GlobalCapital

Japan in the Capital Markets

OCTOBER 2024

Sponsored by:

DBJ Development Bank of Japan

JFM

GlobalCapital

GlobalCapital
Delinian Limited
4 Bouverie Street, London, EC4Y 8AX, UK
+44 20 7779 8888

DELINIAN LEADERSHIP
Chairman, Delinian: Henry Elkington
CEO, Delinian: Andrew Pinder
CEO, NextGen Publishing: Isaac Showman
Managing Director, GlobalCapital: Toby Fildes

EDITORIAL
London bureau chief: Ralph Sinclair
Contributing editor: Rashmi Kumar
Sub-editors: Richard Cosgrove

PRODUCTION
Production editor: João Fernandes

COMMERCIAL
Head of sales: Jack Thomson
Head of business development: Holly James
Business development manager: Katherine Tapper
Subscription sales: Jordan Craig, Rory Hopkinson, Mike Jeanes, Marcus Maben
Customer success manager: James Anderson

Head of marketing: Kristina Lakstutyte
Marketing executives: Sadia Mohammed, Sophie McGrahan, Alex Nefeli

Director of events and commercial content: Sara Leech
Operations director: Karly Eist
Senior operations manager: Chloe Forrester

Japan in the Capital Markets

BONDS

SSA ISSUERS ROUNDTABLE

ESG

The shorter the better: BoJ rate rise changes tone of Japan's bond market

The landmark rise in interest rates announced by the Bank of Japan in July was a turning point for the country's bond market, fuelling interest in shorter-dated deals and possibly triggering changes in investor portfolios, writes **Rashmi Kumar**

Among all the world's major central banks, the Bank of Japan takes this year's prize for keeping market participants on their toes.

Take its July 31 announcement: after a policy meeting, the BoJ raised its policy rate to 0.25%, taking many by surprise as there was little evidence that inflation was rising. Simultaneously, it confirmed plans to cut its monthly purchases of ¥6tr ($40.6bn) of Japanese government bonds (JGBs) by ¥0.4tr every quarter to ¥3tr by the first quarter of 2026.

The July rate increase was a landmark moment, as it signalled a major shift in Japan's ultra-loose monetary policy.

Critically, it came after years of large stimulus programmes and an eight-year period of negative interest rates, which the BoJ ended in March when it raised the rate by 10bp to a 0%-0.1% range.

But instability immediately followed July's increase. The hike, combined with hawkish comments from BoJ governor Kazuo Ueda, triggered an unprecedented spike in the yen from near a multi-decade low, disrupted yen carry trades, and caused a global stock market rout in early August.

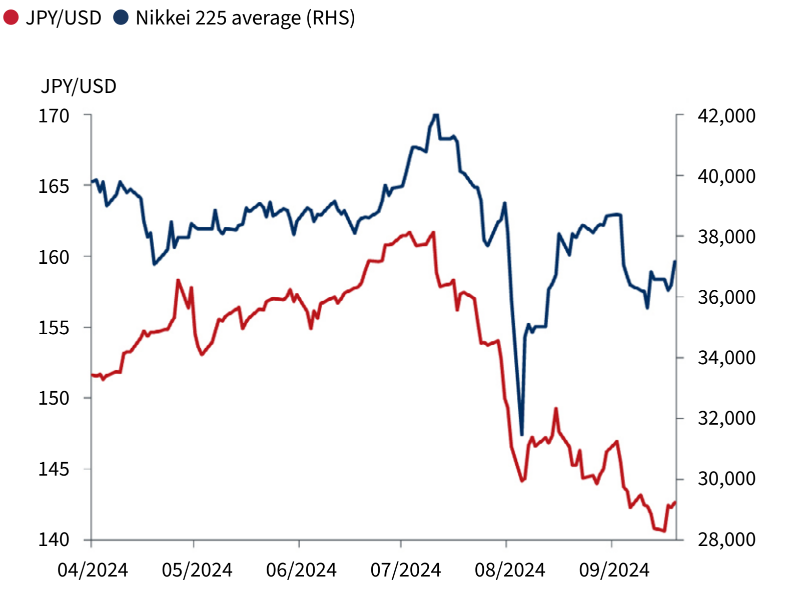
The increase also marked a turning point for Japan's bond markets.

The country's ultra-low interest rates meant borrowing was cheap for Japanese companies and global borrowers looking to sell Samurai bonds at minimal cost. But by normalising Japan's rate regime, the BoJ effectively ended this era — even if yen rates remained much lower than those in dollars and euros.

"There is a very clear message to the market, to issuers and to investors, that rates may go higher in the future," says Hiroshi Oikawa, head of Japan DCM syndicate at Bank of America, Tokyo. "What that means is that investors are becoming cautious, and from an investment grade bonds point of view, there is demand towards the shorter end to the five year part of the curve. This is purely because of the risk that comes with longer duration bonds."

