Minutes of the Advisory Council on Government Debt Management
(36th Round)

1. Date: Friday, April 17, 2015 (10:00 a.m. to 12:05 p.m.)

2. Place: Ministry of Finance, Special Conference Room 3

3. Gist of the Proceedings

(1) Council member Toshiki Tomita gave explanations about the history of debt management policy (Annex 1), followed by a free exchange of opinions among the attendees.

(2) Next, explanations were given by the Bank of Japan about the liquidity of the JGB market and some other related matters (Annex 2), and by the Financial Bureau about the measures to maintain and enhance liquidity of the JGB market (Annex 3), followed by a free exchange of opinions among the attendees.

(3) Subsequently, the Financial Bureau gave explanations about the current situation of overseas Investor Relations and international conferences (Annexes 4-1 and 4-2), followed by a free exchange of opinions among the attendees.

▸ The following is the summary (made by the authority) of the views and opinions presented by the Council members in attendance:

<u>**Opinions and questions about the History of government debt management policy**</u>

- U.K. is an example which had gradually reduced its debt-to-GDP ratio over a period of nearly a hundred years. Is there anything we should learn from such a debt management policy adopted by U.K.?
- We hear it is generally believed that before the 1951 Accord between the Department of the Treasury and the Federal Reserve, U.S. government bonds were massively purchased by the FRB in order to maintain their prices. Is there any different view? How should we evaluate such a policy today?
- In the course of the fiscal policy adopted by finance minister Korekiyo Takahashi, the Bank of Japan sold the government bonds it had underwritten in the market. Did the bank do so for the purpose of enhancing liquidity in the JGB market?
- The replacement of marketable bonds with non-marketable bonds made in the U.S. following the 1951 Accord has much in common with a central bank’s purchase of bonds and its holding to maturity under the current unconventional monetary policy, in respect of the decrease of government debt traded in the market. Such replacement also relates to what portion of future collectible taxes will be applied to payment of interest on government debt. The link between a macroeconomic monetary policy and a fiscal policy is very important.
- Achieving the best mix of a spending cut and a tax hike is precisely a political and economic issue. Among feasible methods are: (i) to set a cap on expenditure to prevent any further

spending; (ii) to create an independent body in charge of monitoring fiscal restructuring as seen in the Netherlands; (iii) to allow the JGB market pressure to function by means of an interest rate rise; and (iv) to convince the nation of the necessity and objective of stabilizing or lowering the country's debt-to-GDP ratio.

- We take your opinion as a message that market liquidity and fiscal discipline are important for government debt management. While we learn much from history we should pay attention to differences between the past and the present. One of such differences is the introduction of floating exchange rate system.

Opinions and questions about the Liquidity of the JGB market and other matters related

- I assume that the JGB market liquidity for each investor, including banks, pension funds and life insurance companies, should be analyzed differently. May we be informed of that point if you know? In our view, banks will particularly be affected by the financial regulation due to be implemented in accordance with the Basel Accords. How will they really be affected?
- The minimum premium currently charged by the Bank of Japan in Securities Lending Facility is 50bp while in the U.S. investors may have bonds lent for some 10bp. Admitting that certain rules are required, if we can borrow JGBs more easily from the Bank of Japan, whether on an overnight or short-term basis, we will be able to smoothly make a market for almost all the issues. It will dramatically increase the liquidity of the JGB market.
- When compared with Treasury trading one of the problems we see in JGB trading is the absence of an established "fail" practice. The Bank of Japan's Securities Lending Facility and an established fail practice will remarkably enhance the liquidity of the JGB market.
- Investors may have different opinions about the JGB market being liquid or not. But it is certain that the market has become increasingly less liquid after the "2013 Quantitative and Qualitative Monetary Easing," which was followed by the last year's additional easing. The JGB market liquidity is likely to further decrease in the coming months.
- Let me take a look at how the bond futures market currently stands. Last year, for the first time in recent JGB history, foreign investors held more than 50% of JGB futures. It shows how JGB futures trading by domestic investors have decreased. Futures order books have become increasingly "thin" recently; then, in a chain reaction, any massive selling pressure would cause the market to be volatile, which would lead to greater VaR, forcing in turn investors to reduce the amount of the risk they take.
- While there is no way to prevent the JGB market liquidity from decreasing as the result of the Bank of Japan's massive purchases it is necessary to ease the requirements for the bank's Securities Lending Facility for reducing its cost, and get the entire JGB market to accept a fail practice.
- The Bank of Japan has announced what amount of JGBs it will purchase. So currently we are in a very special market situation where there is a player whose timing and volume of purchase is

quite clear. Even in a particular situation affected by an extraordinary policy that is aimed for a special player the issuing authority should do what it can to maintain the market function to an extent possible.

- I wonder if the market survey data does not cause the Bank of Japan to be concerned to any extent about how the market would be able to maintain its primary function. In the course of fiscal 2015 the bank will absorb a considerable amount of JGBs from the market, and I wonder how the bank recognizes and is being prepared for the risk arising from massively purchasing JGBs over a long term.

Opinions and questions about the Reports on the JGB-related IR activities performed in overseas markets, international conferences, and some other matters

- We now find ourselves in an extraordinary situation where yen interest rates have become relatively attractive particularly because of lowering interest rates in Europe. Some foreign investors are revaluating JGBs.
- Can you tell me how we should or could convince overseas investors of JGBs' attractiveness in the future when overseas interest rates begin to rise and normalize ahead of Japan?
- I wish to see JGBs serving in the future as a benchmark bond in Asia. What can or should we do to give such a status to JGBs? Some Asian countries now have surplus in trade with Japan on the current account basis. Would you tell me how we can have these countries buy a large amount of JGBs?
- Is it necessary to issue Consols (consolidated annuities) for Islamic countries? Or is it possible for them to buy JGBs in their current form?
- Margin requirements for derivatives will become effective in the next year. We should be careful about how to deal with JGBs as eligible collateral.