILP issuance.

Out of ¥400bn of FILP, we can issue both domestic bonds and foreign currency bonds. Foreign currency bonds are issued by means of drawdown from our global medium term note (GMTN) programme.

Takahisa Nakagaito, JFM: We need to offer a full explanation to our investors when considering the foreign bond market. Several public institutions in Nordic countries whose objectives are working for the local governments have already established presence in the international capital market, but JFM is still required to become more well known. We really want to enhance our reputation among foreign investors, and that is a very important goal for us over the medium term.

Last year, the total amount of funding was ¥1.1tr ($10bn) of issuance, and this fiscal year, we will issue around ¥1tr in the public markets. We sold ¥220bn ($1.83bn) of foreign benchmark bonds in two transactions, and that is something we intend to repeat again. The financial landscape is not clear in the domestic market, and our issuance plan is going to be reduced. But we want to be flexible, so if the environment improves, we could issue more rather than less. We are increasing ¥20bn ($170m) for our flex-framework, given us flexible issuance of ¥170bn ($1.42bn).

Hiroyuki Nakashima, JBIC: We also have largely the same budget as we had this fiscal year, which is around ¥500bn ($4.17bn) in the foreign bond market and about ¥20bn ($170m) in the domestic market. We will continue to concentrate on benchmark-sized bonds in the foreign bond markets. Our dollar financing needs are very high so we like to take a steady approach to our funding programme. We have issued ¥10bn ($80m) FILP bonds this fiscal year, after an interval of three-and-a-half years, and the budget of FILP bonds in the next fiscal year will be ¥20bn ($170m).

Atsuko Inagaki, TMG: After careful communication with investors and consideration of the market environment, we tried to incorporate as much investor demand as possible this financial year. In line with our initiative to promote Tokyo as a financial centre, last December TMG issued A$50m ($38.42bn) of Uridashi bonds for retail investors in Tokyo metropolitan areas for the first time. We had previously only issued yen-denominated bonds towards retail investors, but for investor diversification purposes, we decided to start issuing both yen-denominated and foreign currency-denominated bonds. We saw strong demand to the Uridashi bonds and about 70% of the retail investors were first time buyers of TMG bonds.

For the next financial year, we plan to issue a total of approximately ¥800bn ($6.67bn) of domestic and international bonds. As market uncertainties are increasing and becoming more challenging than this year, we need to diversify our investor base and secure funds on an ongoing and stable manner. We will continue to keep public offerings of bonds as the main funding source and — as for the currency — considering the after-swap funding cost US dollar issuance makes the most sense in the current market.

GlobalCapital: The dollar-yen swap is now drastically in favour of Japanese issuers going overseas and swapping the proceeds of their deals into yen. But at the same time, a lot of Japanese investors are looking to go overseas to find a way to boost their yields. Should issuers be attempting to entice some of these investors into their foreign currency deals — or is it best to keep local investors strictly for local deals? And more generally, how attractive is the dollar market for you right now?

Nagata, JICA: Foreign currency loans are our main objective, but at the same time the dollar-yen basis swap is something we are always aware of, since it gives you a good sense of whether it would be better to fund elsewhere. The dollar market is still the best market for us. The euro market can be attractive, but right now, it is not as cheap, and the demand from our clients for euro-denominated lending is not as strong.

Japanese domestic investors are already buying our yen bonds, and that is something we want them to focus on, whereas we want to expand our foreign investor base by having them participate in our offshore dollar deals. There is a certain attractiveness to the idea of bringing Japanese investors into our foreign deals, though, because Japanese investors would not need to do much credit work to start buying our foreign deals. They could move very quickly. This is something we have certainly paid attention to, but we still think it is better to reserve them for our local deals.

Nakagaito, JFM: Unlike other issuers, we do not need to fund in foreign currencies. Our lending basis is almost entirely in Japanese yen. We look at foreign bonds entirely to diversify our funding sources. That is important for us, and it is something we want to continue in the future. I mentioned already that our overall funding target is around ¥1tr at the moment. It could grow to ¥2tr in a few years. Should we fund this entirely through the domestic market? Absolutely not. The foreign bond issuance environment is strong at the moment, and we feel that the market is ready for us to issue. We want to make the most of that.