Japanese stocks plunged in early August

Japan: FX rate and stock price index



Source: Oxford Economics and Haver Analytics

Short and sweet

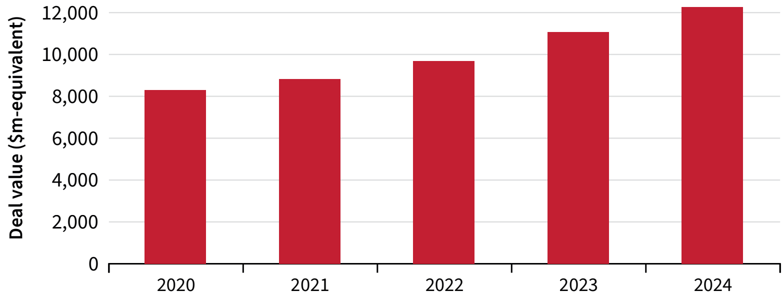
Debt bankers in Tokyo and the rest of Asia say yen bonds sold since July's rate rise reflect investors' preference for shorter tenors and their reluctance to load up on longer tenor bonds.

Take the ¥162bn dual-tranche Samurai bond sold by the ANZ in mid-September. The bank opted for three and five year tranches, taking ¥110.4bn from the three year portion — more than double the size of the ¥51.6bn five year tranche.

"This deal shows that the shorter end of the curve is more constructive than the longer end," says a Singapore-based DCM banker familiar with the situation. "For longer tenors, borrowers will need to pay a higher spread so investors can feel comfortable taking that risk."

When West Nippon Expressway Co turned to investors in late

Samurai bond issuance volumes, year to October 2



© Dealogic 2024

August, it opted for a four tranche outing, taking ¥20bn from a 0.489% two year, ¥90bn from a 0.67% five year, ¥19bn from a 0.8% seven year, and ¥12.7bn from a 1.007% decade note, shows Dealogic.

Other issuers, such as Mizuho Leasing Co and NTT TC Leasing Co, included three year portions in their August deals, while firms like Nagoya Expressway Public Corp and Nexco East had two year tenors in their September transactions, according to Dealogic data.

BofA's Oikawa says issuers have to pay 10bp-20bp more in spreads for longer-dated bonds since July.

"It varies from issuer to issuer, of course, but the shorter curve is relatively more stable compared to longer tenors of seven or 10 years," he adds.

As a result, Oikawa says he expects spreads in the shorter end of the curve, such as three or five years, to be stable, while bonds of 10 years or longer could be subject to volatility and further widening as investors factor in risk premiums for those maturities.

Hiroshi Oikawa, head of Japan DCM syndicate at Bank of America

Yields on the benchmark 30-year JGBs, for instance, have risen about 40bp to more than 2% following the BoJ's rate raises.

Investor opportunities

The yen bond market offers plenty of buying opportunities for international and domestic investors.

Global issuers of yen debt will also have a strong following among international portfolio managers. Samurai bond issuers typically pay small premiums over their local currency bonds, appealing to asset managers who prefer to buy Samurai and then swap to their local currencies to pick up extra yield.

Domestic investors, on the other hand, have long looked outside Japan for higher yields, but market watchers say many will start reining in their external investments and returning to yen over the next few quarters.

Many large Japanese investors have been burnt by their global investments. For instance, in June Norinchukin Bank said it would sell ¥10tr or more of its US and European government bonds, as higher global interest rates were hurting its financials. The bank's investments had largely been funded by high-cost short-term borrowings that led to losses as the investment income was less than the cost of the funding. As of March 2024, Norinchukin had ¥24tr-equivalent of foreign bonds on its books.

Other Japanese investors are in a similar boat. As yields on long-term JGBs rise, market watchers say there will come a point where some of Japan's largest asset managers, such as insurance firms, will start to bolster their holdings of local debt.

Japan's local corporate bond market can also be appealing. In the year to October 2, Japanese issuers raised around $17.4bn-equivalent via 554 yen-denominated bonds, according to Dealogic data, just a little less than the $18.2bn via 580 trades during the same period in 2023. But this year's tally is still higher than year to date volumes for 2021 and 2022.

Bankers say the pipeline for Japan is strong, across both domestic yen issuance and global deal flow.

"Japan overall is a theme people are focusing on globally," says Oikawa. "Japan is the only central bank in the world hiking rates now when every other central bank is cutting rates, which means that a lot of issuers, investors and market participants are keen to know what is happening in Japan. What is the economic cycle in Japan? How are rate movements likely to be and what are the new opportunities in Japan? It helps that Japanese corporates are very strong and have healthy finances." GC

Issuers unleash Samurai bonds

This year, the Samurai market emerged as a firm favourite among global issuers as they diversified their fundraising sources. But in addition to the usual, repeat corporate and financial issuers, the market is now a go-to for emerging market sovereigns.

