

## **Minutes of the Meeting of JGB Market Special Participants (81st Round)**

1. Date: Friday, June 21, 2019 (3:55 p.m. to 4:45 p.m.)
2. Place: Special Conference Room 1, Central Common Government Offices No.4
3. Gist of Proceedings

### **1. Issuance amount of Inflation-Indexed Bonds in the July-September quarter 2019**

▶ The Financial Bureau gave the following explanation about the issuance amount of Inflation-Indexed Bonds in the July-September quarter 2019:

▪ As shown on page 3, the JGB Issuance Plan for FY2019 announces issuance of Inflation-Indexed Bonds four times a year with the amount of ¥400 billion per each time while stating “the issuance amount may be adjusted in a flexible manner in response to market circumstances and demands of investors, which will be determined based on discussions with market participants”. Therefore, we would like to hear your opinions about the amount of issuance in the July-September quarter 2019 at today’s meeting.

▪ In the April-June quarter 2019, as shown on page 4, we conducted an auction of issuance for the amount of ¥400 billion in May, and Buy-Back Auction for the amount of ¥20 billion in each of April and June.

As shown on page 5, the result of the auction of issuance in May was comparable with those of past auctions, with the bid-to-cover ratio at 3.72.

As shown on page 6, the Buy-Back Auction and Outright Purchase of JGBs by the Bank of Japan have resulted in generally similar level as the market rates.

As shown on page 7, despite a decline in interest rates on nominal bonds, the BEI has recently remained almost flat at around 0.2% in the secondary market.

▪ In such circumstances, we asked for your opinions beforehand. While there were some opinions that showed concern about the fact that purchases of Inflation-Indexed Bonds have not been so active as to raise the BEI after the auction of issuance and the expansion of investor base for Inflation-Indexed Bonds is continuously limited, many of the opinions supported maintaining the current amounts of issuance and Buy-Back in the July-September quarter because some investors were purchasing the bonds when they were considered to be undervalued.

▪ In view of such circumstances and these opinions, as shown on page 8, we are considering an issuance auction of Inflation-Indexed Bonds for the amount of ¥400 billion and carrying out a Buy-Back Auction for the amount of ¥20 billion in August in the July-September quarter, which is in the same amount as the April-June quarter. In addition, as stipulated in the proviso, we will keep watching the market environment and other factors closely and take appropriate actions as the debt management office in accordance with the situation.

▪ We consider the development of the Inflation-Indexed Bond market to be an important goal of the debt management policy. We would like to hear your opinions regarding the amount of issuance for the July-September quarter and related matters.

▶ Summarized below are the views and opinions expressed by the attendees:

- We agree to the Financial Bureau's proposal. Since the auction in May, which was passed without a problem, the supply-demand balance for Inflation-Indexed Bonds has stayed steady as there has been demand from investors at the BEI level of around 20bps. The results of Outright Purchases of JGBs by the Bank of Japan (BOJ) that followed the auction were also stable and in line with the market rates. In consideration of the external environment, we have the sense that the supply-demand balance is appropriate at present. On the other hand, we are still concerned about the facts that the liquidity is basically low and that the expansion of investor base is limited despite the fact that the BEI level of 20bps is relatively low. Therefore, we request the Financial Bureau to continue dialogue with the market.
- We agree to the Financial Bureau's proposal. As the external environment is not favorable, inflation expectations have remained low. On the other hand, the Inflation-Indexed Bonds have remained undervalued, which is inducing some investors in Japan to start considering Inflation-Indexed Bonds as their potential investment targets. In this situation, we request the Financial Bureau to assist the growth of the market of Inflation-Indexed Bonds by maintaining the current amounts of issuance and Buy-Back.
- We agree to the Financial Bureau's proposal. At present, although the BEI level is somewhat low, it is not so low as to require a revision of the current amounts of issuance and Buy-Back. If concerns arise that the gap between the BEI level and the general inflation expectations may widen further in the future, we request the Financial Bureau to respond by increasing the amount of Buy-Back and other means.
- We agree to the Financial Bureau's proposal. Although there has not been a change in the expansion of investor base and the liquidity situation yet, I suppose it is appropriate to keep patiently waiting for the maturing of the market while maintaining the current amount of issuance.
- We agree to the Financial Bureau's proposal. Although I sometimes feel it is better to increase the amount of Buy-Back, it is appropriate to maintain the current amounts of issuance and Buy-Back for now, considering the results of auctions, which shows that the frequency of cases decreased in which the lowest price comes to a much lower level than the market prices.
- We request the Financial Bureau to conduct Buy-Back Auctions every month. Although the BEI has not changed much recently, the CPI is not projected to rise in the future, which makes it hard to expect new demand to arise. Therefore, we request the Financial Bureau to increase the amount of Buy-Back to some degree, considering the supply-demand balance in the future.

