

## **Fiscal Confidence Shocks and the Market for the Japanese Government Bonds**

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This paper asks if the sovereign default risks are being priced in the market for the Japanese Government Bonds (JGBs). On the surface, the Japanese debt problem seems out of control. The gross national debt to GDP ratio is currently well above 200%. On the other hand, the JGB market seems to remain surprisingly calm. If anything, yields on JGBs have been falling in recent years. Does this mean that, as some economists have suggested, the market has a perfect confidence in the government's will to ultimately balance the budget in a distant future? Or, if we dig deep enough, could we find even a trace of anxiety in the minds of the market participants?

This paper starts with identifying events that could have changed people's perceptions about future sustainability of the government budget, through a careful newspaper analysis. I then ask if there is any sign that the market has reacted to any of those news. Here, I look at the JGB futures index and the JGB VIX. Most of those events turn out to have no discernible impact on those variables. However, two notable exceptions emerge. One is in 2012, when the infighting within the then-ruling party (Democratic Party) over whether to raise the consumption tax rate broke out. The second is in 2014, when Prime Minister Abe of the Liberal Democratic Party announced that he would delay the consumption tax hike which had been scheduled for 2015.