In the second half of 2024, the Republic of Hungary, Mexico and Slovenia all hit the Samurai market in quick succession.

Mexico raised ¥152.2bn ($1.029bn) across five tranches, Slovenia took ¥45.1bn from three tranches, and Hungary bagged ¥39.6bn from a dual-tranche outing. In early October, Romania raised ¥33bn from a three-tranche debut green Samurai transaction.

The Indonesian sovereign also issued a Samurai in May, bagging ¥200bn from a seven-tranche outing.

Slovenia's deal was notable as the borrower had to adapt to a changing rates environment. It initially unveiled plans for a three, five, seven and 10 year tranche deal, but finally priced a three year and a five year, as that made sense from pricing and size perspectives.

Meanwhile, financial credits like Crédit Agricole, Deutsche Bank, KKR Group and Berkshire Hathaway have continued to be frequent Samurai issuers.

"It's a market with constant appeal," said a Hong Kong DCM banker. "Many issuers don't go to Samurai because of the costs, because they do have to pay a premium over their dollar or euro bonds — they go there for the relationships, the liquidity and the diversification they can get. It's also easier to return to the Samurai market after your first issuance because you will have a programme and documentation set up."

Financial firms have raised $12.26bn-equivalent from 39 Samurai bonds year to date, according to Dealogic data — more than the $11.1bn from 32 trades over the same period in 2023.

The pipeline is also strong, say bankers. At the time of writing, Warren Buffett's Berkshire Hathaway had mandated banks for its second Samurai of the year, having sold its largest ever yen deal, worth ¥263.3bn, in April.

Japan's SSAs steer bond plans through Bank of Japan and Fed rates volatility

Japan's top issuers have not had an easy year, due to volatile local and international markets caused by the Bank of Japan's and US Federal Reserve's different approaches to interest rates. Staying in touch with domestic and overseas investors and carefully timing bond deals has been critical, and will likely remain important in the year ahead.

In late September, *GlobalCapital* held a virtual roundtable with two of Japan's leading SSA issuers — the Development Bank of Japan and the Japan Finance Organization for Municipalities — to discuss the issuers' fundraising plans, their views on ESG-labelled issuance, and share tips on navigating the choppy rates environment.

***GlobalCapital*: Let's start by looking back at your funding plans so far this financial year. How have the past six months been for your global and domestic fundraising? And how have you navigated the volatile rates environment?**

Masataka Ishikiriyama, JFM: The interest rate environment has been very volatile this year, with changes from the US Federal Reserve and the European Central Bank, and with the Bank of Japan making its first rate hike in 17 years in July. But despite this environment, JFM's fundraising has been smooth and successfully conducted. Market volatility has been very high in this period, but for the size that we have been continuously issuing, investors have been putting in firm orders.

When it comes to JFM's direct approach, investor relations meetings have been carried out. Through these meetings, we were able to have close communication with investors. For example, in the first half alone, including web meetings, we held 130 meetings with investors, of which 100 were with domestic investors and the remaining with global investors — and we have received robust interest from them in these meetings.

Keisuke Nakayama, DBJ: For this fiscal year, we planned to raise a total of ¥1tr ($6.7bn) through the domestic and overseas bond markets. Considering the risks of changes in monetary policies in various countries, political situations, such as the US presidential election, and geopolitical risks, we were aiming for early bond issuance. In the first half of this fiscal year beginning in April 2024, our bonds progressed smoothly both domestically and internationally, with demand strong and stable.

From late July to early August, the stock and the bond markets fluctuated significantly and volatility increased sharply. We had planned to issue transition bonds for the first time by a Japanese financial institution during this period. Although the market environment became challenging, with many investors taking a risk-off approach, we managed to accumulate steady demand, including from ESG [environmental, social and governance] investors. Thanks to careful marketing, we successfully issued a ¥10bn transition bond.

***GlobalCapital*: The dollar and euro markets are clearly important offshore funding markets for Japanese borrowers. What was the currency split for your bond deals in the first half? And did that change versus previous years?**

Nakayama, DBJ: There was no change in our currency split in the first half of this financial year. Things went as planned with DBJ raising ¥335.9bn-equivalent from foreign currency bonds and ¥295bn from the domestic yen market.

Ishikiriyama, JFM: In the first half of this financial year, we sold one $1.5bn benchmark bond in the dollar market as part of our total ¥1.1tr fundraising plan this year.