## **2. Liquidity Enhancement Auctions in the July-September quarter 2019**

▶ The Financial Bureau provided the following explanations regarding the Liquidity Enhancement Auctions in the July-September quarter 2019:

▪ As shown on page 10, the FY2019 JGB Issuance Plan states the following about Liquidity Enhancement Auctions:

- (1) While the operating assumption is that the total annual issuance amount will be ¥12.6 trillion (¥2.4 trillion for the remaining maturity of 1-5 years zone, ¥7.2 trillion for the remaining maturity of 5-15.5 years zone, and ¥3.0 trillion for the remaining maturity of 15.5-39 years zone)
- (2) "The issuance amount and its allocation among each zone may be adjusted in a flexible manner in

response to market circumstances and demands of investors, which will be determined based on discussions with market participants.”

Accordingly, we would like to hear your opinions about the amount of issuance for each zone in the July-September quarter.

- As shown on page 11, in the April-June quarter, we issued JGBs worth ¥400 billion in May (odd-numbered month) for the remaining maturity of 1-5 years zone, ¥600 billion in each month for the remaining maturity of 5-15.5 years zone, and ¥500 billion in April and June (even-numbered months) for the remaining maturity of 15.5-39 years zone, as stipulated under the FY2019 JGB Issuance Plan.
- Page 12 and after show the results of the recent Liquidity Enhancement Auctions. Regarding the results of the auctions for the remaining maturity of 15.5-39 years zone, the price tail was long and the bid-to-cover ratio was low in some cases. Therefore, it will be necessary to keep watching the future situation closely. However, the result of auctions for other zones have been generally stable.
- When we heard opinions under these conditions about the Liquidity Enhancement Auctions in the July-September quarter in advance, there were many opinions that it is appropriate to maintain the current amount of issuance.
- In view of this situation, we have prepared our proposal for each zone’s issuance amount during the July–September quarter (see page 15). We are considering issuing ¥400 billion in July and September (odd-numbered months) for the remaining maturity of 1-5 years zone, ¥600 billion each month for the remaining maturity of 5-15.5 years zone, and ¥500 billion in August (an even-numbered month) for the remaining maturity of 15.5-39 years zone, as we did in the April-June quarter.
- Following today’s discussion, we will decide the amount of issuance for each zone of the Liquidity Enhancement Auctions in the July-September quarter. We would like to ask for opinions.

▶ Summarized below are the views and opinions expressed by the attendees:

- We agree to the Financial Bureau’s proposal. However, while the bid-to-cover ratio was high in the remaining maturity of 15.5-39 years zone in the auction in April, it fell again in the auction in June. Therefore, we need to keep a close watch on the future situation. In that zone, the results of auctions could change considerably depending on whether or not there are bids from investors. Our understanding is that the original purpose of the Liquidity Enhancement Auctions was to enable securities companies to cover their short positions. However, if the bid-to-cover ratio remains low, the Financial Bureau may consider the possibility of reducing the per-auction amount of issuance by ¥500 billion in the future. With respect to the remaining maturity of 5-15.5 years zone, it is appropriate to maintain the current amount of issuance. On the other hand, with respect to the remaining maturity of 1-5 years zone, though the tight supply-demand balance temporarily eased, interest rates have been falling steeply since the beginning of June. Depending on the circumstances, it may be better to consider increasing the amount of issuance for that zone in the future.
- We agree to the Financial Bureau’s proposal. Although it may be possible to reduce the amount of issuance in the remaining maturity of 5-15.5 years zone, the situation is not such that the amount should immediately be reduced as the possibility of a squeeze occurring in the zone near the cheapest issues has diminished.

- We agree to the Financial Bureau's proposal. However, it may be appropriate to increase the amount of issuance in the remaining maturity of 1-5 years zone slightly though the situation is not yet such that the allocation of issuance should be changed. Even so, while the annual issuance amounts are fixed, we do not have a specific idea about in which zone the amount of issuance should be reduced in exchange for an increase in the remaining maturity of 1-5 years zone, nor do we feel the need for reduction. We do not expect that the low bid-to-cover ratio and the price tail's tendency to be long in the remaining maturity of 15.5-39 years zone will immediately lead to an argument for the reduction of the issuance amount because they are attributable to the long duration and high volatility of the eligible issues and because there are certain amounts of demands from investors.

