

**Minutes of the Advisory Council on Government Debt Management
(52nd Round)**

- 1. Date: Monday, June 22, 2020 (13:30 p.m. to 15:00 p.m.)**
- 2. Place: International Conference Room, Ministry of Finance**
- 3. List of proceedings**

1. Current and future JGB issuance
2. COVID-19 and medium-to long-term challenges in Japan
(Suezawa Hidenori, SMBC Nikko Securities Co., Ltd.)
3. Current status of and future efforts in the JGB futures market
(Ichimoto Hiroyasu, Director of Osaka Exchange, Inc.)

First, the Financial Bureau explained about "Current and future JGB issuance" (Document 1).

- Below is a summary of the Financial Bureau's presentation:

(Current state of JGB issuance in Japan)

- As a result of the formulation of the supplementary budget twice in April and May, the total amount of JGBs to be issued in FY2020 increased by about 100 trillion yen from 153 trillion yen initially to 253 trillion yen, which is the largest issuance amount in history. The calendar-based issuance amount also exceeds 200 trillion yen, which is also the largest amount in history.
- When changing the calendar-based issuance amount by maturity, a meeting of JGB Market Special Participants and a meeting of JGB investors were held in April and May, respectively to discuss with the market in order to see what kind of room for additional amount was available for each zone. Although there has been an increase in amount in a wide range of zones, the change of plan on this occasion is characterized by an increase focused on short-term zones. Incidentally, no significant change in interest rates occurred before and after the revisions of the issuance plan.
- The JGB issuance amount will be increased from July. However, since the amount of Treasury Discount Bills (T-Bill) has been already increased in April and May in order to

finance the Treasury, the additional amount in the short-term zones has already started in anticipation of the increase in JGB issuance.

(Status of the issuance of government bonds overseas)

- Large-scale fiscal measures are being taken in every country in response to the new coronavirus infections, and an increase and changes in government bond issuance are being undertaken accordingly. Issuance of discount bonds has been given preference to the start of the additional issuance of coupon-bearing bonds from July in Japan. Similarly, a relatively large amount of discount bonds is being issued in the US, Germany and France. The increased issuance of coupon-bearing bonds is relatively focused on the short term zones of roughly 1- to 7- years in every country.

(Challenges in the future)

- While it is expected that JGBs will continue to be issued at a large amount in the future, it is considered important for the debt management office to sufficiently exchange opinions with market participants in order to ensure secure and smooth issuance by issuing JGBs in accordance with the needs. In addition, it is also necessary to minimize the medium- to long-term costs.
- The MOF sets three future considerations. The first of them is to flexibly respond to the actual status of the issuance in order to ensure the necessary fundraising.
- The second of them is to identify the medium- to long-term needs of investors from the perspective of minimizing the medium- to long-term fundraising costs to continue stable and transparent government bond issuance. In addition, it is necessary from the perspective of appropriate debt management to predict the future JGBs issuance outlook and conduct cost-at-risk analysis and so on.
- The third of them is to consider change in the structure of operations in the circumstances in which a variety of working systems such as split working sites, working from home, etc., are implemented since the declaration of state of emergency due to the spread of the new coronavirus infections by considering the possibility that this will continue in the future. Following this experience and reflection, it is necessary for the debt management office to develop a system which allows the auctions to be conducted securely and JGBs to be traded more securely in the secondary market as well and it is also desirable for market participants to conduct necessary studies about that system.

- In terms of recent efforts in the JGB issuance plan, MOF decided on flexible issuance of Treasury Discount Bills. Since the issuance amount of Treasury Discount Bills has been increased significantly in the issuance plan after the second supplementary budget, it is clearly mentioned in the plan that the issuance maturities, number of auctions and issuance amount may be flexibly adjusted, and it is our intention to issue Treasury Discount Bills in a flexible manner based on this statement.
- The second effort is to change the JGB issuance plan in the middle of the fiscal year. It has been the rule so far not to change basically the JGB issuance plan in the middle of the fiscal year. However, it was mentioned during the discussion of the initial plan last year regarding the possibility of a change in the JGB issuance plan in the latter half of the fiscal year in response to the market situation and issuance status. At that time, the change was focused on the reduction in amount, but it will be necessary that changes be made as needed according to the occurrence of an additional financial demand and the discrepancy between the plan and the results in the future, etc. We are considering that we will hold a meeting of JGB Market Special Participants and a meeting of JGB investors to hear from market participants on the matter before making any change from the perspective of ensuring predictability and reducing an adverse effect on the market.
- We consider that it is one of the challenges to firmly understand in behavior changes of investors in the drastic change in market environment. In particular, we need to consider measures to do in order to better understand the movement of overseas investors. Investor relations (IR) continue to play a key role in understanding the movement of overseas investors, but no IR event has been held since early February. Since overseas business trips will continue to be difficult, we would consider the option of holding an IR event via web conference.

