Minutes of the Meeting of JGB Market Special Participants

(73rd Round)

・Date: Wednesday, November 22, 2017 (4:00 p.m. to 5:00 p.m.)
・Place Special Conference Room 3, Ministry of Finance
・Gist of the proceedings

1. **JGB Issuance Plan for FY2018**

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

(Introduction of the discussions of the Advisory Council on Government Debt Management (held on Oct. 18))

・In the Advisory Council held last month, the floor was opened to comments after an issue was posed by the debt management office regarding the Debt Management Policy. First of all, using the excerpts from the explanatory materials from the council, we will introduce the debt management office's awareness of the issue.

※Regarding the debt management office's explanation at the Advisory Council on Government Debt Management, please refer to the minutes of the Advisory Council on Government Debt Management. (Attachment)

・As shown on page 22, regarding the outline, consensus was reached regarding the need for more stable, transparent JGB issuance while identifying a medium-to-long term demand trend. Moreover, it was pointed out that it would be important to identify possible changes in the JGB ownerships structure.

・On the other hand, as mentioned on page 23, council members were divided over JGB demand by maturity. Some called for revising the traditional policy of increasing super-long-term issues while reducing short- to medium-term issues. On the other hand, some others pointed to continuous demand for super-long-term issues and the significance of lengthening debt maturities.

・In addition, many council members positively assessed Liquidity Enhancement Auctions as securing the flexibility of JGB issuance responding to the market environment.

（Regarding the JGB Issuance Plan for FY2018）

・Regarding the JGB Issuance Plan for this fiscal year, the funding was 8.2 trillion yen less than the previous year.　However, due to the reduction of 5.0 trillion yen in the public sector (the Bank of Japan(BOJ) rollover), decrease in the market issuance volume was restrained. However, as a result, the BOJ rollover amount has become 3 trillion yen and it is difficult to do the same in the next fiscal year.

Additionally, the total amount required to finance for the next fiscal year depends on the ongoing budget planning process, but according to the trial calculation using the figures from the medium to long-term estimate by the Cabinet Office, the total amount of newly-issued bonds and refunding bonds is expected to be approximately 3 trillion yen less than the present fiscal year.

・Another point that requires consideration according to the debt management office is the integration method of the plan.

Page 27 shows the comparison of the estimate and revenue performance balance at the time of planning with regard to the JGB Issuance Plan for FY2016. There are aspects which cannot be helped, such as reduction in government bond issuance due to changes in income and revenue. However, “calendar-based JGB Market Issuance amount” which indicates government issuance from ordinary bidding exceeded 2.7 trillion yen, and as a result thereof, there was a downturn in the “adjustment between fiscal years,” in other words, becoming a factor for the increase in the issuance of front-loading issuance of refunding bonds.

This is due to the fact that the JGB Market Issuance amount was integrated with the prerequisite of issuance at par. In the JGB Issuance Plan for FY2018, from the optimization aspect of the estimate, it is necessary for the JGB Market Issuance amount to be integrated taking into consideration the issuance at a price above per value so as to suppress the upward swing of revenue performance.

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

・In order to respond to investor needs and to enhance liquidity by temporarily correcting the supply-demand imbalance, we desire an increase in the Liquidity Enhancement Auctions and reduction for current issues.

Regarding super long-term bonds, with respect to 30-Year and 40-Year Bonds, expansion in potential investor demand is not apparent and the characteristic is that investor demands vary greatly according to the interest rate level and seasonality. Therefore, regarding both 30-Year and 40-Year Bonds, we desire a reduction of 100 billion yen per auction and an increase of 100 billion for Liquidity Enhancement Auctions of the 15.5 - 39 - remaining - year zone, thereby enhancing market liquidity. On the other hand, there is an expansion of range in the investor base regarding 20-Year Bonds and the supply-demand balance is maintained with the present issuance amount.

