Minutes of the Meeting of JGB Market Special Participants
(99th Round)

1. Date: Wednesday, June 15, 2022
2. Place: Held in writing
3. Gist of Proceedings:

1. Issuance size of Inflation-Indexed Bonds in the July-September 2022 quarter

▶ The Financial Bureau gave the following explanation about the issuance size of Inflation-Indexed Bonds in the July-September 2022 quarter:

・ As shown on page 3, according to the JGB Issuance Plan for FY2022, it is stipulated that there will be issuance of Inflation-Indexed Bonds four times a year at a size of ¥200 billion each time while it is stated that "The issuance may be adjusted in a flexible manner in response to market circumstances and demands of investors, which determined based on discussions with market participants." In addition, as shown on page 4, it is stipulated about Buy-back Auctions that "to be implemented based on market conditions and through discussions with market participants." Therefore, we would like to hear your opinions about the size of issuance in the July-September quarter at today's meeting.

・ As shown on page 5, for the April-June quarter, based on market conditions and discussions with market participants, we have decided to conduct an auction in May with a size of issuance of ¥200 billion, and to conduct Buy-back Auctions of ¥20 billion each month. The results of the issuance auction and of Buy-back Auctions are shown in pages 6 and 7, respectively.

・ The situation of the secondary market is shown on pages 8 and 9. Looking at the changes over the past six months, BEI has risen sharply, with some swings, due in part to the effects of soaring oil prices. Looking at the market situation by issue, although there continues to be wide variation, BEI is rising sharply for all bonds.

・ Under these circumstances, we asked for your preliminary opinions, and most of the participants agreed that there would not be a problem in increasing the size of issuance in stages, since the expected inflation level seems to continue to attract attention and the results of the issuance auction indicate good demand for the current issue.

・ On the other hand, a small number of participants suggested that normalization should be done sooner rather than in stages in the current environment where there is demand for Inflation-Indexed Bonds, and conversely, another small number of participants expressed the opinion that it would be desirable to maintain the current size of issuance, because an increase in the size of issuance could lead to a decline in market prices under the current situation in which the balance between the supply and demand are not favorable, especially with off-the-run bonds.

・ We believe that the development of the Inflation-Indexed Bonds market is an important part of the Debt Management Policy, and recognize the issuance size and Buy-back Auctions size for the April-June quarter of FY2022 are still normalizing after unusual and extraordinary measures related to significant deterioration of market conditions triggered by the COVID-19 pandemic. In line with this, at the meeting in March, we stated that we would like to consider normalization even after the July-September quarter, and at that time, we would like to make a careful decision based on the auction status, market conditions, and the opinions of participants as in the past.

・ Based on these circumstances and the opinions of participants, the proposals of the Financial Bureau are shown on page 10. Regarding the July-September quarter, from the viewpoint of steady and gradual normalization, we are considering a Buy-back Auction of ¥20 billion each month while having a single issuance auction of ¥250 billion, an increase of ¥50 billion. However, if market conditions deteriorate significantly during the period, we intend to take measures such as flexibly increasing the offer amount for Buy-back Auctions.

・ Since last year, we have been considering increasing the issuance size and reducing the Buy-back Auctions size, with a view to "normalization from unusual and extraordinary measures," and implemented a reduction in the Buy-back Auctions size in January this year. If the proposed increase in the size of issuance from the July-September quarter is implemented, we expect to proceed with careful consideration thereafter, keeping in mind the medium- to long-term development of the Inflation-Indexed Bonds market.

・ As stated above, we explained the situation about the Inflation-Indexed Bonds market and our proposal based on it.
Regarding the issuance size for the July-September quarter, we will make a comprehensive decision based on the contents of today's meeting, and we will ask your opinions again.

▶ Summarized below are the views and opinions submitted:

・ We support the proposal to gradually normalize the size of issuance of Inflation-Indexed Bonds, which was reduced urgently due to the COVID-19 pandemic, under the current environment where the BEI level has recovered to the 1% level and long-term inflationary pressures are expected to continue.
In addition, overseas inflation markets are becoming increasingly volatile due to caution about an economic slowdown, and we support the maintenance of monthly Buy-back Auctions of ¥20 billion in order to continue to support the balance between the supply and demand of the Japanese market.

