Minutes of the Meeting of JGB Investors
(76th Round)

・Date: Tuesday, September 25, 2018 (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 October - December 2018 quarter

▶The Financial Bureau gave the following explanation about the issuance amount of Inflation-Indexed Bonds in the October - December 2018 quarter:

・As regards Inflation-Indexed Bonds the JGB Issuance Plan for FY2018 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 amounts in the October - December 2018 quarter.

・For the July - September 2018 quarter, as shown on page 4, we conducted the auction for the issuance amount of ¥400 billion in August, and Buy-back Auctions in the amount of ¥20 billion in August, respectively. Page 5 shows that the bid-to-cover ratio for the August auctions was 3.12, which is a level comparable to that in past auctions. While we saw some wavering of the bid-to-cover ratio with regard to Buy-back auctions and Outright Purchase of JGBs, the results generally conformed to market yields (page 6). Regarding the secondary market, page 7 indicates that the BEI was temporarily 0.4% prior to the August auction, but it subsequently returned to its former level and is now transitioning by just under 0.5%.

・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; but since we are seeing trading with a BEI in the 0.4% to 0.6% range, many of you expressed a desire to maintain for the October - December quarter the current issuance amounts of Inflation-Indexed Bonds and Buy-back Auctions.

・In view of such a situation, as shown on page 8, 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 months of October and December, in the same amount as the July - September quarter.

This plan was also discussed at the Meeting of JGB Market Special Participants last Friday and endorsed by most of the attendees.

・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.

▶In addition to many responses stating that there were no objections to the proposal regarding the issuance amount for Inflation-Indexed Bonds in the October - December 2018 quarter, some members expressed the following:

・We see no problems with the proposal. The liquidity of Inflation-Indexed Bonds is not still enough, and they are difficult to trade. But as we witness global wages rise and prices also show signs of increasing, we expect that demand for the Inflation-Indexed Bonds in Japan will increase a little more in the future. As the debt management office continues with its current issuance amount, we also request to maintain the Buy-back Auctions to alleviate the recent inadequacies regarding liquidity.

・We have no objections to the proposal. Although the current BEI continues to transition at a lower level from 40bps to 50bps, we do not see any problems with maintaining the current issuance amount for Inflation-Indexed Bonds when we consider factors such as the deepening debate surrounding the future consumption tax increase. We also request to continue with the Buy-back Auctions to create an opportunity for selling.

・We saw some instability with the prices of Inflation-Indexed Bonds around the time of the August auction, but buyers did come at the cheap prices, and the BEI level has stabilized. In terms of market development, maintaining an issuance amount of ¥400 billion is appropriate.

2. Liquidity Enhancement Auctions for the October - December 2018 quarter

▸The Financial Bureau provided the following explanation regarding the Liquidity Enhancement Auctions for the October - December 2018 quarter:

・Regarding the Liquidity Enhancement Auctions, As shown on Page 10, the FY2018 JGB Issuance Plan stipulated that the total annual issuance amount of ¥12.6 trillion (¥2.4 trillion for 1 - 5 - remaining - year zone, ¥7.2 trillion for 5 - 15.5 - remaining - year zone, and ¥3.0 trillion for 15.5 - 39 - remaining - year zone) 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 11, in the July - September quarter we issued ¥400 billion in July and September for the 1 - 5 - remaining - year zone, and ¥600 billion in each month for the 5 - 15.5 - remaining - year zone, and ¥500 billion in August for the 15.5 - 39 - remaining - year zone, as in the FY2018 JGB Issuance Plan.

・Page 12 and after shows results of the latest Liquidity Enhancement Auctions. In general, results were stable.

・When we heard opinions under these conditions about the Liquidity Enhancement Auctions for the October - December quarter from the JGB Market Special Participants in advance, some of you expressed a desire to increase the issuance amount for the 15.5 - 39 - remaining - year zone, but there were many opinions that maintaining the current issuance amount is appropriate.

