Minutes of the Meeting of JGB Market Special Participants
(91st Round)

1. Date: Thursday, November 26, 2020 (4:00 p.m. to 5:20 p.m.)
2. Place: International Conference Room, Ministry of Finance (online)
3. Gist of Proceedings:

1. Latest JGB market situation and outlook in the future
2. Current status and issues for the compilation of the JGB Issuance Plan for FY2021

▶ The Financial Bureau gave the following explanation about the current status and issues for the compilation of the JGB Issuance Plan for FY2021.

・ We would like to explain the current status and issues for the compilation of the JGB Issuance Plan for FY2021 by using the materials of the meeting of the Advisory Council on Government Debt Management and show the opinions received from the members at the meeting of the Advisory Council on Government Debt Management held on November 4.

(Current status and issues surrounding the issuance of JGBs after the response to the novel coronavirus infection)

・ The total issuance size stands at about ¥253 trillion as a result of increasing the amount by about ¥100 trillion in the first and second supplementary budgets, which marks a record high. The issuance of short-term bonds was mainly increased to finance the funding needs. What needs to be borne in mind is the fact that the short-term bonds will be redeemed next year and need to be refinanced.

・ The yield curve has slightly bear steepened compared to the time before the spread of the novel coronavirus infection.

・ We are doing future estimates of the JGB issuance size based on the Economic and Fiscal Projections for Medium to Long Term Analysis by the Cabinet Office. If we estimate based on the assumption that the proportion of the issuance of each maturity after the second supplementary budget of FY2020 will be maintained from FY2021 onward, the issuance of short-term bonds will be continued at a reasonably large scale. As a result, it is expected that the amount of refunding bonds and the total issuance size will continue at the current level.

・ Therefore, we believe that it will be necessary to reconsider the composition of maturities to meet the market needs while curbing the issuance size of refunding bonds through a reduction of T-Bills which were increased this time when it is possible to reduce the total issuance size after we see calm-down of the coronavirus pandemic in light of a variety of economic indexes.

・We looked at the change in cost and risk in the issuance plan before and after the spread of the novel coronavirus infection by means of a cost-at-risk analysis. We can see that both the cost and risk have increased as a result of the large scale increase in the order of ¥100 trillion. While the increase focused on T-Bills has not resulted in the increase in the average cost as much, the risk of future interest rate fluctuations for the refinancing has increased.

・ Basically, there is a trade-off between cost and risk, but both cost and risk have increased this time. This derives from the fact the overall issuance size has increased. Therefore, from the perspective of reducing both the increased cost and risk, the major premise is the curbing of the overall JGB issuance size, while adjusting the issuance maturities to market needs.

・ Regarding the utilization of front-loading issuance of refunding bonds, there are times where it is necessary to increase the issuance size of government bonds in the short run when there occurs an emergency situation such as the Financial Crisis in 2008, the Great East Japan Earthquake, etc. In a situation where the total issuance size increases sharply, we have managed to control the calendar-based total JGB market issuance so as to prevent a sharp change by using front-loading issuance of refunding bonds. We believe it will be necessary to take full advantage of its function as well in the future when issuing JGBs.

・ If we look at the BOJ's JGB purchase ratio to issuance, it has basically been on a downward trend since the introduction of its yield curve control. However, we can see that the ratio with a maturity of 10 years or shorter which are subject to yield curve control in particular has increased in the short run. On the other hand, there is no considerable change in the ratio with a maturity longer than 10 years and the downward trend continues. We will need to take note of the effect of the monetary policy and the attitude and the stance of the Bank of Japan (BOJ) on the JGB market and interest rates.

・Banks' JGB holding ratio, which has been decreased in recent years, seems to have bottomed out and turned to increase most recently. We believe this is due to the increase in collateral demand.

・ Regarding life insurance companies, we are of the view that there are needs for ultra-long-term bonds to a certain extent that they need to fill the duration gap between their assets and liabilities before the introduction of ICS (Insurance Capital Standards) in 2025. Under the circumstances, we believe it will be necessary to pay close attention to how their pace of bond purchasing will change toward 2025 or what difference in their needs will be there before and after 2025.

・ After the outbreak of the novel coronavirus, it was seen that the JGB market was also volatile due to the work attendance restrictions and telework as well as investors risk-aversion as a result of the declaration of the state of emergency by the government. We believe it will be necessary to be aware of strengthening the BCP system to allow JGBs to be steadily issued and financed under any circumstances under the assumption that an abnormal state such as the one this time may occur in the future.

(Main opinions at the Advisory Council on Government Debt Management [November 4])

・ we received opinions including the one arguing that regarding the bond maturity composition, we will need to level off the imbalance in the composition in the future where too many T-Bills have been issued; that regarding the issuance of ultra-long-term zones, although the demand will continue to expand, sufficient consideration must be given to the amount of interest rate risk; and that while the issuance of new government bonds will decrease in the future, it will be necessary to redeem T-Bills issued in large quantities on this occasion and lengthen the average redemption period.