When it comes to Japanese investors coming into our foreign deals, we are pretty open to that. In February, we issued a benchmark dollar bond and we

Shohei Takahashi,
Nomura

got strong demand not only from foreign investors, but also from Japanese investors. They are very hungry for foreign bond exposure at the moment, and that is something we will continue to support in the future.

Shohei Takahashi, Nomura: The swap is not only making things more interesting for Japanese issuers going overseas; the flipside has, of course, also occurred. Samurai bond issuance last year was more than ¥2tr ($20bn), but this year the flow has shrunk quite a bit. There have only been a handful of issuers coming to this market, and that is certainly driven by the change in the basis swap that you mentioned. The swap is not relevant to all Japanese issuers, because many of them want to keep the foreign currency. But if you concentrate only on the basis swap, funding in the dollar market does look beneficial at the moment.

Nakashima, JBIC: The foreign bond market has been very welcoming over the last few years. It has been a very good environment for us, especially since we are focused on funding in the dollar market to fund our loan portfolio. But interest rates are set to rise in the US, and the European market is becoming a bit tighter, so we need to be very careful over the next two or three years.

Depending on the funding needs, we are happy to consider funding in other currencies. We have funded in sterling, Canadian dollars and Thai baht, for example. But those deals are to fund loans made in those currencies.

Inagaki, TMG: Dollar-denominated bonds are certainly an attractive funding source, since they allow issuers to diversify their investors by both geographies and sectors. And considering both the yen-dollar basis swap and launch spreads in the current market, dollar issuance has advantages compared to the other markets.

When we issued a bond in May 2014 [a $1bn five year deal], we started preparations well in advance and looked for the best timing to issue the bonds. We also explained the soundness of TMG's financial base and the investment highlights of our bonds through roadshows and investor meetings to create enough demand for our issuance. As result, we found oversubscribed demand and have been able to issue in favorable terms.

Matsui, DBJ: We have both yen assets and foreign currency assets, so we see both sides of the coin as for dollar-yen swaps. In some cases we are keeping our foreign bond proceeds, but at other times, we are looking to swap them back into yen. The dollar market has a strong investor base abroad already, but we can see the advantages of bringing Japanese investors into our foreign deals.

The outlook for US interest rates is a major concern for us, especially because the expectations of rising interest rates can lead to increase volatility in the funding markets and that makes the decision of issuing timing more difficult for us. This is the biggest concern we have right now.

GlobalCapital: This is a point we should dwell on a bit. There is a lot of speculation about when the US Federal Reserve will raise interest rates but the consensus seems to be that it will happen at some point this year. How is this going to impact the ability of the issuers on this panel to meet their funding targets, given the likely rise in volatility?

Takahashi, Nomura: There is some debate about when US interest rates will be raised, presuming they will be raised at some point this year. The most common scenario is a rate hike in September, but some people think it could even happen in June. The timing is going to depend on the economic data coming out of the US. The March non-farms payroll number was quite good, but we are waiting for the April payroll data to see if that continues. There is still a lot of uncertainty.

In a sense, it does not really matter, from an issuer's point of view, whether interest rates go up or not. The speculation about whether it will or will not happen, and when it will happen, is going to have an impact anyway. It will increase volatility and make issuance difficult for Japanese issuers, as well as issuers elsewhere in the world. Those issuers that are swapping back into yen may find that the market is not attractive for them.

The timing is only going to get more and more difficult, especially as we get closer to June and speculation about the timing of US rate hikes grows. It is difficult to recommend one policy to issuers across the board: the recommendations need to happen specifically, on a case-by-case basis. But there is likely to be a window of opportunity before June, and one after that, when investors and issuers have more clarity about the direction of US interest rates. It is around June that things are likely to be very tough.

Akihito Nagata,
JICA

Nagata, JICA: Asian investors are very yield-hungry at the moment. Those investors are less active in the dollar market at the moment, given that yields have been falling. But after US rates go up later this year, these investors will come back to the market, so there will be some benefit from the rising rate situation. It does, at least, help you diversify your pool of investors.

GlobalCapital: There were some eye-catching euro-denominated deals from Japan's public sector issuers last year, including landmark issues from DBJ and JFM. Is the euro-denominated market likely to be be a key part of your funding strategy in the coming financial year?

