

Japan

Rating report

Rating rationale

Wealthy, diversified and sophisticated economy: Japan benefits from its high wealth levels as well as its diversified and competitive economy, supported by a high-tech economy and the presence of highly-innovative firms. These act as crucial supports for Japan's investment-grade credit ratings.

Strong profile of sovereign debt and an independent monetary policy: Japan benefits from very-strong funding flexibility and very-low rates, a very-significant domestic investor base, significant government assets, and continued market intervention from the accommodative policy of the Bank of Japan (BoJ) under an independent monetary policy, significantly reducing risks from comparatively weak long-run fiscal fundamentals and very-elevated public debt.

A robust external position and reserve currency: Japan's status as the world's leading external creditor reflects its structural current-account surpluses, high domestic savings, alongside a sophisticated domestic banking system. This, combined with low gross external debt and global safe-haven and reserve-currency status, significantly reduces vulnerability to external crises and risks concerning external-debt sustainability.

Ratings challenges: i) elevated gross government debt – the highest ratio to GDP within Scope's rated sovereign universe – reflecting a material risk over the very long run; ii) the country's comparatively low nominal growth potential – linking to a rapidly-shrinking and ageing population alongside an historical record of deflation; and iii) rising pension and healthcare-related costs.

Figure 1: Japan's sovereign rating drivers

Risk pillars	Quantitative		Reserve currency*	Political risk**	Qualitative***	Final rating
	Weight	Indicative rating	Notches	Notches	Notches	
Domestic economic risk	35%	aaa	JPY	Japan	- 1/3	A
Public finance risk	20%	b-			- 1/3	
External economic risk	10%	aaa			2/3	
Financial stability risk	10%	bb+			- 1/3	
ESG risk	Environmental factors	5%	[+1]	[-0]	- 1/3	
	Social factors	7.5%			0	
	Governance factors	12.5%	aaa			
Sovereign Quantitative Model			a+		-1	
Additional considerations					0	

*The reserve-currency quantitative adjustment applies to currencies in the IMF's Special Drawing Rights (SDR) basket. **The political-risk quantitative adjustment is based on the World Bank's Political Stability & Absence of Violence/Terrorism index. ***The qualitative scorecard analyst adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. For details, please see Scope's [Sovereign Rating Methodology](#). Source: Scope Ratings.

Foreign currency

Long-term issuer rating/Outlook

A/Stable

Senior unsecured debt

A/Stable

Short-term issuer rating/Outlook

S-1/Stable

Local currency

Long-term issuer rating/Outlook

A/Stable

Senior unsecured debt

A/Stable

Short-term issuer rating/Outlook

S-1/Stable

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Credit strengths and challenges

