Minutes of the Meeting of JGB Investors
(83rd Round)

1. Date: Thursday, April 2, 2020
2. Place: Held in writing
3. Gist of Proceedings:

1. Latest JGB market situation and outlook for future investments
2. Changes in the JGB Issuance Plan associated with the supplementary budget in FY2020

▶ The Financial Bureau gave the following explanation about the changes in the JGB Issuance Plan associated with the supplementary budget for FY2020

・ As shown in Document 1, the Prime Minister instructed the formulation of economic measures and compilation of the supplementary budget for FY2020 at the 24th Meeting of the Novel Coronavirus Response Headquarters on March 28. They will be formulated and compiled in the next 10 days and it is expected that the scale of economic measures this time will exceed the scale of economic measures of ¥56.8 trillion at the time of the global financial crisis. Based on this assumption, we would like to hear your opinions on an increase in the issuance amount of JGBs, as Document 2.

・ In addition, regarding the method of setting the coupon rate of interest-bearing bonds, although it was decided that the coupon rate would be basically set by rounding down fractions at the actual market price from the auction in January, 2020, it will be set by rounding off the fractions from the auction in April, 2020 from the perspective of mitigating the impact on the market due to the additional JGB issuance. In addition, the reduction of the lower limit of the coupon rate of interest-bearing bonds which was planned to be implemented from October this year in the JGB Issuance Plan for FY2020 will be implemented around April, 2021 by delaying implementation time.

▶ Summarized below are the views and opinions submitted:

・ Regarding the current state of the JGB market, while concerns over the global recession have been increasing with the spread of the new coronavirus infection, interest rates all over the world are fluctuating widely due to concerns over a large-scale increase in the issuance amount of government bonds associated with a significant expansion of expenditure and a decrease in tax revenue by each country, in addition to a concern of interest rate rise due to the reduced risk tolerance of market participants. Although the expansion of fluctuations has been suppressed to a certain extent by measures such as large-scale asset purchase of the central banks of each country, the volatility of JGBs has been higher than before and the fluctuations will continue.

Regarding the outlook for future investments, although it is difficult to forecast the future of the global economy, we plan to manage JGBs while watching the trends in risk asset prices and overseas interest rates as well as assessing the interest rate levels in the circumstance where the current Yield Curve Control by the Bank of Japan (BOJ) will be extended.

Regarding the changes in the JGB Issuance Plan associated with the compilation of the supplementary budget for FY2020, it is desirable that the issuance amount for each term maturity will be increased in a balanced manner. The outlook for the macroeconomic environment will continue to be highly uncertain. However, in view of the current monetary policy and the stance of the market operations by the BOJ, including the Outright Purchase of JGBs, a further increase in the issuance amount is possible for the short-term, medium-term and long-term zones.

In addition, we agree to the method of setting the coupon rate and the implementation timing for the reduction of the lower limit of coupon rate.

・ Regarding the current JGB market, some securities companies have introduced split operations. It is difficult for them to aggressively take a position for fear of a lockdown. In this circumstances, the bid–ask spread have been wide because of the decline in the liquidity of the JGB market.

Since it is expected that the scale of the emergency economic measures this time will exceed the scale of economic measures taken at the time of the global financial crisis considerably, it is desirable to increase the issuance amount of JGBs in multiple maturities without concentrating on a specific maturity. However, regarding the 40-Year Bonds that have been decided already to be increased by ¥100 billion per auction, the issuance amount of ¥500 billion per auction should be maintained to figure out the demand and supply situation. On the other hand, an increase in the issuance amount of around ¥100 billion per auction for the 30-Year Bonds will be financed since life insurance companies have a certain level of needs for bonds with remaining maturities of 30 years. In addition, regarding the remaining maturities of shorter than 10 years zone, an increase in the amount of the Outright Purchases of JGBs has been indicated in the “Monthly Schedule of Outright Purchases of Japanese Government Bonds (Competitive Auction Method)” for April 2020. The purchase support in the medium- to long-term zone will remain strong as long as the amount of the Outright Purchase of JGBs is sustained. Therefore, regarding the 2-Year, 5-Year and 10-Year Bonds, an increase in the amount of ¥200-300 billion per auction will be financed stably.

