Minutes of the Meeting of JGB Investors
(79th Round)

・Date: Monday, March 25, 2019 (11:00 a.m. to 12:20 p.m.)
・Place: Special Conference Room 3, Ministry of Finance
・Gist of Proceedings

1. Issuance amount of Inflation-Indexed Bonds in the April - June 2019 quarter

▶The Financial Bureau gave the following explanation about the issuance amount of Inflation-Indexed Bonds in the April - June 2019 quarter:

・As regards Inflation-Indexed Bonds the JGB Issuance Plan for FY2019 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 April - June 2019 quarter.

・For the January - March 2019 quarter, as shown on page 4, we conducted the auction for the issuance amount of ¥400 billion in February, and Buy-back Auctions in the amount of ¥20 billion, respectively.

As shown on page 5, the result of February auction was comparable with those of past auctions, with the bid-to-cover ratio at 3.34, although there was a sense of caution due to a steep decline in the BEI at the end of last year.

As shown on page 6, Buy-back Auction and Outright Purchase of JGBs have produced results generally in line with the market rates since the beginning of this year, although the bid-to-cover ratio fluctuated at the end of last year because some investors rushed to sell the bonds.

As shown on page 7, in the secondary market, the BEI has remained flat after falling to 0.2% at the end of last year.

・In such circumstances, we asked for your opinions beforehand and found that as for the supply-demand trend after the auctions, while purchases have not been so active as to raise the BEI, there has not been an overwhelming sell-off, with some investors purchasing the bonds because they considered them to be undervalued, therefore being of the opinion that the debt management office should desirably maintain a wait-and-see stance for the moment while keeping the April - June quarter the current issuance amounts of Inflation-Indexed Bonds and of Buy-back Auctions. Even so, some of you are concerned about the continuing limited expansion of the investor base for Inflation-Indexed Bonds and the future supply-demand trend.

・In view of such a situation, as shown on page 8, we are considering issuing Inflation-Indexed Bonds in the April - June quarter in the amount of ¥400 billion in May and carrying out Buy-back Auctions in the amount of ¥20 billion in the even-numbered months (April and June), in the same amount as the January - March quarter., as stipulated in the proviso, we will keep a close watch on the market environment and other factors and take appropriate actions as the debt management office if an overwhelming sell-off continues, leading to a significant decline in liquidity, for example.

・In addition, each March we discuss the method of reopening and the auction method of Inflation-Indexed Bonds during the next fiscal year. Our current thought is to reopen only one issue for a year via single-price auction, just as we did in FY2018.

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

・We consider the development of the Inflation-Indexed Bond market to be an important part of the JGB Management Policy and would therefore like to hear your opinions regarding the issuance amount and related matters for the April - June 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 April - June 2019 quarter, some members expressed the following:

・We agree to the debt management office’s proposal. At the end of last year, as the BEI became undervalued at some times, we assume that some JGB market special participants expressed hopes for an increase in Buy-back Auctions. However, the current issuance amount of Buy-back Auctions should be maintained because investors are expected to purchase Inflation-Indexed Bonds when they are undervalued.

・We have no particular objection to the debt management office’s proposal. Concerning the

Inflation-Indexed Bond, we would like the debt management office to make patient efforts to develop the market.

・We have no objection to the debt management office's proposal. Although we are actively investing in the Inflation-Indexed Bond, liquidity has not increased much. Therefore, trading is conducted only when Buy-back Auctions and BOJ's Outright Purchase of JGBs have been implemented. We have the sense that this situation is inevitable as expectations for future inflation rates have mostly converged now, resulting in a lack of difference in the perception of inflation. One effective way of stimulating trading activity may be to increase both the issuance amounts of Inflation-Indexed Bonds and the amounts of Buy-back Auctions when difference has emerged in the perception of future inflation rates, followed by an increase in trading activity.

2. Liquidity Enhancement Auctions for the April - June 2019 quarter

▶The Financial Bureau provided the following explanations regarding the Liquidity Enhancement Auctions for the April - June 2019 quarter:

・As indicated on page 10, the FY2019 JGB Issuance Plan states the following about Liquidity Enhancement Auctions:
(1) While the operating assumption is that the total annual issuance amount will be ¥12.6 trillion(¥2.4 trillion for the 1 - 5 - remaining - year zone, ¥7.2 trillion for the 5 - 15.5 - remaining -year zone, and ¥3.0 trillion for the 15.5 - 39 - 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 April - June quarter.