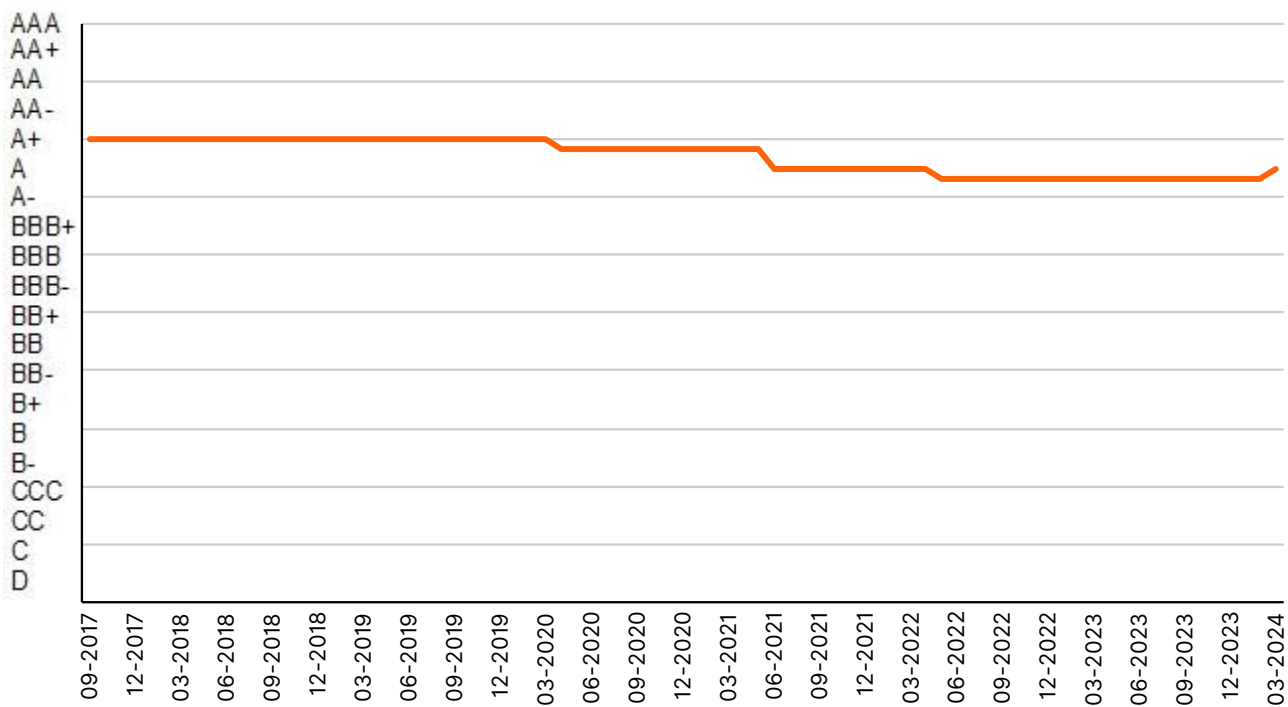
Credit strengths	Credit challenges
<ul style="list-style-type: none"> • Wealthy, competitive and diversified economy • Strong funding flexibility, very-low rates, debt monetisation • Robust external position and yen as reserve currency 	<ul style="list-style-type: none"> • Very-high public-debt stock • Comparatively low nominal-growth potential • Rising pension and healthcare-related costs

Outlook and rating triggers

The Stable Outlook reflects Scope’s view that risks to the ratings are balanced.

Positive rating-change drivers	Negative rating-change drivers
<ul style="list-style-type: none"> • Debt-to-GDP declines, supported by higher nominal economic growth and/or fiscal-consolidation steps • Achievement of stronger sustainable economic growth, such as achievement of sustainable 2% inflation and/or dividends from growth-enhancing structural reforms 	<ul style="list-style-type: none"> • Debt sustainability weakens significantly, such as expectations of a material rise of debt-to-GDP or significant rise of the interest-payment burden • The government sees unexpected significant reduction in its funding flexibility and/or weakening of yen’s reserve-currency status

Figure 2: Rating history¹



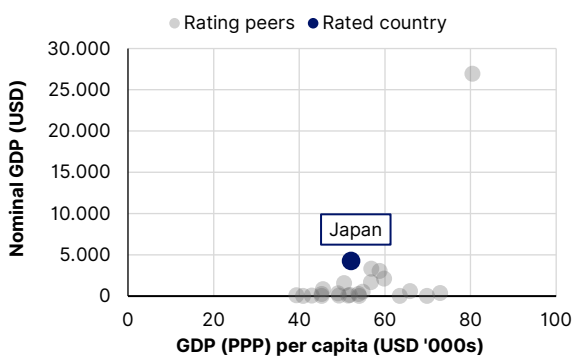
¹Foreign-currency long-term issuer rating. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment. Source: Scope Ratings.

Domestic economic risk

Overview of Scope's assessments of Japan's Domestic Economic Risk

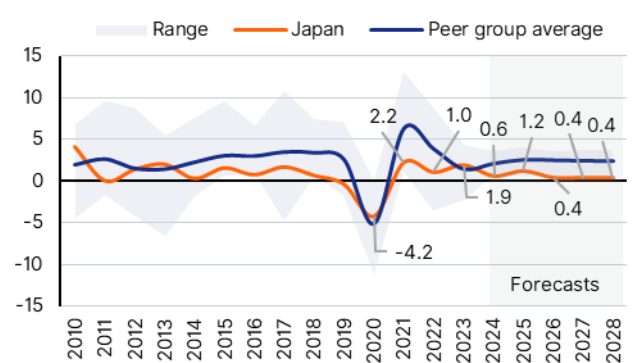
SQM* indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Growth potential and outlook	Weak	-1/3	Comparatively-low growth potential despite ongoing structural reforms; shrinking population and workforce presents challenges
	Monetary policy framework	Neutral	0	BoJ is a leading global central bank; the ultra-accommodative policy has kept rates exceptionally low and monetised half of government debt; independent monetary policy; failure historically to meet inflation objective
	Macroeconomic stability and sustainability	Neutral	0	Large, competitive and diversified economy; high-tech, innovative and export-oriented economy