***GlobalCapital*: What was your strategy around timing and pricing your deals given the volatile environment?**

Nakayama, DBJ: We have not changed anything special. We have been selling deals with the same maturities as always and listening to the voices of investors in the market as much as possible. But we are trying to come up with the appropriate pricings and spreads, in line with meticulous dialogue with investors. Regarding timing, at the beginning of April, we sold government guaranteed bonds, and after that, non-government guaranteed sustainability bonds in the summer, when market and geopolitical risks were contained. Therefore, as much

Roundtable participants

Keisuke Nakayama, director, division of financing, treasury department, Development Bank of Japan (DBJ)

Masataka Ishikiriyama, director, finance, finance department, Japan Finance Organization for Municipalities (JFM)

Moderator:
Rashmi Kumar, editorial consultant, *GlobalCapital*

as possible, we have been exploring deal times when market risk is the least.

GlobalCapital: When we last spoke in March, JFM's biggest challenges were the weakening yen and foreign exchange rates. How has the currency situation and your fundraising evolved since then?

Ishikiriyama, JFM: The last time this roundtable was held, the weakening of the yen was mentioned as one of the challenges for our fundraising. But since March through today, the yen has actually been getting stronger, although the yen forex rates have been fluctuating significantly. For our funding outside of Japan, we convert them into Japanese yen to on-lend the funds raised so the FX fluctuations continue to be one of the concerns. We will closely watch how the yen is going to fare, and find the right windows to issue foreign currency bonds.

GlobalCapital: What are your fundraising plans for the rest of the financial year?

Nakayama, DBJ: For this fiscal year ending in March 2025, we plan to issue a total of ¥550bn in domestic bonds and ¥450bn-equivalent in international bonds. Domestically, we have plans to sell Fiscal Investment and Loan Program agency bonds in October and January 2025, and we also plan to continue selling government guaranteed bonds.

Internationally, we regularly issue government guaranteed bonds denominated in dollars or euros, and non-government guaranteed bonds in dollars, euros and sterling. There are no plans to tap other currencies for the moment.

In the second half, we plan to sell dollar denominated government guaranteed bonds and sterling denominated non-government guaranteed bonds.

Ishikiriyama, JFM: For the full financial year, JFM plans to raise ¥1.973tr from the bond market. We have already raised ¥1.1tr, and the remainder will be raised in the second half through the issuance of domestic and international bonds.

Our funding plans are determined based on the needs of Japan's local municipal governments. So, this constrains how much bond issuance will account for under the local government finance plan. Towards the end of the year, we are going to formulate a plan based on the budget and estimate how much shall be funded from bonds in the next fiscal year, and coordinate with the relevant parties.

GlobalCapital: The Bank of Japan's July move to raise rates triggered plenty of financial market instability immediately after. What questions are investors asking you as a result — and how are you communicating with them effectively?

Ishikiriyama, JFM: Some investors asked us questions about the interest rate rise and the impact on our business and the risks it may bring. But when it comes to interest rate fluctuation, we have enough reserves in our hands, so there is no concern about the impact on the management of the business. So, when such questions were raised, this was our answer.

I also want to reiterate that as there is big interest rate volatility in Japan and overseas, through investor relations meetings, we kept close communication with investors so we can hear their voices and concerns carefully. We have held some 130 IR meetings in the past year so we continue keeping our communication channels open.

Nakayama, DBJ: Regarding the Bank of Japan's interest rate hike, we have not received any direct questions from investors in the domestic market. But overseas market investors have asked about the impact of the rate hike in Japan, on our business and on the business of our clients. We are carefully addressing these questions. We have taken appropriate control measures in accordance with our bank's policy, so we currently do not anticipate a particular market risk that may have a significant adverse impact on our financial performance or bond issuance plan. We will continue to monitor the outlook for interest rates.

Since the Covid-19 pandemic ended, we have been increasing our face-to-face investor activity, in addition to web and call meetings. We plan to continue engaging with investors through marketing activities, deal roadshows and non-deal roadshows.

GlobalCapital: Let's talk a bit about the important topic of ESG. How has investor interest changed on the back of the Japanese government's transition bond? What are your expectations for growth of this market?

Ishikiriyama, JFM: This fiscal year, we held overseas investor relations meetings about issuing ESG bonds. We received multiple questions which shows that overseas investors are strongly and increasingly interested in ESG themes. Against this backdrop, the Japanese government's sale of the ESG bonds was really favourable. As a result, we expect the issuance amount related to ESG debt in Japan to grow.

Nakayama, DBJ: The overseas market appears to be gradually becoming more aware of the Japanese government's Green Transformation (GX) Policy. At DBJ, we have implemented our GRIT strategy as part of our midterm management plan. 'G' is for green, 'R' is for resilience and recovery, 'I' is for innovation, and 'T' is for transition and transformation. Through this, we are focusing on supporting our clients' green and transition journeys. Investors have started to ask us about the alignment between the Japanese government's GX policy and our GRIT initiatives. We believe that both green and transition approaches are needed for achieving decarbonisation in society, and we expect an increase in these projects and an expansion of the ESG bond market that supports them. We will also continue to support such ESG initiatives.

GlobalCapital: There have been criticisms about Japan's GX policy and transition pathway as it's unique to the country. What are your thoughts on that and whether this approach is something that can be sustainable and replicated by other countries?