・As shown on page 11, in the January-March quarter, we issued JGBs worth ¥400 billion in January and March (odd-numbered months) for the 1 - 5 - remaining - year zone, ¥600 billion in 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, as in the October - December quarter, as stipulated under the FY2018 JGB Issuance Plan .

・Page 12 and after shows the results of the Liquidity Enhancement Auctions. The results of the auctions for the 1 - 5 - remaining - year zone that was conducted today have not yet been reflected in the annex. However, although the tail was somewhat long in some auctions for the 15.5 - 39 - remaining - year zone, the auction results until now have been generally stable.

・When we heard opinions under these conditions about the Liquidity Enhancement Auctions for the April - June quarter from the JGB Market Special Participants in advance, there were many opinions that it is appropriate to maintain the current issuance amount.

・In view of such a situation, we have prepared our proposal for each zone's issuance amount during the April - June quarter (see page 15). We are considering issuing ¥400 billion in May (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 April and June (even-numbered month) for the 15.5 - 39 - remaining - year zone.

On this point, at last Friday's 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 April - June 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 for the April - June 2019 quarter, some members expressed the following:

・Regarding Liquidity Enhancement Auctions, we make investment in line with the cash flow on the liability side from the viewpoint of enhancing ALM-based investment, so we would like the debt management office to increase the issuance amount for the 15.5 - 39 - remaining - year zone, even if slightly, because off-the-run issues in the super long-term zone are very valuable.

・Issues with negative interest rates are increasing and issues with positive interest rates are decreasing now. In this situation, as demand for issues with positive interest rates for the ALM purpose is expected to increase in the future, it is desirable to slightly increase the amount of Liquidity Enhancement Auctions for the 15.5 - 39 - remaining - year zone from the current level.

3. Methods of reopening and auction methods of fixed-rate JGB issues

▸ The Financial Bureau gave the following explanations about methods of reopening and auction methods of fixed-rate JGB issues:

・Shown on page 17 onwards are the plans that we formulated in consideration of your opinions we had heard in advance for carrying out methods of reopening and auction methods of fixed-rate JGB issues for FY2019.

・Since FY2015 we have kept reopening 10-Year Bonds in each case where the difference between a market yield on an auction day for a new issue and the coupon rate of an earlier issue with the same maturity date is not wider than 30bps. Upon hearing your opinions in advance we learned that some of you suggest the bonds be reopened in principle for the purpose of securing its market balance per issue while, others indicate that in a circumstance where interest rates fluctuate to a great extent issuing a new 10-Year Bond and generating demand among investors will serve for a stable issuance of JGBs.

・In consideration of the investors who continue to support the current method, and from the viewpoint of ensuring the market balance of each issue and improving the liquidity of 10-Year Bonds (which are deliverables for futures transactions), we are thinking about maintaining the status quo for FY2019 and issuing by way of a reopening if the difference between a market yield on an auction day for a new issue and the coupon rate of an earlier issue with the same maturity date is within approximately 30 bps.

・Since the vast majority of you support the method of reopening of 20-Year Bonds, 30-Year Bonds, and 40-Year Bonds, we are considering four issues of 20-Year Bonds and 30-Year Bonds per year and one issue of 40-Year Bonds per year, just as was done in FY2018.

・Regarding the auction method of 40-Year Bonds, many of you previously suggested that we should maintain the current single-yield (Dutch-style) method while some recommended transitioning to a multiple-price(conventional) method.

・Those who were in favor of maintaining the single-yield auctions noted that the investor base for 40-Year Bonds is limited compared to 20-Year and 30-Year Bonds, etc., which causes the supply and demand for those bonds to become biased due to seasonal changes and to be relatively low liquidity. Some also remarked that single-yield auction contributes to the stable issuance of these bonds because they are close to the yield curve.

・On the other hand, investors who desire a transition to multiple-price auctions stated that doing so would not present any problems because the investor base for 40-Year Bonds is diversifying, which causes to enhance liquidity. Some also pointed out that single-yield auctions create the risk of buying at an inflated price since they often produce strong results relative to actual market yields.