Figure 3: Nominal GDP and GDP per capita



Source: IMF World Economic Outlook (WEO), Scope Ratings

Figure 4: Real GDP growth, %



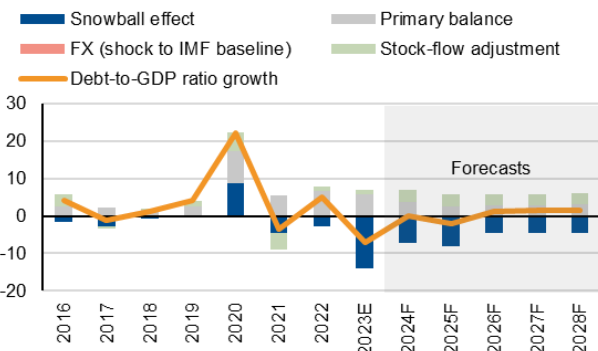
Source: IMF WEO, Scope Ratings forecasts

Public finance risk

Overview of Scope's assessments of Japan's Public Finance Risk

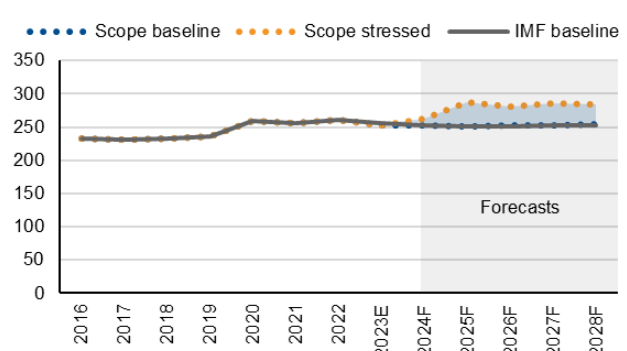
SQM indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
b-	Fiscal policy framework	Weak	-1/3	Persistent fiscal deficits exacerbated by ageing population and associated shrinking tax base; ongoing efforts at fiscal consolidation
	Long-term debt trajectory	Weak	-1/3	Very-high debt ratio poses sustainability challenges over very long run
	Debt profile and market access	Strong	+1/3	Excellent market access and very-low rates, smooth redemption profile but elevated financing requirements, large domestic investor base, debt all denominated in yen, monetisation of debt by central bank, world's largest creditor

Figure 5: Contributions to change in debt levels, pps of GDP



Source: IMF WEO, Scope Ratings forecasts

Figure 6: Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

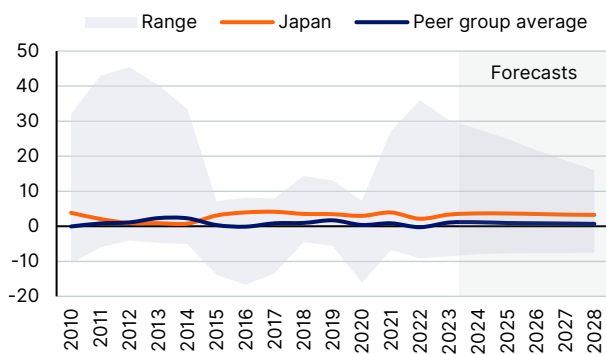
*Sovereign Quantitative Model.

External economic risk

Overview of Scope's assessments of Japan's External Economic Risk

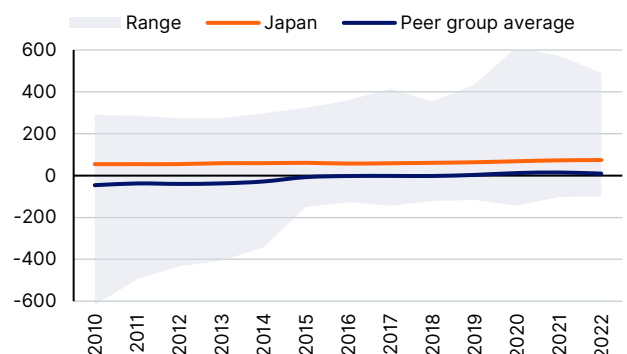
SQM indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Current account resilience	Strong	+1/3	Record of current-account surpluses supported by diversified export base and significant external-creditor position
	External debt structure	Neutral	0	Moderate external-debt stock; significant share of short-term external liabilities
	Resilience to short-term external shocks	Strong	+1/3	Reserve-currency status of yen, large FX reserves and strong net external creditor position