Regarding short - to - medium - term zones, amid globalization of Japanese government bonds, there is a growing need among foreign investors for off-the-run issues compared to current issues. Therefore, by implementing a combination of reduction of current issues and increase in Liquidity Enhancement Auctions in the 1 - 5 - remaining - year zone, market growth may be achieved.

・Generally-speaking, reduction in issuance is less stressful on the market compared to increase, making reduction for a wide range of maturity possible. However, considering the current market environment, it is better to maintain the issuance amount for 20-Year Bonds and Inflation-Indexed Bonds. Regarding 20-Year Bonds, because of the comparatively high interest rate, there is a broad range of investors and the maintenance of market liquidity is required. Furthermore, consideration to the issuance balance for the various maturity in the super long-term zone is required. Therefore, it is preferable to prioritize the maintenance of the issuance amount for 20-Year Bonds over 30 and 40-Year Bonds. Regarding Inflation-Indexed Bonds, liquidity remains low and from the aspect of future market development, the issuance amount should be maintained.

Regarding Liquidity Enhancement Auctions, due to the decline in the liquidity of off-the-run issues and increasing demands, an increase in the amount of issuance is desirable. There are demands in each zone, and in particular demands in zones with the 1 - 5 - remaining - year zone and the 15.5 - 39 - remaining - year zone are great, therefore, a 100 billion yen increase per auction for both zones is desirable in exchange for a reduction in the amount for current issues.

・There are many approaches in considering the maturity term structure, but from a market maker stance, a sound secondary market where many investors can carry out transactions flexibly needs to be maintained in order to support the stable issuance of government bonds. From this perspective, the present issue is that price quotation is becoming extremely difficult due to foreign investors making considerable purchases in the zones with shorter than remaining 5 years to maturity.

Therefore, amid the situation in which the JGB market issuance amount for the next fiscal year is on a downward trend, in considering which maturity term should take the precedence, we feel that reduction for bonds with a longer duration should take precedence over bonds with a shorter duration which were subject to reduction before.

Specifically, regarding the super long-term zone, reduction for 30 and 40-Year Bonds should preferentially be implemented over reduction for 20-Year bonds. It is true that certain demands exist in 30 and 40-Year Bonds and some investors do not want the amount to be reduced. However, the issue lies more with interest rate levels rather than the amount of issuance. We have the impression from examining the transition of government bond holding balance by life insurance firms in the past 2〜3 years and the figures for net buying by life insurances this fiscal year which have been released by Japan Securities Dealers Association (JSDA) that the problem is not the deficiency in the issuance amount but rather the low interest rate level. Needless to say, if the issuance amount increases, the supply-demand balance is directly impacted due to the close connection between the issuance amount and interest rate level. However, the present interest rate level is for the most part determined by the BOJ's financial policy.

It is not easy to anticipate future financial policies, but in recent times, the BOJ is gradually making references to the side effects from the continuation of the present financial policy. Bearing these points in mind, there is a possibility that discussions aimed toward the increase in the interest rates for the super long-term zone will be held in the next fiscal year, such as steepening of the yield curve and reduction of BOJ purchasing operations, etc.

If that is the case, even if the issuance amount for 30-Year and 40-Year Bonds is reduced, there is sufficient possibility that the interest rates may reach the level desired by investors. Therefore, in considering the constitution of the maturity term it is better to maintain the stance of reducing the super long-term zone over the short – to – medium - term zone.

Regarding Liquidity Enhancement Auctions, with the prolonged large-scale purchasing of government bonds by the BOJ, decline in liquidity of off-the-run issues rather than current issues is keenly felt. Therefore, we request the debt management office increase the issuance amount considerably.

・Regarding the zone shorter than remaining 5 Years, there is a great demand among both domestic and foreign investors including collateral demand. While 2-Year Bonds cannot be reduced, reduction for zones longer than 5 Years is possible since the demand-supply balance for the current issues has not been tight in recent times. However, from the market development aspect, it would be desirable to maintain the amount of issuance for the 40-Year zone so as to secure a liquidity. In addition, regarding 10-Year Bonds, with consideration that they will become the cheapest issue of futures, it is preferable for the reduction in the issuance amount to be minimal.