Nagata, JICA: We do not exclude a real possibility that we may issue in the euro market, but the dollar must come first for us. We are still a newcomer in the offshore market; we just started issuing last year. We need to make sure that we are holding on to our dollar demand, and increasing our investor base there as much as possible. It does not mean that we will not sell a euro-denominated deal, but it is not a priority for us at the moment.

Nakashima, JBIC: We would certainly be happy to go the euro market if we had demand for euro-denominated loans from our clients. But currently, we do not have a lot of euro currency-based needs, so the only rationale would be swapping euros into dollars. Right now, the dollar market seems to be much more attractive from a cost perspective when you look at after-swap costs from euros and, indeed, from many other currencies.

Nakagaito, JFM: The cost advantage is certainly with the dollar market. We had our first issuance experience in the euro market this financial year, selling a €1bn deal. That was a very successful deal, and we would be happy to return to the market in future. But like the other panelists, we certainly want to emphasise the dollar market first.

GlobalCapital: DBJ closed a very interesting deal in the euro market, becoming the first Japanese credit to sell a green bond when it issued a €250m three year deal in October. How much was your decision to turn to the euro market driven by the funding cost, and how much was simply down to the fact the European market already has a pretty well developed investor base for green bonds?

Matsui, DBJ: The green bond was our second deal in the euro market in this fiscal year. We also sold a €100m private placement last May as well as the €250m green bond in this October. The green bond was not driven primarily by our euro needs but because, as you mentioned, there is a strong green bond investor base in the euro market already. Nordic and continental Europe investors, in particular, were hungry for green bond issuance. They were not major investors in our dollar deals before, so issuing green bonds in euros presented a good opportunity for diversification of our investor base.

We are going to continue to issue green bonds or other SRI types of the bond over the next several years. There is a large investor base that wants this sort of product in the world, especially when denominated in euros, and that investor base looks likely to grow rapidly.

The idea of green bond issuance and its structure was created by global investment banks as "Green Bond Principals", and based on that idea, we have structured our green bond, and approached various asset managers. It was important that we got a range of opinions on the deal from those investors, and that meant meeting a lot of investors that were not as familiar with DBJ as a credit. We want other Japanese private issuers to follow this global movement of issuing green bonds. It has come to my ears that some Japanese private corporations are looking deeply into green bond markets, however, it seems they need more time to structure and issue green bonds.

Nagata, JICA: We've received many pitches on issuing green bonds to expand our investor base. But what is challenging for us is that all of our lending is for ODA [official development assistance] projects. That means there is always a socially responsible investing angle to our deals. It is very difficult for us to sell a green bond to fund a particular project, because investors will naturally ask: are your other projects not green? Are they not socially responsible? That's just not the case. That is what we explain to investors during meetings, so there is a bit of a hurdle for us in defining some deals as more socially responsible than others. All of our bonds are regarded as socially responsible investment products and such explanations have been well received by investors so far.

Nakashima, JBIC: We are seeing wind power and other renewable energy project loans growing rapidly. That is very much something we have focused on in our business. We have also received many proposals for green bonds as well, and it is an area we are studying. But it is unlikely to happen right away; we do not have enough momentum in that direction at the moment.

Nakagaito, JFM: Investors quite often ask us whether we will issue green bonds, and we are interested in looking into this. But the funding that we do, for municipalities, tends to have mixed uses. It is difficult to identify which loans are green and which are not because of that. There is also an admin issue to overcome when you decide to sell a green bond. The documentation work is another thing that holds us back. But we do feel this is a promising product, and we want to continue to study it.

We have observed that investors have recently became more proactive on socially responsible investments (SRIs). Recently, the national government has discussed the vitalization of local communities suffering a drastic fall in population. JFM has financially supported the local governments and has been responsible for social development in the regional area. As investors become more aware of SRIs, we may urge investors to understand our socially responsible operations in the future.

Yasuhiro Matsui,
DBJ

Takahashi, Nomura: The interest among domestic institutional investors in the green bond market is not that strong yet. They have not yet figured out how to cope with green bonds yet, but we do see individual investors are becoming a lot more interested in socially responsible investing. They are mainly buying international deals in this area at the moment, but in the future, we expect some growth in the domestic demand for green bonds.