・ Regarding fiscal discipline, there were various opinions including one which states that it is important for both the public and private sectors to have an awareness of the current balance of payments and fiscal discipline as the competitiveness of the nation, and for the market to issue messages including fiscal discipline in order to accommodate additional measures; and that although it is desirable to balance the costs and risks involved in issuing government bonds while considering the market needs, it is also important to take care of detailed communication with the market to avoid misunderstanding both in Japan and abroad about our stance on fiscal discipline.

・ In addition, we received an opinion that in the wake of heightened uncertainties in the market under the declaration of the state of emergency amid the ongoing Covid-19 pandemic, both the public and private sectors need to work to strengthen the BCP system.

・ We will compile the JGB issuance plan in close communication with all of you by taking into consideration the possibility of a further increase in the issuance depending on the size of the third supplementary budget as well as an increase in the issuance size of refunding bonds in FY2021 for redemption and refinancing of the T-Bills increased this fiscal year.

▶ Summarized below are the views and opinions submitted by the participants:

・ While interest rates on JGBs in the ultra-long-term zone are gradually rising, we believe that interest rates on bonds with a maturity of 10-year or shorter will remain almost unchanged during the time in which the end of the yield curve control by the BOJ is not in sight.

・ The current situation is such that JGBs do not react all in all to macroeconomic factors such as rise in overseas stock prices, except JGBs in the ultra-long-term zone which is out of the yield curve control fluctuate in response to overseas interest rates and stock prices.

・ Regarding the JGB issuance plan for the next fiscal year, amid uncertainties about its total size, we believe that it is the market consensus that the supply and demand balance for 6-month T-Bills whose size of issuance has been increased is considerably loose and investors for them are scarce, and thus, a decrease in this maturity is inevitable.

・ Regarding JGBs in the ultra-long-term zone, there is a strong demand for 20-year bonds, mainly from banks. There are investment needs in both 30-year bonds and 40-year bonds for life and non-life insurance companies and we feel that their investment in 40-year bonds has increased more than before. According to the yield curve, there is only a spread of 2bps between 30-year bonds and 40-year bonds, and the supply and demand balance for 40- year bonds is in a very tight position. We are of the view that an increase in amount of 20-year bonds and 40-year bonds is largely promising when considering the JGB issuance plan for the next fiscal year.

・ In addition, there are needs for Liquidity Enhancement Auctions, which were not discussed at the time of the increase in JGB issuance this fiscal year, by securities companies. We would like to see an increase in JGBs, especially with a remaining maturity of 1 to 5 years and in JGBs and with a remaining maturity of 15.5 to 39 years if the overall issuance size is increased this time.

・We see the current situation as such that the volatility of JGBs continues to be low despite some fluctuations in overseas bonds amid the novel coronavirus infection and the US presidential election and thus, the operation of Outright Purchase of JGBs as the BOJ's yield curve control policy is effective.

・ Regarding the issuance plan for the next fiscal year, we feel that the liquidity of 40-year bonds is quite low. In particular, since the demand for duration matching by life insurance companies is strong regardless of interest rate levels, we believe we would like to see the increase in mainly

40-year bonds if the overall JGB issuance size is increased.

・ From the shape of the yield curve, since the spread between 40-year bonds and 30-year bonds is considerably narrowed, even if the spread widens due to the increase in issuance, there is no problem with the shape of the yield curve. We feel that it is desirable that the JGB issuance should be focused mainly on 40-year bonds.

・ JGBs with a maturity of 20-year or shorter continue to remain very stable due to the BOJ's strong yield curve control. Although there are some off-the-run issues which lack liquidity, they generally continue to remain stable. Regarding JGBs in the short-term zone, there are collateral needs and dollar-based needs of overseas investors involving currency swaps, as well as strategic needs in view of the prolonged monetary easing, low volatility and carry and roll-down of JGBs, not only of domestic investors, but also of overseas investors, as seen over-the-counter of our company despite a decrease in the trading volume by investors. On the other hand, although there is a certain need by investors for 30-year bonds and 40-year bonds to comply with the regulation, yield adjustments have been made because of the increase in issuance size and the stance of Outright Purchase of JGB, which can be confirmed by the change in the yield curve. Under the circumstances, the demand for 40-year bonds is larger than 30-year and we can see duration needs and broadening investor base.

・ We believe that this situation will continue under the BOJ's monetary easing and JGBs will continue to be stable. Provided, however, that great care should be taken of the difference in supply and demand between current bonds with large quantities and existing bonds, depending on zones. In addition, we have to be wary of the effects of external factors on JGBs amid the increasing presence of overseas investors.

・ Regarding the JGB issuance plan for the next fiscal year, we believe that while there is room for an increase in bonds in the ultra-long-term zone with investors' demand, a further increase in T-Bills should be abstained. However, regarding Liquidity Enhancement Auctions, we would like to see an increase or change to monthly issue in JGBs with a remaining maturity of 1-5 years. Due to the effects of Outright Purchase of JGBs, the JGB balance in the market has decreased, with repurchasing getting tight and liquidity decreasing. The demand for this zone is strong mainly from overseas investors and thus, we would like the debt management office take this into consideration.

