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Moody's Lowers Japan's Debt Outlook

By WILLIAM SPOSATO

TOKYO—Moody's Investors Service sent a warning to Japan's political leadership Tuesday, announcing that it was cutting the outlook on the nation's Aa2 bond rating to negative from stable, citing the political gridlock that is dimming chances for action soon to rein in the nation's ballooning debt load.



Rising oil prices are pushing Asian stock markets lower, and the outlook on Japan's debt is downgraded. WSJ's Jake Lee and Heard on the Street Editor Mohammed Hadi discuss.

The move, another headache for Prime Minister Naoto Kan, comes hot on the heels of Standard & Poor's move on Jan. 27 to lower its debt rating for Japan to double-A-minus from double-A.

S&P said at the time that the government "lacks a coherent strategy" to deal with the debt situation. The Moody's action isn't a downgrade but a change in outlook, and is often the first step to a full downgrade of a debt rating.

The current Moody's rating is one notch higher than the S&P level.

Japan's total government debt load is nearly 200% of its total annual economic output, the highest debt level among all major industrialized countries.

While the debt burden has been growing steadily, successive governments have been unable to come up with a solution. Moody's noted that even Bank of Japan Gov. Masaaki Shirakawa

has said that "as history shows, no country can continue to run [large] fiscal deficits forever."

Mr. Kan has proposed a tax restructuring that would see an increase in the consumption tax to help pay for the needs of Japan's aging society. However, his weakened political state means that this is increasingly unlikely to pass as his support erodes. The opposition parties, whose support would be necessary to pass budget-related bills, have ruled out any help to the administration and there are growing calls for Mr. Kan to step down.

"The key event that we will be watching is an announcement of the comprehensive tax reform program in June. We have some concerns about that package in the current political environment in which the Diet is divided...and also in view of the intensifying political challenges to [Mr. Kan's] leadership," Thomas Byrne, credit officer for Asia and the Middle East in the sovereign risk unit of Moody's, said at a news briefing.

Mr. Byrne later said no further action on Japan's debt was likely until at least June.

With the possibility now being raised of a snap election, the long-running political turmoil is likely to last. Mr. Kan is already the fifth prime minister in the past four years.

In the latest flare-up, a group of 16 lawmakers within the ruling party have threatened to vote against the government, further complicating the political maneuvering.

"The rating action was prompted by heightened concern that economic and fiscal policies may not prove strong enough to achieve the government's deficit reduction target and contain the inexorable rise in debt, which already is well above levels in other advanced economies," Moody's said in its statement.

Given Japan's massive pool of savings and the fact that its debt is almost all held domestically, Moody's said the growing fiscal problems weren't likely to cause an immediate crisis in the Japanese government bond market in the near- to medium-term but said that such pressures will grow over the longer term.

"Japan's very large economy and very deep financial markets provide the wherewithal to absorb economic shocks. Nevertheless, the inexorable rise in government debt suggests that actions are urgently needed to regain a path of fiscal consolidation," Moody's said in its statement.

Finance Minister Yoshihiko Noda declined to comment on the downgrade.

The Moody's announcement comes even as some opposition politicians worry that political gridlock is driving the country over a fiscal cliff. Taro Kono, a member of parliament in the opposition Liberal Democratic Party said his own party's attempt to block legislation needed to permit further borrowing to finance the deficit "is a dangerous move. We are not sure how markets will react." He added that "the two parties need to sit down and learn how to make an agreement."

Markets showed no sudden reaction to the move, with Japanese government bond prices little changed.

The announcement did exacerbate a slide in the Nikkei Stock Average, which closed down 1.8% at 10,664.70. Banking and other financial sector shares were especially hard hit on the prospect of a decline in the value of their JGB holdings.

Mitsubishi UFJ Financial Group fell 3.6% to 453 yen (\$5.45), while Nomura Holdings fell 4.9% to 522 yen.

The dollar was at 83.25 yen late Tuesday in Tokyo, little changed from before the Moody's announcement.

Credit default swaps, which measure the perceived risk that a country may default on its debt, widened slightly to 81.50-84.00 basis points for the five-year maturity, traders said.

Japanese government bond prices rose despite the Moody's action, with the focus on the perceived "safe-haven" of Japanese bonds amid Middle East turmoil. The price rise pushed down the yield on the benchmark 10-year bond to 1.270%, down 4.0 basis points from Monday.

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