・In view of such a situation, we have prepared our proposal for each zone's issuance amount during the October - December quarter (see page 15). We are considering issuing ¥400 billion in November for the 1 - 5 - remaining - year zone, ¥600 billion each month for the 5 - 15.5 - remaining - year zone, and ¥500 billion in October and December for the 15.5 - 39 - remaining - year zone.

Most of the attendees at the Meeting of JGB Market Special Participants last Friday stated that the current issuance amounts are balanced and that maintaining them the same is appropriate.

・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.

▶In addition to many responses stating that there were no objections to the proposal regarding the Liquidity Enhancement Auctions in the October - December 2018 quarter, some members expressed the following:

・Since the issuance amount for the Liquidity Enhancement Auctions was just increased this fiscal year, we have no objection to the proposal of maintaining the status quo.

・We request to increase the issuance amount for the 15.5 - 39 - remaining - year zone and decrease the issuance amount for the 1 - 5 - remaining - year zone, which has negative interest rates. During the last fiscal year there was a sense that interest rates would increase, and we therefore witnessed a phenomenon in which the liquidity of the super long-term zone became tight around the time when insurance companies and other entities ended their accounting periods. But this fiscal year began with no such expectation of future interest rate increases, therefore buying demand in the super long-term zone is not so strong. Under these circumstances, the issuance amounts for 30-Year and 40-Year Bonds have decreased this fiscal year, and we get the impression that demand and supply has continued to be tight from the start of the term. We ask the debt management office to consider these facts.

・Since we think that there is a lot of potential demand for the Liquidity Enhancement Auctions in the super long-term zone, we request to increase the issuance amount for that zone in an effort to improve liquidity.

・We request to increase the issuance amount per auction to ¥600 billion for the 15.5 - 39 - remaining - year zone. The super long-term zone is one in which many investors hold a stable buy-and-hold strategy, even if interest rates are expected to rise in the future. As we look ahead, it may be desirable to supply JGBs to these investors.

3. Latest JGB market situation and outlook for future investments

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

・Strengthening the Framework for Continuous Powerful Monetary Easing at the end of July highlighted the side effects of extending monetary policies, as we saw the fluctuation range of long-term interest rates expand. The JGB market is now focused on how the Bank of Japan (BOJ) will operate its monetary policies moving forward, based on those revisions. We feel there is an awareness now that if the CPI exceeds 1% and exhibits a rising trend, the fluctuation range for long-term interest rates could expand or other changes may occur. The JGB market could be influenced to some degree by the movement of CPI and other metrics in the future. In that sense, it seems that the market has become sensitive in responding to market environmental changes, which we see as a very good thing.

On the other hand, the surprise timing of the BOJ's revisions to its monetary policies shows that the changes were not entirely conducted based on strong communication with investors. That created some volatility, but of a type that is not so good. As the debt management office, it is important to build a market that reflects pure economics and does not allow this sort of volatility to emerge.

Since the loan-deposit gap shows signs of expanding, our investment stance requires us to invest in JGBs. But because the market is shifting easily, we want to carefully consider future CPI forecasts and market conditions when making our investments.

・The revisions to the BOJ's monetary policies at the end of July allowed the fluctuation range for long-term interest rates to increase to a certain extent. What concerns us, however, is that security companies lowered the amount of trading that they would accept from investors in a single go, and trades valued at the same amount as before now take more time to complete. Since we expect the percentage of JGBs owned by the BOJ to remain enormously high, we ask the debt management office to continue with its efforts to supplement liquidity.

・Volatility recovered somewhat following the monetary policy meeting at the end of July. We think that the introduction of forward guidance has maintained the ultra-low interest rates in the short-to-medium-term zones and created the chance for a steepening of the yield curve around the long-term and super long-term zones. However, the absolute level of interest rates is exceedingly low as of late, and using JGBs as an asset to build portfolios while the market continues to be strongly influenced by the BOJ is considerably difficult.