Figure 7: Current-account balance, % of GDP



Source: IMF WEO forecasts, Scope Ratings

Figure 8: Net international investment position (NIIP), % GDP



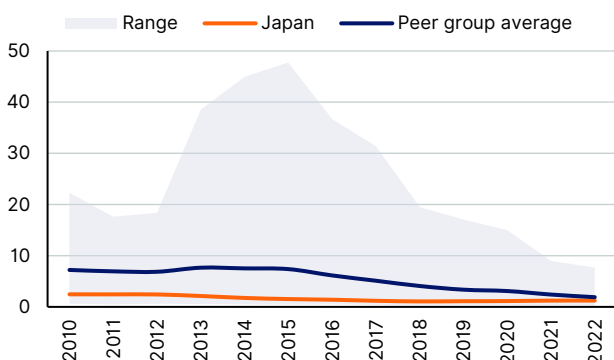
Source: IMF, Scope Ratings

Financial stability risk

Overview of Scope's assessments of Japan's Financial Stability Risk

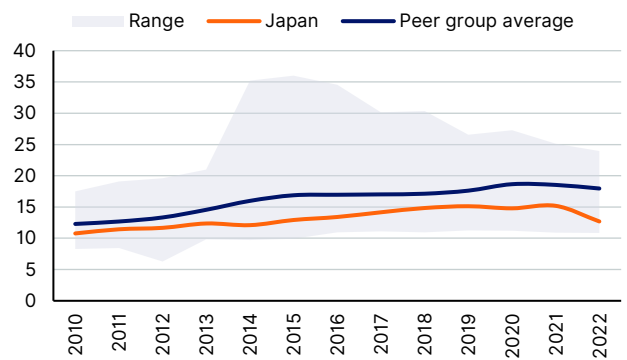
SQM indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb+	Banking sector performance	Weak	-1/3	Banking-system profitability challenges but era of negative rates has recently ended; low NPLs; comparatively low tier-1 ratio; significant liquidity
	Financial sector oversight and governance	Neutral	0	Strong oversight frameworks under BoJ and Financial Services Agency
	Financial imbalances	Neutral	0	Moderate levels of private-sector debt

Figure 9: Non-performing loans (NPLs), % of total loans



Source: World Bank (WB), Scope Ratings

Figure 10: Tier 1 capital, % of risk-weighted assets



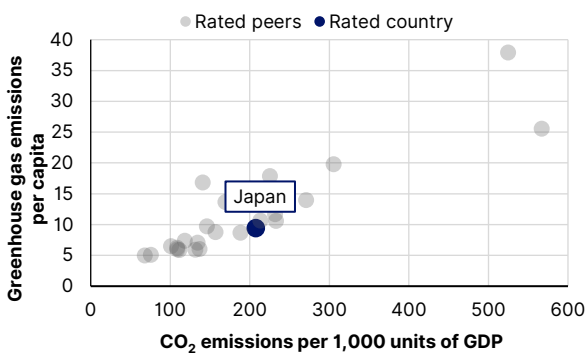
Source: IMF, Scope Ratings

Environmental, Social and Governance (ESG) risk

Overview of Scope's assessments of Japan's ESG Risk

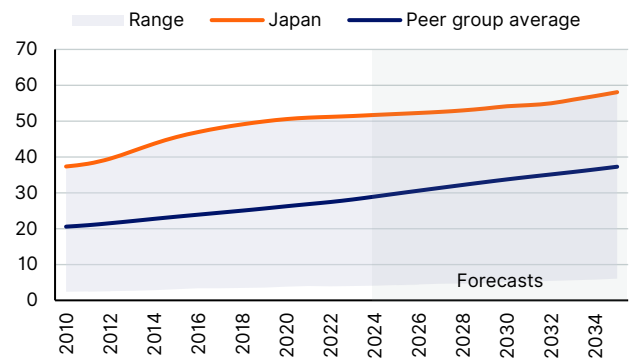
SQM indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a	Environmental factors	Weak	-1/3	High exposure to natural-disaster risk; constraints in natural-resource endowments
	Social factors	Neutral	0	Low inequality, strong social-insurance system; adverse demographics pressure social-care systems; very strong health metrics; deteriorating social conditions of the elderly
	Governance factors	Neutral	0	High-quality democratic institutions although historical government instability; declining polling for ruling Liberal Democratic Party