・ Compared to the situation around mid March, the market volatility and the liquidity of the

JGB market have been showing signs of recovery due to powerful monetary easing measures taken by central banks in each country in response to the spread of the new coronavirus infection. However, the liquidity in the super long-term zone will continue to be very low while there is a strong investor demand. Even if the JGB issuance amount is increased in this situation, it is unlikely for interest rates to increase for the time being because of the monetary easing measures taken by the BOJ and strong investor demand. Although making a comprehensive investment at the current interest rate levels is difficult, considering the balance with the liability, there is a need for the super long-term zone from the ALM purposes. Therefore, we plan to make a certain level of investment in consideration of the liquidity and market situation.

Assuming that the JGB issuance amount will be increased by around ¥16 trillion this time, and given the scale of the increase, the increase in the issuance amount should be distributed to JGBs with a wide variety of maturities. Due to the needs of duration extension from the perspective of ALM, the demand for JGBs in the super long-term zone is strong mainly by life insurance companies. In addition, with the long-term interest rate moving around 0%, other investors would have investment needs for super long-term bonds as well for hunting for yields. Therefore, the increase in the issuance amount should be focused on super long-term bonds compared to the current issuance amount allocation. Specifically, we suggest an increase in the amount of ¥100 billion per auction for the 40-Year Bonds, an increase in the amount of ¥200 billion per each auction for the 30-Year Bonds, 20-Year Bonds, 10-Year Bonds, 5-year Bonds, 2-Year Bonds and 1-Year T-Bill, respectively, and an increase in the amount of ¥4 trillion per year for the 6-Month T-Bill. In addition, it is appropriate to increase the amount by ¥100 billion per auction for the Liquidity Enhancement Auctions in the remaining maturities of 15.5-39 years zone since the liquidity in this zone has been low.

・ Although a significant decline in the market liquidity and the decline in yield of physical bonds compared to JGB futures were in a critical situation temporarily with the spread of the new coronavirus infection, the situation has restored calm due to the strengthening of the Outright Purchases of JGBs by the BOJ. However, due to concerns about worsening economic fundamentals in the future, the liquidity will continue to be prioritized in every market for some time. We will take a cautious stance towards investment management for the time being.

There is relatively a lot of room to increase the issuance amount of short- and medium-term zones and 20-Year Bonds. In addition, it is reasonable to start increasing the issuance amount from July. It is appropriate to increase the issuance amount by ¥100 billion per auction for the 30-Year Bonds, by ¥500 billion for the 20-Year Bonds, by ¥100 billion for the 10-Year Bonds, by ¥400 billion for the 5-Year Bonds and by ¥400 billion for the 2-Year Bonds. Since we do not deal with T-Bills, we refrain from commenting on them.

In addition, we have no objection to the method of setting the coupon rate for interest-bearing bonds and the change in the scheduled timing for lowering the lower limit of the coupon rate of interest-bearing bonds.

・ There is no change in our view on the latest JGB market situation and outlook for future investments since the last meeting.

Although the market liquidity has been returning to normal from mid to late March, the number of financial institutions which introduce a split operations and remote work will continue to increase in future as a measure against the spread of the new coronavirus infections. Therefore, for the time being, market participants are expected to continue to lack mobility and flexibility. If the metropolitan area is locked down in the future, we request the Financial Bureau to deal with the situation flexibly, including postponement of auctions.

Regarding the change in the JGB Issuance Plan associated with the compilation of the supplementary budget for FY2020, an increase of around ¥100-200 billion per month for each maturity in the super long-term zone will be financed without significantly affecting the market because many investors prioritize a level of interest rates. In addition, regarding JGBs with remaining maturities of shorter than 10 years, the impact of the increase in the issuance amount on the market would be suppressed since this zone has been targeted by Yield Curve Control policy by the BOJ.

The issuance amount should be increased as soon as possible in view of the market situation because if the timing for the increase is delayed, the issuance amount per auction will increase.