・ As for the current market situation, there have been a variety of issues related to the novel coronavirus epidemic such as the increase in JGB issuance size from July. The yield curve should have shifted upward with an increase in volatility, however, the yield curve remains stable at a low level. In future, as long as the yield curve control continues to be maintained for a long period of time, the market will continue to be fairly stable.

・ If there is a need for increasing or decreasing the issuance size, we believe that T-Bills should be decreased and interest-bearing bonds with a remaining maturity of 10 years or less which are under the yield curve control should be increased. As regards the ultra-long-term zone, a further increase in 30-year bonds will be difficult as seen in their performance since July. Although we are of the view that the issuance size of both 20-year bonds and 40-year bonds should be desirably left unchanged, if an increase is necessary for JGBs in the ultra-long-term zone as well, we believe that there is room for that in 40 year-bonds and then 20-year bonds in this order.

・ We have the impression that the current JGB market remains extremely illiquid. Due to the trading within a very narrow range, both the daily trading volume and turnover is very small. Particularly, we feel that the liquidity of the off-the-run issues is low and very strong results of Liquidity Enhancement Auctions of this month reflects the current situation.

・ In the next month of December, a large amount of JGBs will be redeemed. Although we look forward to the overall market being motivated, we feel that such a low liquidity will continue.

・ Regarding the JGB issuance plan for the next fiscal year and beyond, investors who are our customers consider it highly desirable if interest rates rise with an increase in issuance. Over-the-counter of our company, many customers invest mainly in 10-year bonds and 20-year bonds and consider favorably the interest rate rise in these zones. Investment will be induced and encouraged if interest rates rise in the sector of the ultra-long-term zone as a result of an increase in issuance of 30-year bonds and 40-year bonds. However, the liquidity of 40-year bonds is low compared to that of bonds of other maturities, and we feel that we must be cautious in light of the trading over-the-counter of our company.

・ Regarding the market environment, the volatility is very low, and currently it is on a downward trend, and the market seems at a deadlock. We have the impression that the market reaction to external factors is weak and there is decreased interest rate functionality. Therefore, we feel now is the time to adopt measures to improve the functionality by reducing the amount and frequency of Outright Purchase of JGBs, etc.

・ As regards JGBs in the ultra-long-term zone, while 20-year bonds are supported by banks for their investment needs for positive interest rates, there is a sense of excess issuance for 30-year bonds and the yield curve is steepening. Regarding the JGB issuance plan for the next fiscal year, we believe it desirable in view of such a situation to maintain the current issuance level of 40-year bonds in the ultra-long-term zone because we consider that the current remarkably strong demand for them by life insurance companies this fiscal year will gradually start to dwindle from the next fiscal year onward. Regarding 30-year bonds, we believe it rather necessary to reduce their issuance amount due to the fact that there was a long tail in the auction after the increase in issuance size and the yield curve has steepened. As regards 20-year bonds, as the demand for them by banks continues, we believe that at least the current issuance size should be maintained. If an increase is considered, we believe it necessary for the debt management office to carefully consider the potential continuity of the demand from banks.

・ Since 5-year bonds and 10-year bonds are strongly supported by the BOJ's yield curve control, we believe that either an increase or a decrease in amount is possible. As for 2-year bonds, we think it necessary to reduce the amount when considering the reduction of refunding bonds in future.

・ As for Liquidity Enhancement Auctions, we would like to see that at least the issuance size will be maintained because of a significant drop in liquidity of existing bonds due to the prolonged Outright Purchase of JGBs.

・ Regarding the latest JGB market trends, the volatility is low due to the effects of the BOJ's yield curve control policy. 10-year bonds are within slightly positive interest rates range and are in a very stable situation because when interest rates are positive, demand arises while when they turn negative, demand almost disappears. We are of the view that the market will continue to remain stable in light of no foreseeable change in the framework of monetary policy.

・ Regarding the JGB issuance plan for the next fiscal year, when it comes to the matter of maturities with room for an increase in issuance size, we believe that there is room for increase in JGBs in the ultra-long-term zone which continues to remain stable despite a recent yield curve steepening in the circumstance where Outright Purchase of JGBs are centered on bonds with a remaining maturity of up to 10 years with hardly any consideration for the ultra-long-term zone. We believe that there is room for increase in 20-year bonds or 40-year bonds. The market for 30-year bonds is rather weak.

・ On the other hand, since the amount of Outright Purchase of JGBs in the medium-term and long-term zones can be adjusted, we believe that JGBs in these zones can be either increased or decreased

・ Although we are aware that T-Bills can be controlled by the BOJ, if their amount is increased unexpectedly, there is a possibility that a temporary surge in interest rates may occur. Even though it is predicted that arbitrage will work to some extent depending on the demand of investors including overseas investors, we have to be wary of the fact that the market may become very volatile.

・ We see that there is no particular problem with the recent JGB market situation because interest rates are very stable even if liquidity is low.