Nakayama, DBJ: I am aware that investors have various views on the

"... we have to increasingly address challenges around determining the size of our ESG issuance, and how we use the ESG bond proceeds appropriately"

Masataka Ishikiriyama, Japan Finance Organization for Municipalities (JFM)

pathway to carbon neutrality undertaken by the government or through policies, and ways of thinking about transition. But even though the time horizon might be different, as I mentioned earlier, I believe that both green [policies] and transition are effective and realistic for achieving carbon neutrality. I hope that this understanding will spread to the market globally.

Ishikiriyama, JFM: It is difficult to comment on the policymaking or approaches of Japan as a whole, but at JFM we are committed to providing funding to local governments through the issuance of domestic and international green bonds, as well as promoting the initiatives of local governments related to ESG.

GlobalCapital: How much of your bond fundraising is ESG labelled?

Ishikiriyama, JFM: For us, the plan is to raise ¥1.97tr from bonds this fiscal year. We started this fiscal year with a plan to raise domestic green bonds in the amount of ¥20bn. But in the first half, we have already exceeded that amount to reach ¥21bn. In the second half, we expect to see continued interest from investors, so we believe JFM will be able to issue another ¥10bn of green bonds. This is the magnitude we are considering now. Outside of Japan, we started printing green bonds in 2020. Last fiscal year, we issued €500m through international green bonds, and we plan to raise a similar amount through international green bonds this fiscal year as well.

Nakayama, DBJ: This fiscal year, in the domestic market, we issued a ¥10bn transition bond. We aim to contribute to decarbonisation as a whole and to invigorate the domestic transition finance market by expanding the funding capacity to meet the growing demand for transition projects. In the international market, we continue to issue sustainability bonds. As highlighted in our Policy on Sustainability, we aim to resolve the issues of our customers and the larger society and realize the sustainable development of Japan and the world. We believe that the issuance of sustainability bonds supports the advancement of sustainable businesses. From a funding perspective, the issuance of ESG bonds helps diversify and expand our investor base, including overseas and ESG investors.

GlobalCapital: What kind of investor response and pricing benefits have you seen for your ESG deals?

"There are still a lot of unknowns around what's going to happen to rates and the market environment. We aim to remain focused on monitoring those..."

Keisuke Nakayama, Development Bank of Japan (DBJ)

Ishikiriyama, JFM: At our institution, we started selling ESG bonds in 2020, first in the international market. An Impact Report related to international green bonds has been published, and been well received by international investors. That is the feedback we have received so far. When it comes to the purpose or use of our green bonds, it has been limited to specific projects and has been very clear-cut, which investors also like. There has always been enough demand from investors for our ESG labelled bonds.

Nakayama, DBJ: DBJ sold the very first green bond by a Japanese issuer, and this is the 11th consecutive year for our ESG labelled issuance. Our support for the market has become well recognised among international investors and we have seen stable demand for each of our deals.

GlobalCapital: What are some of the challenges you face in issuing ESG bonds, be it around communication, reporting requirements, costs for third-party opinion or other factors?

Ishikiriyama, JFM: One of the challenges for us is creating the impact report. How can we provide feedback that meets the needs of investors? This is one of the challenges, especially as our funds go to support Japan's local municipalities. We conduct a questionnaire survey of the local governments, and based on that, we create our impact report. Thanks to the support from local municipalities as to the effect of their work on environmental improvements, we have been able to disclose our progress proactively. Moving forward, we have to increasingly address challenges around determining the size of our ESG issuance, and how we use the ESG bond proceeds appropriately.

Nakayama, DBJ: We have been issuing ESG bonds for 11 years. Over the years, we have engaged with international investors and seen the practices around ESG themes as they evolve. We are aware that different investors have different perspectives and areas of interest when it comes to ESG. Through our dialogue with them, we receive various questions, opinions and feedback. These include requests for more detailed reporting and expanded ESG disclosures. We also feel that the framework of ESG itself has evolved based on market changes. We hope to continue refining these efforts while maintaining appropriate communication with our investors and ratings agencies, considering the trends in ESG.

GlobalCapital: Broadly, what are you most optimistic about in the year ahead, and what are you most worried about?

Ishikiriyama, JFM: JFM is also supported by municipalities as investors. The local government tax revenue has been favourable, so despite the fact that the market is volatile, we are supported by significant investment money from municipalities. We anticipate that to continue to a certain extent, so we expect to achieve stable funding going forward.

My concerns are about the global economic outlook. In March, there was a trend of depreciation of the yen, and the yen forex volatility directly impacts our procurement of foreign bonds, or the issuance of foreign bonds. We have to carefully watch the forex market to ensure we can have a stable issuance window.