As for Liquidity Enhancement Auctions, there is continued and accumulative large-scale purchasing of government bonds by the BOJ and considerable decline in the liquidity of off-the-run issues, a flexible response in continued close communication with the market is desired while taking into account possible increase depending on the market environment.

・While reduction in the calendar-base market issuance amount cannot be avoided, it is vital to know how much increase or maintenance is possible with regard to the Liquidity Enhancement Auctions. One characteristic of the Japanese government bond market is that the increase in the transaction volume of off-the-run issues leads to enhancement of liquidity and increased trading volume in the market. Therefore, we hope that for the time being, a sufficient supply of off-the-run issues through Liquidity Enhancement Auctions will continue to be provided proactively. In particular, due to BOJ purchasing and foreign investors demands, off-the-run issues in the medium-term zone, in particular in zones with 3 - 4 - remaining - year, the supply-demand is always tight and the market tends to incline in one direction. Therefore, we would like to see an increased amount for the zone with the 1 - 5 - remaining - year zone. In addition, a portion of the Japanese government bond market tends to depend on futures trading to achieve liquidity. Therefore, we request that the issuance amount in the zone with the 5 - 15.5 - remaining - year zone is maintained.

Amid such a climate, there seems to be the need to decrease the issuance amount evenly for each maturity term, but if we were to set priorities, the priority should be lowered in the zone for bonds that are 2 years or less, for not only off-the-run issues but also current issues since the demands are continuing to be strong. Regarding 40-Year Bonds, since the issuance frequency and the amount per issuance have been increasing at a steady pace in recent time, the current supply-demand is somewhat bad-balanced and a comparatively low price is maintained. Therefore, it is thought that there is sufficient room, comparatively speaking, for reduction with regard to 40-Year Bonds. Regarding 30-Year Bonds, reduction may be possible if an overall even reduction is to be implemented. However, if we think in terms of developing 30-Year Bonds into a benchmark for the super long-term zone, it is necessary to maintain a certain level of issuance amount. Moreover, if the interest rates rise, there will be a demand for 30-Year Bonds in the super long-term zone. Regarding 5-Year Bonds, there is the aspect that the negative interest rate margin in the medium-term zone can be comparatively eased, and since the demands thereof are increasing, a certain measure of balance should be maintained. However, since it is a zone in which investor demands continue to be relatively low, the reduction of bonds of this maturity should be relatively easy among those in the medium-term zone. As for 10-Year Bonds, since these will be the deliverable issues of futures in years to come, the reduction should be avoided to the extent possible.

・Amid the situation where an overall reduction in the issuance amount is implemented, it would be natural for the issuance amount of 30-Year and 40-Year Bonds to be reduced by 100 billion yen per auction, respectively. Regarding these maturity terms, the ratio of the purchase amount by the BOJ to issuance is decreasing, resulting in fluctuations in the supply-demand balance according to the trends of the final investors. Presently, the interest rate of 30-Year Bonds has dropped below 1%, and based on data from JSDA, the purchase by life insurance companies are limited. The average monthly net purchase amount since the beginning of year has been around 200 billion yen, and comparing this to the average monthly net purchase amount from 2013 when Mr. Kuroda was appointed the governor of the BOJ to 2016, the figure has dropped by about 50%. Therefore, reduction in the issuance amount is thought to be inevitable.

Because the demand trends of final investors are determined more by the interest rate level than the issuance amount, we should focus not only on reduction of the issuance amount, but also on how the BOJ controls interest rates accordingly. Financial policies are determined by the BOJ by observing both economic and price fluctuations and cannot be explained by a simple demand-supply balance. In either case, the interest rate level depends on the BOJ's policy and the impact of increase or decrease in the issuance amount is small by comparison.

