S&P Global Ratings

RatingsDirect®

Tokyo Metropolitan Government

October 18, 2023

This report does not constitute a rating action.

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Credit Highlights

Overview

Credit context and assumptions	Base-case expectations
Strong tax revenue base as the economic center of Japan	High level of tax revenue supported by moderate domestic economic growth
Fiscal discipline evident in strong record of revenue and expenditure management	Continued moderate decrease in debt, led by positive fiscal balance
Sovereign rating constrains Japan's local and regional governments (LRGs)	Exceptional liquidity as reserves accumulate and debt declines

S&P Global Ratings believes Tokyo Metropolitan Government's (TMG) fiscal balance will remain positive for the next two years despite a likely increase in expenditure on priorities. We expect TMG's expenditure to rise because it has been proceeding with sustainability measures related to matters such as a falling birthrate and strengthening urban infrastructure under inflation. Nevertheless, we anticipate TMG's fiscal surplus after capital accounts will remain slightly positive, as its tax revenue will remain high. We base this on our assumption that the domestic economy will continue to grow moderately for the next two years.

We forecast TMG's debt will continue to decline moderately. We hold this view because TMG will likely maintain flexible financial management by striking a balance between securing reserves and fundraising through bond issuance, while it will likely continue an expansionary fiscal policy supported by a high level of tax revenue. We also expect TMG's interest burden is unlikely to increase considerably over the next two years, even in a rising rate environment. We base this on progress in its debt reduction, diversification of bond maturities, funding at fixed interest rates, and the comparison with past funding rates.

Our long-term sovereign rating on Japan will continue to cap that on TMG. We assess the stand-alone credit profile (SACP) for TMG as 'aa+', which exceeds our long-term rating on Japan (unsolicited; A+/Stable/A-1). However, our long-term rating on TMG is the same as that on Japan. This is because we believe a stress scenario in which the sovereign defaults would strongly affect TMG's creditworthiness.

Outlook

The stable outlook on TMG reflects that on our long-term sovereign credit rating on Japan. We believe the SACP for TMG will remain as 'aa+'. TMG does not rely on the central government's vertical fiscal adjustment system. But it is not immune to the overall impact of deteriorating economic conditions and market confidence at a national level. Therefore, our long-term rating and outlook on the Japan sovereign constrain those on TMG.

Downside scenario

In the next two years, we would more likely lower our long-term rating on TMG if we were to take a negative rating action on Japan, rather than because of a downward revision of our SACP on TMG. We do not envisage a downside scenario under which the SACP would weaken enough to cause us to change the rating.

A combination of adverse scenarios, such as deterioration of local economic activities associated with a global economic slowdown and central government revisions to tax law that materially reduce TMG's revenue, may substantially hurt TMG's budget balances, reduce its reserves, and increase its debt. Under such circumstances, we anticipate TMG's management team would maintain a strong commitment to fiscal discipline and adjust annual budget balances and make other moves to alleviate pressures on its creditworthiness.

Upside scenario

An upward scenario for the rating over the next two years would depend on any upward movement in the sovereign rating.

Rationale

Flexible fiscal management under a very wealthy economy as Japan's capital

We view TMG's economy as the key strength for the rating. TMG is at the heart of Japan's economy and attracts widespread economic, political, and other value-added activities that support diverse job opportunities in a variety of industries, along with high residential income. We estimate TMG's GDP per capita is above ¥8 million, which is large among Japanese and global LRGs.

We anticipate the local economy will perform mostly in line with the national economy. Moderate growth in the domestic economy will continue, in our view. Our macroeconomic outlook is for Japan to have real GDP growth of 1.8% in 2023 and 1.0% in 2024. We expect a continuing moderate pace of population inflow to the capital in tandem with full resumption of economic and social activities. However, we think TMG's population could peak at its present level because of natural attrition of Japan's population.

In our view, TMG's flexible financial management will likely continue, while expenditure on priorities will likely increase. Under the leadership of Governor Yuriko Koike, TGM has been making active use of reserves and striving to secure financial resources through project reviews. The TMG treasury team's record leads us to think it will maintain sufficient control to preserve disciplined financial management.

In addition, we think TMG has a good record of revenue and expenditure management, prudent debt and liquidity policies, and strong supervision of government-related entities (GREs). Offsetting these strengths are the city's constrained political and managerial capabilities. We continue to view these as weaknesses because no party has a majority in the local assembly and the governor's initiatives do not always win support. Nevertheless, we believe the main strength of the city's management is its long record of fiscal consolidation regardless of the balance of power.

We think the institutional framework of Japan's LRGs will remain very predictable and well-balanced. Japan has a mature intergovernmental system, and the central government's strict control of regulations and budgets for LRGs ensures the system's predictability, transparency, and accountability. We view fiscal conditions of Japanese LRG sector as stable, considering the strong support mechanism from the central government to LRGs as observed in the COVID-19 pandemic, while the central government's fiscal position is weak.

Debt continues to decrease moderately thanks to a fiscal surplus even amid inflation, backed by a high level of tax revenue

We forecast TMG's balance after capital accounts will remain slightly positive over the next two years. We expect TMG's tax revenue to remain high even compared with pre-pandemic levels. Factors supporting this are strong corporate-related tax revenue, robust employment and property prices, and higher local consumption tax revenue because of recovery of economic and social activities. On the other hand, TMG's expenditure is likely to rise somewhat because part of the increase in tax revenue will flow into fiscal adjustment grants for its special wards. Moreover, TMG will proceed with medium- to long-term initiatives, such as supporting start-up companies and measures to support child rearing and decarbonization. Meanwhile, TMG's total operating revenue and expenditure have been shrinking because of declining revenue transfers from the central government related to the pandemic and associated expenditures. We think a rise in expenditure has increased the likelihood of TMG's fiscal balance turning negative if tax revenue drops sharply because of economic deceleration and additional central government measures regarding redistribution of TMG’s tax revenue sources.

