Minutes of the Meeting of JGB Investors
(78th Round)

・Date: Friday, December 14, 2018 (1:30 p.m. to 2:30 p.m.)
・Place: Special Conference Room 1208, 12th Floor, Central Common Government Offices No.4
・Gist of Proceedings

1. Issuance amount of issuance of Inflation-Indexed Bonds in the January - March 2019 quarter

▶The Financial Bureau gave the following explanation about the issuance amount of Inflation-Indexed Bonds in the January - March 2019 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 January - March quarter.

・For the October - December quarter, as shown on page 4, we planned to conduct the auction for the issuance amount of ¥400 billion in November, and Buy-back Auctions in the amount of ¥20 billion in October and December, respectively.

Page 5 shows that the November auction were carried out without any problem, showing the bid-to-cover ratio of 3.70.

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 has fallen into the 0.3% range since the beginning of December, following a decline in interest rates for nominal bonds.

・In such circumstances, we asked for your opinions beforehand and found that many of you expressed a desire to maintain for the January - March quarter the current issuance amounts of Inflation-Indexed Bonds and Buy-back Auctions. However, some of you are concerned about the continuing limited expansion of the investor base and about over the future demand-supply trend due to the recent market environment.

・In view of this situation, as shown on page 8, in the January - March quarter, we are considering issuing Inflation-Indexed Bonds in the amount of ¥400 billion and carrying out Buy-back Auctions in the amount of ¥20 billion in the even-numbered months, in the same amount as the October - December quarter. As the wording of the provision, we would like to continue to closely follow market environment, and consider flexible response as necessary.

This plan was also discussed at the Meeting of JGB Market Special Participants yesterday 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 January - March quarter.

▶All attendees agreed that they have no objection to the proposal regarding the amount of issuance of the Inflation-Indexed Bonds in the January - March 2019 quarter.

2. Liquidity Enhancement Auctions for the January - March 2019 quarter

▶The Financial Bureau provided the following explanation regarding the Liquidity Enhancement Auctions for the January - March 2019 quarter:

・As shown on page 10, the FY2018 JGB Issuance Plan states the following about the Liquidity Enhancement Auctions:
(1)While the operating assumption is that the total annual issuance amount will be ¥12.6 trillion (¥3.0 trillion for the 15.5 - 39 - remaining - year zone, ¥7.2 trillion for the 5 - 15.5 - remaining -year zone, and ¥2.4 trillion for the 1 - 5 - remaining - year zone),
(2)ultimately, “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”.

Accordingly, we request you to discuss the issuance amount for each zone in the January - March quarter.

・Page 11 shows that issuance for the October - December quarter went according to the JGB Issuance Plan; ¥400 billion in November (odd-numbered month) 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 October and December (even-numbered months) for the 15.5 - 39 - remaining - year zone, as in the FY2018 JGB Issuance Plan.

・Page 12 and after shows the results of the latest Liquidity Enhancement Auctions. Although the December auction is yet to be carried out for the 5 – 15.5 - remaining - year zone, each zone was generally stable.

・When we heard opinions under these conditions about the Liquidity Enhancement Auctions for the January - March quarter from the JGB Investors in advance, although some of you requested an increase for the 15.5 - 39 - remaining - year zone, 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 January - March quarter (see page 15). We are considering issuing ¥400 billion in January and March (odd-numbered months) for the 1 - 5 - remaining - year zone, ¥600 billion each month for the 5 - 15.5 - remaining - year zone, and ¥500 billion in February (even-numbered month) for the 15.5 - 39 - remaining - year zone, just as we did in the October - December quarter.

On this point, at yesterdays' Meeting of JGB Market Special Participants, many attendees were of the opinion that it is appropriate to maintain the current issuance amounts.

・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 we would like to ask for opinions.

▶In addition to most responses stating that there were no objections to the proposal regarding the Liquidity Enhancement Auctions in the January - March 2019 quarter, some members expressed the following:

・Basically, we agree to the proposal. However, as off-the-run issues in the super long-term zone are a very important investment target with a maturity corresponding to the duration of our liabilities, we request the debt management office to increase the issuance amount in the 15.5 - 39 - remaining - year zone.