・The redemption of JGBs has continued ever since the introduction of negative interest rates, but because new investments are being deferred, holdings will continue to decrease moving forward. Investors traditionally relied on the profits from selling JGBs to cover things such as the disposal of non-performing loans or the write-down of stockholdings, but we fear that may no longer be possible in the future. One of the obvious side effects of extending monetary easing is the recent decline in earnings, but another is a decrease over the medium term in the effectiveness of diversified investment in areas such as lending and stock. For that reason, we hope that the monetary policies will be normalized slowly and without confusion.

・The BOJ's monetary policy revisions at the end of July appear to have increased trading due to the comparatively large increase in the fluctuation range of interest rates. However in the current interest-rate environment, maintaining one's JGB holdings is difficult from the viewpoint of increasing a portfolio that provides stable interest revenue.

・Led by the United States, the global economic climate continues to be bullish. There have been some recent problems, such as trade friction with the US, but they are not enough to cause a significant decline in the world economy. If the BOJ, along with the FRB and the ECB, is bullish on the economy and inflation, we believe that monetary policies will head toward normalization. Accordingly, our policy when making investments is to pay close attention to factors such as inflation trends and the pace at which yen interest rates increase. Regarding JGBs, we assume that interest rates in the super long-term zone will rise in the future; but considering the low level of inflation and the Japanese economy's vulnerability to a strong yen, we feel that the BOJ is the slowest in the world at increasing interest rates, especially compared to the United States and Europe.

・Given the current interest rates, actively investing in JGBs and increasing the amount of them that we hold is difficult. Although interest-rate levels have moved somewhat since the end of July, they are still low, as is volatility. Our company has established a limited capacity for 10-Year and 20-Year Bonds, buying and selling them according to our target levels in order to secure a profit margin. But the interest rate for 20-Year Bonds has not risen to our target level, and we have therefore barely been able to invest in them.

・Since the revisions to the BOJ's monetary policies at the end of July, all the operational changes designed to expand the fluctuation range of long-term interest rates have done is to decrease the amount of the Outright Purchases in the zone with longer than remaining 25 years to maturity on September 21. Interest rates did move immediately following the announcement of the monetary policy revisions, and now again with the reduction of BOJ's Outright Purchases. But this does not mean that rates are changing in accordance with economic or pricing conditions, as the BOJ assumes. The reason for that is the high JGB ownership ratio of the BOJ. The super long-term zone in particular contains many buy-and-hold investors, and when the BOJ also adopts a buy-and-hold strategy in that zone, interest rates become stagnant. When the BOJ pays too much attention to its implicit rule of not decreasing its amount of Outright Purchases the day after an auction of JGBs, the market can become rigid. The reduction in Outright Purchases on September 21 was therefore perceived as the BOJ making some waves.

In terms of future investment prospects, the interest rates for JGBs have risen somewhat but they are still not at a level where purchasing can resume in earnest. For that reason, conditions are not right for us to substantially increase allocation to JGBs or other yen bonds.

・In the current JGB market, situation continues to occur only under the influence of headlines involving the BOJ, and the low level of interest rates themselves has not changed. Under these circumstances, we are adopting a buy-and-hold strategy focused on the super long-term zone with regard to our liabilities, and we have no plans to change our investment policy in the future. But if these low interest rates continue, we foresee our bottom line becoming more severe every year, which we fear will have negative effects such as increasing the premiums of insurance policyholders, decreasing dividends, and reversing the improvement consumer confidence.

・JGB interest rates remain below the average assumed interest rate, and the situation still forces us to limit our JGB investments to the bare minimum needed to achieve duration matching without increasing our JGB interest-rate risk.

・Because the BOJ's yield curve control policies are extremely potent, lately the market only moves at the BOJ's beck and call. Although the BOJ's Outright Purchases decreased somewhat following the revisions to its monetary policies at the end of July, the stock effect is overwhelmingly large and interest rates just are not moving, even after such Outright Purchases reductions. For now, under this yield curve control, yen interest rates are expected to slowly rise toward the upper limit of their permitted range.