・Regarding the JGB issuance plan, we agree to the reduction of T-Bills. We also agree to an increase in 10-year bonds and 20-year bonds for which there is a strong demand.

・ On the other hand, as regards 40-year bonds, we believe it desirable that the debt management office hear opinions from securities companies that are awarded a contract usually. 40-year bonds have been auctioned and issued through the uniform price auction method for more than 10 years and their issuance size has increased. If an increase is required, we believe that it is time to conduct auctions monthly. Although some say that their liquidity is low, we believe that if monthly auctions are introduced, liquidity will be improved. At that time, the debt management office may hear from market participants and consider shifting the auction method to the discriminatory price auction method.

・ Regarding the current situation and outlook for the recent JGB market, the low liquidity and reduced market function are a matter of concern. However, the combination of a large scale governmental financial support and the monetary easing measures adopted by the central bank has functioned smoothly globally, and interest rates on bonds with a maturity of 20-year or shorter have continued to remain stable at a low level, due to the BOJ's yield curve control.

・ Regarding the JGB issuance plan for the next fiscal year, we believe it appropriate in terms of cost at risk to start reducing the amount of T-Bills which were increased this fiscal year. In particular, we believe the change in the frequency of auctions of 6-month T-Bills from once a month to twice a month has posed clearly a burden on the market. Therefore, we believe it more appropriate to reduce T-Bills as much as possible instead of reducing interest-bearing 2-year bonds and 5-year bonds. We believe it most appropriate to undo the change of the frequency of auctions of 6-month T-Bills, that is, from twice a month to once a month.

・ On the other hand, as far as maturities of bonds to be increased are concerned, 20-year bonds attract demand not only from deposit financial institutions but also from a wide range of investors due to its improvement in yields according to over-the-counter sales in our company, and we believe that there is large room for increase. We may say that an increase of ¥100 billion or ¥200 billion per month will be possible.

・ We believe that there is room for an increase in 40-year bonds as well and we have the impression that the investor base is expanding year by year. We believe that the current unbalanced shape of the yield curve is caused by a mismatch between supply and demand for the issuance size Therefore, although we consider that there is room for an increase of ¥100 billion per month, since 30-year bonds were increased by ¥200 billion from July onwards which seems loose in the market, we may think it appropriate to look at the combined issuance size of 30-year bonds and 40-year bonds. All in all, we think that 20-year bonds have the largest investor base and have room for an increase.

・ The market situation in the last month or so has been such that while stock prices and overseas interest rates have risen, interest rates in Japan remain stable.

・ Regarding the current situation and problems in connection with the compilation of the JGB issuance plan for the next fiscal year, we think that there is room for an increase in the ultra-long-term zone and in particular in 20-year bonds which have a wide investor base and enjoy a strong demand. There is no problem in maintaining the status quo for 30-year bonds. As for 40-year bonds, there is room for an increase given that the number of investors has been gradually increasing despite its liquidity has not particularly increased.

・ There is no problem in maintaining the status quo for 5-year bonds and 10-year bonds, and we think that they may be either increased or decreased. As regards 2-year bonds, when we consider that the market often overheats at the time of their auction, an increase may be considered.

・ We may believe that there is room for an increase for 1-year T-Bills in terms of supply and demand. As regards 6-month T-Bills, there may be no problem in maintaining the status quo.

・ The latest JGB market has remained stable with little correlation with the macroeconomic situation. We consider that this is due to the fact that there has been a substantial tightening in the market range, as the downward move of interest rates to the negative range of 10-year bonds has been limited. Changes in supply and demand balance due to the increase in the JGB issuance size from July, and the effect of the BOJ's yield curve control have also contributed to this. As a result, against the backdrop of the stagnant market and low foreign bond interest rates, the demand for income gain in the sector of 10-year bonds to 20-year bonds has increased, resulting in the shift of funds from overseas to JGBs.

・ On the other hand, regarding JGBs with a remaining maturity of over 25 years, due to the impact of the increase in issuance, interest rates continue to gradually rise. When considering that the spreads between 30-year bonds and 40-year bonds are very tight, we believe that there is a demand for the ultra-long-term zone.

・ We expect in the long run the development of vaccines against the novel coronavirus infection. However, since the situation does not allow optimism due to a current increase in the number of cases, we believe that the JGB issuance will be increased and monetary easing will be strengthened for the time being. As a result, the JGB market will be significantly controlled and regardless of whether the JGB issuance size is increased or decreased, the ultra-long-term zone which is outside the BOJ's yield curve control will fluctuate moderately depending on changes in the supply and demand balance and other zones will continue to remain stable.

・ Regarding the reduction in issuance of new government bonds and FILP bonds in the JGB issuance plan for the next fiscal year, we believe it appropriate to mainly reduce T-Bills which were increased rapidly in order to ensure smooth and stable issuance of JGBs. When considering the current inventory of domestic financial institutions and the BOJ, we believe it possible to reduce the amount of T-Bills to ¥30 trillion. However given that the matter should be carefully handled so as not to cause short-term interest rates to significantly fluctuate, changes in the collateral demand of domestic participants and in demand for asset swaps by overseas investors should be taken into consideration.