・In the January - March quarter every year, the needs for purchase of JGBs in the super long-term zone tend to rise due to the necessity of matching the durations of assets and liabilities in preparation for book-closing. As the room for a decrease in the amount of the Outright Purchase of JGBs is shrinking, there are concerns over the tightening of the demand-supply condition in the forthcoming January - March quarter as well, therefore we request the debt management office to increase the issuance amount in the 15.5 - 39 - remaining - year zone.

3. JGB Issuance Plan for FY2019

▶The Financial Bureau gave the following explanations about the JGB Issuance Plan for FY2019:

・Explained below is how the debt management office is now discussing and considering the JGB Issuance Plan for FY2019.

・Shown on the left side of page 17 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.

・However, the issuance amount of Refunding Bonds, which occupy most of the total JGB issuance amount, is expected to be similar to the amount in the current fiscal year, as we have explained at the previous Meeting of JGB Investors based on the estimate of future JGB issuance amounts.

・Shown on the right side of page 17 is breakdown of the issuance amount by financing method. We are still carefully reviewing the amount of JGBs “for Retail Investors” and “for Bank of Japan (BOJ) Rollover.” The amount of “market issuance” will increase or decrease to some extent depending upon the result of the review.

・On pages 18 and 19 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, the majority opinion among both JGB Market Special Participants and JGB Investors is that it would be better to avoid reducing the issuance amount of 30-Year and 40-Year Bonds, for which the issuance amount was reduced in the current fiscal year, because there are investor needs but that it is possible to reduce the issuance amount of 20-Year Bonds, for which the issuance amount was not reduced in the current fiscal year.

・With respect to the zone of 10 or shorter years zone, the participants generally agreed, that the debt management office may reduce issuance amounts to some degree, but regarding 2-Year Bonds and T-Bills, some participants requested the debt management office to give consideration to banks' needs for JGBs as collateral and to foreign investors' strong needs.

・With respect to Liquidity Enhancement Auctions, many attendees were of the opinion that in consideration of the market condition, it is appropriate to maintain the current issuance amount despite a decline in the total JGB issuance amount.

・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.

▶Although most attendees had no additional opinion, the following opinions were also expressed.

・Regarding the JGB Issuance Plan for the next fiscal year, basically, we have no objection. However, with respect to 20-Year Bonds, while the annual issuance amount is not very large, the investor base and investment needs are growing to some degree in the negative interest rate environment, therefore it may be better to keep the issuance amount unchanged.

・Regarding 10-Year Bonds, the interest rate has become very low due to the yield curve control. In addition, it is not easy to use 30-Year and 40-Year Bonds for the purpose of duration control if the balance with liabilities is taken into consideration. Therefore, we have to continue investing in 20-Year Bonds by process of elimination. However, we recognize that if it is necessary to reduce the issuance amount in the super long-term zone in the next fiscal year, 20-Year Bonds may be selected for reduction.

4. Latest JGB market situation and outlook for future investments

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

・Amid continued concerns over a global recession, we fear that the yield curve may flatten due to purchases of JGBs mainly in the super long-term zone and that the difficult investment situation may deteriorate further. Until now, we have continued international diversified investment amid the favorable conditions of overseas markets, but amid uncertainty over the future course of the economy, we expect that we will have to continue international diversified investment while more carefully examining the international situation.

・The global economic situation remains uncertain and unstable. Regarding the uncertainty over the future course of the economy, we expect that it will be necessary to examine whether this is a temporary adjustment or a full-fledged economic slowdown while checking on economic indicators.

With respect to the domestic situation, previously, the market's consensus was that the BOJ is exploring an opportunity for further revision of the monetary policy. However, as the uncertainty over the future has been growing recently, the emerging consensus is that the BOJ will have to continue the current monetary policy for a while. As a result, concerns over an interest rate rise have receded, creating a situation in which JGBs can be purchased without worries, and this may be the reason for the decline in yen interest rate. From now on, we will pay attention to how the BOJ will move in the phase of an interest rate decline. If the uncertainty recedes, making it easier to foresee the future course of the monetary policy, JGBs may become attractive by taking advantage of interest rate movements.