Figure 11: CO₂ emissions per GDP, mtCO₂e



Source: European Commission (EC), Scope Ratings

Figure 12: Old-age dependency ratio, %



Source: United Nations (UN), Scope Ratings

Reserve-currency adjustment

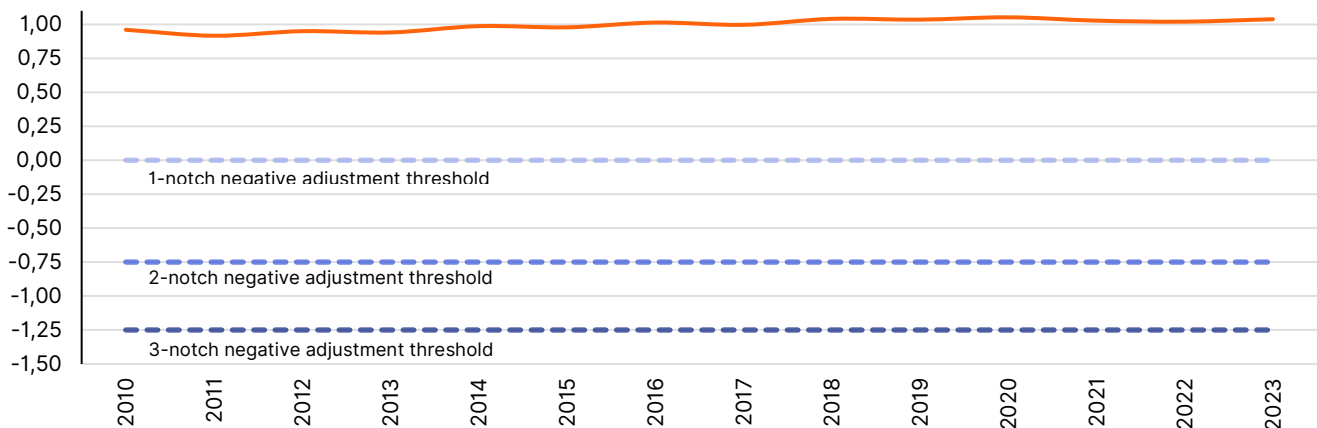
Figure 13: IMF SDR basket and Scope reserve-currency adjustment

Currency	U.S. dollar	Euro	Chinese yuan	Japanese yen	Pound sterling	Other
IMF SDR basket weights, %	43.4	29.3	12.3	7.6	7.4	0.0
Positive adjustment, notches	3	1	1	1	1	0

Source: IMF, Scope Ratings

Political-risk adjustment

Figure 14: WB Political Stability & Absence of Violence/Terrorism index, Japan, 3-year moving average



