Minutes of the Advisory Council on Government Debt Management (46th Round)

1. **Date: Wednesday, February 28, 2018 (10:00 a.m. to 11:30 a.m.)**

2. **Place: Ministry of Finance Special Conference Room 3**

3. **List of the Proceedings:**
   1. JGB Issuance Plan for FY2018 (report) (Material①)
   2. Current status and future trends of the JGB market
      (1) Financial and money market trends for 2018 (Material②)
      (Hidenori Suezawa, SMBC Nikko Securities Inc.)
      (2) Consideration of the impact of Bank of Japan policy shifts as well as the JGB market consensus seen in survey results (Material③)
      (Tadao Sakashima, Daiwa Securities)

The Financial Bureau explained Issuance Plan for FY 2018 (Material①).

Member Suezawa of SMBC Nikko Securities Inc. discussed financial and money market trends for 2018 (Material②) while Member Sakashima of Daiwa Securities talked about the impact of Bank of Japan policy shifts as well as the JGB market consensus seen in survey results (Material③). After that, Council members exchanged opinions freely.

➢ Summary of opinions and such from the members (put together by the MOF) are as follows.

- There are believed to be three changes occurring with the market structure; moving forward, financial and monetary policies must be implemented under the assumption that some market transition such as the one seen in the early February can occur at any time.
- The first change has to do with the possibility of significant shifts in money flow as the result of monetary policy normalization in major countries, mainly in the United States. The second is the rising presence of investment funds will make the overall finance more tightly linked to the financial market. And lastly, the third change is brought about by introducing A.I. to the market: an increase in transactions that can follow and respond to trends by using techniques such as algorithms or high-speed automated transactions. These market changes—which would not normally be expected to have a large economic impact—might trigger

a large change in the market all over the world and create the substantial market adjustments.

- In anticipation of those adjustments, we should investigate some kind of precautionary measures and some mechanism to relieve the shock in regards to JGBs issuance.

- Does the rise in interest rates in the US since the beginning of the year have any relations to the concerns of deterioration of the US financial climate?

- The United States has enjoyed high growth and low interest for the past ten years due to an influx of human resources and funds from overseas, but will funds continue to be generated if the current policies continue? I feel that the U.S. economy is undergoing a transition.

- Japan has its unusual structure of economy where people worry over increases in the value of its currency. I assume that it is a problem because a stronger yen is always seen as a negative factor and thus a downward spiral is fixed. Where is the opportunity for us to escape from this spiral?

- The United States recovered from the financial crisis in 2008 by swiftly adopting measures to keep dollar week, and the E.U. owes much of its recent prosperity to the week euro which is brought by the Greek financial crisis. And there is no doubt that the weak yen under Abenomics has contributed to a healthy Japanese economy. In order for a nation’s economy to improve with its strong currency, the country must contain large-scale innovation similar to that seen in the U.S. in the 1990s. With its declining population forcing Japan to rely on foreign resources, it seems unlikely that the Japanese economy is about to undergo structural changes that would make a stronger yen desirable.

- Japan’s imports and exports each make up approximately the same percentage of the country’s GDP. Import prices in Japan respond asymmetrically to currency fluctuations, reacting slowly when the yen appreciates but instantly when it depreciates. Eliminating this asymmetry may reduce the effects of fluctuating exchange rates on the economy.
- If retail investors invest more on foreign currencies and assets, institutional investors can save the currency hedging cost and also retail investors can diversify their portfolios.
- If the domestic demand on JGB declines, we will be forced to rely on foreign

investors and thus destabilize the JGB market as it was seen in Greece. Given that the investment capabilities of life insurance companies and pension funds are liable to decrease due to a declining birth rate and aging population,etc., the problem is how stably JGBs will continue to be issued as the years go by.

- The issue of currency diversification among individuals was raised, honestly, I feel that movement of money from savings to investments in Japan hardly occurs. There is a greater disparity of wealth in the United States than there is in Japan. Wealthy Americans own assets and can afford to take risks, so they actively invest, but no one steps up to take the risk in Japan because the gap in wealth is not as large as the United States.

- Recently, life insurance companies (including some major Japanese entities) surely have expanded their sales of saving products in foreign-currency.
- In addition, although we currently limit the purchases of JGBs only for the purpose of control of interest rate risk under the current low interest rates because buying JGBs is difficult as an investment destination for the saving products, but when interest rates rise, there is a surplus to increase the purchases.

- It seems that sales of JGBs for retail investors is favorable these days, but these bonds can be redeemed before the maturity. Hence, we should bear in mind the risk of a large number of redemption before the maturity occurring suddenly at the same time, say, when the market is changing rapidly, even though the outstanding amount of JGB for retail investors is small,.

- The strong sales of JGBs for retail investors is due to the fact that banks find their cost of keeping deposits is high these days, and so there is a trend of converting deposits into JGBs for retail investors. If interest rate levels return, then the sales of them may return to its previous level.

- In Europe, the chaos surrounding the Italian election has drawn considerable attention, and opinions regarding the German coalition government are largely pessimistic. The United Kingdom is navigating the rough waters of Brexit negotiations as Prime Minister May struggles to maintain control. Economic conditions are good, but there is an impression that there are a lot of things to keep an eye on.
- It is concerning that our country has not made any progress on reforming social security. The government and the Bank of Japan stated in the joint statement that

they would be combining monetary easing and fiscal consolidation and so the social security is in dire need of immediate reform.

- Another concern is that we are currently receiving no warnings from the market about fiscal discipline. If they cannot be sent using interest rates, market participants need to come up with some other way to dispatch warnings.

- When debating government policies, it is imperative that we define the data and statistics on which the discussion will be based. For instance, the consumer price index (CPI) shows that prices for mobile devices and cellular usage are currently falling—but this is a product of technological innovation, not deflation. In cases like these, it is not appropriate to reference indicators that exclude particular items; instead, we should base our discussion on a trimmed CPI.
- The market tends to trust in things that are convenient for it, while government policies tend to escape any dramatic reform. And if people start mistakenly thinking that the situation will remain static, then seismic shifts are bound to occur when the big picture of macro economy changes. The debt management office must recognize these tail risks and give thought to possible measures it should take when the risks appear.

- The constant delays plaguing initiatives toward financial consolidation are also a sign that the voices of the market are going unheeded. It is problematic when the market sees only what it wants to see. Declining credit can be obscured by low interest rates, but if we look closely we notice for example that the costs of procuring foreign currency have risen, which explains the deterioration of Japan's credit.
- It was stated that, at this rate, the BOJ will soon hold more than half of the outstanding amount of JGB; can the market function be remained under those conditions? We must also use opportunities such as these to discuss the sustainability of the JGB market in these terms.

- This year, upon the news that Jeff Bezos, Warren Buffet, and Jamie Dimon would be launching a new healthcare enterprise, it was impressive how much the price fell for stocks related to medicine and healthcare services. Investors would have anticipated changes in the profitability of such stocks if those gentlemen were to rally enough people to lead a change that would reduce wasteful medical treatment across all of America.
- Will individuals with this kind of initiative spring forth from Japan as well? Perhaps there are things we can achieve outside of the national government and

its councils (entangled as they are in special-interest groups). For example health-insurance associations at large corporations might be able to improve the medical care efficiency. We should summon the intelligence within society and work to create a system capable of targeted medical treatment.