Minutes of the Meeting of JGB Investors
(71st Round)

・Date: Monday, September 25, 2017(3:00 p.m. to 4:30p.m.)
・Place: Special Conference Room 3, Ministry of Finance
・Gist of the Proceedings

1. Issuance amount of Inflation-Indexed Bonds in the October - December 2017 quarter

▶The Financial Bureau gave the following explanation about the issuance amount of Inflation-Indexed Bonds in the October - December 2017 quarter:

・As regards Inflation-Indexed Bonds the JGB Issuance Plan for FY2017 says on page 2 that "the debt management office flexibly adjust issuance amounts taking into consideration opinions exchanged with JGB market participants, the market environment and investment demands" for making four issuances in the year by the per-issuance amount of ¥400 billion. Therefore, today we would like to hear your opinions about the issuance amounts in the October - December 2017 quarter.

・For the July - September 2017 quarter, as shown on page 3, we conducted the auction for the issuance amount of ¥400 billion in August, and Buy-back Auctions in the amount of ¥20 billion in the same month. Page 4 shows that the August auction continued to successfully end, showing the bid-to-cover ratio of 3.19. The Bank of Japan (BOJ)'s Outright Purchase on September 19, the bid-to-cover ratio had declined while the Average Successful Bid Rate/Yield Spread were also positive among Buy-back Auctions and the BOJ's Outright Purchase showed generally successful results as shown on page 5. However, these results may have been affected by news reports of the consumption tax increase connected to the snap general election called right before operation.

The secondary market, page 6 shows that although BEI at one point dropped to upper 0.2%, it picked up again and is now moving around 0.4%.

・In such circumstances, we asked for your opinions beforehand and found that many of you are concerned about the continuing limited expansion of the investor base for Inflation-Indexed Bonds, therefore being of the opinion that the debt management office should desirably maintain for the October - December quarter the current issuance amounts of Inflation-Indexed Bonds and of Buy-back Auctions.

・In view of such a situation, as shown on page 7, we are considering issuing Inflation-Indexed Bonds in the October - December quarter in the amount of ¥400 billion and carrying out Buy-back Auctions in the amount of ¥20 billion in the even-numbered month of October and of December, in the same amount as the July - September quarter. Per the discussion at the Meeting of JGB Market Special Participant last Friday, there were essentially no objections to this plan.

・The development of the market for Inflation-Indexed Bonds, is an important issue related to the Debt Management Policy. Therefore, we would like to hear your opinions, on the direction of our policy related to the issuance amounts in the October - December quarter, the auction schedule at equal intervals, etc.

▶Many attendees agreed to the proposal for the issuance amounts of Inflation-Indexed Bonds in the October - December 2017 quarter and other things, while some attendees expressed the following opinions:

・Unless there is an increase in inflationary expectations including the effects not only of monetary policies but also of fiscal policies, expansion of the investor base in Inflation-Indexed Bonds cannot readily be achieved. With respect to inflationary expectations, foreign countries are taking the lead over Japan, and we are investing in US Inflation-Indexed Bonds where inflation has become a reality.

・Not only do we not yet have an outlook of a long-term escalation in prices, but the level of BEI does not sufficiently have better value, resulting basically in our taking a discreet stance toward investment in Inflation-Indexed Bonds. In addition, as the liquidity in the secondary market is inferior to fixed-rate bonds, it is difficult to embark in the active management of Inflation-Indexed Bonds.

・Until confidence that continuous increase can be seen in the core-core CPI, it is basically difficult to invest in Inflation-Indexed Bonds. Due to the lowering of BEI level, the downside risk has also declined; however, the upside also remains limited. Another drawback is low liquidity.

・In the long run, there are two ideas to enhance the liquidity of Inflation-Indexed Bonds. One idea is to increase the issuance amount as well as the BOJ Outright Purchase of JGBs and Buy-back Auctions so as that the BOJ and the debt management office may create buying and selling. Another idea is to impose market making of Inflation-Indexed Bonds on security firms in some way.

2. Liquidity Enhancement Auctions for the October - December 2017 quarter

▶The Financial Bureau provided the following explanations regarding the Liquidity Enhancement Auctions for the October - December 2017 quarter:

・Regarding the Liquidity Enhancement Auctions, as shown on page 9, the FY2017 JGB Issuance Plan stipulated that an annual amount of ¥10.8 trillion would be issued, and that "based on discussions with market participants, the issuance amount for each zone would be adjusted flexibly manner in response to the market environment and investment demands". Today, we request you to discuss the issuance amount for each zone in the October - December quarter.

・As shown on page 10, in the July - September quarter we made additional issues for those that lacked liquidity and reexamined the issuance amount for each zone in light of the purpose of Liquidity Enhancement Auctions, which aim for the maintenance and enhancement of liquidity with JGB markets. More specifically, for the 1 - 5 - remaining - year zone, ¥100 billion increase was made to the per-auction amount in addition to the ¥300 billion issued in July and September. In addition, for the 5 - 15.5 - remaining - year zone, a monthly amount of ¥550 billion was issued as was done previously, and for the 15.5 - 39 - remaining - year zone, the per-auction amount was decreased ¥100 billion while ¥400 billion was issued in August.