・ While the Inflation-Indexed Bonds market has been difficult for many securities firms to make a market in reasonable amounts in the secondary market, the liquidity of the market is not high, as prices are sometimes formed during the day with little or no trading and the market is still recognized as immature. Given the global uncertainties in the market environment, it seems that the market is most likely to be affected in the event of a shock, so we have not changed our view that the increasing of the size of issuance should be implemented with extreme caution. On the other hand, we are in favor of increasing the issuance size by ¥50 billion from the current ¥200 billion to ¥250 billion. This is because we believe that the current outlook for rising domestic prices will support Inflation-Indexed Bonds and an increase in the issuance size can be absorbed over the medium term as long as the annual issuance size and the annual absorption size by including the Outright Purchase of JGBs is roughly balanced.

・ The BEI of Inflation-Indexed Bonds has risen in correlation with the rise in crude oil prices since March, which is a normal price action in the current supply and demand environment. On the other hand, inter-dealer trading remains scarce and participation remains limited, and the aforementioned correlation could be affected by changes or deterioration in the supply and demand environment, which could reduce the attractiveness of the price-linked bond product. Therefore, it is preferable to maintain the current size of issuance of ¥200 billion, but an increase of ¥50 billion would be absorbable.

・ Judging from the results of the auction, it seems that there is a strong demand for current bonds. Therefore, there is no objection to the increase of ¥50 billion. On the other hand, since there seems to be a strong willingness to sell off-the-run bonds while there is little trading in the secondary market, we continue to believe that a ¥20 billion Buy-Back Auction is appropriate.

・ The BEI of the Inflation-Indexed Bonds is on an upward trend due to concerns about rising global inflation and the strengthening of the US dollar. Therefore, while at first glance the increase of the issuance size appears to be fine, the Inflation-Indexed Bonds market is still slightly underperforming compared to other markets, and the many weak results in the Outright Purchase of JGBs and Buy-back Auctions also indicate that the balance between the supply and demand is not good, especially with off-the-run bonds. If the balance between the supply and demand deteriorates due to the increase of the issuance size and the Inflation-Indexed Bonds do not correctly reflect the market's inflation expectations, confidence in the Inflation-Indexed Bonds will decline, leading to a decrease in market participants, which may in turn lead to a spiral of further market declines. Therefore, at this point, we believe it is appropriate to maintain the issuance size and Buy-back Auctions size.

・ We support the proposal.

・ We agree with the proposal. When market liquidity had declined significantly, the debt management office reduced the size of issuance, implemented Buy-back Auctions, and implemented other measures in rapid succession, thereby maintaining the market's function, and we recognized that the market is currently in a stabilizing phase. While the market has remained stable since the most recent reduction of Buy-Back Auctions, it will be necessary to gradually normalize the market from the perspective of maintaining market functionality, and there is no discrepancy with respect to increasing the size of issuance in the next quarter.
In addition, with investor demands gradually increasing, we believe that the proposed increase can be absorbed without major upheaval in the market, because the issuance and absorption will generally be balanced.
However, the expansion of the base of trading participants in the Inflation-Indexed Bonds is still in progress, and if there is another sharp change in prices, market liquidity is expected to almost disappear at once. Therefore, in the event of an emergency, from the perspective of ensuring liquidity, a flexible increase of the size of Buy-Back Auctions should be considered as well as this increase of the issuance size.

・ Considering the strong results of recent auction, it may be possible to absorb the issuance size of ¥300 billion. Given the current environment in which Inflation-Indexed Bonds are in demand, we believe it is better to accelerate normalization by increasing the issuance size by ¥100 billion rather of the gradual pace of ¥50 billion.

・ The intention to proceed with normalization at this meeting has long been indicated, and we agree with the proposal.