From the perspective that the holding rate of the BOJ is high, if reduction in the issuance amount and reduction in purchasing by the BOJ occur simultaneously with regard to 5-Year and 10-Year Bonds, the supply-demand balance will be achieved more easily. On the other hand, with respect to 2-Year Bonds and T-Bills, due to the increase in demand by foreign investors, reductions should not be carried out to the extent possible. Additionally, the liquidity of off-the-run issues are declining, and in particular, there is considerable decline in liquidity in the zone with the 1 - 5 - remaining - year zone. Thus, we hope considerations will be given to increase in the issuance amount for this zone.

・30-Year and 40-Year Bonds which have had continuous increase in the issuance amount may be reduced and the issuance amount for 20-Year Bonds which are comparatively low-priced on the yield curve can also be reduced. It is ideal for 2-Year and 5-Year Bonds to be increased corresponding to the amount of decrease in the aforementioned bonds, but it does not matter if this is not achieved.

There is a strong demand with regard to Liquidity Enhancement Auctions, and we do not oppose increase in the issuance amount thereto. However, if there is continuous deficiency in goods in the zone with the 1 - 5 - remaining - year zone, this may be due to purchasing by the BOJ or demands by foreign investors. However, essentially, this is attributed to insufficient issuance of current issues thus far. Therefore, this problem should be addressed by increasing the issuance amount of 2-Year and 5-Year Bonds and not by increase in Liquidity Enhancement Auctions.

・All zones have an extremely tight supply-demand. However, if there were to be a reduction, it should be done evenly in maturity terms with large issuance amounts and which would have little impact from reduction. Specifically, the impact of reduction by 100 billion yen per auction for 2-Year, 5-Year and 10-Year Bonds should be small. Collateral demand by banks consists mainly of T-Bills up to 2-Year Bonds. In addition, demands by foreign investors are dependent on basis swap, and it is unlikely that such demands will continue in the medium to long-term. Therefore, it is advisable to gradually reduce these maturity terms. However, we are also of the impression that no major effects will be felt if 30-Year and 40-Year bonds were to be reduced in minimal quantity.

Regarding Liquidity Enhancement Auctions, since there are off-the-run issues in the 1 - 5 - remaining - year zone that are extremely difficult to purchase, we hope there will be an increase in the issuance amount mainly in this zone.

・In the next fiscal year, while a certain measure of reductions for the calendar-base market issuance amount is necessary, basically an even reduction of all maturity terms should be implemented. However, reductions for Inflation-Indexed Bonds and 20-Year Bonds should not be implemented. Regarding Inflation-Index Bonds, from the liquidity perspective, further reductions should be avoided. As for 20-Year Bonds, under the present yield curve control environment, there is a certain level of demand and the demand-supply balance is maintained. In the past few years, reduction of 20-Year Bonds in the super long-term zone has taken precedence; therefore, in the next fiscal year, the issuance amount of 20-Year Bonds should be put on hold and reductions in other maturity terms should be implemented. Needless to say, some investors say that there is a demand in the super long-term zone. Therefore, it is thought that if reductions are carried out on 40-Year Bonds which have a relatively small issuance amount and which may contribute to market development, there should be less reductions made compared to other maturity terms.

With regard to Liquidity Enhancement Auctions, since the present supply-demand of off-the-run issues is tight in comparison to that of current issues, we hope an increase in these issues while reducing the amount of current issues.

・Considering the supply-demand of the medium-term zone, it is better not to reduce 2-

Year Bonds but instead to reduce 5-Year Bonds. Since 2-Year Bonds and T-Bills have an active demand regardless of the shape of the yield curve or the level of interest rates, if reduction is to be implemented for the medium-term zone, it is better to reduce 5-Year Bonds in greater amounts. Regarding the super long-term zone, when comparing 30-Year and 40-Year Bonds, although reducing 30-Year Bonds may be possible, it is advisable not to reduce 40-Year Bonds. 40-Year Bonds are in the process of market development and if the issuance amount is not increased at a certain level, liquidity could remain low. Therefore, not increasing bonds with shorter than remaining 2 years to maturity and implementing larger] reductions of 5 Year Bonds, at the same time not reducing 40-Year Bonds but implementing larger reductions of 20-Year and 30-Year Bonds as well as reducing 10-Year Bonds are recommended.