Next, Mr. Suezawa Hidenori from the SMBC Nikko Securities talked about "COVID-19 and the medium- to long-term challenges in Japan" (Document 2). After that, the members exchanges opinions freely.

- Views expressed by the members have been summarized (by the Financial Bureau) below:
 - While a very large amount of JGBs is planned to be issued as a result of the first and second supplementary budgets, it was a favorable decision that the issuance is focused on short-term zones from the perspective of secure issuance.
 - The spread of 10-Year JGBs and 30-Year JGBs has continued to steepen since March 13 when the spread shrunk to below 30bps to reach 50bps as of Friday last week. We believe

that if the JGB issuance plan had been focused on coupon-bearing bonds, there would have been the possibility that interest rates rose much higher than the current levels and the yield curve steepened, causing the effects of the economic measures to be partly jeopardized accordingly. However, we would like to add that the additional issuance amount will actually start from the next month onwards, and that market participants will be keenly watching the demand of investors and the purchase schedule and amount of long-term bonds of the Bank of Japan (BOJ) to be announced at the end of this month.

- Currently, we are witnessing a serious crisis like the corona shock that may occur once in every 100 years or even once in every 10 years. We believe, however, that, if we look back at the past, such a crisis is basically a process in which the burden of private companies and households will be gradually replaced by the government debts by means of a variety of measures.
- This time as well, supplementary budgets of an unprecedented scale have been formulated and a large amount of JGBs will be issued according to the policy. In such a circumstance, the challenge for each country will be whether the government bonds can be purchased in global market. We believe that the selection of government bonds in each country depends basically on the market's trust in each country's current account balance and fiscal discipline that is maintained or damaged in some cases.
- In the case of Japan, the current account balance, so-called national power or the competitiveness, has been maintained macroscopically, and a certain level of consideration for fiscal discipline has been given. In the future, the problem is naturally how these can be maintained. In that sense, it is important also for market participants to check these situations from the perspective of the market. Although a fiscal expansion is necessary, considering the magnitude of the problem in particular, it is important, for example, to check fiscal discipline –especially under the present budget including 10 trillion reserve funds. In addition, we have to continue to closely watch the credit rating of JGBs which has shown a slight change or a worsening symptom from the perspective of the market towards overseas investors.
- While the issuance of green bonds is very few in Japan, its amount is much in foreign countries. The "90% green and 10% gray" and the "80% green and 20% gray" are also called green bonds. Considering all of these as green bonds, they are issued as government bonds or as municipal bonds in Northern Europe, and the companies or financial institutions that purchase them are considered to be making green investments. According to the Green Bond Principles, (unreliable) green bonds may be issued and, strangely enough, the popularity

of those financial institutions buying them is enhanced. From this perspective, it is important for the Japanese government to decide whether to allow the issuance of green bonds or to wait until the preparations are in place for the issuance thereof in the future, lest the Japanese financial industry or companies are adversely rated.