・ Currently, the total amount of the Buy-back Auctions size and the Outright Purchase of JGBs size is ¥240 billion in 3 months, which is ¥40 billion more than the issuance size. Looking at the BEI trends over the past year, BEI has been on an upward trend due to the support of the external environment, but the current issue's BEI has been struggling at 100 bps due to selling on temporary recovery. While we agree with improving the environment for Inflation-Indexed Bonds after the COVID-19 pandemic, we are in favor of issuing at ¥250 billion, which would result in a positive net issuance, because absorption events often continue to be weak relative to the secondary market and the supply and demand environment may deteriorate over a long-time horizon, depending on the external environment.

・ We think that the issuance size should be maintained, but we will follow the opinions of the top bidders.

・ There is no excessive rise in inflation expectations, and we hope to maintain the issuance size. For increasing net supply, we believe it is appropriate to make further adjustments by decreasing the size of Buy-back Auctions and the size of the Outright Purchase of JGBs, even though these auctions are conducted for the selling demand for off-the-run bonds. In addition, increasing the size of issuance will not increase liquidity in the secondary market, and it is desirable to create a market environment that facilitates the establishment of short positions.

・ Investor demand for Inflation-Indexed Bonds is still strong, and recent auctions have significantly exceeded market expectations. Therefore, we believe even the increase of ¥100 billion can be absorbed without problems. However, if you are to consider the market and proceed with normalization in stages, we would like you to increase the amount by ¥50 billion first, and then leave it to the participants to decide whether to further increase the issuance size based on the results of the auction and other factors.

・ We agree with the proposal.

・ We would like to agree with the proposal regarding the size of issuance in August and the size of Buy-back Auctions in July to September. There is room to increase the size of issuance, but we believe it is too early to return it to ¥400 billion.
Uncertainty is increasing globally and the balance between the supply and demand may change suddenly. Therefore, we need to continue to operate with caution, but if the market deteriorates in the future, we believe that it is better to increase the size of Buy-back Auctions rather than

decrease the issuance size. Auction results show strong demand for current bonds, while the Buy-back Auctions and Outright Purchase of JGBs results continue to be sluggish and the ratio of current bonds bid is low. Investor demand for buying tends to be biased toward newer issues, mainly current bonds, and investors demand for selling tends to be biased toward older issues.

・ We have expressed our support for the proposal to the issuance size of ¥250 billion in August and conduct a Buy-back Auction of ¥20 billion per month (¥60 billion per quarter). However, the liquidity of the JGB market has been extremely low, and this situation does not improve in August, it may be better to maintain the issuance size at ¥200 billion. While rising global inflation expectations are a tailwind, the possibility of capital outflows from Inflation-Indexed Bonds funds, etc. is a headwind due to the current risk-off environment. Basically, we believe that small increases should be made cautiously while aiming for normalization, but we believe that it is also an appropriate decision to be more cautious about the extreme deterioration of liquidity.

・ We agree with the proposal.

・ With the outlook for prices is on the rise, if the size of issuance is too small, the balance between the supply and demand may become tight and the market liquidity may decline. Therefore we believe that this level of increase should not be a problem. Since this is not a highly liquid market, we are comfortable with the fact that you will proceed cautiously and in stages.

2. Liquidity Enhancement Auction Size in the July-September 2022 quarter

▶ The Financial Bureau gave the following explanation about the Liquidity Enhancement Auction Size for the July-September 2022 quarter:

・ As shown on page 12, according to the FY2022 JGB Issuance Plan regarding Liquidity Enhancement Auctions,

(1) while it is assumed that a total of ¥12.0 trillion will be issued for the year, including ¥3.0 trillion for bonds with a remaining maturity of 1 to 5 years and for bonds with a remaining maturity of 15.5 to 39 years, and ¥6.0 trillion for bonds with a remaining maturity of 5 to 15.5 years,

(2) finally, "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,"

Today, in response to this plan, we would like to hear participant's opinions regarding the size of issuance for each maturity zone for the July-September quarter.

・ As shown on page 13, in the April-June quarter, we decided to issue ¥500 billion each in May of odd-numbered months for bonds with a remaining maturity of 1 to 5 years, monthly for bonds with a remaining maturity of 5 to 15.5 years, and in April and June of even-numbered months for bonds with a remaining maturity of 15.5 to 39 years. These results are as shown on pages 14 to 16.