While the future market does have some causes for concern (such as trade friction), the business climate around the world is expanding and next year may even be bullish. The FRB may continue raising interest rates next year and even the year after that, and the dollar could easily become strong on the back of slowly increasing US interest rates. Considering these circumstances, there is a chance that the BOJ will move toward normalizing its monetary policies next year, and the yen-bond market will probably make its transition while watching for BOJ's monetary policy changes that indicate the next interest-rate hike.

Since our liabilities are denominated in yen, our investment policy will be to continue investing as required for ALM, but beyond that we plan to invest mostly in foreign bonds for now.

・The US bonds market and its interest-rate indicators are very bullish, but we get the impression that the market is a little too optimistic. We believe that the negative effects of past rate hikes are going to start gradually appearing from now on. Interest rates for JGBs in the super long-term zone rose as a result of the reduction in BOJ's Outright Purchases. If rates would increase just a bit more, the average duration of portfolios could even be extended little by little.

・Although interest rates for JGBs increased due to the monetary policy revisions the BOJ conducted at the end of July, it was an exceedingly short-lived adjustment. And because the BOJ's effect on the JGB market is so heavy, we believe that the BOJ's September 21 reduction in Outright Purchases for the zone with longer than remaining 25 years to maturity was intended to indicate that it would decrease its presence in the market, and these reductions in Outright Purchases may continue steadily.

We would like for that to result in restoration of the JGB market's function, but we doubt whether such movement will occur immediately since the BOJ has been controlling the yield curve for such a long period of time. In addition, the BOJ has continued to increase its ownership of JGBs under its Inflation-overshooting commitment, and the stock effect is correspondingly powerful; these factors make it quite difficult for interest-rate fluctuations to return to their original desirable state.

Global business markets are expanding, as evidenced by recent events such as the BOJ reducing its Outright Purchases of JGBs to scale back its presence in the market as well as the continuing interest-rate hikes in the United States. We believe that such circumstances provide an opportunity for JGB interest rates to rise as well, therefore we find it difficult to purchase them until they approach the upper limit of their rate fluctuation ranges.

・The JGB market will probably continue to be led by the monetary policies of the BOJ. Following the expansion of the fluctuation range for long-term interest rates at the end of July, the BOJ's adopting of a more flexible approach to its Outright Purchases has unshackled the previously restrained volatility, improved risk premiums, and increased interest rates.

Although the yield curve is heading in a healthy direction, its flattening since the end of last year, has only been slightly corrected, and compared to global interest rates it is not yet at a level where investors can purchase JGBs.

Moreover, the market's price-discovery function has not been revived sufficiently, as we can see from the dramatic shift in market prices that accompanied the BOJ's reduction in Outright Purchases for the longer than remaining 25 years to maturity on the day following the 20-Year Bond auction.

・At the end of July, the BOJ allowed the fluctuation range for long-term interest rates to approximately double. But as the BOJ's ownership ratio of interest-bearing bonds approaches nearly 50%, the amount of bonds held by private investors continues to decrease and market liquidity shows no signs of improvement. We request that the BOJ reduce its Outright Purchases to at least a level where private ownership rates can level off.

Furthermore, because the BOJ holds over 80% of bonds with about 7-10-remaining-yerar —even exceeding 90% for certain issues—we request the BOJ to consider Securities Lending Facilities such as introducing term lending or abolishing the ¥1 trillion sales cap per bond.

In addition, we request that the debt management office recognize the increased importance of Liquidity Enhancement Auctions as long as the current monetary policies of the BOJ continue.

・Based on our discussions here today, we get the impression that not much has changed in terms of movement since the BOJ's monetary policy meeting at the end of July. We believe that the forward guidance is could be viewed as to curb speculation and expectations for early normalization as much as possible. Meanwhile, there has been some discussion about making tuition free as a way to combat the declining birthrate. But while it may be true that interest rates are extremely low, expanding the budget deficit will without a doubt increase the future burden on citizens. Listening to the market is critical, but we are concerned that the voice of the market is not being heard and that the budget will be compiled without taking such information into account.