Minutes of the Meeting of JGB Investors

(73rd Round)

・Date: Friday, December 15, 2017 (1:30 p.m. to 2:20 p.m.)
・Place: Special Conference Room 3, Ministry of Finance
・Gist of the Proceedings

1. Issuance amount of Inflation-Indexed Bonds in the January - March 2018 quarter (see Annex 1)

▸The Financial Bureau gave the following explanation about the issuance amount of Inflation-Indexed Bonds in the January - March 2018 quarter:

・As regards Inflation-Indexed Bonds the JGB Issuance Plan for FY2017 says on page 3 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 amount in the January - March 2018 quarter.

・For the October - December 2017 quarter, as shown on page 4, we conducted the auction for the issuance amount of ¥400 billion in October, and Buy-back Auctions in the amount of ¥20 billion in October and in December, respectively. Page 5 shows that the October auction continued to successfully end, showing the bid-to-cover ratio of 3.09. Buy-back Auctions and the Bank of Japan (BOJ)'s Outright Purchase showed generally successful results as shown on page 6. The secondary market has continued to be stable over the past months with the BEI around 0.5% as shown on page 7.

・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 January-March quarter the current issuance amounts of Inflation-Indexed Bonds and of Buy-back Auctions.

・In view of such a situation, as shown on page 8, we are considering issuing Inflation-

Indexed Bonds in the January-March 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 February, in the same amount as the October - December quarter.

・On page 9 we show opinions provided by you about a desirable auction schedule for Inflation-Indexed Bonds. Currently, we hold auctions for the bonds in April, August, October and February, at irregular intervals. Many of you expressed an opinion in favor of issuances at equal intervals to avoid a disproportionate demand-supply balance.

For issuance of Inflation-Indexed Bonds in and after the next fiscal year the debt management office is considering to change auction schedules at equal, three-month intervals in May, August, November and February for the purpose of the stable issuance. If in carrying out this planned revision we have difficulty in conducting auctions on our traditional two-times-a-week basis, we may hold auctions three-times-a-week, on Monday, Wednesday and Friday, with the bonds of smaller issuance amounts being auctioned at the beginning or end of a week.

・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 January - March quarter, the auction schedule at equal intervals, etc.

▶Many attendees agreed to the proposal for the issuance amounts of Inflation-Indexed Bonds in the January - March 2018 quarter and other things, while some attendees expressed the following opinions:

・We request the debt management office to maintain the current amount of the Buy-backs because the Buy-backs provide important selling opportunities and help secure liquidity.

・We have no objection to the proposal. With respect to the schedule of issuance of Inflation-Indexed Bonds, we find that the current schedule of issuance are reasonably determined to some extent in consideration of the overall demand-supply balance of the bonds, while we also find it reasonable for the debt management office to adopt an equal interval-based auction schedule in consideration of the bonds' demand-supply balance as well as their stable issuance.

2. Liquidity Enhancement Auctions for the January - March 2018 quarter (see Annex 2)

▶The Financial Bureau provided the following explanations regarding the Liquidity Enhancement Auctions for the January-March 2018 quarter:

・Regarding the Liquidity Enhancement Auctions, as shown on page 11, 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 January - March quarter.

・As shown on page 12, in the October - December quarter we issued ¥300 billion in November for the 1 - 5 - remaining - year zone, and ¥550 billion in 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, as in the July - September quarter.

・Page 14 shows the results of the Liquidity Enhancement Auctions. Although the December auction is yet to be carried out, each zone was generally stable.

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

・In view of such a situation, page 16 shows that for the January - March quarter, we have an idea of issuing the same amount for each zone as the October - December quarter, which involves ¥300 billion in January and March for the 1 - 5 - remaining - year zone, ¥550 billion each month for the 5 - 15.5 - remaining - year zone, and ¥400 billion in February for the 15.5 - 39 - remaining - year zone.

At yesterday's Meeting of JGB Market Special Participants we were provided with the opinion by many of the participants that if premised upon the size of the issuance plan referred to above the current issuance amounts are well balanced and that therefore it is appropriate to maintain the current balance.