・ Under these circumstances, we asked for your opinions on the Liquidity Enhancement Auctions for the July-September quarter in advance, and while some participants pointed out that the auction results for bonds with a remaining maturity of 15.5 to 39 years are often weak, all participants, including the above, agreed that it was appropriate to maintain the size of issuance at the current level.

・ In response to this, we prepared the proposal of the issuance size for each maturity zone in the July-September quarter, as shown on page 17. We are considering issuing ¥500 billion each in July and September of odd-numbered months for bonds with a remaining maturity of 1 to 5 years, monthly for bonds with a remaining maturity of 5 to 15.5 years, and in August of even-numbered months for bonds with a remaining maturity of 15.5 to 39 years.

・ Regarding the issuance size for each zone for Liquidity Enhancement Auctions for the July-September quarter, we will make a comprehensive decision based on the contents of today’s meeting, and we will ask your opinions again.

▶ Summarized below are the views and opinions submitted:

・ The issuance has been stable since the amount of issuance is distributed in a balanced way for each maturity zone and is supported by the short covering of securities companies and investor demand. Therefore, we believe that allocation at the same level as the current situation is appropriate.

・ The Liquidity Enhancement Auction for bonds with a remaining maturity of 15.5 to 39 years conducted since February have produced large tails, but prior to that the tails were generally within 0.5 bps, and we believe that the unstable market conditions since February have played a major role. We agree with the proposal to maintain the status quo while investor demand for ultra-long-term off-the-run bonds continues to drag on.

・ We agree with the proposal. It should be noted that the Bank of Japan (BOJ)'s unscheduled large-scale purchases of long-term JGBs, including in the future, are likely to raise concerns about the liquidity of Cheapest-to-Deliver (CTD) issue of 10-year JGB Futures in the future, and the market will be forced to rely on Liquidity Enhancement Auctions in such cases.

・ We have no objection to maintaining the issuance size of each zone.

・ Given that there are some bonds with consistently tight repos in each maturity and some distortions in the shape of the yield curve, we believe that it is desirable to maintain the market function at the current size of issuance.

・ Although the results of the Liquidity Enhancement Auctions for bonds with a remaining maturity of 15.5 to 39 years have been weak, we support the proposal as it stands because we do not believe that we have reached a situation where a distortion of the balance between the supply and demand has occurred due to the Liquidity Enhancement Auctions.

・ We hope to maintain the status quo.

・ We agree with the proposal.
Investors tend to prefer low-coupon existing bonds to current bonds, and with the recent rise in interest rates, current bonds have higher coupons than existing bonds, and we believe that a certain level of demand for existing bonds is still being secured, as confirmed by the reasonable demands in yesterday's Liquidity Enhancement Auctions.

・ We believe that the status quo should be maintained, but we will follow the opinions of the top bidders.

・ For bonds with a remaining maturity of 1 to 5 years, before the increase of the issuance size, Auction results tended to be strong, far from the quotes among brokers on the morning session of the auction day, but looking at the results of the initial auction, which was increased to ¥500 billion, it appears that there is finally a balance between the supply and demand. Therefore, we believe it is appropriate to leave the issuance size unchanged at ¥500 billion.
The auction for bonds with a remaining maturity of 15.5 to 39 years may have had weak results lately, but we believe this is due to high market volatility and not because of reduced demand in the ultra-long-term bonds zone. Therefore, we believe that the size of issuance should remain

unchanged at ¥500 billion.

・ We agree with the proposal to maintain the status quo.

・ We agree with the proposal.

3. Latest JGB market situation and outlook in the future

▶ Summarized below are the views and opinions submitted:

・ Global interest rates continue to rise due to high inflationary pressure in overseas markets, and although JGBs are supported by fixed-rate purchase operations by BOJ, the upward pressure on interest rates in other zones is strong and the yield curve is severely distorted, including the basis in the futures market. While it is difficult to predict whether overseas interest rate trends will stabilize in the near term, it is easy to close positions, and further distortions are feared.