・ Responding to the spread of the new coronavirus infection, it is unavoidable to implement a large-scale economic measures and increase the issuance amount of JGBs associated with the supplementary budget to the level that is comparable to those at the time of the global financial crisis. However, considering a decline in the risk tolerance of market participants, we request the Financial Bureau to deal with the increase based on the purchase needs of various types of investors. Specifically, given that the impact of the new coronavirus infection is unclear, it is appropriate to put a focus on the increase on T-Bills with the remaining maturities of 1 year or shorter, enabling to adjust the issuance amount flexibly. In addition, there is a room for increase for the 2-Year Bonds for which there is a need for collateral purposes and the 10-Year Bonds for which there would be a certain demand when interest rates increase to a positive range. In addition, the amount of the 20-Year Bonds may be increased to some extent in order to secure the carry depending on its absolute level.

In FY2020, we will continue with the stance to purchase the 10-Year JGB, government guaranteed bonds and local government bonds in medium- to short-term zone which have positive interest rates.

In addition, we agree to the method of setting the coupon rate for interest-bearing bonds and the change in the scheduled timing for lowering the lower limit of the coupon rate of interest-bearing bonds.

・ Currently, the risk-off sentiment due to the spread of the new coronavirus infection has been gradually restoring calm. However, when its adverse effect on the global economy becomes clear, interest rates may decline further. Although a large-scale fiscal measures will be adopted in each country in the future, the increase in the issuance amount of government bonds is unlikely to cause a significant rise in interest rates globally due to aggressive monetary easing measures taken by the central banks of each country. Interest rates will basically remain stable at low levels. Regarding the outlook for future investment, we will basically accumulate stable assets with yen interest rates from the perspective of ALM though we may incorporate risk assets, including stocks and credits, in our portfolios from the perspective of diversified investment in the environment where interest rates stay low.

Regarding the increase in the issuance amount by maturity, it is desirable to increase the issuance amount of super long-term bonds considerably since the investment needs for bonds with positive interest rates by domestic institutional investors is strong. An increase by around ¥300 billion per auction for the 30-Year Bonds and the 20-Year Bonds, an increase by around ¥300 billion per auction for the 10-Year Bonds, an increase by around ¥350 billion for the 5-Year Bonds and the 2-Year Bonds per auction, and an increase by around ¥300 billion per auction for the 1-Year T-Bill will be acceptable, which results in a total monthly increase of around ¥1.9 trillion and an annual increase of around ¥17 trillion for all maturities.

・ As the financial market as a whole is confused and the volatility is extremely high, the liquidity of the JGB market has declined significantly and the correlation between derivatives, including JCB futures and interest rate swaps, and physical JGBs has not been observed. Under the circumstance, the risk-taking ability of securities companies has dwindled and volatility will likely increase temporarily at the time of auctions for the time being. However, under the Yield Curve Control policy by the BOJ, the risk of falling into an extreme situation is low. The market will gradually restore calm. There is no significant change in our management plan and we will conduct ALM by holding JGBs to match yen-denominated insurance liabilities.

There is a room for an increase in all maturities except for the 40-Year Bonds which have already been decided to be increased for FY2020. An increase by ¥100 billion per auction for the 30-Year Bonds, by ¥100-200 billion for the 20-Year Bonds, by ¥200-300 billion per month for the 10-Year Bonds and the 5-Year Bonds, and ¥300-400 billion per month for the 2-Year Bonds and the 1-Year T-Bill can be financed. In addition, regarding Liquidity Enhancement Auctions, it is possible to increase the amount by ¥100 billion per auction for each zone. Although a large increase in the issuance amount is expected, it is unlikely for interest rates to rise significantly due to the Yield Curve Control policy by the BOJ. In addition, a well-balanced increase among different maturities is preferable.

We have no objection to the method of setting the coupon rate for interest-bearing bonds.

・The liquidity of the JGB market has been falling due to the significant increase in volatility of risk assets and the collapse of trading based on relative values in each country's bond market. As the liquidity of the short-term financial market is sufficient and a financial crisis has been avoided, abnormal values in various indicators is likely to subside in the future. However, there is a possibility that it will take some time for the recovery depending on the impact of the spread of the new coronavirus infection. Regarding the interest rate level, it will remain stable at low rates because of a strong and prolonged monetary easing by the central banks of each country. Regarding our asset management and investment in the future, we plan to continue to buy and hold JGBs in light of the market trends.