・ We believe that there is room for an increase or a decrease in the long-term zone.

・ As regards the ultra-long-term zone, since 40-year bonds are capital efficient for duration extension purposes, we feel that they have been picked up and we believe that there is room for an increase. We also think that there is room for an increase in 20-year bonds because it seems that the demand for them is increasing, although our priority is low. On the other hand, we feel that the supply and demand balance of 30-year bonds is relatively loose in the ultra-long-term zone and thus, there is no room for an increase, rather there is room for a decrease. Provided, however, that since the ultra-long-term zone as a whole is outside the BOJ's yield curve control and a significant change in supply and demand balance may lead to a sudden change in the market, the amount of reduction should be limited to ¥100 billion per month.

・ Regarding the sector with a remaining maturity of 10 years or less, when considering that the market of the sector remains stable and it is under the BOJ's yield curve control, we would say that either an increase or a decrease of a maximum of ¥400 billion in 10-year bonds, ¥300 billion in 5-year bonds and ¥600 billion in 2-year bonds may be possible.

・ Even though such a large amount of issuance was increased, the market is extremely stable. We have the impression that banks are not buying aggressively, but they are forced to buy, as collateral is required in monetary policy. We do not see much change in future.

・ Regarding the JGB issuance plan for the next fiscal year and beyond, we believe that JGBs with a maturity of 10-year or shorter can be either increased or decreased in units of several hundred billion yen on the premise that the pace of Outright Purchase of JGBs will be maintained. As regards the ultra-long-term zone, the supply and demand balance of 30-year bonds is clearly out of balance as seen in the change in the yield curve from July. If an increase is necessary, 40-year bonds should be picked up. As regards 20-year bonds, they can be also increased in the next fiscal year on the assumption that the long-term interest rates will stay around zero percent under the yield curve control. However, if the demand from banks is strong on the basis of that premise and the supply and demand balance is supported as a consequence, we request the debt management office to consider that a further increase will pose a risk when the yield curve control is ended because the current balance is already huge.

・ Regarding the outlook for the JGB market, as the monetary policy of the BOJ exerts strong effects on the market, its environment is generally stagnant and less volatile than other overseas markets. The United States will get out of the covid-19 epidemic in the long run and interest rates are slightly biased upward globally. Regarding short-term economic downturn, since it is unlikely in Japan that there will be political conflicts on fiscal stimulus package like those in the United States, we believe that at least concerns over decreasing interest rates are not so strong as before, in the Japanese market. If interest rates rise in the future, we believe that the focus will be on the extent to which the BOJ will allow the rise in interest rates for each maturity.

・ Regarding the JGB issuance plan, we believe it is desirable to issue JGBs in line with demand. We believe that the banking sector has increased most its investment capacity this fiscal year. We believe also that there is a strong investment demand for 10-year bonds and 20-year bonds from a variety of investors including banks. Therefore, we are of the view that 10 year-bonds and 20-year bonds are strong candidates for an increase or for maintaining the status quo even if the overall issuance size is reduced.

・ We believe that there are various views on the ultra-long-term sector. We are of the view that interest rates on 30-year bonds are rising, meaning an excess supply, while 40-year bonds are consistent due to duration demand. Therefore, for example, it may be worthwhile to consider increasing 20-year bonds and 40-year bonds, while reducing 30-year bonds. We believe all in all that T-Bills will be decreased or temporarily increased as far as the overall JGB issuance size is concerned. However, if JGBs are issued and the BOJ buy them, this means that JGBs are just replaced with overnight debts in terms of consolidated government, which we must bear in mind. Therefore, although it seems the issuer can reduce the refinancing risk, this needs to be reconsidered from the perspective of whether this leads to debt stability for Japan as a whole.

・ The market depends entirely on the yield curve control, whether now or in future. If an upward pressure is put to the US interest rates with the recovery of global economy, the FRB will respond, but as the FRB's monetary policy does not work as strongly as that of that of the BOJ, their yields are expected to slightly rise. In this case, there may be a case where Japanese interest rates will rise along with both the US interest rates. However, since the yield curve control will act on interest rates in yen eventually, we presume that fluctuation of interest rates on 10-year bonds will be up to 0.2 percent which is the upper limit allowed by the BOJ up to the end of next year.

・ The risk, if any, derives from the fact that the stock market has a high opinion of the effects of vaccines. It is needless to say that pharmaceutical companies profit from the fact. However, from a macro perspective, it is important how many people will get vaccinated in addition to the kind of effects to be produced. In particular, in Japan, we believe that the end of the novel coronavirus epidemic will be seen more clearly in social terms than in pharmaceutical and medical terms and the path thereto is unclear.