・ European government bonds fell sharply in response to the soaring German CPI announced at the end of May, and the US CPI announced later was similar, greatly accelerating the global sell-off in bonds, while in the JGB market, 10-year JGB Futures have sold off by over ¥2 in three business days as 10-Year Bond rates have not moved at all due to YCC policy. In addition to the Fixed-Rate Purchase Operations, the temporary Outright Purchase of JGBs has also had an impact, widening the gap between the futures market and the cash bond market, and with the launch of the Fixed-Rate Purchase Operations for the CTD issue today, June 15, the gap has become even more pronounced. At this point, it is difficult to see what process will lead to normalization, and we believe that a reduction in market liquidity will remain a concern for now.

・ The extremely strong US CPI, the emergence of the possibility of a 75 bps rate hike at the FOMC meeting, and the awareness of the possibility that not only the FRB but also the ECB may raise interest rates significantly have intensified market challenges to the BOJ’s YCC, and as for JGBs, 10-year JGB Futures and ultra-long-term bonds have been sold, and swap payments have been extremely strong. The BOJ is expected to continue to defend itself through the Conduct of temporary Outright Purchase of JGBs and Fixed-Rate Purchase Operations for consecutive days, and we are concerned about significant losses in terms of market functionality and liquidity. Although interest rate hikes subsided after the temporary Outright Purchase of JGBs in March, they were eventually challenged again by the market less than three months later, and even if

interest rate stop rising again, we assume that the risk of being challenged again is high as long as overseas interest rates remain high. For the time being, it is expected that the volatility of the interest rate market will increase significantly.
While we do not anticipate any monetary policy changes in the near term, we will continue to be aware of the risk that if the implementation of the YCC accelerates the depreciation of the yen and raises prices of foreign products, the public will become more vocal about their concerns, and this will evolve into a political issue, forcing the BOJ to revise its policy.

・ Compared to the rise in overseas interest rates, the volatility in yen interest rates has been contained by the YCC, but we believe it should be noted that distortions in the yield curve, swap spreads, etc. are still occurring.

・ The 20-year JGB Futures Market Stimulation Program has been implemented since April 2022. We believe that the ability to build interest rate risk without using balance sheets is in demand by a wide range of investors, not just securities firms.

・ Interest rates in Japan have been rising in tandem as interest rates in the United States and Europe rise further, and in recent days, intraday volatility has been large and liquidity has been declining. This situation may continue for some time, and market participants seem to be bracing themselves.

・ Against the backdrop of a sharp rise in US and European interest rates in expectation of central banks becoming hawkish, selling pressure from market participants, especially foreign investors, is increasing in the JGB market as well. However, the BOJ has announced a Fixed-Rate Purchase Operation including CTD issue for futures and an increase in the Outright Purchase of JGBs, rekindling the composition of the BOJ versus foreign investors. The view that the BOJ will lose ground to market pressures is gaining ground among foreign investors, and this week's monetary policy meeting gathers attention. Market liquidity has deteriorated significantly due to the Outright Purchase of JGBs, and prices in the futures and cash markets have diverged beyond theoretical values, so prices are likely to remain volatile for the time being. In the future, the importance of measures taken by the debt management office, such as strengthening Liquidity Enhancement Auctions, is likely to increase.

・ Speculation about the BOJ's policy changes and operation of management responses have distorted the market in various ways, and we feel that the market is in danger of further decline in its functioning. We hope that various exchanges of views with market participants in the future will lead to the restoration of functionality and liquidity.

・ In addition to the rise in overseas interest rates, the yen's depreciation and other factors have raised speculation that the BOJ will revise its YCC policy. (There are doubts, especially among foreign investors, as to whether the Bank of Japan can maintain its YCC policy.) Market conditions remain extremely volatile. The BOJ's temporary Outright Purchases of JGBs, including ultra-long-term bonds, have kept the yield curve at a low level, but in the process, the ultra-long-term interest rate moves up and down by 10 bps per day, and measures are inevitably taken in a follow-up manner. Therefore if this situation continues, it will hinder the stable issuance by auctions. We request that related agencies will continue to work closely together.