If we carry out JGB issuances in accordance with the plan the amount to be issued within the current fiscal year via the Liquidity Enhancement Auctions will amount to ¥10.9 trillion.

So we are planning to modify the JGB Issuance Plan.

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

▶Many attendees agreed to the proposal for the Liquidity Enhancement Auctions for the January-March 2018 quarter, while some attendees expressed the following opinions:

・We agree to the proposal. Judging from our particular situation, we want a greater allocation of issuance for the attractive long-term and super long-term zones; however, we realize the current tight supply and demand environment in the market in the short - to - medium - term zone, so we would see no problem if the debt management office makes the best allocation of issuance amounts according to its own judgment.

・We have no objection to the proposal. One different idea, however, will be to increase issuance in the 1 - 5 - remaining - year zone and decrease in the 5 - 15.5 - remaining - year zone.

・Toward the end of a book-closing period JGB investors are likely to buy the super long-term bonds and thus lengthen the duration of their JGB holdings in an effort to fill the duration gap between assets and liabilities. The recent drop in interest rates on 30-Year and 40-Year Bonds is presumably attributable to JGB Investors having been engaged in such operations for their December book closing. Because of a large number of JGB Investors who close their books at the end of March, we expect needs to rise in the super long-term zone causing the tight supply and demand. So we request the debt management office to allocate larger issuance amounts in the 15.5 - 39 - remaining - year zone in the January - March quarter.

3. JGB Issuance Plan for FY2018 (see Annex 3)

▶The Financial Bureau gave the following explanations about the JGB Issuance Plan for FY2018:

・Explained below is how the Financial Bureau is now discussing and considering the JGB

Issuance Plan for FY2018.

・Shown on the left side of page 18 is the breakdown of the issuance amount by legal grounds or by purpose. The size of issuance of Newly-issued bonds and Reconstruction Bonds will be decided in the budget formulation process while Fiscal Investment and Loan Program Bonds (FILP Bonds) is decided in the process of formulating the Fiscal Investment and Loan Program plan. At this moment, we are not in a position to say anything certain about the issuance amount of such bonds.

・With regard to Refunding Bonds, we have so far explained based on the figures given in the Budget Request submitted last August that we expect to decrease their issuance by ¥1.5 trillion exclusive of Reconstruction Bonds, and by ¥1.8 trillion including Reconstruction Bonds and Refunding Bonds; however, as noted in the lower left of page 18, we expect to decrease the issuance of Refunding Bonds by further ¥1.0 trillion due to the fiscal year-end adjustment of the balance of the Government Debt Consolidation Fund. As a result, the total JGB issuance amount is expected to decrease by a certain amount.

・Shown on the right side of page 18 is breakdown of the issuance amount by financing method. We are still carefully reviewing the amount of JGBs “for Retail Investors” and “for BOJ Rollover.” The amount of “market issuance” will increase or decrease to some extent depending upon the result of the review. In addition, as we explained at our previous meeting, we think a decrease in the amount of market issuance in the JGB issuance plan for the next fiscal year will be necessary in consideration of additional revenue from issuance at a price above per value.

・On pages 19 and 20 we organized opinions presented at last month’s Meeting of JGB Market Special Participants and of JGB Investors relating to the maturity composition of the JGB market issuance amount.

・With respect to super long-term bonds, many of JGB Market Special Participants were of the opinion that while decreasing issuance amount of 30-Year or 40-Year Bonds would be appropriate if the total JGB issuance amount is decreased, the amount of issuance of 20-Year Bonds should desirably be maintained because of their broad investor base. We heard different opinions from JGB Investors. Many of them requested us to maintain the size of issuance including the issuance of 30-Year and 40-Year Bonds, some of them suggested we should reduce issuance amount principally of 30-Year and 40-Year Bonds.

・With respect to the zone of 10 or shorter years zone the participants generally agreed, that the Financial Bureau may reduce issuance amounts to some degree, with many of them being of the opinion that the issuance amount particularly of 5-Year Bonds may be decreased to a relatively substantial degree.

・With respect to Liquidity Enhancement Auctions, the participants agreed that it would be appropriate to increase issuance amount to some degree in consideration of the lowering liquidity of the off-the-run issues even when the total JGB issuance amount is reduced.