Matsui, DBJ: This goes back to the discussion earlier about Japanese banks investing in offshore deals. Because we see green bonds as being a source of diversification for us, there is not much advantage for issuers since green bond demand in the domestic market might not help us to diversify our investor base immediately. But I hope both domestic green bond investors and green bond issuers will grow in the near future.

GlobalCapital: How attractive is the dim sum bond market at the moment? Does the fact that few Japanese issuers rarely want to keep the renminbi mean that dim sum supply should strongly correlate to dollar supply, since so much is driven by the swap?

Takahashi, Nomura: Japanese issuers were interested in the dim sum market when it really started to take off a few years ago. There were a few deals, and there were quite a lot of enquiries from issuers about their chances of issuing in the market. There are a few hurdles, however. There are still questions, as there were years ago, about how easy it is to bring the proceeds of an offshore renminbi deal into China, and for those issuers who do not want to remit the proceeds of their deals, the supply is naturally going to be quite limited. But besides this, we also find that the political situation is quite difficult at the moment.

Nagata, JICA: This has been a theme for a long time. I remember 10 years ago, I was involved in a Thai baht issue. We were already talking about renminbi Panda bond issuance back then. It has taken a long time for the market to catch up to what issuers were hoping for then. There has certainly been some progress since that time but for us, it is difficult to tell whether the local authorities would allow us to issue in the local market or how easy it would be to remit an offshore deal. We want to follow our lending currencies, and that certainly includes emerging market currencies. But we cannot break into this market overnight.

Nakashima, JBIC: There are Japanese companies investing in China that have a need for renminbi-denominated loans. But the demand for each loan is not very big at the moment. We don't have to issue bonds because the cross-currency swap can be used to raise renminbi to fund those loans. The size is small enough at the moment that this works fine.

If demand for our renminbi loans grew larger, depending on the terms of each funding method, the possibility to issue renminbi-denominated bonds in the offshore oronshore markets could be a theme for us. But the onshore market is relatively difficult to get access to at the moment. The government has approved only a handful of issuers in the market, and the dim sum market is much more convenient because of the easy access.

At the moment, though, neither a Panda bond nor a dim sum bond is a serious consideration. It is good for us to explore these possibilities, and we occasionally get pitches on turning to the market. But we really need to make the decision based on what our borrowers need. There is just not enough demand for renminbi loans at the moment.

Matsui, DBJ: Three years ago, we studied dim sum bond issuance. But thereafter we have suspended further studying of a deal simply because the loan demand was simply not big enough. As long as the demand for renminbi loans remains as small as it is today, the currency swap is good enough.

Takahashi, Nomura: I was a member of the Asian Bond Market Forum for several years, and I engaged in various discussions about the unification of the Asian bond markets. The difficulty is that in Asia, foreign exchange management is still a major issue. Japan and Singapore are perhaps the only countries where foreign exchange is liberalised. Even in South Korea there are still some restrictions on foreign exchange. These foreign exchange restrictions are a major hurdle to more cross-border issuance, and that is certainly one of the things that get in the way of more renminbi business.

GlobalCapital: **Moody's downgraded Japan from Aa3 to A1 in December, a move that appeared to have very little impact on the Japanese government bond market. How much has this downgrade changed your discussions with investors? And has it had any palpable impact on demand for your bonds?**

Matsui, DBJ: There are different opinions when it comes to the impact of the downgrade. However, the biggest impact we have seen is from European bank treasuries. They stopped buying Japanese public sector bonds as a result of the downgrade, so there has certainly been some impact on certain parts of our investor base. There are still some investors willing to buy our bonds, however, as long as we offer proper deals in appropriate sizes.

We are discussing now who could fill the gap left by the European bank treasuries. That is something we have to think about while preparing for the next issuance, and we do and will carry out IR activities to that end. We would like to take a close look at investors' behaviour. We're going to have one-on-one meetings in the next financial year so that we can see how much the downgrade has impacted investors' appetite abroad and how we can manage the situation.

Nakashima, JBIC: The downgrade was initially a major cause of concern for me. In February, we sold a $1bn bond, and at that time I visited several foreign investors and had discussions with them about their level of confidence. The impact of the downgrade was actually less than we had anticipated in the beginning.

