Minutes of the Advisory Council on Government Debt Management
(49th Round)

1. Date: Friday, March 8, 2019 (2:55 p.m. to 5:05 p.m.)

2. Place: Ministry of Finance Special Conference Room 3

3. List of proceedings

1. FY 2019 budget and JGB Issuance Plan (report)

2. Current state and future trends of the JGB market

(1) Investment trends of life-insurance companies

(Iwao Matsumoto, Sumitomo Life Insurance Company)

(2) The global financial and fiscal environments

(Hajime Takata, the Mizuho Research Institute)

First, the Budget Bureau presented the FY 2019 budget (Document 1), followed by an explanation of the JGB Issuance Plan for FY 2019 by the Financial Bureau (Document 2).

Second, Mr. Iwao Matsumoto from Sumitomo Life Insurance Company discussed investment trends among life-insurance companies (Document 3). Then, Mr. Takata from the Mizuho Research Institute talked about the global financial and fiscal environments (Document 4). After that, the members exchanged opinions freely.

➢ Views expressed by the members have been summarized (by the Financial Bureau) below.

- This year will be a turning point as we enter a new era “Reiwa” in Japan. It is a good time to send a message about the future of fiscal management.

- Considering JGBs issuance in the future, there are three important points. First is the future transition of investors’ demands for JGBs. Second is the balance between JGBs issuance and the amount of interest rate risks that the market can manage. For example, while JGBs issuance putting weight on the super-long zone can decrease the refinancing risk, it provides the market with further interest rate risk. We need to consider if the market can deal with the risk when some stress are added to it. It is especially important to evaluate the amount of risks the market can take and balance the issuance amount for each maturity zone in the process of the BOJ's exiting from monetary easing. Third is the validation of the cost of the JGBs issuance. While the refinancing risk has decreased by lengthening maturities, it might have been more efficient in terms of cost if the maturities had been shorter. While the first point, the future transition of investors' demands for JGBs for each sector, has already been discussed in the Advisory Council on Government Debt Management, the meeting of JGB Market Special Participants and other meetings, it is also important to conduct risk analysis and cost validation for implementation of stable and smooth issuance of JGBs.

- While it was explained that there will be demands from life-insurance companies for super-long term bonds after the interest rates rise, it is the process where the interest rates are rising rather than after the rising has stopped that we should pay attention to in evaluating JGBs demands.
- JGB issuance plans have been formulated taking fiscal deficit as a given thus far. However, it is also becoming important to commit to fiscal consolidation reflecting the sustainability of JGBs issuance and risk analysis.

- When considering what might happen if interest rates rise based on an integration account of the government and the BOJ, we must keep in mind that the purchasing of JGBs by the BOJ leads to convert long-term JGBs to short-term liability. As Mr. Takata explained, some "operations" were needed to be conducted while "anesthesia" was working. However, though interest payments have been decreased by the negative interest rate policy, fiscal discipline was rather weakened during the period as evidenced by the fact that the target year for primary balance surplus was postponed to 2025.
- It has been explained that increase of life span could require life-insurance companies to extend their asset durations. However, considering the decline in the working-age population rather than life span, the demand for life insurance can relatively shrink due

to the close relationship between the total income of working age population and the revenue from insurance premiums. In addition, a lengthening of the third stage of life will lead to the creation of many other products, such as nursing insurance. It is important to think not only about individual annuity insurance but about the change of insurance products as a whole.

- Recently, demand for insurance products with inheritance functions such as term insurance and permanent insurance are declining among various kind of insurance products. On the other hand, need for insurance products for nursing care or work incapacity is increasing. Also, demand for insurance products for savings for the post-retirement years is strong as well evidenced by the increasing sales of foreign currencies denominated insurance with higher interest.
- The demand for super-long term bonds will increase because the expanding sales of saving based products leads an accumulation of reserves with relatively long duration, which creates a need of investment of the corresponding assets.