- According to the textbook, if the money supply increases by such an amount, inflation will surely come sometime and the nominal interest rate will rise in a normal circumstance. When this occurs, we believe that the interest payments will be an important problem. How do other market participants view this situation?
- Currently, due to operational difficulties and the deflationary effects caused by the COVID-19 pandemic, we have no choice but to buy government bonds in a risk-off manner. Since short-term bonds are particularly more convenient, the majority, that is, 80 to 90 percent of about \$2 trillion that has already been quickly issued in the US are also short-term bonds, and currently, the rise in long-term interest is suppressed by the increase in the issuance of short-term bonds, as a result. Although, currently short-term bonds are preferred due to a flight-to-quality, due to the pandemic, it is unclear whether this will continue in the medium-to long-term perspective.
- Recently, the frequency and magnitude of crises are increasing, and we sense a feeling of crisis that every time a crisis occurs, government bonds are issued for raising necessary funds in Japan. It goes without saying that low interest rates and low inflation are the global trends. However, since the issuance amount of refunding bonds is large in Japan, even if the nominal long-term interest rates are low, it does not mean that the issuance of JGBs may be increased, and it is necessary to closely study the breakdown. For example, long-term interest rates can be considered either as a term premium for the risk or as expectations, and there is an analysis result in which the long-term premium has risen in the corona pandemic and the risk of rising interest rates is higher in the corona shock than in the Lehman shock. As a result, it is convincing that the additional issuance of JGBs due to the corona pandemic is focused on short-term bonds.
- Needless to say, it is important to flexibly issue JGBs in such a crisis. For example, according to the figure on page 4 of MOF document, the JGB issuance plan of every fiscal year is published in December of the previous year together with the budget, and the plan is very detailed with the issuance plans of each fiscal year in advance in Japan. Naturally, annual plans are published in advance also in Germany, France and the UK. The plan of the UK, for example, however, is a little bit rougher, in which only short, medium and long maturities are determined beforehand and the details thereof will be adjusted flexibly. We

believe that it is important to focus on flexibility in the time of a crisis.

- We believe that the stable issuance of JGBs issued in a large amount is ensured by a close coordination between fiscal policy and monetary policy in the current environment. However, given the possibility of an additional issuance due to a future fiscal expansion and the demand for refunding the existing short-term bonds, we do not predict an interest rate rise originating in Japan with a strong home bias, but we are concerned about an interest rate rise originating in foreign countries, especially, in the US which has implemented an unprecedented fiscal adjustment and in which dynamic market fluctuations occur. When a large amount of JGBs needs to be financed under such an environment, we believe it is worthwhile considering fund-raising by borrowing (from the private sector) in addition to bond issuance. This is due to the fact that loans held for investment purposes by the private sector are not subject to mark-to-market accounting and these loans may be easily held.
- We believe that the biggest risk for the Japanese economy is the low birthrate and aging population. However, this is not a risk, but rather inevitability as a result of turning a blind eye to an obvious fact. In the future, it is expected that various economic indicators will worsen, including a decrease in the economic growth rate, a decrease in the saving rate, a progress in the current account deficit, etc. We consider it is necessary to take an early action to mitigate the effects thereof.
- We think the general account of the government is a distorted account. If the government wishes to ensure a stable issuance of government bonds, the actual financial situation of Japan needs to be shown using figures of the national accounts.
- Currently, two-thirds of expenditures are related to social security, but we believe what is most threatening is the global warming. We wonder if it is not time to revise the expenditure to tackle the global warming issue that threatens more people.
- Stable and smooth JGB issuance depends on interest rates, interest rates depend on the BOJ, the BOJ depends on the inflation, and the inflation depends on the total demand and the total supply. Regarding the total demand, many countries have introduced a large fiscal stimulus program. This is due to a large decrease in the demand of the private sector. One of the key points in the future is to measure the correct balance between the recovery of the demand in the private sector and the decrease in the public spending in response to the recovery. As far as the supply is concerned, the rate of technology innovation has decreased in some sectors due to monopolization and it is uncertain whether new technologies will continue to impact industries in the same manner as before. In addition,

since the trade relationship between the United States and China will get worse and there is a possibility that the worldwide trade volume will decrease due to the spread of the new coronavirus infections, the supply situation will rather get worse. If supplies worsen despite an increase in demand, inflation will be triggered. It is worthwhile to further delve into the matter.

- A large scale change in the JGB issuance plan was required this time to respond to the significant supplementary budgets. We understand very well that the issuance is focused on short-term bonds from the perspective of ensuring the smooth financing in the market.
- Looking ahead in the future, it is likely that it will take a few years, not only for the Japanese economy, but also for the world economy to return to the previous levels due to the prolonged situation with COVID-19. Under such circumstances, we foresee a situation in which all countries will be required to issue a large amount of government bonds so as not to create a fiscal cliff when considering the macro impact.
- When considering that it will be inevitable that a large amount of government bonds need to be issued for a few years to come, we believe it is important to review the JGB issuance plan and study the desirable form for JGB issuance.