・Page 11 onwards show the results of recent Liquidity Enhancement Auctions. Each zone was generally stable.

・When we heard your opinions under these conditions about the Liquidity Enhancement Auctions for the October - December quarter in advance, and there were many opinions that maintaining the current issuance amount is appropriate.

・In view of such a situation, page 14 shows that for the October - December quarter, we have an idea of issuing the same amount for each zone as the July - September quarter, which involves ¥300 billion in November for the 1 - 5 - remaining - year zone, ¥550 billion each month for the 5 - 15.5 - remaining - year zone, and ¥400 billion in October and December for the 15.5 - 39 - remaining - year zone.

Though there was debate over this proposal during the Meeting of JGB Market Special Participants last Friday, a majority of participants agreed to it.

・Based on today's discussion, we will decide the issuance amount for each zone of the Liquidity Enhancement Auctions in the October - December quarter, and so we would like to ask for opinions.

▶The following opinions were given, in addition to having no objection to the proposal regarding the Liquidity Enhancement Auctions for the July - September 2017 quarter.

・We agree with the proposal. As a final investor, investment in JGBs that give a positive yield is a prerequisite. However, depending on the situation even in JGBs with a negative yield, there is a possibility for objective of management to be cash-crushing. Therefore, liquidity of the medium-term zone is vital.

・We have no objections to the proposal. We would not purchase JGBs with a negative yield other than for collateral needs; however, we proactively purchase medium-term zone issues from overseas central banks. For example, even if JGBs with a negative yield of 20bps is purchased, if the SC repo rate is minus 30bps, carry revenue may be secured. Such needs may arise to a certain extent.

・We agree with the proposal. However, we have not made any investments in the negative interest rate zone. If there is an easing of demand for short - to - medium - term zone in the future, we desire to increase the amount in the zone with the 15.5 - 39 - remaining - year zone and return to the April - June quarter distribution.

・We basically agree with the proposal. It is highly beneficial to make adjustments with Liquidity Enhancement Auctions when there is an issue with a tight supply-demand balance. However, from the ALM perspective, for our company which invests in super long-term off-the-run issues, Liquidity Enhancement Auctions are extremely effective means of investment. When the tight supply-demand balance settles down, we hope that the issuance amount per zone would return to the April - June distribution.

・It is not that we have any objections toward the proposal, but in the long run, is it recommendable to provide a large supply to the medium-term zone which is the target of foreign investors who are seeking to buy even with a negative yield? Investors with needs in the super long-term zone are merely restraining transactions due to the low interest rate. If we think in terms of maintain the liquidity in the zone with the actual demand, we hope the price will return to that before the reduction for the super long-term zone as early as possible.

・If possible, we request the issuance amount of the super long-term zone to be increased. At present, it appears unlikely that there will be major changes in the interest rate, so trading may be carried out without any trouble. However, in the event that situations may arise in the future in which major changes in the interest rate occur, there are concerns with regard to the liquidity of the super long-term zone. On the other hand, presently, our company is not purchasing JGBs with a negative yield, and if there is a need for a medium-term zone, our current policy is to purchase local government bonds.

・We request that the issuance amount per zone be returned to the distribution for April-June. We realize that the proposal was made in response to the fact that issues of concern with regard to liquidity is concentrated in the 1-5 - remaining - year zone. However, we hope that more attention will be given to the super long-term zone which is the main investment target of our company.

We endeavor to match the duration with liabilities, and there are times when we want to buy and sell in large quantities. However, in the current situation where the interest rate does not change much due to the yield curve control, it is inevitable that we expend much in trading and curb our trading volume per day to one-tenth of the plan. In the future when major changes occur in the interest rate, it would be difficult with the present market liquidity to carry out transactions for the volume desired.

3. Latest JGB market situation and outlook for future investments

▶Summarized below are the views and opinions presented by the attendees:

・The economy itself is strong from a global perspective. However, it is important to discern the effects of the FRB balance sheet reduction. Although the interest rate is being restrained due to geopolitical risks, etc., because of the extremely low level of interest rates, many are exercising caution with regard to investments.

As part of a flow in which FRB began to raise the interest rates and implemented balance sheet reduction, followed by European nations, the BOJ is taking a discreet stance toward the normalization of monetary easing. Although the economic expansion has continued to a great degree, there is a possibility to become the recession in 2 or 3 years. At that time, if Japan is still carrying on with monetary easing, further monetary easing may be required amid such an economic slowdown.

・The present market seems to underestimate the FRB's interest rate rise and balance sheet reduction. In addition, while there is no prospect for the yield curve control policy to change, it is possible that the BOJ governor appointment next year may become a market fluctuation factor. In the present situation where the domestic market continues to remain unchanged, we have no choice but to maintain the stance of carrying out investments while observing overseas market trends, particularly of the United States and Europe.

・In the investment plan in the latter half of the fiscal year, the focus will be on measures against the risks of rising interest rates and IRRBB. In this climate of low interest rates, the result is a decrease in the sales volume of JGBs, decrease in liquidity and rise in sales costs. Therefore, it is difficult to accumulate profit on sales by dealing flexibly and there is a need to increase the duration in order to secure profits or to invest in credit products.