・Since the introduction of the negative interest rate policy, basically, we have refrained from investing in JGBs. After the revision of the BOJ's monetary policy at the end of July, we considered resuming investment in the zone with 20 years remaining to maturity because interest rates rose slightly, but the level of long-term interest rates has recently declined again because of the U.S.-China trade friction and strengthened expectations of a global economic slowdown. As the U.S.-China trade friction and political and fiscal problems in Europe are all deep-seated issues, rather than temporary ones, the normalization of the monetary policy by the BOJ may make little progress and the possibility of the BOJ being forced to adopt an additional easing measure may not be ruled out. In this situation, we are concerned that the difficult investment environment regarding JGBs may be protracted further.

・Since the revision of the BOJ's monetary policy at the end of July, yen interest rates have come to move in such a way that reflects domestic and overseas economic environments. Because of concerns over a global economic slowdown and a change in the perception concerning the U.S. monetary policy, downward pressure is on interest rates in a broad zone, but compared with the previous situation, we have the sense that the liquidity and functionality of the JGB market are improving. As the cost of procuring U.S. dollar funds with maturities beyond the end of the year has recently been increasing, the attractiveness of JGBs is growing relatively strong. We will make investment while watching the future course of the market because there are many uncertainty factors.

・Regarding the liquidity of the JGB market, there has been no particular change, but we request the debt management office to continue to conduct management with full awareness about complementing the liquidity of the JGB market. As uncertainty over the future course of the global economy is growing, we are making investment with a somewhat increasing sense of cautiousness about the risk of an interest rate decline.

・We have a favorable view of the fact that market activity is increasing slightly in response to the revision of the BOJ's monetary policy at the end of July. However, as yen interest rates have recently been declining, led by overseas interest rates, there are concerns over the possibility that long-term interest rates will turn negative again. At the current interest rate level, it is difficult to invest mainly in JGBs, therefore we will continue increasing diversified investments in overseas assets.

・Yen interest rates are declining in tandem with the global interest rate trend, including in the United States, rather than in response to factors specific to Japan. In the future, yen interest rates may rise or fall depending on the FRB's monetary policy. In this situation, 10-Year Bonds are not attractive in consideration of the current interest rate level. Although we are investing some funds in 20-Year Bonds for the purpose of duration adjustment, the bonds are not so attractive as to motivate us to allocate a large amount of investments because their interest rate is also low. Even so, as a result of the BOJ’s flexible management of the Outright Purchase of JGBs, we believe that yen interest rates have come to move more than before, and liquidity has also grown somewhat.

・As our liabilities are denominated in yen, the main investment targets continue to be yen-denominated bonds, such as JGBs, Local Government bonds, and corporate bonds, but we would like to invest in hedged foreign bonds as an alternative while taking into consideration the exchange hedging cost. Recently, as a result of the flexibilization of the BOJ’s Outright Purchase of JGBs, the JGB market has recently come to move in tandem with overseas interest rate. We hope that the BOJ will continue the flexibilization of its Outright Purchase of JGBs and that the JGB market will move in tandem with overseas markets and fundamentals.

・Since the revision of the BOJ’s monetary policy at the end of July, interest rates temporarily showed volatile movements and trading volume increased, but after the movements settled down, the market returned to a situation little different from the one in which it was before the revision of the monetary policy. If we take into consideration the bid-ask spread and the volume that can be traded at a time, liquidity has not recovered much. Amid the global decline in interest rates due to concerns over an economic slowdown, we have the sense that yen interest rates are declining in tandem with overseas interest rates, but on the other hand, we are skeptical about the possibility that when overseas interest rates rise, yen interest rates will rise in tandem. As there is not a sufficient amount of JGBs that can be traded in the market due to the large balance of JGBs held by the BOJ, we request the BOJ to continue flexible management of its Outright Purchase of JGBs so that it can also respond to an interest rate rise.