・ Regarding the JGB issuance plan, there are various opinions. It is a matter of course that the debt management office does not want to see a rise in interest rates, investors want to see a rise in interest rates and we, as traders, would like to see volatility. Therefore, while investors and traders want to see an increase in issuance, the problem is where the target of the debt management office is. Since it is probably true that interest rates will not rise significantly even if the amount is increased due to the BOJ's yield curve control and the existence of the interest rate term structure. Given that there is demand for 20-year and 40-year bonds in the ultra-long-term zone, they may be increased. However, just as the increase in issuance of 40-year bonds was avoided in July, if the debt management office wants to stop the increase in the JGB issuance amount, we believe that there are such options as using adjustment between fiscal years including front-loading issuance of refunding bonds and issuance of JGBs in the accounting adjustment term, as well as not necessarily increasing bonds in line with the request of the market. We should judge how the message of the increase in the JGB issuance size is received by the market from a longer perspective.

・ The market is expected to continue to be stable at a low level. Amid the circumstances where overseas interest rates are rising, no interest rate rise in Japan is particularly seen in 10-year bonds and 20-year bonds and only interest rates on 30-year bonds and 40-year bonds are rising. This shows the fact that they are effectively under the yield curve control.

・ Under these circumstances, we often see a phenomenon where quite a lot of trading is concentrated in the start of bidding in the auction. We believe that this occurs, not only because investors trade under the BCP system or working from home, but because overseas investors go short before bidding and go long at the time of bidding. In such investment behavior, orders tend to be placed at an average winning bid, leading to a squeeze on the day of the auction and resulting in an issuance at a considerably high price to leave some bonds unsold in the market. In view of the situation where the number of orders at an average winning bid is increasing, we believe some measures need to be taken, which may include, shift to the uniform price auction system, or if this is difficult, for example, an increase in the issuance size of the non-price competitive auction I.

・ Regarding the JGB issuance plan for the next fiscal year, we believe that basically the amount of T-Bills should be reduced if the overall issuance size is reduced. Not only that there is room for reduction of ¥20 trillion or more only with a reduction in Outright Purchase of JGBs, but also if financing related to measures against the novel coronavirus epidemic is reduced, the BOJ's Special Funds-Supplying Operations to Facilitate Financing in Response to the Novel Coronavirus will be also reduced, decreasing collateral demand. All in all, we believe it possible to reduce ¥20 trillion or more, however if a reduction in excess of ¥20 trillion or more is made, it will be necessary to carefully watch out for the actual state of collateral demand and overseas demand.

・ As for interest-bearing bonds, there is room for increase in 20-year bonds and 40-year bonds in the ultra-long-term zone. The investor base is expanding considerably for 20-year bonds and the spread between 30-year bonds and 40-year bonds remains only about 2 bps. If we take into consideration that life insurance companies are looking for JGBs with a longer maturity, we believe that there is plenty of room for an increase of ¥100 billion per auction in the issuance size of 40-year bonds. The amount of 2-year to 10-year bonds can be increased or decreased depending on the BOJ. As regards 10-year bonds, we understand that the supply and demand environment is in an excellent state that they will be sufficiently financed by investors' demand without an increase in the BOJ's purchase. On the contrary, if the amount is reduced, the reduction should be countered by the reduction in the amount of purchase by the BOJ. However, since 10-year bonds are the principal target zone of the yield curve control and the reduction response tends to take more time in view of the past history, a careful consideration is required.

・ As for the liquidity of the JGB market, it is difficult for a large amount of transactions except the auctions and Outright Purchase of JGBs. Current bonds, old bonds and double-old bonds can be traded to a certain extent, however trading other than them is difficult in the secondary market. This situation has neither improved nor deteriorated.

・ The current market situation is that JGBs with the maturity of 10-year or shorter are traded in a narrow range without any clear direction. As regards the ultra-long-term zone, despite an increase in overseas interest rates, due to concerns of an increase in issuance, the ultra-long-term zone remains stable with active demand even though those interest rates rise temporarily. Of course, it all depends on the extent of support by the BOJ. However, under the circumstances where, after the US presidential election, expectations for a large fiscal stimulus are disappearing and interest rates on US bonds of maturity of 10 years or longer are stable, and where there is a concern over global re-expansion of the novel coronavirus epidemic, it is difficult for overseas interest rates to rise and it is also difficult for ultra-long-term interest rates in Japan to rise. While interest rates of 10-year bonds remain in a narrow range between zero and 0.05 percent, interest rates of JGBs with a shorter maturity do not go neither upward nor downward. The upward direction is suppressed by the yield curve control; and since expectations for the deepening of negative interest rates have receded as seen last year, it is difficult for interest rates to fall further. If the content of the third supplementary budget would be as has been reported, the market may become somewhat volatile. However, we believe that this will be a temporary phenomenon and interest rates will be stable again under the yield curve control and due to stable overseas interest rates.

・ Regarding the JGB issuance plan, we believe it appropriate to maintain the current status quo as a whole when considering that there is basically a growing tension in auctions more than before, because although the amount of purchase by the BOJ increased gradually before July when the issuance size of interest-bearing bonds was increased, the pace of the purchase by the BOJ was slower than the increased issuance size of interest-bearing bonds.