Since a large fiscal expenditure is expected, it is desirable to increase the issuance amount of JGBs among a wide variety of maturities from T-Bill to the 40-Year Bonds. Demand for JGBs with remaining maturities of 10 years and longer with positive interest rates is expected to be strong. In addition, there would not be any problem in financing JGBs in the remaining maturities of shorter than 10 years in the market since an increase in the Outright Purchases of JGBs by the BOJ in this zone is also expected. On the assumption that the increase in the issuance amount will start in July, a possible increase in the issuance amount per auction will be ¥100 billion for the 30-Year Bonds, ¥200 billion for the 20-Year Bonds, ¥200 billion for the 10-Year Bonds, ¥100-200 billion for the 5-Year Bonds and ¥200-300 billion for the 2-Year Bonds. Although an increase in the amount of a few trillion yen per year for T-Bill is possible, this will be considered in the balance with front-loading Refunding Bonds. Regarding the 40-Year Bonds, there is a room for a further increase in view of the situation of the market while it is required to confirm the market environment after the scheduled increase.

・ With the pandemic of the new coronavirus infection, the global market has fallen into an extremely unstable situation. However, the volatility in each market has been gradually returning to normal and the market function is being restored due to the fact that a flexible and aggressive purchase of government bonds by the BOJ, the Fed, and the ECB has been functioning successfully and expectations about future monetary policy has been growing. However, since the declaration of a state of emergency in Japan has become more likely, investors and securities companies have introduced the split operations and remote work in a full-fledged manner, which makes it difficult for them to continue smooth operation as usual and leads to a decline in the risk tolerance of each company. Therefore, in the circumstance where a significant increase in the issuance amount of JGBs is inevitable, the market will be vulnerable to shocks, including weak auctions, raising concerns of depletion of liquidity and losing functionality of the market. In light of such a situation, we plan to increase outstanding investment amount gradually when interest rates increase. While it is unclear whether the BOJ will deepen negative interest rates, the Yield Curve Control policy is expected to continue functioning firmly. We will focus on long-term and super long-term JGBs with positive interests.

We understand that the market consensus is the increase in the issuance of JGBs in T-Bills for which collateral needs are expected and the short- to medium term zone for which the ratio of Outright Purchases of JGBs is high. Since the yield curve for JGBs with remaining maturities of shorter than 10 years will be controlled by the Yield Curve Control policy by the BOJ, JGBs in that zone can be financed without any particular problem as long as the increased amount is in line with the consensus. On the other hand, regarding JGBs in the super long-term zone, it is unlikely that the BOJ will provide an aggressive support. In the circumstance where there is a concern over a decline in the risk tolerance of market participants, it is appropriate to increase the amount considering the demand by final investors in order to avoid an unnecessary rise in volatility.

・ Although there has been an expectation of a rise in interest rates due to the effect of the increase in the issuance amount of JGBs associated with the supplementary budget for FY2020, a risk of a sharp rise in interest rates is limited even in a case a significant amount of JGBs is additionally issued, considering an increase in the amount of Outright Purchase of JGBs in April. On the other hand, there is a concern over further decline in the liquidity of the JGB market due to a reduction in the number of employees from the perspective of Business Continuity Plan (BCP) in response to the spread of the new coronavirus infection.

Although the effect on the JGB market will be limited for the time being, the possible amount of increase in JGB issuance will be around ¥100-200 billion per auction for the 20-Year Bonds, and around ¥200-300 billion for the 10-Year Bonds. We will not invest aggressively in JGBs with a remaining maturity of less than 5 years unless interest rates become positive.

・ The repo market has been tightened due to the seasonal reason of the fiscal year end and other factors, including the decrease in the number of market participants because of a change in the operational system as measures against the spread of the new coronavirus and the decline of the market liquidity due to an increase in the amount of Outright Purchase of JGBs in the JGB market.