・While we recognize that the investor base for 40-Year bonds is limited compared to bonds with other terms and their price fluctuations tend to be large because they are close to the yield curve, while the market for 40-Year Bonds has developed since they were introduced and the investor base for 40-Year Bonds is diversifying. In light of this current situation, we believe that achieving stable issuance by maintaining the current single-yield method is the best approach, as many of you noted. Page 18 therefore indicates our proposal for continuing with the single-yield auction for 40-Year Bonds in FY2019.

・Since we would like to make a final determination regarding methods of reopening and auction methods of fixed-rate JGB issues based on discussions at this meeting, we would like to hear your honest opinions regarding these matters.

▶In addition to many responses stating that there were no objections to the proposal regarding methods of reopening and auction methods of fixed-rate JGB issues, some members expressed the following:

・We agree to the debt management office's proposal. Regarding the auction methods of fixed-rate JGB issues, we believe that it is easier to participate in the single-yield method in the case of issues for which it is fairly difficult to predict the interest rate level, such as super long-term bonds.

・Regarding the methods of reopening the 10-Year Bond, we are in favor of maintaining the current method. We expect that it will be easier for investors to issue the bonds if the coupon is set in accordance with the market rate at the time when interest rates show volatile movements in the future. We believe that it is possible to complement the liquidity of individual issues through Liquidity Enhancement Auctions and Securities Lending Facility.

・Concerning the auction methods, it is easier to make investment through the single-yield method because we invest in JGBs mainly from the viewpoint of ALM and because we do not significantly change the investment allocations according to the interest rate level.

With respect to the methods of reopening the 10-Year Bond, it may be better to consistently issue four issues per year than to apply the existing 30bps. It is easier to make investment if the number of issues remains fixed, as in the case of foreign government bonds, such as US bonds. In addition, we also consider that it may be better to do so in consideration of the squeeze on deliverable issues for JGB futures.

・Regarding the auction methods, we basically believe that the multiple-price method is appropriate, but it is reasonable to conduct auctions through the single-yield method with respect to the 40-Year Bond and other bonds with low liquidity.

・Regarding the auction method of the 40-Year Bond, we hope that a shift to the multiple-price method will be implemented so that bids will approach the market yield because bids tend to be at a robust level in the case of the single-yield method and also because the yield on the 40-Year Bond has come close to the yield on the 30-Year Bond after the passage of a long-period of time since the start of issuance of the 40-Year Bond.

・With respect to the methods of reopening and auction methods of fixed-rate JGB issues, we assume that it is easier to make investment if the bonds are constantly issued at an interest rate level similar to the market yield because our stance is to continue purchases at a relatively constant pace and adjust the portfolio as necessary. Therefore, we would like the debt management office to consider that point.

・We agree to the debt management office's proposal. Regarding the methods of reopening of the 10-Year Bond, we are in favor of maintaining the current method because the liquidity of individual issues may be improving compared with some time ago due to the downtrend in the Bank of Japan (BOJ)'s Outright Purchase of JGBs and an increase in the issuance amount of Liquidity Enhancement Auctions over the past several years.

・Concerning the methods of reopening of the 10-Year Bond, we expect that the general methods of reopening, whereby four issues per year are issued, will provide a greater sense of security. If the bond is issued as a single issue in the current situation, a squeeze is likely to occur. It may be better to shift to the general methods of reopening in consideration of the likelihood that four issues per year will be issued in the current environment even if the 30bps rule is applied.

4. Latest JGB market situation and outlook for future investments

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

・Regarding future demand for JGBs, although interest rates are extremely low or negative, in the current situation, we have no option but to purchase a certain amount of JGBs. On the other hand, we expect that if the risk premium related to foreign bonds and stocks declines in relative terms due to the prolonging of monetary easing worldwide, it may be possible to shift funds to those assets. Therefore, from a long-term perspective, whether or not to maintain the current investment ratio will depend on future conditions.

