Minutes of the Advisory Council on Government Debt Management (37th Round)

1. **Date: Tuesday, June 16, 2015 (1:00 p.m. to 3:00 p.m.)**
2. **Place: Ministry of Finance, Special Conference Room 1**
3. **Gist of the Proceedings**

(1) Opinions and Questions about the Recent developments in the world economy and the JGB market (Annex 1)

(2) Opinions and Questions about the Recent moves (2) in the international financial regulation (Basel Regulations) (Annex 2)

(3) Opinions and Questions about the Follow-up on the “Wrap-up of Discussion” (Annex 3)

(4) Opinions and Questions about the Schedule of future Council meetings

I. Council member Hidenori Suezawa gave explanations about the recent developments in the world economy and the JGB market, followed by a free exchange of opinions among the attendees.

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

- In the U.S., for normalizing its monetary policy the Federal Reserve intends to prevent the market from becoming unstable and volatile by reducing uncertainty about the policy rate and controlling fluctuation of the term premium ― this is my impression. Now our concern is how much the yield curve will be affected by demand and supply factors in a future phase of interest rate hike.
- In Europe, Germany wants the European Central Bank to raise policy rate to some extent in the near future, but they face debt problems afflicting Greece and some other Southern European countries. So it is not clear what monetary policies will be taken after all in Europe.
- Money supply has expanded worldwide, leading to zero interest rate in several advanced countries. In these circumstances, the world economy has recently been affected by the movement of German interest rate in many ways. My impression is that such cyclical synchronization has substantially increased worldwide compared with a few years ago.
- How should we evaluate the risk of capital outflow from emerging economies when the U.S. normalizes its monetary policy? How does the authority expect such risk would affect in turn the Japanese financial market?

II. Explanations were given by the Financial Services Agency about recent moves (2) in the international financial regulation (Basel Regulations), followed by a free exchange of opinions:

▸ The following is the summary (made by the authority) of the views and opinions:

- According to the definition of the Basel regulation, core deposits are the deposits not to be withdrawn in a short time. But, at a time of crisis, I think, core deposits should be treated in a manner totally different from under normal economic conditions. What does the authority think of such a viewpoint?

- The financial regulation being referred to may significantly affect JGB investors. The period up to September is available for public comments on this issue. For the financial industry we would like to properly express and communicate our opinions on the regulation.
- If the Pillar 1 capital requirement is enforced, the situation would become more procyclical in cases where the Basel regulation is put into effect at the same time as the U.S. implements its "exit" strategy or where substantial synchronization exists in a global low-interest rate environment. We are in the phase where more careful discussion is needed since it is more and more likely that we cannot foresee the effect of the financial regulation to each country. Particularly relating to Japan, we should take into consideration its specific circumstances where funds are apt to flow into financial intermediaries as deposits.
- In the phase of a tapering of monetary easing, bond prices will become very volatile particularly in emerging economies. In the absence of risk-absorbing players, bonds' market prices will become too volatile. It would be quite unwise to go on discussing only how to prevent all investors from taking risk; we should rather argue that it is natural to have more market-making players.
- With the JGB market grown to such a large size, the regulation or risk of holding government bonds is getting tighter, but there has been too little discussions aimed at protecting the JGB market. We feel such a lack of balance between these discussions, which is problematic.
- Given our current huge deposit-lending gap, financial institutions have no other choice than to invest in JGBs. But the financial regulation that has recently been stepped up puts difficulty to our JGB investments.
- One of the primary dealers' important roles is to supply liquidity to the JGB market. We are worried that this role is now being constrained restrained by financial regulation.
- The biggest event for the latest month is the plunge experienced by German bonds. It has been such a shocking event for many market players. In the circumstances where different regulations are causing market liquidity to deteriorate, the U.S. will come to an "exit." Viewing from such a context, the effect of any tighter interest rate risk regulation will not be negligible. Particularly relating to Japan, we should keep in mind that our country slipped into deflation ahead of other advanced economies under liquidity surplus and became the world's largest sovereign bond market.

III. Explanations were given by the Ministry of Finance about the follow-up made on the "Wrap-up of Discussion," followed by the expression of opinions by Council members in attendance.

▸The following is the summary (made by the authority) of the views and opinions:

- We find that the follow-up documents appropriately summarize and wrap up what we discussed at our past meeting.

- We feel that we are facing a number of issues that need to be considered and addressed in an environment where the JGB market may be affected in relation to the Basel regulation and the monetary policy adopted by the Bank of Japan.
- An important thing is how to diversify the JGB holders, including individual investors, in an environment where the existing financial institutions face greater difficulty in holding JGBs, including due to the Basel regulation.
- Given the increasing ratio of the Bank of Japan's JGB holdings, it is important to work in closer collaboration with the Bank of Japan.
- We definitely would like to request that the authority consider what medium-to-long term measures will be required in order to properly maintain the functioning of the JGB market. We think that the authority has made much progress over the past year in doing what it should do or it can do.
- We request that there be sufficient and appropriate exchange of opinions between the issuing authority and the financial regulatory authority.
- We request the authority develop as many stable JGB holders as possible in overseas markets.
- We request the authority to draw up an appropriate fiscal balance simulation toward a phase of an interest rate hike and work out a scenario that suggests what it should do in case of a normalization in monetary policy.
- We request the authority to reflect the voices of Japan and other Asian countries in discussions on financial regulations in international conferences and see carefully that such conferences are not dominated by U.S. or European voices.
- In our view, the environment surrounding the JGB market may be subject to changes in the future from the following four perspectives: (i) normalization of monetary policy in the U.S.; (ii) the direction of (international) financial regulations including the Basel regulation; (iii) Japan's pulling out of deflation and the direction of its future monetary policy; and (iv) change in the Japanese household's behavior toward JGB holdings prompted by the decreasing birthrate and aging population. In light of these perspectives, it will be increasingly important in the future to show an appropriate healthier fiscal consolidation plan that will maintain the confidence from the market.
- An important thing is to ensure that Japan will not be substantially affected in case the Chinese economy slows down. We should be more conscious of an increasing probability that the Japanese economy will be caused to slow down upon a deceleration of the Chinese and other foreign economies. To avoid the influence, it is important to proceed fiscal consolidation in a circumstance where both the real economy and the labor market are apparently improving. While it is important for the issuing authority to make efforts for more efficient JGB issuances in accordance with economic or financial trends, we request that the authority advance appropriate discussions toward fiscal consolidation. In order to protect the Japanese economy, it is necessary to go on working decisively for fiscal consolidation by taking appropriate steps.

IV. Chairman Naoki Tanaka expressed his intention to have the Council continue meeting in and after the coming autumn, to which all members in attendance agreed.