It is likely that the market will continue to be unstable until the spread of the new coronavirus infection subsides. However, it is hardly imaginable that interest rates will rise in the circumstance where each country has strengthened monetary easing measures in response to the concern over a worldwide economic recession. We are willing to invest in JGBs with positive interest rates from the perspective of ensuring income gains. We will also aggressively conduct trading of JGBs for capital gains in order to supplement low interest rates.

Regarding the increase in JGB issuance, in consideration of the demand of investors, the effect on the market can be restrained by increasing the issuance amount by ¥100-300 billion per auction for each of the 2-Year Bonds to the 30-Year Bonds and allocating the remaining amount to T-Bills. However, as far as our current situation is concerned, the outstanding amount of JGBs we hold has decreased considerably compared to before the introduction of the negative interest rate policy. Therefore, on the assumption that the current monetary policy will be continued, it is most beneficial to increase the issuance amount of JGBs with remaining maturities of 2-5 years from the perspective of ensuring liquidity and of collateral needs.

・ As liquidity has been declining rapidly, we operate by compressing the balance sheet. In case JGB is downgraded, repo dealers, including Japanese financial institutions, will be also downgraded. We are wary of the risk that foreign investors may be obliged to restrain or stop investment in JGBs.

Regarding the increase in the issuance amount due to the change in the JGB Issuance Plan associated with the supplementary budget for FY2020, increase among a wide variety of term maturity, excluding Inflation-Indexed Bonds, will be necessary, premised on the assumption of a large issuance amount. We suggest as follows: an increase in the amount of ¥100 billion per each auction for the 40-Year Bonds, 30-Year-Bonds and the 20-Year Bonds from July; an increase in the amount of ¥200 billion per each auction for the 10-Year Bonds from July; an increase in the amount of ¥300 billion per each auction for the 5-Year Bonds and 2-Year Bonds from July; an increase in the amount of ¥200 billion per each auction for the 1-Year T-Bill from July; an increase in the amount of ¥800 billion per each auction for the 6-Month T-Bill from October; an decrease in the amount of ¥100 billion per each auction for Inflation-Indexed Bonds from May; and an increase in the amount of ¥150 billion per each auction for Liquidity Enhancement Auctions from July.

Also, it is desirable to increase the amount for Liquidity Enhancement Auctions. The liquidity of the off-the-run issues for the term of maturity subject to an increase in the Outright Purchases of JGBs by the BOJ is expected to decline further. Also, the liquidity of off-the-run issues with remaining maturities longer than 20 years for which there is a strong demand by investors has been depleted.

・ Due to the global market turmoil triggered by the spread of new coronavirus infection, the JGB market has also experienced a temporary rise in volatility and a considerable decline in liquidity. Despite some signs of recovery of stability observed recently, it will take time for the market liquidity and investors' risk tolerance to be restored as uncertainty continues with the spread of the new coronavirus infection. For the time being, we will pay close attention to the effect of the new coronavirus infection on the real economy and market liquidity. Also, we will invest cautiously in JGBs under the BOJ's Yield Curve Control policy when they become relatively cheap in consideration of our portfolio situation.

Regarding the increase in JGB issuance, considering a global increase in the issuance of government bonds, its effect on the JGB market can possibly be significantly large, depending on the issuance volume, the risk tolerance of investors and market environment, including liquidity. It will be desirable to increase the amount of issuance mainly in T-Bills for which a certain demand is expected for collateral purposes even with negative interest rates. Also, an increase in the issuance amount in the zones with remaining maturities of shorter than 10 years is appropriate because a sharp rise in interest rates will likely be restrained due to the Outright Purchases of JGBs in a large scale under the Yield Curve Control policy. On the other hand, the increase should be restrained in the super long-term zones with remaining maturities of longer than 20 years. Although it is hard to expect demand for bonds with negative interest rates by domestic investors, a certain level of demand can be expected for bonds in the remaining maturities of less than 10 years zone compared to the super long-term zone, considering the global fiscal expansion.