- We agree to the Financial Bureau's proposal. As the bid-to-cover ratio remained low, at around 2, and the price tail tended to be widened in the remaining maturity of 15.5-39 years zone in the Liquidity Enhancement Auctions in the second half of the previous fiscal year, we thought that the reduction of the amount of issuance should be considered. However, investors' demand for the super-long-term zone has become very strong due to the reduction of the amount of issuance for 20-Year Bonds since April this year, though the June auction for the same zone showed a relatively long price tail because interest rate fluctuation was substantial just before the auction.

- We agree to the Financial Bureau's proposal. In the remaining maturity of 15.5-39 years zone, the bid-to-cover ratio is low and the price tail tends to be long because the issuance amount is ¥500 billion. However, as demand is robust in this zone over the long term, it is appropriate to maintain the current amount of issuance.

- We believe that it is appropriate to increase the amount of issuance slightly in the remaining maturity of 1-5 years zone. The Liquidity Enhancement Auctions in the remaining maturity of 5-15.5 years zone are not contributing to improvement of the liquidity of the issue whose supply-demand balance is tight, but just providing undervalued issues. Meanwhile, the possibility of a liquidity squeeze occurring for the cheapest issues in the future is decreasing because the BOJ has reduced the minimum fee rate of the Securities Lending Facility and relaxed conditions for the delivery of cheapest-to-deliver issues. Therefore, we request the Financial Bureau to reduce the amount of issuance for the remaining maturity of 5-15.5 years zone, for which the auction is held every month, by ¥50 billion and increase the amount of issuance for the remaining maturity of 1-5 years zone, for which the auction is held every two months, by ¥100 billion.

### **3. Latest JGB market situation and outlook for future investments**

▶ Summarized below are the views and opinions expressed by the attendees:

- At the previous meeting of JGB Market Special Participants, I stated "as the market's mood may be becoming such that investors are feeling that from the beginning of the fiscal year, they must increase the outstanding balance by investing in longer-term bonds with higher interest rates. If investors accelerate moves to increase the outstanding balance from the beginning of the fiscal year, it could cause interest rates to fall further." As for the domestic situation, what I predicted has actually occurred. Moreover, amid the interest rate decline around the world, investment in European bonds by Japanese investors is becoming less attractive, which is leading the flow of funds to JGBs with long maturities. Also, foreign investors are purchasing bonds with long maturities too, including JGBs. Those are probably exerting downward pressure on interest rates. While expectations for additional monetary easing in Japan, the United States and Europe are growing, conceivable policy options will have substantial adverse side effects and there are few effective

measures left in the case of the BOJ. Therefore, in the market, there was the view that additional easing would be difficult. However, if global trade volume declines because of the U.S. trade policy, Japan is more prone to suffer a negative economic impact than the United States, and the yen is prone to appreciate, which will require the BOJ to take some action. Neither ECB President Draghi nor BOJ Governor Kuroda has made comments with further information. However, the market sentiment that there will be an additional easing is being cultivated by the fact that an expected interest rate cut by the FRB has almost completely been priced into the market.

Going forward, as a U.S.-China summit meeting, which was difficult to be arranged, will be held at the end of this month, the situation may evolve in a new direction. Towards July, interest rates may temporarily rebound globally and the yield curve may steepen. On the other hand, as the trend of global economic slowdown remains unchanged, the scenario that low interest rates will be maintained globally, including in Japan, will probably remain unchanged.

- Market expectations for interest rate cuts exerted pressure on the FRB, and subsequently, ECB President Draghi made a comment with some implications. As the possibility of additional easing by the BOJ emerged as a result, interest rates on JGBs have also declined steeply. Now that the interest rate on 10-Year Bonds has fallen close to negative 0.2%, we have no option but to purchase JGBs with long maturities in an effort to secure positive interest rates. In addition, while the BOJ is gradually reducing the amount of Outright Purchases of JGBs, the amount has already been only ¥400 at the time of each purchase operation for a monthly total of ¥120 billion in three auctions in the remaining maturity of 25-39 years zone, leaving little room for further reduction. Therefore, the supply-demand balance remains favorable. Although interest rates fall steeply at some times, that does not mean panic buying on the part of investors. That is probably a result of price volatility due to the reduced market liquidity.

