Tokyo Metropolitan Government

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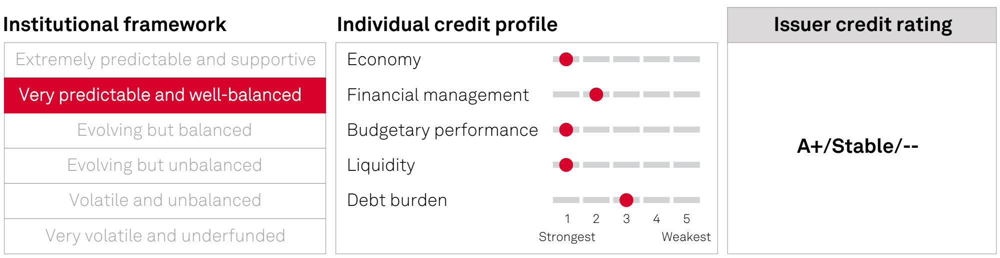
This report does not constitute a rating action.

Ratings Score Snapshot



Credit Highlights

Overview

Credit context and assumptions	Base-case expectations
Strong tax revenue base as the economic center of Japan	Growth in 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, led by increasing tax revenue. TMG's budget for fiscal 2024 (ending March 31, 2025) is the largest ever on a COVID-19 normalized basis, as it will address priorities such as child rearing and elder care support, urban infrastructure upgrades, and decarbonation. Nevertheless, we anticipate TMG's fiscal surplus after capital accounts will remain slightly positive, supported by continued growth in its tax revenue. We base this on our assumption that the domestic economy will continue to grow steadily for the next two years.

We forecast TMG's debt will continue to decline moderately. We believe TMG will continue its financial management with a focus on sustainability, such as through reserve accumulation and debt control, while balancing revenue and expenditure. 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 our expectation that the Bank of Japan will raise its policy rate at a moderate pace. We also 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 high among Japanese and global LRGs.

We anticipate the local economy will perform 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 0.8% in 2024 and 1.1% in 2025. Tokyo's population temporarily declined due to the COVID-19 pandemic but has started to increase due to migration from other prefectures and outside Japan with the full resumption of economic and social activities. However, it is unlikely that TMG's population will grow further from its current level, given the natural attrition of Japan's population.

We believe TMG will continue its financial management by balancing revenue and expenditure. TMG's budget has inflated in recent years due to COVID-19 related temporary subsidies from the central government and other related expenditures. Excluding the period of pandemic, its budget for fiscal 2024 is the largest in history as it increases spending on priorities, backed by tax revenue growth. Under the leadership of Governor Yuriko Koike, TMG has been making active use of reserves and striving to secure financial resources through project reviews. The Tokyo gubernatorial election is scheduled in July 2024. However, 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 the fiscal conditions of Japan's LRG sector as stable, considering the strong support mechanism from the central government to LRGs seen during the COVID-19 pandemic, while the central government's fiscal position is weak.

Debt continues to decrease moderately thanks to higher revenue covering increased expenditure

We forecast TMG's balance after capital accounts will remain positive over the next two years, with growth in revenue exceeding that in spending. We expect TMG's tax revenue to continue to increase. Factors supporting this are strong corporate-related tax revenue, robust employment and property prices, and higher local consumption tax revenue. On the other hand, TMG's expenditure is likely to continue rising as TMG pursues medium- to long-term initiatives such as supporting child rearing and elder care, accelerating decarbonization, and strengthening urban infrastructure to be more resilient to natural catastrophes.

We think the likelihood of TMG's fiscal balance turning negative has increased if tax revenue drops sharply such as because of economic deceleration and additional central government measures regarding redistribution of TMG’s tax revenue sources. TMG's total operating revenue and expenditure are likely to be lower than their levels in fiscal 2021 and fiscal 2022 due to a decline in revenue transfers from the central government related to the pandemic and associated expenditures. We expect TMG to receive some additional subsidies from the central government, such as those to combat inflation and to support children and child-rearing. However, we believe it will be at a lower level.

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. Its average operating margin for the five years from fiscal 2021 to fiscal 2025 will likely exceed 14%, in our view.

We expect TMG's debt burden to remain very low compared with its Japanese peers and similar to that of international peers. We anticipate TMG’s capital expenditure will increase to further strengthen urban infrastructure against natural catastrophes such as for disaster prevention and mitigation and to establish transportation and logistics networks. However, TMG's debt balance is unlikely to start rising, considering its financial discipline, which keeps spending within revenue. We estimate TMG will contain the ratio of its tax-supported debt to consolidated operating revenue at below 90% over the next two years, even considering the impact of the end of central government transfers and grants related to the pandemic.

TMG's ratio of interest expense to operating revenues is likely to hover around 0.5% for the next two years. 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 (0.05% in 2024 and 0.50% in 2025 for Japan's policy rate) will be much smaller than that in other major economies. As a result, we 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. Despite rising domestic interest rates, TMG maintains its strong liquidity position by accumulating fiscal adjustment reserve and controlling the level of debt. The 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	2021*	2022*	2023bc*	2024bc*	2025bc*	2026bc*
Operating revenue	9,180	8,710	8,183	8,131	8,183	8,280
Operating expenditure	8,167	7,416	6,902	6,867	6,877	6,940
Operating balance	1,013	1,294	1,281	1,264	1,306	1,340
Operating balance (% of operating revenue)	11.0	14.9	15.7	15.6	16.0	16.2
Capital revenue	265	257	261	261	261	261
Capital expenditure	1,105	1,432	1,427	1,522	1,565	1,599
Balance after capital accounts	174	119	115	3	1	2

Tokyo Metropolitan Government Selected Indicators

Balance after capital accounts (% of total revenue)	1.8	1.3	1.4	0.0	0.0	0.0
Debt repaid	318	340	350	320	370	360
Gross borrowings	248	239	235	317	369	358
Balance after borrowings	104	17	0	0	0	0
Direct debt (outstanding at year-end)	3,919	3,818	3,703	3,700	3,698	3,696
Direct debt (% of operating revenue)	42.7	43.8	45.3	45.5	45.2	44.6
Tax-supported debt (% of consolidated operating revenue)	76.0	79.1	82.5	82.9	82.4	81.5
Interest (% of operating revenue)	0.5	0.5	0.5	0.5	0.5	0.5
Local GDP per capita (¥)§	8,113,765	8,248,392	--	--	--	--
National GDP per capita (¥)	4,418,197	4,540,205	4,806,271	5,011,348	5,193,851	5,383,304

*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 2022 is S&P Global Ratings' base-case expectations.

Rating Component Scores

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. 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
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Institutional Framework Assessment: Japanese Prefectures And Cities, July 13, 2022
- Institutional Framework Assessments For Local And Regional Governments Outside Of The U.S., April 8, 2024

Ratings Detail (as of April 18, 2024)*

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.