・ Interest rates are rising globally against a backdrop of non-peaking inflation in the United States and Europe, and JGBs are also experiencing strong upward pressure on the yield curve in general, with the exception of 10-Year Bonds, which is being purchased without restriction at 0.250%. The inversion of the curve is occurring at the bottom of the 10-year interest rates, which is supported by the YCC, and the focus of market participants is on the sustainability of policy.

・ The yield curve distortion is rapidly widening as futures-driven interest rates continue to rise, and the market's risk capacity appears to be declining. We believe that there may be some temporary and unexpected turmoil in the market. Therefore, we request debt management office to continue to monitor the market closely.

・ The Fixed-Rate Purchase Operations have caused a distortion of the yield curve, and market making has been very difficult in this situation. Foreign investors are also continuing to sell 10-year JGB Futures, and it is expected that highly volatile market development will continue for some time.

・ A significant rise in overseas interest rates has reignited the challenge for the BOJ's YCC policy which caps 10-year yield at 0.25%, and the BOJ has been buying eligible 10-Year Bonds in the trillions of yen daily in the Fixed-Rate Purchase Operations for Consecutive Days. Nevertheless, futures-driven market declines are continuing, causing inverse yield and distortions in the yield curve in the 7- to 10-year zone. As for the 30-Year and 40-Year Bonds in the ultra-long-term zone, the 20-30 year yield spreads are steepening as the increase of the issuance size of the 40-Year Bond is weighed down by slow buying by domestic investors.
The future will depend on developments in overseas interest rates, but as long as overseas rates do not fall, the BOJ's YCC policy will be tested at every policy meeting, especially by foreign

investors.

・ Amid growing concerns about global inflation, the JGB market is also under great pressure to raise interest rates. The BOJ's stance of continuing easing is clearly shown by temporary Outright Purchases of JGBs and Fixed-Rate Purchase Operations, but 10-year JGB Futures have not stopped declining, market liquidity has declined, and price discovery functions have declined significantly. When considering increasing the overall issuance size in the future, we believe that the issuance size should be increased for bonds with years for which sufficient demand is expected.

・ On April 28, the BOJ regularized Fixed-Rate Purchase Operation at 0.25% of 10-Year Bonds. Since then, the growing concern about global inflation and the resulting rise in US interest rates have increased selling pressure in the JGB market as well. However, since the Outright Purchase of JGBs mentioned above has basically set the yield ceiling at 0.25% for 10-Year Bonds, yields in other zones, such as 10-year JGB Futures (linked with 7-year zone) and the ultra-long-term zone, have risen significantly. The yield curve became bear steep and heavily distorted with 10-Year Bonds being left behind.
It must be said that future developments will depend on the BOJ. If the BOJ sticks to its current policy through various means, the term structure (interest rates period structure) will eventually come into play and a smooth curve shape will be restored, with 10-Year Bonds hovering at 0.25%. On the other hand, if the BOJ were to modify its policy by widening the range of 10-Year Bond yields, the curve would still be smooth, but bear steepening, in the form of a sharp rise in 10-Year Bond yields. The BOJ's official position is that "widening of the range as tantamount to an interest-rate increase," and it is unlikely that the policy will be modified in such a way as to lose out market pressures. Therefore, our outlook is mainly for the former. In any case, however, the battle between the market and the BOJ will probably continue in the near term. And what is worrisome is the further decline in liquidity.

・ The BOJ's daily Fixed-Rate Purchase Operations have caused liquidity to dry up and the yield curve to become distorted, and it would be a weak expression that the JGB market is no longer functioning well. We are concerned that the Fixed-Rate Purchase Operation of the 356th bond conducted today will also only result in the destruction of the basis in the futures market, which is the nodal point between the cash and futures.

・ The BOJ has taken a strong interest rate control stance through its operations, and upward pressure on interest rates is limited compared to overseas markets. The liquidity reduction caused by the Fixed-Rate Purchase Operations, which had been a concern, has not been a major impediment to market trading at this time.

4.Communication from the Financial Bureau

・ We believe it is important to listen to the opinions of you and other market participants not only at this meeting but also on a regular basis. Although the market has been somewhat volatile at times this week, we intend to continue to flexibly address the issues discussed today after this meeting, if necessary, after receiving your feedback. As always, we would appreciate your cooperation.

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