Nakayama, DBJ: Looking forward to the next year, there is little to be optimistic about. In addition to the factors and risks around the economic outlook, monetary policy, political situation and geopolitical risks, we have also experienced risk scenarios materialising in the market environment from the end of July to early August. Internationally, we have had successful deals at favourable timing so far, so we hope to maintain this momentum. There are still a lot of unknowns around what's going to happen to rates and the market environment. We aim to remain focused on monitoring those and continue our funding efforts. GC

Japan's bold bet on transition bonds offers new pathway for the world

Japan's landmark sovereign climate transition bonds have made it a frontrunner in global efforts to achieve net zero and — despite criticisms — offer a much-needed template for other countries pondering their own transition frameworks. **Rashmi Kumar** reports.

The transition to a net-zero world, in order to stave off the worst effects of global warming, is not easy. The United Nations has described it as one of the greatest challenges facing humankind. But Japan's unique take on transition financing might be a model for other countries to follow, especially in Asia.

While many economies, both in Asia and the West, have focused on adopting green taxonomies to include elements of transition financing, Japan has gone in a different direction. It is directly providing technological guidance with a range of potential transition pathways, which have been specifically developed for its own economy and the challenges it faces.

Japan's Ministry of Economy, Trade and Industry (METI), is driving the move, having established the Green Transformation (GX) policy, along with the Ministry of Finance (MoF), to meet the market's long-term growth and energy security objectives.

Importantly, the programme includes a ¥150tr ($1.04tr) package of long-term public-private financing to be raised over the next 10 years, of which ¥20tr will come from the sale of sovereign climate transition bonds by the MoF.

Japan made its first landmark outing early this year, raising ¥800bn on February 14 from a 10 year climate transition bond, followed by another ¥800bn five year priced on February 27. These were the world's first sovereign climate transition bonds.

Then in May, it raised about ¥350bn from a 1% 10 year, and in July another ¥350bn from a 0.5% five year. It is slated to raise a further ¥350bn from its next 10 year auction in late October, and the same amount from a five year tranche in January 2025.

The deals have put Japan on the ESG map, making it a pioneer in transition financing. But its GX strategy was not without its critics — particularly for including natural gas and nuclear power as part of the energy decarbonisation approach, and including emerging technologies like ammonia co-firing for coal plants and fossil fuel phase-out strategies.

"What has been a challenge is that the international market is still working out what transition means," says Tokyo-based Jason Mortimer, head of sustainable investment, fixed income, global solutions, investment department, at Nomura Asset Management. "We're all talking about transition finance, but different people have different meanings for it."

Different strokes

Mortimer adds that, in Japan, the focus is on hard-to-abate sectors that do not have a clear-cut net-zero pathway, as well as relatively untested technologies, to help with the transition.

This resonates well with other markets across Asia and in southeast Asia in particular, where countries are grappling with similar problems, given their long reliance on heavy industry, combined with a lack of access to sufficient financial and technological resources to navigate transition.

"Asia is getting there in terms of accepting the need for transition, but the global market is still hesitant because there is no agreed standard for it," says Mortimer. "If an investor buys something that is brown but with scope for transition, their brown-green ratio still goes in the wrong direction. That is holding investors back from aggressively participating in these kinds of bonds."

"Decarbonising the Japanese power and industrial sectors remains crucial to ensuring Japan achieves real-world decarbonisation, whilst balancing just and equitable considerations. We provided feedback around several specific areas including ammonia co-firing in coal plants. We were encouraged when the inaugural issuance took on board these considerations"

Tongai Kunorubwe, T Rowe Price

As a result, international investor interest for Japan's maiden climate bonds was only modest — despite METI and the MoF engaging with investors on global roadshows — with domestic investors driving the deal.

Market sources say this was partially expected, as foreign investors hold only a small portion of conventional Japanese government bonds overall.

But that's not to say international investors are not supportive of Japan's ambitions.

Tongai Kunorubwe, head of environmental, social, and governance in the fixed income division at T Rowe Price in London, says his team "welcomed the basic premise that sat behind GX".

"This is not least because decarbonising the Japanese power and industrial sectors remains crucial to ensuring Japan achieves real-world decarbonisation, whilst balancing just and equitable considerations," says Kunorubwe. "Additionally, at the time, we provided feedback around several specific areas including ammonia co-firing in coal plants. We were encouraged when the inaugural issuance took on board these considerations."

Mortimer adds: "We're starting to hear the government really emphasise now that this is a growth strategy, and this is what we need to do to fund carbon pricing and fund the R&D to create different technologies. Some of them are not going to work out in every single situation and there is some risk here, but this is the way we can transition from brown to green."

Big opportunities

The path ahead is not going to be easy, especially as the transition finance market is still nascent.

Despite the world's first transition bond coming in mid-2017 — through Castle Peak Power Finance Co, a subsidiary of a Hong Kong electric power company — and the International Capital Market Association publishing its climate transition finance handbook in December 2020, issuance has been limited.