・ The situation remains unpredictable especially in urban areas such as the Tokyo metropolitan area regarding the spread of the new coronavirus infection. It is necessary to consider the possibility that market participants, including institutional investors, will unable to trade JGBs under the same conditions as in normal times in case restrictions on the movement of people and economic activities are strengthened to prevent the spread of infectious diseases.

If the spread of the new coronavirus infection becomes more serious and prolonged, the economic damage may be greater than the estimate at the time of the compilation of the supplementary budget. In such a case, a further financial support may be required. From the standpoint of preparing for an additional supplementary budget and a significant reduction in tax revenue, it will be necessary to leave a room to flexibly respond to changes in the situation in the latter half of the fiscal year in order to stabilize the market.

・Although an extremely tight market situation has begun to subside including the stabilization of LIBOR dollar rates which surged in March, USD/JPY cross-currency basis has remained high and there is an increase in emerging countries' credit default swaps. In addition, many market participants have pointed out that the liquidity in the JGB market has declined due to a decrease in the risk tolerance of market participants.

The effects of the new coronavirus infection will begin to be more apparent from now. Given the possibility of a city lockdown in Japan, the establishment of BCP is an urgent task. There is a possibility that the worldwide supply chains will be disrupted and the restoration and reconstruction will take a long time. A financial crisis might happen in the meantime.

Regarding the change in the JGB Issuance Plan, most market participants have assumed that the increase in the amount of JGB issuance will be similar to that at the time of the global financial crisis. In the JGB Issuance Plan for FY2009, JGB issuance of ¥16.9 trillion was added as measures against economic crisis in April 2009, followed by a further addition of ¥2.1 trillion in October, 2009. In January 2010, the second supplementary budget for FY2009 was compiled, which included the addition of JGBs in the amount of ¥9.3 trillion in order to cover the reduction in tax revenue for the amount of ¥9.2 trillion. It will be necessary to consider the possibility of reduction in tax revenue on this occasion as well.

It seems that the feasibility of achieving the Primary Balance (PB) surplus in FY2025 has declined as a result of the measures against the spread of the new coronavirus infection. The possibility of downgrade of JGBs cannot be denied as pointed out by some market participants because its outstanding amount is far larger than that in other countries.

Under these circumstances, it is necessary to avoid causing a disturbing effect on the market, which has been still unstable internationally, by the additional issuance of JGBs. For this reason, the increase in issuance in the super long-term zone should be limited as much as possible. The increase in issuance should be focused on T-Bills and JGBs with remaining maturities of less than 10 years, which are under the Yield Curve Control policy. In addition, it is necessary to aggressively reduce the amount of front-loading Refunding Bonds, which has significantly increased by maintaining its status of "regular and predictable issuance."

・ The effect of the spread of the new coronavirus infection has caused a significant impact on the real economy. Implementation of fiscal policies for a wide variety of businesses is inevitable including personal compensation. Since a reduction in tax revenue is expected to be considerable, the total amount of JGB issuance must be increased greater than the amount initially estimated. In addition, the amount of Outright Purchases of JGBs by the BOJ is expected to reach an unprecedented scale. Therefore, unlike the conventional case, it will be impossible or extremely difficult for the issuance of JGBs to be adjusted over time in light of supply and demand of each term maturity.

Under these circumstances, it is important to consider the needs of the market over a wide variety of term maturities while recognizing the role of the JGB as collateral, avoiding a further decline in the liquidity of the market. There is a possibility that the JGB market will fluctuate significantly according to the situation in the future. In order to maintain the market stability, it is necessary for the Financial Bureau to have a firm understanding of the supply and demand of JGBs by maturity and by type to continue issuing JGBs without jeopardizing the market stability.

The Meeting of JGB Investors and the Meting of JGB Market Special Participants will play a vital role in allowing the market adjustment mechanism to function when there is a significant movement in the JGB market. Therefore, we request the Financial Bureau to be well-prepared for holding meetings in emergency at any time. If possible it is preferable to introduce a video conference using a communication application, instead of holding a meeting in writing. The new coronavirus infectious disease has caused a large shock to be remembered in the history of Japan and world. The Financial Bureau and market participants should establish close cooperation to cope with the difficult situation and to maintain the market stability in preparation for an emergency eventuality.

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