Going forward, considering the expectation that the U.S.-China trade negotiations are likely to remain unsettled for a while, once a phase of interest rate cut starts, it is likely to last for around a year. The view that the interest rate is in a phase of long-term decline has remained unchanged. Even though the interest rate fall rapidly and that causes a rebound, some investors would buy on the dip, resulting in an interest rate decline again. Also, some investors are purchasing short-term bonds for insurance purposes because the BOJ might cut interest rate, current level of which is negative, when yen is appreciated. In addition, the amount of purchase by the BOJ is substantial in such zone, which makes it easier to lead a tightening of supply-demand balance and a sudden decline of interest rate.

- “The measures contributing to the continuation of powerful monetary easing”, which were determined by the BOJ in April, will contribute to the improvement of liquidity and the stabilization of interest rates at a low level. The expansion of eligible collateral assets is very beneficial for market participants who have been struggling with collateral management due to a further fall of the negative interest rates on JGBs in the medium- and long-term zones. This enables those investors who have faced the problem of securing new eligible collateral assets because of their collateral assets reaching maturity to make an effective use of the small amount of securities that they hold. In particular, the inclusion of non-publicly offered local government bonds among eligible collateral assets is a very meaningful measure for regional financial institutions that underwrite a lot of such bonds. On the other hand, the relaxation of the requirements regarding the BOJ’s Securities Lending Facility contributes to the easing of a squeeze for futures. However, this measure will likely become more effective in improving liquidity if the BOJ makes it a more convenient tool through further fine-tuning while exchanging opinions with the market.

- “The measures contributing to the continuation of powerful monetary easing,” which were determined by the BOJ in April, were adopted out of consideration for the improvement of liquidity in the market and

collateral management by regional financial institutions. These measures have had no direct impact on the movements of interest rates on JGBs.

Recently, as expected interest rate cuts by foreign central banks have been priced into the market, the BOJ is also inevitably coming under some degree of pressure. Both the interest rate on 10-Year Bonds and short- and medium-term interest rates have fallen to the most recent lowest level. In addition, as the negative interest rate on 10-Year Bonds is expected to persist for a long time, 20-Year and 30-Year Bonds, which carry positive interest rates, tend to be attractive to investors. Currently, purchases and swap receiving by life insurance companies in the super-long-term zone are gradually growing though those activities are not as conspicuous as they were in 2016, when interest rates fell steeply. Also, the active purchases of 20-Year and 30-Year asset swap since the beginning of this month is contributing to the favorable supply-demand balance in the super-long-term zone.

As for the future outlook, ahead of the G20 summit at the end of this month and the ECB Council meeting and the FOMC meeting scheduled for next month, investors will continue to find it difficult to take positions. As the current low-interest-rate situation abroad is expected to continue, purchases by foreign investors in the short-, medium- and long-terms of JGBs are likely to continue. In addition, the needs for positive interest rates in the super-long-term zone and insurance companies' needs are expected to continue. Therefore, at least in the first half of the current fiscal year, the interest rate is likely to stay in the negative 10bps range for 10-Year Bonds and between 10bps and 30bps for 20-Year Bonds.

- “The measures contributing to the continuation of powerful monetary easing”, which were determined by the BOJ in April, are making significant contributions to the improvement of liquidity in the market. As many market participants regard bidding rate for the BOJ’s Securities Lending Facility as the lower limit of the repo rate, the lowering of the minimum lending commission has the effect of minimizing the margin of decline in the repo rate of issues for which the supply-demand balance in the market is tight. Consequently, that is reducing the volatility of the repo rate and curbing an excessive distortion of the yield curve. In addition, the easing of requirements regarding the delivery of the cheapest issues is expected to reduce the possibility of a squeeze occurring for those issues, making it easier to handle futures.

While there were concerns that the expansion of eligible collateral could lead to a decline in demand for T-Bills as collateral, the impact of a decline in demand as collateral on the T-Bill market will be minor because the main investors of T-Bills, which carry deep negative interest rates, have recently been foreign investors.

The clarification of the forward guidance for policy interest rates has raised awareness that the current monetary policy will continue for a long time, and in addition, expected policy interest rate cuts by foreign central banks have been priced into the market, leading to an increase in investors' demand for positive interest rates. As a result, currently, the yield curve is flattening in the super-long-term zone. In this situation, the presence of foreign investors as net purchasers is growing. Since the revision of the monetary policy in July last year, the volatility in the market has increased, making it necessary to face the market, and in that sense, a positive tension is being created.