In a note published in September, Akane Enatsu, head of the Nomura Research Centre of Sustainability, says that the total outstanding amount of transition bonds from Japanese issuers stood at $19bn at the end of June 2024 — accounting for 68% of the total global issuance of $28bn.

"What investors want to see is an ecosystem of corporate issuers so we can create a diversified portfolio out of this. If you ask an issuer now if they want to do a green or transition bond, they would probably say green because it's more standardised and less risky. I think the market needs more incentives to really go all in on transition finance"

Jason Mortimer, Nomura Asset Management

This shows that the transition market has not yet taken off strongly outside Japan, where issuers have tended to favour sustainability-linked bonds that are earmarked for general corporate purposes but that come with performance targets that need to be met to avail of any pricing benefit.

But to take Japan's transition market further, corporates need to jump on the bandwagon.

The government is now the largest issuer of transition bonds in the country. Other issuers include companies with high greenhouse gas emissions, from sectors like electric power, gas and oil refining.

Japanese groups had raised $2.2bn-equivalent through 14 transition bonds between January 1 and September 24, shows Dealogic. This compares to $1.4bn-equivalent from seven deals and $2.5bn-equivalent from 12 bonds in the same period in 2023 and 2022 respectively.

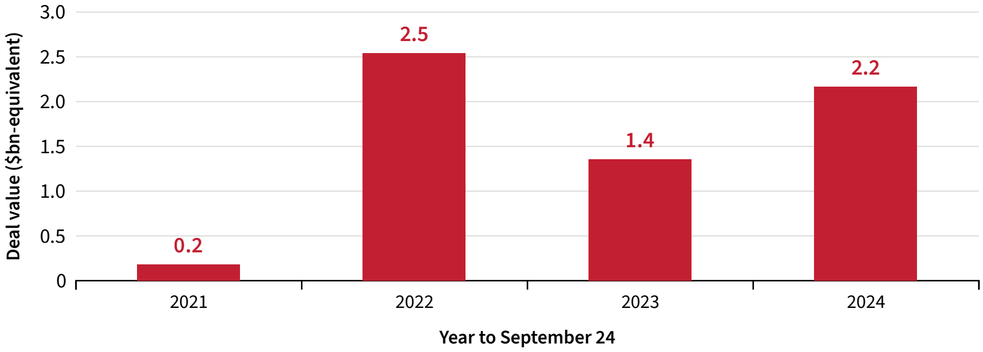
This year's deals include a ¥30bn dual-trancher from Mitsubishi Heavy Industries in August, a ¥30bn note from Mazda Motor Corp in July, a ¥45bn issue from Kansai Electric Power Co also in July, and other deals from JFE Holdings, Kyushu Electric Power Co, Osaka Gas, Chugoku Electric Power Co, Japan Airlines, Mitsubishi Materials Corp, NYK Line and Jera Co, according to Dealogic.

"What investors want to see is an ecosystem of corporate issuers so we can create a diversified portfolio out of this," says Mortimer. "If you ask an issuer now if they want to do a green or transition bond, they would probably say green because it's more standardised and less risky. I think the market needs more incentives to really go all in on transition finance."

He adds: "Pledges are good to have but having a descriptive plan that investors can look at and that companies produce about their transition, that will create an ecosystem of data disclosures and pricing will become healthier off the back of that. And then the market will have a deeper understanding of why transition is important."

Communication would be key to get the market really rolling,

Japanese transition bond issuance volumes



Excludes the sovereign's transition bonds

© Dealogic 2024

especially if issuers continue to tailor bonds that best serve their transition needs.

For instance, for Japan, energy sustainability and affordability are priorities, which is why it included natural gas and nuclear power within its decarbonisation approach, despite criticism from international investors.

A Singapore-based DCM banker focused on sustainability says the market "needs to recognise" that Japan and other countries in Asia will need to build their own transition finance frameworks based on their national circumstances. "There's no one fixed template, but rather a trial-and-error process," he says.

What's next?

Kunorubwe says there seems to be growing demand for blue bonds in Japan, following the Republic of Indonesia's repeat sovereign blue bond in the Samurai market in May.

Indonesia raised ¥200bn from its deal, split between three, five, seven, 10 and 20 year tenors.

A DCM banker in Tokyo says the blue bond concept makes sense for Japan, as it is the world's fourth-largest island nation. But he reckons there may be limited interest in new labels for the time being, given that interest rates in Japan are rising and overall corporate bond issuance has shrunk, compared to past years.

"The concept of blue bonds resonates more than some other labels, but it may be a challenge to get this off the ground at this point in time," says the DCM banker.