We think TMG will continue to have a more volatile operating margin than other LRGs in Japan. This is because TMG's large share of revenues from corporate-related taxes makes it more susceptible to economic cycles than its peers. Meanwhile, central government tax reforms, including of the tax revenue structure, have made TMG's revenues somewhat less sensitive to economic cycles than during the global financial crisis.

We expect TMG to maintain a very low debt burden compared with its Japanese peers and similar to that of international peers. We estimate inflation will increase TMG’s capital expenditure to further strengthen urban infrastructure such as for disaster prevention and mitigation. However, we forecast TMG's debt will continue to decrease moderately based on our inflation forecasts (3.2% in 2023 and 2.0% in 2024), TMG's disciplined financial management, and the positive impact of inflation on revenue. We estimate TMG will contain the ratio of its tax-supported debt to consolidated operating revenue at below 100% over the next two years, even considering the impact on its revenue of an end to increased central government transfers and grants related to the pandemic.

TMG's ratio of interest expense to operating revenues is likely to remain below 1% for the next two years, in our view. Its interest payments are very predictable because all its borrowings are at fixed interest rates. In addition to TMG’s progress in debt reduction, it has a flexible debt management policy by which it has diversified maturities centered on 10-year bonds. Furthermore, we forecast a rise in domestic interest rates will be smaller than that in other major countries. We, based on this, consider the likelihood of a significant increase in the ratio to be low.

While TMG has stakes in many entities we view as GREs, we expect it to maintain low exposure to those GREs not included in its tax-supported debt balance. We regard the entities as self-supporting or likely to have limited impact on our rating on TMG in the event they require further financial support. TMG has rigorously streamlined the activities of its GREs, including reducing their potential need for extraordinary support. Other contingent risks such as litigation are also limited.

We estimate TMG's projected free cash and liquid assets will continue to cover far more than 100% of its annual debt service costs in all accounts for the next 12 months. We expect its liquidity to strengthen because of a higher fiscal adjustment reserve and a reduction in debt. Main sources of TMG's cash holdings include its debt payment fund, whose balance moves independently of TMG's annual budgetary performance. TMG has a conservative investment policy of maintaining its liquidity in bank deposits, Japanese government bonds, municipal bonds, and other high-grade, low-risk instruments.

In addition, TMG's close relationship with Mizuho Bank Ltd., relationships with other major lenders, and frequent bond issuances in the open market support its access to external liquidity, in our view. TMG's continuous issuance of bonds such as Tokyo Green Bonds and Tokyo Social Bonds, whose cash usage is tied to environmental or social challenges, also helps further expand and strengthen its investor base. We view Japan's domestic bond market as sufficiently deep and external liquidity available from the banking system as strong.

Tokyo Metropolitan Government Selected Indicators

Bil. JPY	2020*	2021*	2022bc*	2023bc*	2024bc*	2025bc*
Operating revenue	7,599	9,180	8,723	8,036	7,824	7,918
Operating expenditure	6,535	8,167	7,486	6,837	6,668	6,751
Operating balance	1,064	1,013	1,237	1,199	1,156	1,167
Operating balance (% of operating revenue)	14.0	11.0	14.2	14.9	14.8	14.7
Capital revenue	432	265	271	268	268	268
Capital expenditure	1,740	1,105	1,401	1,377	1,365	1,377
Balance after capital accounts	(244)	174	107	89	59	58
Balance after capital accounts (% of total revenue)	(3.0)	1.8	1.2	1.1	0.7	0.7
Debt repaid	334	318	346	350	370	450
Gross borrowings	492	248	239	261	311	392
Balance after borrowings	(87)	104	0	0	0	0
Direct debt (outstanding at year-end)	3,989	3,919	3,812	3,723	3,664	3,606
Direct debt (% of operating revenue)	52.5	42.7	43.7	46.3	46.8	45.5
Tax-supported debt (% of consolidated operating revenue)	92.0	76.0	79.5	84.6	86.0	84.4
Interest (% of operating revenue)	0.7	0.5	0.5	0.5	0.5	0.5
Local GDP per capita (¥)§	7,802,161	8,051,856	8,238,976	--	--	--
National GDP per capita (¥)	4,281,066	4,394,447	4,503,354	4,694,845	4,867,392	5,034,468

Tokyo Metropolitan Government Selected Indicators

*Fiscal year ends March 31 of the following year. The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. §Local GDP for fiscal 2021 and fiscal 2022 are S&P Global Ratings' base-case expectations.

Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	2
Economy	1
Financial management	2
Budgetary performance	1
Liquidity	1
Debt burden	3
Stand-alone credit profile	aa+
Issuer credit rating	A+

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

- Sovereign Risk Indicators, Oct. 9, 2023. An interactive version is available at http://www.spratings.com/sri

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019

- Criteria | Governments | International Public Finance: Methodology: Rating Non-U.S. Local And Regional Governments Higher Than The Sovereign, Dec. 15, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- ARCHIVE | General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Sector And Industry Variables | Criteria | Governments | International Public Finance: Institutional Framework Assessments For Local And Regional Governments Outside Of The U.S., March 22, 2023
- Institutional Framework Assessment: Japanese Prefectures And Cities, July 13, 2022

Ratings Detail (as of October 18, 2023)*

Tokyo Metropolitan Government	
Issuer Credit Rating	A+/Stable/--
Senior Unsecured	A+
Issuer Credit Ratings History	
10-Jun-2020	A+/Stable/--
16-Apr-2018	A+/Positive/--
17-Sep-2015	A+/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.