・We have already wanted to adopt JGBs with high liquidity as the core of our portfolio in accordance with the nature of our liabilities, and as a result, we have mainly made investment through buying on dips. On the other hand, amid the super-low interest rate environment, we are considering leveling out purchases of long-term JGBs and local government bonds, such as those in shorter than remaining 20 years maturity, and making investment while earning income through relatively short-term sales in consideration of the income gains and redemptions scheduled for the current fiscal year. In addition, we will also take risks related to foreign interest rates by investing in foreign bonds. As negative interest rates continue, we are in a very difficult situation. However, JGBs are not merely an income source but they also have various functions, including payment reserve and deposit-loan adjustment. Therefore, we will make investment in consideration of those factors.

・As interest rates have recently continued to decline worldwide, the downward pressure on yen interest rates is strong. Regarding investment in JGBs, although we purchase a certain amount of JGBs from the viewpoint of ALM, our basic policy is to continue promoting internationally diversified investment as we are doing now. Therefore, it will be difficult to use JGBs as the main investment vehicle.

With respect to Inflation-Indexed Bonds, we have no need for inflation hedging under the current portfolio. Therefore, basically, we expect that it will be difficult to include Inflation-Indexed Bonds among the main investment vehicles even though we may decide to purchase them after making judgment as to whether they are undervalued or overvalued.

・Until now, we have invested in Europe because we believed that we must implement internationally diversified investment while keeping in mind the expected continuation of interest rate hikes in the United States. However, that premise has changed following the FOMC last week. As it has been confirmed that the current monetary policy will be maintained for a while in the United States as well as in Europe, we recognize the need to make investment from a longer-term perspective. On the other hand, we recognize that the macroeconomic environment in the United States is not such that we must be conscious of a possible recession. Although some European indicators show weak readings, we must take into consideration the trend in foreign demand in light of the spillover effects of China's economic measures. Therefore, it is very difficult to make investment decisions in the current environment. Concerning JGBs, the interest rate level is low, but we believe that they are delivering a decent return relative to the volatility–although the return is not so high as in Europe—considering that the monetary policy trend in the United States and Europe is creating a headwind against the BOJ's move to normalize its monetary policy. Therefore, investment in JGBs may be attractive to some degree.

・Concerning investment in JGBs, it is somewhat difficult to invest in JGBs with a shorter than remaining 10 years to maturity at the current interest rate level. In addition, as the interest rate risk related to long-term JGBs is large, it is difficult to actively invest in them.

・In the current environment, investment for the purpose of duration adjustment is necessary from the viewpoint of ALM, despite the downward pressure on interest rates. Therefore, the outstanding amount of JGBs is expected to remain almost flat or decline slightly as a trend. On the other hand, we expect that diversified investment in foreign assets, such as currency-hedged foreign bonds, will be necessary. Basically, bonds with super long-term maturities are available only among JGBs. Therefore, if interest rates rise in the future, the need for JGB purchases will arise. In addition, although it continues to be difficult to provide yen-denominated products amid the interest rate decline, this situation may change and the need for JGBs may increase if interest rates rise.

・Although our liabilities are mainly comprised of super long-term, yen-denominated ones, it is difficult to match our assets and liabilities because the yields on the asset side continue to decline despite the high assumed yields on liabilities taken on in the past. We would like to invest in yen-denominated credit products in addition to JGBs. However, as the credit market is not so well-developed in Japan as in the United States, we are now investing substantially in currency-hedged foreign bonds. Amid the decline in yen interest rates, the value of our net purchases of JGBs is not very large, and some investors are even reducing JGB purchases while making up for the reduction by investing in currency-hedged foreign bonds. On the other hand, many investors are expected to try to shift funds from currency-hedged foreign bonds to JGBs if yen interest rates rise in the future. Therefore, the potential demand for JGBs is probably strong.

・As for the outlook on future investment, the need to invest mainly in JGBs from the viewpoint of interest rate control for the purpose of ALM will remain unchanged. However, due to the ongoing aging of society, we must pay sufficient attention to changes in the liability structure when making investment.

・Recently, interest rates have fallen rapidly because foreign central banks have become dovish more quickly than expected. Although we have already been aware of the slowdown of the global economy to some degree, it is necessary to carefully think about whether the economy is in such a poor state that the central banks should become so dovish while carefully examining forthcoming economic indicators. In the JGB market, we expect that interest rates are unlikely to rise for a while because of the decline in foreign interest rates as well as the stock effect of the BOJ's Outright Purchase of JGBs. On the other hand, as there are some limits to financial institutions' tolerance of asset investment risk, it is impossible to continue investing only in foreign financial assets. Therefore, we expect that there will be some investor demand for JGBs.