- Empirical analysis of past pandemics shows that a pandemic itself causes deflation. Coupled with the US-China conflict on this occasion, there is a risk that the supply chain may not be restored so easily.
- When the Spanish influenza broke out, the Great Kanto Earthquake and the Great Depression followed. Since crises may occur one after another, it is necessary to pursue the fiscal consolidation during normal times. This is something everyone has in mind, but has never been achieved. According to calculations by the Cabinet Office, the nominal growth rate under the growth realization case is 3.5%, while it is 1.1 to 1.5% under the baseline scenario. We consider it necessary for us to view the baseline case as the main scenario of the normal economy and to steadily promote fiscal consolidation in sight of the end of the corona shock.
- There is an election in the United States. Its results will affect Japan as a creditor nation with very large net foreign assets. Since the yen-dollar exchange rate has a large impact not only on trade, but also on profits generated by foreign assets, it is very important to see how the yen behaves after the election.

- As published by international organizations, we expect that the COVID-19 produces a large adverse effect on the economy. Therefore, we believe that a large fiscal stimulus is

unavoidable for responding to the crisis.

- While we are all experiencing the same pandemic all over the world, when a comparison is made on the issuance amount of government bonds among countries, that in Japan is two times higher than that in other countries. In addition, the outstanding Japanese public debt is exceedingly high originally. The crisis this time occurred under such circumstances. We believe it is increasingly important not only to maintain the market's trust during the crisis, but also to steadily achieve fiscal consolidation during normal times.
- It is difficult to assume a situation wherein long-term interest rates will go up suddenly when considering a variety of circumstances. However, we believe we should bear in mind the possibility of the occurrence of a so-called black swan in which while the end of COVID-19 is not in sight, an international financial crisis, or another disaster such as an earthquake that directly hits Tokyo area might occur simultaneously, in addition to the fact that the structural problems in Japan such as the declining birthrate and aging population are definitely getting more serious.
- Therefore, we consider it is important to keep the matter on the agenda in this meeting by making use of the risk analysis framework discussed so far.
- Regarding the schedule of IR (Investor Relations) events in foreign countries, we believe it is more difficult to make overseas trips, but on the other hand, it is easier to have an interview with a plurality of customers online in terms of costs and time restrictions. We are of the view that this is a good opportunity to turn a pinch into a chance in order to engage in acquiring new customers.
- Due to the current major changes in the environment, for example, crude oil prices have fallen sharply and the economic conditions in the Middle East have changed. Doubtless to say, major global changes are occurring due to the spread of infectious diseases and it is important now to understand the trends of investors. In addition, the number of political confrontations starting with the US-China confrontation and of geopolitical risks is increasing. Therefore, it is important, in that sense, to gain into an understanding of the behavior of international investors.
- In addition, we believe it is very important to understand the trends of overseas investors in order to effectively do investor relations. In particular, in a stock market where the identity of real investors is not well understood for custodian purposes, there are business operators who do the business of grasping the real shareholders. We want the debt management office to develop a system to allow an understanding of overseas investors as much as possible by checking, for example, on the response of overseas issuing authorities.

- We believe that the amount and composition of JGBs to be issued with a focus on short-term bonds have been well planned at this moment. We understand that the plan is premised on the assumption that no inflation will occur for the time being or the current account surplus will continue in the medium term. On the other hand, looking overseas, an unequal wealth distribution in favor of richer people which results in excess savings is becoming a political issue. In this case, if there is a possibility that wealth is equitably distributed to some extent by its re-allocation instead of the continuing global excess savings, this will constitute a cause for inflation in the future.
- In addition, if the United States continues to operate to supply more dollars, the interest rate basis will decrease and the attractiveness of short-term bonds may decline. When considering the amount and composition of JGBs in the medium- to long-term perspective, we believe we should reconsider these market trends and risks of cost-at-risk in the medium- to long- term.

Next, Mr. Ichimoto Hiroyasu, Director of Osaka Exchange, Inc. talked about "Current status of and future efforts in the JGB futures market" (Document 3). After that, the members exchange opinions freely.