・Because of the stock effect associated with the large amount of JGBs so far purchased by the BOJ, the yield curve control has functioned very well, with the result that the situation is equivalent to the JGB market being managed by the BOJ. Since the revision of the BOJ’s monetary policy at the end of July, interest rates temporarily trended upward, but recently, expectations of the future normalization of the monetary policy by the BOJ have receded because of the strengthening of the risk-off trend abroad. Amid the diminishing expectations, the BOJ’s purchase amount still remains large and the market’s potential need for purchase is also large, so interest rates are gradually declining. As for future investment, we are considering continuing to invest mainly in overseas credit markets while carefully monitoring the market conditions.

・As we hold a large amount of super long-term, yen-denominated liabilities, we have to invest in super long-term bonds from the viewpoint of reducing interest rate risk. However, whether or not we may continue investment amid the low interest rate environment is a difficult question, therefore we have to consider making prioritized investment while closely watching the interest rate trend.

・Because of the change in the outlook on interest rate hikes in the United States, yen interest rates are also prone to a downward bias. In this phase of an interest rate fall, we are expecting to engage mainly in sales, rather than active purchase. On the other hand, as we have the impression that interest rates have recently fallen too low, we will also consider investing in 10-Year and 20-Year Bonds if interest rates reverse course and enter a rising phase.

・As for the recent JGB market situation, as overseas interest rates are declining due to such problems as the U.S.-China trade friction and Brexit, yen interest rates are declining slightly in tandem. In addition, there appears to be a certain amount of activities such as short-covering by overseas investors and activities by overseas CTAs and risk parity funds, therefore futures and swaps investments are outperforming cash investments.

Going forward, we see a high likelihood that the BOJ will continue reducing the purchase amount as a countermeasure against side effects of the prolonging of QQE, but amid concerns that the economy will enter recession in 2019, we will need to more closely watch the overseas situation. With respect to JGBs, in the current situation of the term premium being kept low, outright investment is more difficult than relative-value investment.

・What is notable about the recent JGB market is that while yen interest rates are moving in tandem with the global interest rate decline, their decline is large. Broadly, we believe that there are two factors behind that situation.

First, at a time when portfolios became underweight in JGBs because expectations of a future interest rate rise strengthened among investors and because the BOJ steadily reduced the amount of its Outright Purchase of JGBs after the BOJ's monetary policy at the end of July, an interest rate decline, unexpectedly for many investors, caused the rapid unwinding of positions, and as a result, the interest rate decline has become large. The second factor is the strength of the stock effect associated with the BOJ. In view of the prospect that the stock effect will continue to strengthen, a highly functional market desired by the BOJ may be realized only in a distant future.

As the BOJ expanded the range of the interest rate for 10-Year Bonds in July while lowering the price forecast, it may be presumed that prices are not important as a policy reaction function, and in this price environment, the BOJ may revise the monetary policy at any time. However, in view of the political schedule and the U.S. monetary policy cycle, the opportunity for revising the monetary policy is limited, therefore we expect that the current monetary policy may continue for a long time.

Under these circumstances, we expect to execute an investment strategy premised on the absence of high interest rate volatility regarding domestic bond investment—in other words, we expect to make credit investments focusing on carry and in bonds with maturities providing high roll-down.

・The current yield curve is flat in less than remaining 7 years to maturity, but compared with that, the curve in the zone with 7-10 remaining-year remaining to maturity is steep, therefore 7 remaining-year zone is overvalued. In addition, while the liquidity of existing issues is very low, the BOJ's purchase amount is declining somewhat. Therefore, the amount of current issues of 5-Year and 10-Year Bonds absorbed through the Outright Purchase of JGBs has decreased steeply. In light of the uneven balance between issues, we will continue to invest in JGBs with maturities providing high carry and roll-down.

・Against the backdrop of the economic trends in developed countries as a whole, expectations for an upside regarding the Japanese economy and prices are receding, therefore it is difficult to foresee an exit from the yield curve control policy. In this situation, as the size of the initial budget for the next fiscal year is expected to balloon, we are concerned that fiscal discipline may weaken. The market has been unable to give a warning over this situation, in which huge risks are being accumulated for future generations to bear, therefore in our view, it is becoming more and more important for market participants to voice their opinions.