Hiroyuki Nakashima,
JBIC

Investors are seeing that Japan is becoming successful because of Abenomics. There was certainly some impact on European bank treasury demand, but overall the impact was not very big. It is important for us, if the Japanese economy continues to recover, to make that front and centre in our IR activities.

Nakagaito, JFM: We met some investors at the end of last year, right after the downgrade by Moody's. The general message was "don't worry". The impression investors gave me was that they adopt an internal rating-based approach, so we did not need to focus so much on the impact of the downgrade. We're not part of the national government, and we're not government-guaranteed, so perhaps our products still keep some attractiveness for investors.

Nagata, JICA: We issued in the foreign bond market last year before the downgrade, so we were not subjected to a direct impact from it. Afterwards, what I heard is that some investors were not as interested in Japanese issuers. But the important thing is that investors look at us as an individual credit, not just as a proxy for the Japanese sovereign. Those players will continue to be engaged, so we need to tailor our IR activities to those organizations who take a close look at the strength of JICA.

GlobalCapital: We talked about the rate environment earlier, but we have not focused much on the spread environment. What is the spread outlook right now for Japanese issuers, but especially for the public sector borrowers we have on this panel?

Takahashi, Nomura: That's a very difficult question. Japanese issuers tend to face a very stable spread environment. That is likely to continue in the future, and that is something investors should value. But there are some things that could certainly impact spreads in the future, in particular relative value compared to other issues. For example, the European Central Bank has been buying large chunks of European bonds, which has led to a big tightening in the spreads paid by the European issuers such as EIB. Japanese issuers have lagged this performance at the moment, but because they are now cheaper on a relative value basis, we could see a small tightening. It is tough to see when this will happen.

Matsui, DBJ: I agree with Takahashi-san that we cannot expect a major tightening. The market landscape leaves some room for tightening, but right now we are probably close to hitting the limit. The same thing applies to yen interest rates. The interest rate has been declining steadily in the long term, and is probably hitting a limit. Since investors want to cover their own funding costs, the falls in JGB interest rates could even lead to a bit of expansion in domestic bond spreads in the near future.

Nagata, JICA: The tightening in the euro market driven by the ECB does make dollar bonds more attractive to foreign investors, so perhaps we could see a tightening in the foreign currency markets. But in the domestic market, spreads are already very low. I'm sure there are diverse opinions but because we have gone so low in spread terms already, there is not much differentiation between different sectors.

Nakashima, JBIC: Generally speaking, issuers want to pursue tighter spreads. However, we also want there to be fair pricing, because in the long term issuers need to have a good relationship with investors. We want to make sure we're paying the right level for a Japanese name.

Nakagaito, JFM: One of the things that has come up in discussions with investors is the worry that the Japanese government's fiscal tightening is not sustainable. This is something a lot of investors ask us about, and if there is anything that impacts spreads, it is going to be this worry.

GlobalCapital: When you look through the order book composition of your offshore bonds, are there any areas that you think are missing? Perhaps you want more emerging market demand? Perhaps particular investor types stand out as an obvious area of growth?

Nagata, JICA: We feel that there is a lot more room for us to focus on foreign investors. We visited various investors in Europe, Asia and the Middle East last year, but we think there is still a lot of room for us to generate demand and Nordic countries are a good example. Investors in these countries can often provide strong demand for Japanese public sector bonds, and we know we have plenty of scope to grow in this area.

Takahashi, Nomura: In the past few years, Japan's public sector issuers have been quite actively developing their investor relations process. They have done very well to expand their reach already. But there is a lot of room to push that further, in particular by changing the currency denomination.

The difficulty is the cost. Does a particular market offer attractive spreads? How liquid are the swaps? When you talk about expanding the investor base there is still a lot of opportunity, but the timing is very important.

Takahisa Nakagaito,
JFM

Nakagaito, JFM: Dollar bonds are the core of our issuance programme for the foreseeable future. But we did issue a euro denominated bond this financial year, and we found that a lot of European investors were interested in our deal. Many of these investors were first time investors for us, and we hope to continue to get them in our deals in the future. That should be the case even when we issue dollar bonds. We think that by selling that euro denominated deal, we have built some loyal investors that will join our future dollar deals too.

Nakashima, JBIC: We are also focused on the dollar bond market, but we saw when we issued Canadian dollar bonds in 2013 and sterling bonds in 2014 that we expanded our investor base.