- View expressed by the members have been summarized (by the Financial Bureau) below:
 - The fact is that the actual trading volume has decreased obviously due to an influence of COVID-19. We believe that the sale-purchase transactions in the secondary market have been shifted to the primary market due to an increase in telework. Since information available at home is limited, and assuming that information is not available at hand, the primary market in which an order can be placed at one price is valid and the transaction orders are concentrated in the primary market in a sense. If this situation prolongs, we believe that the liquidity of the secondary market will decline, which will lead to the situation in which transactions cannot be completed easily. If this situation occurs, no one will be able to sell and no one will buy naturally, and the primary market will become unstable.
 - In the circumstance, since the futures market supports the secondary market most, it is very important how smoothly this futures market is supported by the large market.
 - The benchmark that was 10-year long-term JGB is currently changing to the 20-year super long-term JGB. However, in the futures market, actually the trading of long-term JGB futures is focused on the 7-year JGB and there is hardly any trading in super long-term JGB futures and mid-term JGB futures. Therefore, the truth is that trading is conducted with the

overall yield curve being hedged by these 7-year bonds. In that sense, it is a fragile market. Attempts have been made several times to encourage the trading of super long-term JGB futures and we believe it is time to support and cooperate for the development thereof.

- If only a few people conduct outright transactions, we believe that a variety of measures need to be taken, such as, for example, implementation of a spread transaction between long-term JGB futures and super long-term JGB futures, and, in this sense, we would like to propose of a market where new forms of transactions can be conducted.
- When considering government debt, we recognize that the market function and fiscal discipline are the two wheels, and in view of the current situation of the spot market, the futures market plays the key role.
- For example, Hong Kong is very politically unstable, and human resource risk is becoming apparent, and Singapore is struggling with COVID-19. Under such circumstances, we recognize that the futures market in Japan may restart as an exchange with a menu of a comprehensive exchange to offer a wide range of products. We consider that this is a good opportunity.
- There have been some articles in the media referring cautiously to high-speed transactions. However, like this web conference, when a new technology becomes available, some time is required to get use to it, and we think we are still in the early days for them. In reality, the situation is such that we have roughly one fourths or one fifths of the share and most of the transactions is done in high-speed transactions. We have the real feeling that they have become indispensable for liquidity.
- The point to bear in mind, however, is that when algorithm is used for judging a transaction, there is the risk that transactions are conducted in one direction or that the market reacts excessively to unexpected news. In order to deal with such a situation, it is important to transmit the financial situation of Japan in a wide range channels with higher transparency than before, including the web conference with which may change the IR channels.
- Green bonds are very popular now in Europe. Although their rules and definitions are still ambiguous in their early days, we have the feeling that the role of a funding channel played by financial markets is somewhat undergoing a change. As the speed of information transmission has increased, it has become necessary to pay attention to what has been invisible such as, for example, minority, sustainability, etc. Both providers and investors expect a return from an investment under the thinking that what is needed grows as far as equity is concerned and what is needed is sustainable as far as debt is concerned. Although they are still in early days, we believe that more efforts are required from the industry as a

whole.

- In the circumstances where the interest rate on government bonds with a redemption period of up to 10 years is almost submerged actually, only JGBs with a maturity of more than 10 years bear plus interests under the yield curve. As a result, only JGBs with a maturity of 10 years or more are the subject for investment from the perspective of income for investors, while investment in JGBs with a maturity of less than 10 years is difficult to be made in terms of actual demand. In that sense, if we look at the increase in the 20 year JGB and super long-term bonds as actual demand, we believe that they are becoming important also in the futures market.
- Globally speaking, the issuance of super long-term bonds has been increasing, including that in the private sector. When considering that the issuance in super long-term bonds has been increasing as cash bonds, it is quite a difficult problem not to be able to develop the market for super long-term bond futures. However, we believe it is necessary in such a circumstance to recognize that their needs as a hedge function are increasing.
- From the perspective of the life insurance industry, the duration of assets is still overwhelmingly shorter than that of liabilities, and the life insurance companies continue to buy 20 year, 30 year and 40 year cash bonds in the primary market. The global regulation on insurance companies called the ICS (Insurance Capital Standard) will be introduced in 2025, and since it is likely that the same regulation will be introduced in Japan, all life insurance companies are trying to bridge the duration gap between assets and liabilities. As a result, we are of the view that it is possible that the purchase of super long-term JGB will be fulfilled to a certain extent by 2025. We think then that a trading using the yield curve, a trading to gain excess return through a combination of 20 year JGB futures and 10 and 30 year cash bonds, etc., will possibly appear. Although 2025 is five years from now, we expect that there is a future for super long-term bond futures in that sense.