・ If the issuance size needs to be increased, we believe that 2-year bonds, 20-year bonds and 40-year bonds are the candidates. As regards 40-year bonds, we believe that an increase of about ¥100 billion per auction is possible in light of the situation that there is active demand from final investors and the bond repurchase market was temporarily very tight. Since we believe it possible to first stop the purchase of JGBs in the zone by the BOJ, all depends on the overall balance. As regards 20-year bonds which provide positive yields, we believe that an increase of about ¥100 billion per auction may be possible because there is demand for them with their positive yields when yields on 10-year bonds continue to remain at nearly zero percent. With respect to 2-year bonds, an increase in the order of several hundred billion yen per month may be possible because there is considerably stable demand for collateral purposes and others under the premise that the purchase stance of the BOJ will remain unchanged. As regards T-Bills, we are of the view that their amount should be gradually reduced basically because the size has been significantly increased and that the volatility in the short-term market has been heightened depending on the auction results, despite the T-Bill market is generally stable, supported by the BOJ and collateral demand. Particularly, 6-month T-Bills whose supply and demand balance has remarkably deteriorated should be reduced first.

・ There is a strong consensus that the yield curve control is effective in the JGB market and JGBs with maturities up to 10 years which are aggressively purchased by the BOJ are very stable. JGBs in the ultra-long-term zone remain also very stable with a monthly range of 4-5 bps despite the interest rate rise due to the increased issuance size from July.

・ The liquidity of the secondary market continues to be not high because there are hardly any people who trade actively in that market. Regarding the derivatives market, investors are not active at all in anticipation of the suspension of LIBOR, and its liquidity is also the concern.

・ Regarding whether interest rates rise in Japan when overseas interest rates rise globally in the future as vaccines will become widespread, we are of the view that they will not rise so much. When comparing with other countries, interest rates have risen already and their fluctuations are limited under the yield curve control.

・ In the compilation of the JGB issuance plan for the next fiscal year, we think it is still uncertain to which extent we will be damaged by the novel coronavirus epidemic in the future. Although psychological optimism will increase, it is difficult to assume an economic recovery all at once. The characteristics of Japanese people, interruption of subsidies, uncertainty of the credit markets may cause eventually a decrease in tax revenue. If all these matters are considered, we do not think it appropriate to increase the amount of interest-bearing bonds.

・ If the issuance size needs to be increased, 40-year bonds have high priority in terms of supply and demand balance. We consider that the demand for 40-year bonds is considerably strong when considering that the purchase amount by the BOJ is small and that its price formation depends entirely on the market. The next candidate is 20-year bonds for which demand is increasing due to the changes in deposit and lending structure of the banking sector amid the coronavirus pandemic and we believe an increase of ¥100 billion per auction is possible. As regards Liquidity Enhancement Auctions which can be revised once in every quarter, we would like to see an increase in JGBs with a remaining maturity of 1-5 years, especially JGBs with a remaining maturity of 3 years are in a very short supply.

・ When reducing issuance size, since there is a concern toward the end of the fiscal year over T-Bills which has been issued in large quantities, we would like them to be reduced. If they are further increased, as a securities company that plays a market making role, we will have to seriously review the balance sheet and profits and loss accounts.

・ Interest rates on 10-year bonds currently remain in a very narrow range of almost 0 percent to -0.05 percent due to the BOJ's strong yield curve control policy, while interest rates over 20 years are rising due to the increase in issuance as a result of the second supplementary budget, and the yield curve is gradually steepening. Deposits are increasing in deposit financial institutions in large quantities due to emergency cash handout program and the demand for bonds with positive interest rates from such investors is increasing, resulting in inflows of funds in 10-year current bonds to 20-year bonds.

・ Regarding the outlook for the future, we believe that the gradual rise in ultra-long-term interest rates and the steepening of the yield curve will continue amid speculation that there may be room for an increase in the ultra-long-term zone in the JGB issuance plan for the next fiscal year. Regarding the JGB issuance plan for the next fiscal year, we are of the view that there may be room for a slight increase in the ultra-long-term zone, in particular, in 20-year bonds which are in strong demand, and 40-year bonds for which the supply and demand balance is tightening because of active demand from life insurance companies.

・ As regards the 1-5 year zone of Liquidity Enhancement Auctions, we believe that an increase from ¥400 billion to ¥500 billion may be possible because there is demand for asset swaps from overseas investors and the supply and demand balance of a wide range of off-the-run issues of 2-year and 5-year bonds is tightening, in addition to the decrease in repurchase interest rates.

・ We believe it desirable to gradually decrease the amount of 6-month T-Bills which were increased substantially.

・ The JGB market is stable due to the effective yield curve control, and we believe that this will continue in the future. Since the governments of all developed countries have adopted a monetary easing policy, basically surplus money support other markets, including stocks, gold, cryptocurrencies, etc.