If possible, our desired position is to be able to secure stable profits by domestic bonds, and while increase in interest rates is desirable, we are wary of sudden fluctuations. Until the interest rates of domestic bonds increase, we will continue investing in foreign bonds, etc.

・Our corporate stance is basically to invest in JGBs. However, because the medium-term zone is a negative yield, we mainly invest in bonds other than JGB with shorter than remaining 10 years to maturity.

・In the long run, we feel that the IRRBB which starts next year is a big issue. With the start of the IRRBB, purchasing of unlimited JGBs will not be possible as before. Thus, when normalization of the monetary easing by the BOJ is achieved, there is concern over whether financial institutions can have the same amount of JGBs as before.

・From a medium - to - long - term perspective, although discussions of primary balance and consumption rate hike are proceeding, it is necessary for the government to make a sincere explanation regarding specific measures taken to achieve fiscal consolidation. It is vital not only to rely on improvement in primary balance through economic expansion, but also to provide specific effective initiatives to achieve fiscal consolidation such as securing financial resources and cutting expenditures. Furthermore, we have the awareness of the issue in that we feel that it is imperative to establish initiatives to secure market stability, having a long-term perspective on the impact on the JGB rating and the rating of relevant Japanese financial institutions.

・Due to the sluggish growth in the popularity of JGBs, we are contemplating on continuing to carry out diversified investments such as making investments in areas other than JGBs. If the yield curve control policy becomes more flexible and the market volatility gradually increases, investor funds may more easily come back in the event of market fluctuation.

・We make investments from the aspect of which is more appealing, by comparing JGBs to currency-hedged foreign bonds. At the present, the hedge costs are increasing, and JGBs are becoming appealing in comparison. If the interest rates rise, we would like to maintain the position of buying JGBs.

・Due to the ongoing low yen interest rate situation, we feel that the buying of mainly currency-hedged foreign bonds will continue for the time being. However, it should be noted that if the current monetary policy continues for too long, due to the sales expansion of products denominated in foreign currency, debts in foreign currency will increase. This will make it difficult to buy large volumes of JGBs as it is done presently, even when the monetary policy is normalized.

・The yield curve control policy is taking effect and factors which normally affect the market does not presently cause any impact. If the market becomes one which can achieve reasonable price formation in the future, it is thought that investors will naturally return.

・While the BOJ is proceeding with the normalization of the monetary policy, the concern is the possibility of absentee investors instead of the BOJ. Investors such as our company purchase JGBs in exchange for the selling of products. However, until products are sold, detailed explanations must be given to the customers and a certain amount of time is required until sales process is completed. Therefore, even if the BOJ stops purchasing JGBs and a need arises for investors to purchase JGBs in their place, responding on short notice is difficult.

・Since the BOJ commenced a large-scale monetary easing policy, purchasing of a sufficient amount of JGBs at a satisfactory level of interest rates has not been possible. If the level of interest rates increases in the future, we would like to proceed with the purchasing of JGBs.

・From a medium - to - long - term perspective, we have become accustomed to the market prices under the present monetary policy. However, we need to make investments with the awareness that these market prices will not last long. What is important for the market are both monetary and fiscal aspects and for the way to normalization to be clearly paved.

・The current issue is that the market lacks liquidity. In particular, when buying off-the-run issues, the security firms sometimes tell us, “We cannot give the rates, we do not have the goods,” In a situation where the BOJ holds large quantities of JGBs, security firms cannot easily make a short position. If the user-friendliness of BOJ’s securities lending facility improves, market liquidity will also be likely to improve.

・First of all, due to long-term low interest rates, deterioration can be seen in a vital infrastructure consisting of human resources who engage in investment. Since the current actual interest rates are negative, there is little choice but to carry out trading by determining whether JGBs are comparatively cheaper or more expensive than others, or making a profit by targeting short-term timing. When such a situation continues for many years, human resources from the aspect of conventional type of investment cannot be cultivated. There will be major problems if there are no investors when the interest rate rises and conventional type of investment becomes necessary.

Secondly, the low interest rates are hindering a vital savings to investments trend that this country has. We may think that low interest rates may cause people to invest in other assets. However, this is not the case. As low interest rates continue, the extreme result of the rational actions of investors has been to have great quantities in cash and to allot a portion of their assets for the short-term trading of bitcoins and other things that have large price fluctuations. From this aspect, if there are yields on bonds, the profit from the bonds can serve as a buffer so that investments in various risk assets may be carried out.

Thirdly, a low-interest policy means transferring wealth from the lender to the borrower, but the problem is how the government who is the borrower makes use of the low-interest environment. Unless the government utilizes the low-interest environment to carry out IT infrastructure investments, the low-interest policy would be meaningless.

・Problems of long-term low interest rates include the slackening of fiscal discipline and the slow response of the market which should point out the slackening of the fiscal discipline. The major issue amid the long-term low interest rate environment is that there is no channel to convey the need for fiscal consolidation.