Latin America is a possible area, but we need to carefully watch the economic situation. The impact of the falling oil price on Middle Eastern demand should also be followed.

Matsui, DBJ: One area we could really develop in the next fiscal year is the US market, since we have not tapped into US onshore market in these years. We also would like to find more investors in Latin America, but what I hear is that it is pretty difficult to get their involvement at the moment.

GlobalCapital: What are the main areas Tokyo Metro wants to stress to investors when on roadshows or having one-on-one meetings?

Inagaki, TMG: TMG is one of the local governments of Japan, but it has an annual budget of approximately ¥13tr ($110bn), which is nearly equivalent to Sweden's. More than 80% of its revenues are based on independent sources, such as local taxes, which include two corporate taxes, fixed assets tax, individual inhabitant tax, and local consumption tax, among others. This provides flexibility in Tokyo's fiscal management without depending on the central government. Given the abundant tax sources, TMG's reliance on new bond issues is kept at low levels of 6.9% of the fiscal year 2015 general account budget, which allows us to maintain a sound financial management.

Matthew Thomas,
GlobalCapital

The Japanese government has a system to subsidise local governments to ensure an appropriate level of government services, if revenues of individual local government fall short of their needs. But TMG has never received such a subsidy. It is, in fact, the only local government that has not received one out of all the 47 local governments. This is a key thing we want to stress to investors: the sound financial management of TMG.

GlobalCapital: What are your main objectives over the next few years? How do you see your funding plans evolving, and how much will a changing domestic and global environment present challenges for you in the years to come?

Matsui, DBJ: As discussed at the beginning of this roundtable, the major topic for DBJ has been the review of our privatisation process. That is almost finalized, so the priority over the next few years is going to be not only maintaining our investor base both in the overseas and in domestic markets but also continuing to expand our investor base as much as we can. To that end, maturities, currencies and products should be diversified. We want to offer a large range of products to attract the most diverse range of investors.

The investors we have relied on at the moment might no longer be able to buy our bonds if the market or global banking regulations would change. We need to be aware of that and make sure we can expand our investors by seeking out as many potential new investors as possible. That is going to be our priority for at least two or three years to come.

We have also set up a Euro commercial paper programme. We first aim to issue short term tenors and would like to increase the tenors going forward.

Nakagaito, JFM: For us, the priority is clear. We now have a funding target of around ¥1tr ($10bn), but in four or five years time, that may double. We will have to raise a big amount in the future. That is going to mean expanding our investor base, and using innovative ideas. We can add new products to bring in new investors. We can extend maturities to attract pension funds and insurance companies. Most of our loans are very long-term, so the extension of maturities is certainly something we should be doing. We can partly do that with FILP bonds, which allow maturities to be as long as 40 years.

Nakashima, JBIC: The major target for us every year is to continue to fund ourselves through benchmark bonds and provide liquidity in the dollar market; we want to continue to support the market to make sure our deals remain liquid. That is a very basic target for us.

We do not have a concrete plan for local currency bond issuing at the moment, but that is likely to change. There are some local currency needs among our clients, so we want to be able to respond to that. There are some infrastructure projects, for example in the power sector, which are going to require long-term local currency financing — and that is often beyond any reasonable liquidity in the swap market. That means we need to examine the local currency markets a lot more over the next few years. We need to be ready to issue at any moment.

Nagata, JICA: We are planning to maintain our overall budget level over the next few years. In the domestic market we will continue regular issuance with benchmark tenors in a predictable way so that investors can easily purchase our bonds. Under the current environment of record-low interest rates, it is vital to reach new investors who are especially willing to buy 10 year deals. In the foreign markets, we still have a lot of room to enhance our investor base. There is still a lot of work to do in Europe, in the emerging markets, and in the US. On our funding side, we want to expand and deepen our network with private sector investors like commercial banks and asset management companies and generate a better understanding of what we are doing. That can lead to new business opportunities as we work together with them for private sector development on our operations side.