・In the coming days, we will decide the specifics of the JGB Issuance Plan for the next fiscal year in light of the above-mentioned opinions and publish it together with the budget for the next fiscal year as usual.

▶Summarized below are the views and opinions about the JGB Issuance Plan for FY2018 presented by the attendees:

・Under the current negative interest rate environment 5-Year Bonds have the smallest demand. For this reason, we believe the debt management office may decrease 5-Year Bonds to a greater extent than the other maturities bonds.

・It is possible, we think, to decrease issuance amounts in the zone with shorter than remaining 10 years.

・In view of JGBs' lowering market liquidity we request the debt management office to increase issuance amounts in Liquidity Enhancement Auctions which will serve to diversify investment opportunities.

・We see no problem about the decrease of 30-Year Bonds; however, it is desirable to maintain the issuance amount of 40-Year Bonds because their market continues to be on its way to development.

・With respect to 30-Year Bonds we request the debt management office not to decrease their issuance amount because globally 30-Year Bonds are benchmark bonds in the super long-term zone.

・We request the debt management office not to decrease the issuance amounts in the super long-term zone as much as possible.

・With respect to the decrease of issuance amounts of 30-Year Bonds and 40-Year Bonds there exist different opinions between JGB Market Special Participants and some of JGB Investors. In the current phase where we see no problem relating to the issuance of JGBs over the short term the debt management office should place greater importance on the opinions of JGB Investors. Investors in the super long-term zone play an important role in the financial area of the Japanese economy. So they should be kept in the JGB market from a long-term perspective. It is natural that low interest rates are desirable for the Debt Management Policy. Excessively low interest rates or an excessively flattening yield curve is not good for the economy, as revealed in Comprehensive Assessment conducted by the BOJ. So we would like to request the debt management office to continue a dialog with the JGB market and communication with the BOJ and address the Debt Management Policy in consideration of the Japanese economy as a whole.

4. Latest JGB market situation and outlook for future investments

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

・In the next fiscal year we expect in an investment environment characterized by uncertainty where low interest rates, the flattening yield curve, low volatility, geopolitical risk and other factors will coexist. So we will continue to be in an environment where earning stable revenue from JGBs is difficult. We will be required to carefully look for investment timing.

Another factor we should be careful of in the next fiscal year is the possibility for central banks around the world to continue reducing their balance sheets and for inflation to be on an upward trend. In such a sense, some change may occur also to the course of policy management adopted by central banks which has already been incorporated by the JGB market. We would like to look for investment timing keeping such points in mind.

・Given lower yields expected to be paid for reinvestment of the money repaid by JGBs and the impossibility to reinvest in the medium-term zone which is subject to a negative interest rate we continue to find ourselves in quite a difficult investment environment. What we can do for the next fiscal year is quite limited. So we will be investing at an opportune moment that shall be provided by an interest rate hike.

・We continue to be unable to invest in JGBs because of negative interest rates in the short-to-medium term zone. We adhere to the investment policy that earn any revenue by allocating funds to investment trust funds by way of risk diversification.

・Declining yen interest rates have kept us increasing investments in currency-hedged foreign bonds and other overseas assets; however, we see that over the recent weeks the yield spread between long-term and short-term foreign bonds has narrowed.

For future investments we plan to continue investing in overseas assets in search of spreads, while at the same time trying to find a way for the portfolio as a whole to improve returns on investing again in JGBs.

・Global trends point toward weaker inflationary pressure and the flattening yield curve. Future destabilizing factors such as the course to be followed by the US administration and geopolitical risk may cause a phase where interest rate volatility may rise temporarily.

On the other hand, we expect yen interest rates to stay stable under the BOJ's yield curve control policy. In such circumstances we would like to invest in JGBs flexibly in consideration of the volume of interest rate risks associated with assets and liabilities.

・Over the recent weeks we have seen low interest rates and low JGB market volatility on the back of low inflation. In such an environment the yield curve has continued to be flattening; however, we expect the curve will steepen at any moment in the future. Precisely at such a moment we want to allocate funds to JGBs. Until such moment comes we should patiently wait without taking duration risks.