・ Regarding the JGB issuance plan for the next fiscal year, if the overall amount is to be reduced, the reduction should be focused on T-Bills. Many market participants talk about 20-year bonds and 40-year bonds for an increase in the issuance size, if there is an overall increase. In order to prevent further worsening of supply and demand balance of 30-year bonds, we believe it necessary to combine those increase with a reduction in 30-year bonds.

・ If the amount is to be increased, bank deposits will increase in the medium to long term. Therefore, the amount in the zones in which banks can easily invest should be increased, which are currently about 15 years of the remaining maturity. Therefore, regarding Liquidity Enhancement Auctions, we believe it possible to increase the amount in zones including a remaining maturity of 15 years or less.

・ The JGB market is expected to continue to move in a narrow range. Even when US interest rates rose in connection with the presidential election, there was strong demand for bargain purchases of JGBs, especially 10-year bonds and 20-year bonds, and we believe investment behavior will continue unchanged for some time. In addition, it seems that the aggressive purchase stance of JGBs by the BOJ under the yield curve control will not change for the time being.

・ Regarding the JGB issuance plan for the next fiscal year, since the overall amount was increased significantly focused on T-Bills, we believe that the issue in future is how to reduce T-Bills. Besides, we believe that the JGB maturity extension is an issue to consider. Specifically, we believe there is room for increase in 20-year and 40-year bonds. Regarding 20-year bonds, as their interest rates continue to be stable under the yield curve control despite an increase of ¥300 billion and we can expect active demand from a wide range of investors, we believe an increase is possible. When considering that the spread between 30-year bonds and 40-year bonds is very tight and there is strong demand for 40-year bonds for duration needs by life insurance companies, there is room for increase as well.

・A feeling of deadlock was gradually spreading in the market, due to the fact the market became used to the significant increase in issuance since July and investors refrained from aggressive risk taking from October in light of the US presidential election. We have the impression that the market is very strong in view of the fact that interest rates in Japan hardly rose even when interest rates on European and US bonds rose after the US presidential election; and JGBs were hardly sold even when stock prices rose with the development of vaccines. We are of the view that this is due to the fact that investors were not active before and after the US presidential election in the JGB market, and interest rates gradually decreased, resulting in a lower selling pressure than before. We have also the impression that there were many cases with a long tail in the BOJ's purchase auction results in the half part of this month.

・ Regarding the price action of JGBs, JGB's interest rates have not risen despite the interest rate rise on European and US bonds and the rise in stock prices, meaning that a variety of investors are looking for buying opportunities even with low interest rates. Investors are ready to buy at any price, certainly for lower interest rates. The rise in stock prices are prompting investors to sell those stocks and buy bonds in terms of asset allocation. We have the impression that the JGB market this month is very consistent with a variety of factors.

・ As for the future outlook, in view of the situation that additional monetary easing has been implemented in Australia and the United Kingdom earlier this month and additional monetary easing at the ECB and FOMC is expected next month, we believe that the JGB market will continue to be stable for the rest of the year unless there are news from supply side about a significant increase in the calendar-based JGB Market Issuance size or news from demand side about the resumption of the flexible purchase by the BOJ, which was performed until February this year.

・ Regarding the JGB issuance plan, if possible, T-Bills should be reduced. If an increase happens to become necessary, we believe that there is room for increase in 1-year T-Bills than 6-month T-Bills.

・ We are of the view that an increase of 2-year bonds, 5-year bonds and 10-year bonds should be carefully reviewed because their issuance size is at the highest level ever.

・ Regarding ultra-long-term zone, 30-year bonds have continued to underperform in comparison to 20-year bonds and 40-year bonds since the increase to ¥900 billion in July, despite a constant certain amount of purchase every month. Thus, it is difficult to think of increasing their issuance size. As regards 20-year bonds, the issuance size has been already increased from ¥900 billion to ¥1.2 trillion in July. Although they have been smoothly financed since the increase in July, we believe that it's largely due to 10-year bonds stability. If asked whether 20-year bonds can be stably financed at a level with ¥100 billion-¥200 billion additional increase when the market volatility increases, we are not sure and must be cautious. Historically, we saw only once in 2017 such a situation that the interest rates on 20-year bonds have been as stable as now and we have to be cautious about a further increase.

・ While there is demand for duration needs by life insurance companies for 40-year bonds to comply with the regulation, there is a considerable imbalance between 30-year bonds which are issued for ¥900 billion every month and 40-year bonds which are issued for ¥500 billion every other month. In addition, 40-year bonds are issued for an amount of ¥100-150 billion per auction in the latest Liquidity Enhancement Auctions. When considering that the investor base for 40-year bonds has increased compared to 2 to 3 years ago, we believe that there is room for an increase of ¥100 billion. While the issuance size was significantly increased in all maturities except 40-year bonds in July, the purchase amount of JGBs in the ultra-long-term zone by the BOJ remains unchanged, and we are of the view that an increase in several maturities in the ultra-long-term zone should be avoided.

Contact:
Market Control Section, Market Finance Division,
Financial Bureau,
Ministry of Finance
03-3581-4111 (ext.5700)