- The inclusion of the reduction of the minimum lending commission in “the measures contributing to the continuation of powerful monetary easing”, which were determined by the BOJ in April, is probably effective in improving liquidity in the market. The easing of the requirements regarding the delivery of the cheapest issues also probably has positive effects for improving market liquidity in that it curbs excessive squeezing and leads to a natural price formation. As how to improve liquidity in the market without distorting price formation was one of the key points, the implementation of the measures by the BOJ in April was great.

On the other hand, it is difficult to maintain liquidity though the market environment has been desirable

for market makers as there are price movements. Although investors' needs are increasing on a flow basis amid the strong stock effect, the BOJ is continuing a substantial amount of purchases, and as a result, distortions are arising with respect to the interest rate level and the term structure. From the viewpoint of domestic investors, there is neither interest income nor yield for the holding period due to the perpetuation of negative interest rates and inverted yield curves, which probably tends to promote flows of funds into zones with positive interest rates and zones where the yield curve is steep. Moreover, insurance companies' needs have combined with these factors to create a situation in which interest rates are prone to fall, such as flattening of the yield curve. As there is no magic bullet for this situation, monetary policy is entering a difficult period.

- The period since the end of the Golden Week of holidays in May can be divided into three phases—(1) the phase in which interest rates of JGBs did not fall at all despite interest rate declines abroad, (2) the phase from June in which interest rates on JGBs fell in tandem with interest rate declines abroad, and (3) the phase from the beginning of this week in which the market is testing a further interest rate fall. There are three factors as to why interest rates of JGBs did not fall after the end of the Golden Week of holidays in the first phase. The first factor is the halt of foreign investors' purchases, which continued until April. The second factor is consciousness about the possibility that the consumption tax hike may be postponed. The third factor is the fact that the measures determined at the Monetary Policy Meeting in April gave the impression that it was difficult to implement additional easing contrary to the intended effect, making it difficult to continue active purchases. However, in the second phase, the mood completely changed when talk about the tariff against Mexico emerged, and interest rates of JGBs fell following foreign interest rates, with the interest rate on 10-Year Bonds dropping to around negative 0.1-0.15%. In the third phase, which started this week, the FRB almost admitted to its willingness to reduce interest rates, and the yen appreciated in the exchange market. As a result, now is the time to test how far the interest rate on 10-Year Bonds will fall, rather than whether or not it will stop falling at negative 0.2%.

As for the future outlook, the market could move considerably on the timing of interest rate cuts by the European and U.S. central banks. However, as the U.S.-China trade negotiations are unlikely to be easily settled, we expect that the supply-demand balance in the market will continue to be tight. If the interest rate on 10-Year Bonds chronically stays lower than negative 0.2%, the BOJ may try to prevent a further decline of interest rate through such measures as setting the lower limits on the interest rates at which it purchases JGBs. Interest rates may temporarily rise, but in that case, there is the possibility that foreign investors may conduct purchases as JGBs become undervalued compared with European bonds. Therefore, a steep interest rate rise is unlikely.

#### **4. Matters explained by the Financial Bureau**

▶ The Financial Bureau gave the following explanations about the notification and announcement of the League Table of JGB Market Special Participants (Primary Dealers).

- At present, notification and announcement of the League Table of JGB Market Special Participants is made quarterly based on the Principal Terms and Conditions for JGB Market Special Participants Scheme. At this time, we will make two changes concerning the League Table, starting with the announcement in July 2019. In light of these changes, we will make the necessary revisions concerning the Principal Terms and Conditions for JGB Market Special Participants Scheme at the end of June this year, and the revised version will be announced on our website.

- First, we will make notification and announcement of a newly created table regarding purchases of

Inflation-Indexed Bonds in particular in order to invigorate the market for the bonds. Specifically, once a year, each participant will be notified of its ranking of the total amount of successful bids for Inflation-Indexed Bonds issued through auctions in the previous fiscal year among JGB Market Special Participants. Also, top five participants will be announced on the MOF website. Regarding the “long-term bonds” category, the notification and announcement will be made based on the total amount of purchases of 10-Year Bonds and Inflation-Indexed Bonds, as has been the custom until now.

As for the timing of the notification and announcement of the newly created table regarding Inflation-Indexed Bonds, that for FY2018 will be conducted in July this year, and thereafter, that will be conducted in April every year.

- Secondly, the notification and announcement of the table of the top participants concerning the amount of total bids will be abolished. At present, each participant is notified of its ranking of the total amount of bids for each of the four categories of bonds among JGB Market Special Participants, and the top five participants are announced on our website. However, the notification and announcement will be abolished, starting with the League Table scheduled to be announced in July 2019.

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