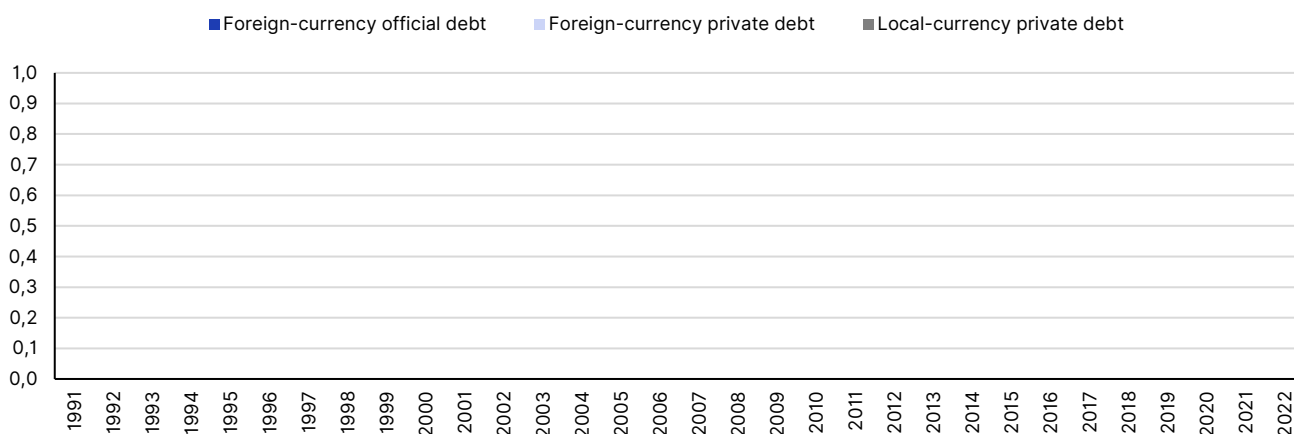
Source: WB, Scope Ratings

Additional considerations

No adjustment was applied to the rating from additional considerations.

Appendix I. Sovereign default history

Figure 15: Sovereign default history, USD m



Depicted private-debt defaults may not always constitute a credit event under [Scope's credit-rating definitions](#).
 Source: [Bank of Canada-Bank of England Sovereign Default Database](#), Scope Ratings.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or adjacent categories, as assigned by Scope's sovereign quantitative model after accounting for methodological reserve-currency and political-risk adjustments.

Peer group*	
Belgium	Malta
Croatia	Poland
Cyprus	Portugal
Czech Republic	Slovenia
Estonia	Spain
France	United Kingdom
Latvia	United States
Lithuania	

*Publicly-rated sovereigns only; the full sample of sovereign-rating peers may be larger.

Appendix III. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bp) as of 21 March 2024	20.6

Appendix IV. Statistical table for selected SQM indicators

This table presents a selection of the indicators (24 out of 30 – with the governance indicator reflecting a composite of five indicators) used in Scope's quantitative model, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global country peers and may therefore differ from data from national and other select international statistical series.

Pillar	Core variable	Source	2018	2019	2020	2021	2022	2023
Domestic Economic	GDP per capita (PPP), USD '000s	IMF	42.8	43.4	42.3	45.3	49.1	52.1
	Nominal GDP, USD bn	IMF	5,041	5,118	5,051	5,012	4,238	4,231
	Real growth, %	IMF	0.6	-0.4	-4.2	2.2	1.0	2.0
	CPI inflation, %	IMF	1.0	0.5	0.0	-0.2	2.5	3.2
	Unemployment rate, %	WB	2.5	2.4	2.8	2.8	2.6	-
Public Finance	Public debt, % of GDP	IMF	232.4	236.4	258.6	255.1	260.1	255.2
	Net interest payment, % of government revenue	IMF	2.3	2.0	1.8	1.6	0.9	0.4
	Primary balance, % of GDP	IMF	-1.7	-2.4	-8.4	-5.6	-6.5	-5.5
External Economic	Current-account balance, % of GDP	IMF	3.5	3.4	3.0	3.9	2.1	3.3
	Total reserves, months of imports	WB	14.7	15.4	18.5	16.1	12.4	-
	NIIP, % of GDP	IMF	61.1	63.9	68.7	73.0	74.5	-
Financial Stability	NPL ratio, % of total loans	IMF	1.1	1.1	1.1	1.2	1.2	-
	Tier 1 ratio, % of risk-weighted assets	IMF	14.9	15.1	14.3	14.6	13.8	13.4
	Credit to the private sector, % of GDP	WB	167.3	175.4	193.7	194.9	196.1	24.1
ESG	CO ₂ per EUR 1,000 of GDP, mtCO ₂ e	EC	220.3	213.8	210.5	208.6	207.8	-
	Income share of bottom 50%, %	WID	16.2	16.2	16.2	16.2	16.2	-
	Labour-force participation rate, %	WB	79.5	80.2	80.3	80.6	-	-
	Old-age dependency ratio, %	UN	49.1	49.9	50.6	51.0	51.2	51.4
	Composite governance indicators*	WB	1.4	1.3	1.4	1.4	1.4	-
	Political stability, index	WB	1.0	1.0	1.0	1.0	1.1	-

*Average of the following five World Bank Worldwide Governance Indicators: *Control of Corruption, Voice and Accountability, Rule of Law, Government Effectiveness, Regulatory Quality*.

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