Inagaki, TMG: In terms of international bonds, we plan to continue making efforts to diversify our investor base that will benefit our funding by helping it to become more stable. TMG is currently promoting initiatives for a "Tokyo Global Financial Center" to create an environment that helps facilitate business activities in Tokyo. In line with such initiatives, from the next issuance of international bonds, we are considering a dual listing our bonds which will see them trading on Tokyo PRO-BOND Market as well as the London Stock Exchange. Through the dual listing of TMG's international bonds, we anticipate the recognition of the Tokyo PRO-BOND Market to rise — and the use of the market by issuers to increase more and more in the years to come. ▲

More supply needed as domestic investors increase their appetite

Japan's domestic debt market has long proven to be one of the most resilient in the world, backed by an army of institutional investors that have a clear preference for buy-and-hold strategies and familiar credits. That resilience was put to the test at the end of last year, after Moody's announced that it had downgraded the sovereign. **Matthew Thomas** reports.

JAPAN'S ECONOMY has faced peaks and troughs, from the heady 1980s to the period of deflation and stagnant growth that followed. But the country's domestic economy has always been regarded as being, in terms of credit, one of the best in the world, and the country had not been downgraded since the election of Shinzo Abe in 2012. That was until the end of 2014, when Moody's cut Japan from Aa3 to A1, blaming uncertainty about fiscal consolidation, doubts about the government's growth plans and fears over the public debt level.

While that was not a surprise, it did raise the question of what impact it would have on the domestic debt market. Japan has, for many years, been one of the lowest yielding bond markets in the world, where the top names can pay only a few basis points over the sovereign, and lower-rated names retain the price-setting power in the bond market. Usually a downgrade by one of the big three rating agencies would strengthen investors' hands, allowing them to demand higher spreads. But in this case Japanese investors did not have the power to force the issue.

The downgrade had essentially no impact on domestic bond spreads, according to bankers. Some investors did start asking a few more questions during client meetings, and the subject was certainly not ignored among the local investor base. But the net impact in pricing negotiations was somewhere close to zero."

This is because cash-rich investors do not have enough options to play hardball in the domestic market. Japanese banks, with their enormous balance sheets and desire to lend, reduce supply in the bond market by trying as hard as they can to increase their loan books. That makes most domestic debt issuance opportunistic; not something that leaves issuers feeling they are at the whim of investors.

"There is a scarce pipeline of deals at the moment and the Japanese investment community has shown that it is hungry for new deals," says Koh Kawana, head of global fixed income capital markets at SMBC Nikko. "The downgrade may have had more impact on foreign investors, but they aren't coming into the market much anyway."

Panasonic Centre, Tokyo

It is not hard to see why some issuers are finding the bond market an attractive source of funding at the moment. The combination of a hungry investor base, an aggressive central bank and an easy alternative from bank lenders means that now seems as good a time as any for Japanese issuers to review their bond funding plans. It should come as little surprise that bankers were able to close the largest domestic yen transaction in more than four years.

Panasonic Corp managed to drum up demand for a ¥400bn ($3.34bn) deal split between five, seven and 10 year tranches in March. The transaction, which came a month after Moody's upgraded the company to Baa1, underscored the impressive turn-around of the company over the last few years, says Reiko Hayashi, head of Japan global capital markets at Bank of America Merrill Lynch.

"We had around 40 investor meetings to explain to potential investors just how much they had improved their financial situation," she says. "They have put a huge effort into turning around the company and, in the end, investors proved very supportive of the deal."

This deal does more than show Panasonic's impressive turnaround. It also demonstrates the huge liquidity available in Japan's domestic bond market. But most bankers think similar deals will be few and far between.

There are still opportunities for eye-catching yen bonds. There may be a few deals this year worth more than ¥100bn. But the deep liquidity in the banking market, combined with the practical non-existence of high yield credits in the Japanese market, means that banks should not expect to significantly grow their fee pool from domestic bonds over the next few years. The exception, as always, is from mergers and acquisitions, something that Japanese bankers are always hoping will give a boost to their bottom line.

"Corporates around the world are in an acquisitive mood at the moment and this is when the capital market can be opportunistic for them," says Morifumi Yotsumoto, head of debt capital markets at Barclays Japan. "Of course, bank loans are the most commonly used funding tools for them. But these acquisitions are likely to be funded, at least partly, in the debt capital market to diversify the funding sources. This will allow them access to a greater range of investors, globally." ▲

Samurai market suffers but innovates, too

The Samurai bond market has taken a big hit over the last three months, as supply has dwindled in response to an expensive dollar-yen basis swap and issuers have chosen instead to fund elsewhere. But although bankers looking back at the last fiscal year are likely to bemoan the tepid volumes, they can take some solace in one clear innovation the market has made. **Matthew Thomas** reports.