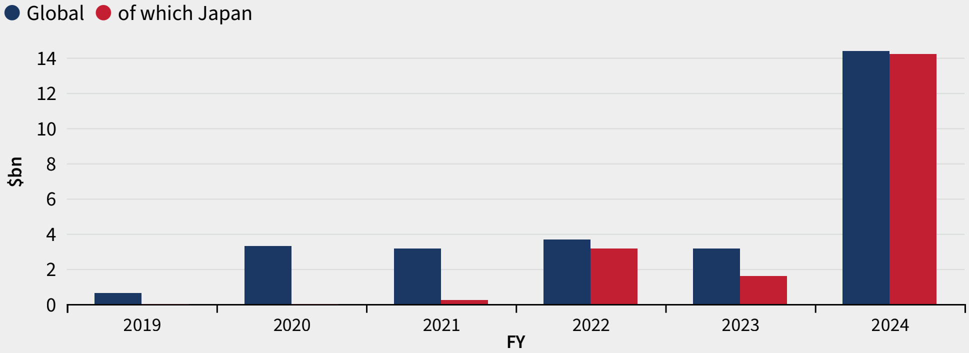
On the other hand, the transition journey will evolve as more ESG ratings providers and data providers find ways to include transition in their credit assessments and scorings.

"It's going to be really necessary for us to move transition finance forward because the green finance market faces challenges due to political pushback and real economy constraints," says Mortimer. "Transition bonds need to be part of the overall conversation around energy security and energy costs and Japan's sector pathway is a good model, especially for other Asian countries."

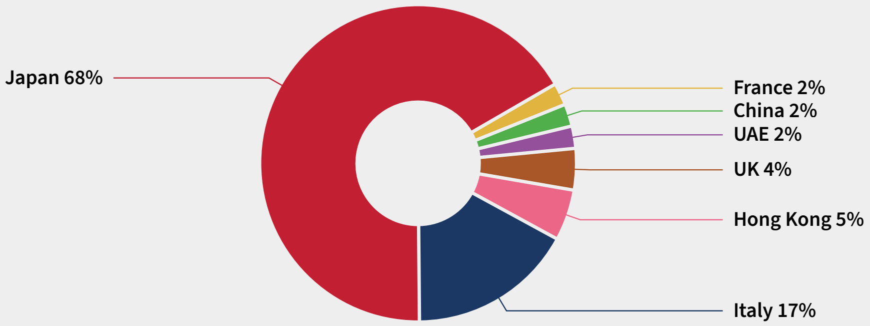
The global market for transition bonds may still be in its infancy, but the hope is that Japan's efforts could serve as a catalyst for growth — both at home and abroad. GC

Issuance of transition bonds

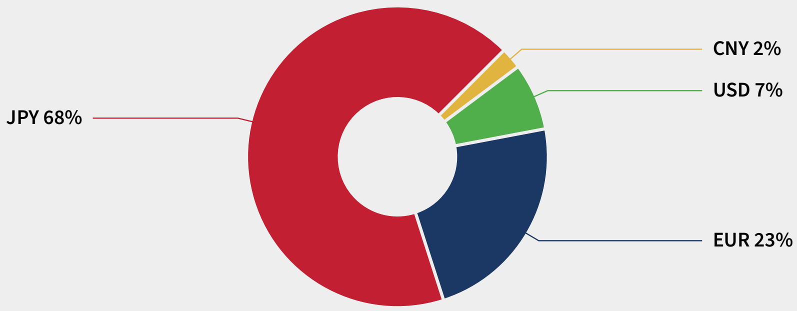
Issuance volumes



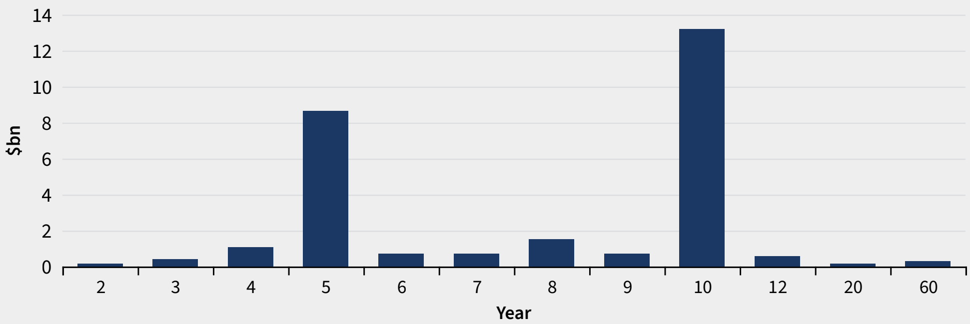
Outstanding by country/region



Outstanding by currency of denomination (global)



Outstanding length of maturity at issuance (global)



Note: GX Economy Transition Bonds are a type of Japanese government bond to be redeemed by FY2050 using fossil fuels levies and specific business operator contributions. GX Economic Transition Bonds can be issued separately under the name CT government bonds. Another option is to issue them as ordinary government bonds.

Source: Nomura