・We are discussing our investment plan for the next fiscal year. We are thinking of investing in JGBs to an extent that we do not much increase the balance of our JGB holdings.

・Insurance companies generally tend to increase investment in JGBs for ALM purposes toward the end of a book-closing period regardless of interest rate levels or economic fundamentals. We are concerned that such movements on the part of insurance companies may cause the market to move substantially toward the end of the fiscal year in a circumstance where the BOJ holds more than 40 percent of all the outstanding JGBs.

We are not in a situation that will allow us to aggressively increase investments in currency-hedged foreign bonds nor in a situation that encourages us to increase investments in JGBs which pay interest at a rate lower than the cost of our liabilities. Consequently, our investment idea is principally centered on increasing investment in open foreign bonds or currency-hedged foreign bonds issued in different currencies.

・Precisely at this moment we are discussing our investment plan for the next fiscal year, but we do not intend to substantially change our investment policy. We would like to go on investing in the super long-term zone in an amount that matches our liabilities in order to reduce interest rate risks.

・We have increased our currency-hedged foreign bond positions in substitution for JGBs. We see, however, that over the recent weeks dollar hedging costs have substantially increased making currency-hedged foreign bonds less attractive, while JGBs have become relatively attractive. However, because the interest rates on JGBs are far from satisfactory and a rapid increase in investments in JGBs will exert strong flattening pressure on the yield curve, we will go on investing in a careful manner watching interest rate levels.

As one of those who represent institutional investors we think it is necessary to proactively work for development and vitalization of the super long-term yen-denominated bond market. We expect issuance of corporate bonds and yen-denominated foreign bonds on a larger scale in addition to JGBs that constitute the core of super long-term bonds.

・At this moment we are in the process of considering our investment plan for the next fiscal year. There are needs for us to go on buying yen-denominated bonds to a certain amount for ALM purposes. We also intend to invest in currency-hedged foreign bonds.

Over the recent days the USD LIBOR has risen and the negative spread of the USD/EUR basis has widened. We feel the current of dollar liquidity is changing. We also see that currencies of emerging economies, too, are being sold to some extent. It is necessary, we think, to carefully watch these global market developments.

・There is a possibility for the bond market to globally suffer low volatility or the yield curve to flatten for a prolonged period of time. We will continue to invest principally in currency-hedged foreign bonds and JGBs including 20-Year Bonds as they are relatively attractive.

・From a global perspective the economy is expected to continue robust and we have an impression that prices of corporate bonds or high-yield bonds have already incorporated such a factor. In such circumstances it is our portfolio's investment policy to have sufficient flexibility and liquidity for the moment so that we may take sufficient risk when an investment opportunity comes around upon any substantial change occurring in the bond market.

As the yen interest rate is linked to global interest rate fluctuations we find it difficult to invest in yen-denominated bonds for the moment. We expect the BOJ will modify the level of the policy interest rate under its yield curve control policy in the middle or second half of next year. We want to be careful in taking any interest rate risk.

・Given their low liquidity and extremely low volatility we are investing in JGBs in quite a contained manner. We expect that in the next year, the JGB will continue to be little volatile and further illiquid. So we will continue to invest in JGBs in a contained manner.

・We expect that under the yield control policy long-term interest rates in Japan will continue to be stable and little volatile. Given the improving global economic outlook it is possible that the lower limit of the interest rate range has risen. So we do not expect a scenario in the future where long-term interest rates will be in negative territory.

If we assume that under the yield curve control policy the long-term interest rates will continue to be as little volatile as they are now, JGBs in the 15 - 20 - remaining - year zone will be attractive. So we would like to invest principally in such zone.

The other day the governor of the BOJ referred to the reversal interest rate. We will carefully watch if there is any change in his way of thinking about monetary policies. We do not foresee, however, that the BOJ will adjust its monetary policy anytime soon. So we will maintain unchanged our present investment stance.

・Different from any past phase of economic expansion we see that over the recent years labor share has been on a declining trend worldwide. Such a decline in labor share may affect monetary policies and interest rate trends in Japan and some other countries. We should carefully watch its effect.