SAMURAI BOND issuers are, by and large, a familiar bunch. European and Australian banks, South Korean policy lenders, and a handful of highly rated corporations — the same names appearing in the market again and again.

The Samurai market is, to hear bankers tell it, one of the key areas where Japanese investors look to increase their returns. But their appetite for foreign names does not extend very far from the top of the credit curve, and usually does not leave much room for debut issuers.

This can leave bankers prone, perhaps more than in other markets, to the vagaries of volatility. There is certainly room for the top bookrunners to stand-out from the crowd and deals such as Caisse des Dépôts et Consignations' ¥40bn ($330m) Samurai last year show that new names can sometimes break in to the market, albeit usually those from the top of the credit curve. But all too often, the ebb and flow of the market comes down to one crucial question: where is the dollar-yen swap?

The answer to that question, over recent months, has not been one that Samurai bond specialists have treated as particularly good news. The roughly 60bp that Samurai issuers would have to add to their funding costs when swapping yen proceeds into dollars put many issuers off tapping the market, and led to less than $1.5bn of issuance in the first three months of 2015. That is barely 25% of what they achieved in the same period last year, but it does offer a big growth on the first quarter of 2013, when an uncertain economic outlook pushed many issuers to the sidelines.

Although that weak quarter meant that Japanese Samurai dealers ended their own fiscal year with little more than a whimper, there is reason to be bullish about the prospects for the Samurai market in the year to come. After all, they also managed to add a rare bit of spice to the market by bringing a pair of tier two bonds from European banks.

Rabo points to new direction

Rabobank, a well respected issuer in the Samurai bond market, convinced Japanese investors to buy the first tier two bond from a foreign name last year. The borrower faced a sizeable task: not just in convincing local investors to adopt a structure that they were unfamiliar with, but also working with the Dutch banking regulator to ensure it was happy that the language in the documentation made it qualify as capital. Rabobank's ability to navigate these issues won plaudits from bankers. Reiko Hayashi, head of Japan global capital markets at Bank of America Merrill Lynch says that no other issuer would have been able to open the market.

The issuer had a few things in its favour. Its instant name recognition in the local market was clearly one of them. But its "bail-in" language, while unfamiliar to Japanese investors, also helped generate strong demand. The European language is less investor friendly than the Japanese version. But unlike tier two documentation in Australia, for instance, which threatens to leave investors holding equity, Rabobank's deal offered no such possibility.

"That was one of the major factors that helped us generate strong demand for the deal," says Kazuhide Tanaka, chief representative and head of long term funding in Japan at Rabobank. "Investors didn't know how to treat such an instrument should a conversion [into equity] take place, so the fact that we could assure them this would always be a debt instrument helped overcome some doubts from the buyside."

The end result was a ¥50.8bn ($427.4m) 10 year bond that offered

"The fact that we could assure them this would always be a debt instrument helped overcome some doubts from the buyside"

Kazuhide Tanaka, Rabobank

a new funding avenue for the issuer and priced inside where it could have closed a deal in the euro market. The deal ended up pricing roughly in the middle of where Rabobank could have sold dollar and euro transactions, said Tanaka. But perhaps more important than this issuer-specific success was the market-wide ramifications. Investors now had a new product to sink their teeth into. It did not take long for bankers to offer them a second bite.

French bank BPCE followed with its own tier two Samurai just over a month later, selling a ¥27.2bn 10 year fixed rate bullet, a ¥7.9bn 10 year non-call five tranche and a ¥13.2bn 10 year floating rate note. The economics clearly worked out for the issuer. It benefited from the chance to diversify its subordinated investor base, but the pricing was roughly in line with where it would have closed a euro denominated transaction, said bankers working on the transaction.

Japanese DCM bankers are realistic enough not to expect a rush of tier two deals to come to the market this year. These transactions are not often opportunistic, nor quick to put together. But by opening up a new area of the market for foreign issuers to consider, they have given themselves a good chance to increase their revenues from the market this year. As long as dollar-yen swaps remain unattractive to most Samurai issuers, this kind of innovation is a must. ▲