- There are some trending theories on the global scene that could once again put weight on fiscal policy. In addition to the discussions about Fiscal Theory of the Price Level (FTPL) and helicopter money discussed in 2016, Modern Monetary Theory (MMT) has recently gained momentum in the United States. It is crucial to consider which policy course Japan should take.
- There have been discussions about the importance of determining how to prepare for rising interest rates; however, we feel that the risk of continuation of the current situation of super-low interest rate is more serious. Countries around the world are finding it difficult to increase their inflation rate. Japan in particular finds it difficult for interest rates to increase due to the demand for asset management that prepares for the "100-year life".

- From March through September of 2016, the Economic Solvency Ratio (ESR) declined considerably. At the time, the interest rate for 20-Year Bonds had reached zero percent and the balance between the assets and liabilities of life-insurance companies faced with a serious condition, which even worsened as the interest rate fell. Assuming the situation where the interest rate for 20-Year Bonds reaches zero percent once again, the current financial climate in Japan and worldwide makes it concerned that the interest rate gets stuck at the same low level, not as 2016 when it rebounded. Also, the low market liquidity is another concern. When the market price swings to one side due to technical reasons, it is usually modified by investment on the other side. However, the low market liquidity might prevent such spontaneous movements from happening. We must continue discussing these issues with the MOF and the BOJ so that we can deal with these extraordinary circumstances.

- It was stated that the current super-low interest rate is severe for life-insurance companies whose liability maturity is relatively long. On the other hand, there have also been news reports of banks facing with a serious condition in terms of their revenue, which impresses me that this extended period of low interest rates has had a considerable impact on the entire financial industry of Japan.

- I agree with the opinion that the world is experiencing transitions of various aspects. Looking back over the past three decades, crises have happened about once every ten years. Examining various economic indicators, we see that the global economy is reaching its peak. In addition, although the world's economy has been supported by the growth of emerging countries during last thirty years, population aging advances in the countries like China. Under these circumstances, further growth will be difficult without large-scale innovation. I personally feel strong anxious, facing with the transitions without having any solutions as past crises.

- The reason the real economy has not been improved even under the low interest rate environment is that there has been little decline in risk. Although there is a lot of potential in households, businesses, emerging countries, and technologies, we are still in a period of technological transition and it might take for a while..

- An important challenge to tackle in debt management policy is maintaining the function of the bond market. Human resource issue is especially concerned among the problems. It is important to keep attracting market participants, including traders and investors. For example, wealthy class in emerging countries are getting stronger presence as new investors. It is important to attract those who are interested in the JGB market through IR activities.

- Despite the fact that China’s fiscal situation is not necessarily sound, the Chinese government easily reacts to economic issues by resorting to fiscal measures. Also, in the United States, fiscal policies seem to be used more easily under the Trump administration. This behavioral pattern in major nations that they immediately turn to fiscal measures is alarming.
- It is reassuring if the MOF announces that Japan won’t follow the same path as these other countries because the room for fiscal expansion is especially small in Japan. Even though tax revenue has increased for past a few years, Japanese economy is still experiencing serious fiscal deficit. I feel it is reducing the expenditure that is essential for solving fiscal problems.

- It is often said that the bond market has fallen into a state of dysfunction. However, we can say that the market is functioning properly in that it is reflecting the situation that the change of the business cycle made it difficult to earn by stocks and gaining revenue from carry and roll down in the bond market is the only way.
- Monetary easing has failed in leading an appropriate capital investment with increased demand for a long time. Instead, the funds are being diverted to developing countries, with earnings from the investment ending up in real estate investment or the credit markets. The reason why the financial markets have not experienced a crisis under this environments is that introduction of financial regulations following the 2008 financial crisis prevent participants from taking an excessive risks. The market seems to be functioning properly in this sense as well.

- A longer period of the “second stage” and the “third stage” of people’s lives in the "100-year life” requires them to save for post-retirement years, which leads a shrink of consumption. Moreover, there is a concern that the period of saving might become further longer. In addition, while the low interest rate environment is prolonged, the central bank is facing with the zero lower bound. We confront the fundamental challenge; how to manage the issues maintaining the market in this unprecedented world.