・At a time when it is necessary to secure the yields on liabilities taken on in the past because the assumed interest rates are not falling much while benefit payouts are increasing rapidly due to the aging of society, we have to shift more investment to alternative assets in relative terms. Therefore, from the viewpoint of ALM, it is very difficult to invest in JGBs.

・As interest rates are falling globally because major central banks, such as the FRB and the ECB, have recently become dovish, yen interest rates have also declined to the level seen around the time when the yield curve control was introduced. Therefore, JGBs have become much less attractive and it has become difficult to earn returns.

Currently, we do not think that the level of recession risk is so high as is suggested by the market's reaction. However, the hurdle for the FRB to raise interest rates again is considered to have become higher now that the central banks have clearly become dovish. Therefore, we expect that both foreign and yen interest rates will remain low for a while.

In this situation, in order to earn returns, we will invest in the super long-term zone, where interest rates remain positive, in the case of JGBs. However, in order to make up for a shortfall in the return, it will be necessary to secure interest margins by investing in credit products with relatively high interest rates.

・Due to concerns over global recession, negative interest rates have become entrenched for the 10-Year JGB. In this situation, we cannot purchase JGBs on the premise of holding them until maturity at the risk of suffering losses at redemption. Therefore, we will shift investment to zones with many years remaining to maturity for the purpose of yield hunting, and this will result in further flattening of the yield curve. One of the reasons why investments are concentrated in JGBs in the super long-term zone is probably that unlike in other countries, apart from JGBs, there are no investment vehicles with very long maturities, such as mortgages, in Japan.

Currently, it is highly likely that recession will occur in the next three to five years. In this situation, we will have to purchase at least some amount of JGBs.

・In the JGB market, interest rates are continuing to fall in tandem with the global interest rate trend, rather than being affected by domestic factors. Yen interest rates' linkage with foreign interest rates, particularly those in developed countries, became stronger toward the end of last year following the monetary policy revision at the end of July, and it still remains strong now.

In the future, the BOJ's monetary policy management will seek a balance between countering the adverse side effects of the prolonging of monetary easing and supporting the economy. For the moment, emphasis will be placed on economic support, and that may cause the current monetary policy to be maintained for a long period of time. On the other hand, there are probably limits to further monetary easing. Therefore, from now on, we plan to make investment on the assumption that the current monetary policy will be maintained.

・Recently, the political situation has been very unstable in Europe, including the United Kingdom, Germany and France. The political situation is also not stable in the United States, where the presidential election will be held next year. Amid the political turmoil worldwide, which is affecting even Oceania as exemplified by the occurrence of the indiscriminate shooting incident in New Zealand, JGBs, which are issued in Japan, a country where the political situation is relatively stable, may be viewed as a safe asset.

Moreover, Japanese financial institutions may prefer investment in yen-denominated bonds compared with investment in foreign bonds because it is difficult for them to gather information on foreign trends, whereas information on domestic trends is easily available.

・In Japan, the economic growth rate is higher than interest rates now. Therefore, it is expected that even if the outstanding amount of debts increases in absolute terms, it will decline as a proportion of GDP over the next several years, rather than growing. Perhaps because of this expectation, Japan has pushed back the target year for fiscal consolidation by five years, aiming to achieve a surplus by 2025, by which time all people of the baby-boomer generation will have turned 75 years old or older. Therefore, although the scale of the government's budget for the next fiscal year is the largest ever, it is possible to explain that Japan is moving toward fiscal consolidation.

In this situation, the amount of issuance through Non-Price Competitive Auction Ⅱ, in which the issuance price is the same as the average accepted price of the auction, is increasing. As interest rates have remained unchanged for a long period of time, problems related to the supply of capital and human resources to business sections handling JGBs may be arising. If the trend is moving toward purchasing JGBs through Non-price Competitive Auction Ⅱ as a result, the preparedness for and resilience against interest rate rises may be weakening.