Regarding Liquidity Enhancement Auctions, an increase is desired. It may be difficult to implement a large-scale increase when overall reductions are being made. However, with regard to zones with the 15.5 - 39 - remaining - year zone, an increase of 100 billion yen per auction is desired. Needless to say, the optimum scenario is an increase in Liquidity Enhancement Auctions in all zones, but when considering the costs of using a balance sheet in market making, the sector with the greatest burden is the zone with 22 - 26 - remaining - year. Therefore, at the very least, an increase in the zone with the 15.5 - 39 - remaining - year zone is desired.

・As a general remark, we agree with the opinion of reducing current issues and increasing Liquidity Enhancement Auctions. In Japan, the BOJ Outright Purchases determine the level of interest rates and the shape of the yield curve. Amid such a situation, it is important to determine which maturity terms are in actual demand by final investors and which maturity terms are dependent on BOJ purchasing, and reduce the issuance of the latter. The demand for zones 2 Years and under is high, making reduction difficult. In addition, 40-Year Bonds should not be reduced, since the investor base has become significant broader compared to before. On the other hand, those that are predominantly dependent on BOJ purchasing are 5-Year Bonds in the medium-term zone and current issues of 30-Year Bonds in the super long-term zone, and reduction is possible for these zones.

Furthermore, regarding 10-Year Bonds, from the perspective that they will become the cheapest issues after 3 years of issuance, there may be side effects when a large-scale reduction is implemented. However, since there is no actual demand, reduction is possible if there is a decrease in the BOJ purchasing amount. Based on the aforementioned, if we were to place a priority order in the reductions, 5-Year Bonds and 30-Year Bonds will come first, followed by 10-Year Bonds.

・Even if reduction on newly-issued bonds are implemented, since it is ultimately a matter of balance with the BOJ Outright Purchases, it does not matter which of the 40-Year, 30-Year, 20-Year or 10-Year Bonds is reduced. However, if reduction is evenly implemented on newly-issued bonds, we would like Liquidity Enhancement Auctions to be increased by 100 billion yen per action. In addition, the auctions are presently implemented bimonthly for zones with the 1 - 5 - remaining - year zone and the 15.5 - 39 - remaining - year zone, but we hope considerations will be given to implementing auctions monthly for all zones.

2. Latest JGB market situation and outlook for future investments

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

・The yield curve control policy by the BOJ is proving effective, and long-term interest rates have improved from 0% to around 0.1%. When the supply-demand becomes tight due to the stock effects from government bond holding by the BOJ, and the government bond interest rates decline, the BOJ Outright Purchases is reduced, thereby achieving a balance in the supply-demand. This framework collapses when the inflation rate reaches 2%, but it is thought that changes in the present framework of the market will not be seen in the foreseeable future. Regarding the JGB Issuance Plan, the system and financial policies are extremely unstable depending on the situation from moment to moment.

Therefore, when discussing the JGB Issuance Plans, it may not be necessary to be constrained by the outlook for the far future. It is more important to take adequate measures to cope when changes in the system or financial policy occur, including the current supply-demand, and to take advantages of meetings such as this meeting and the meeting of JGB Investors .

・Short-term market trends are dependent on BOJ policies. However, our understanding is that only a part of BOJ policies is determined by domestic supply-demand factors, and the greater part depends basically on exchange rates and overseas trends. While the issuance amount of government bonds will decrease in the next fiscal year, it is thought that the established policy will be for the pace of BOJ purchasing to slow down in the future. Then, the balance of government bonds held by investors will become stabilized and the stock effect by BOJ’s government bond holding will continue, but it is expected that the flow effect will most likely weaken or disappear in the relatively near future.

(Attachment)

Minutes of the Advisory Council on Government Debt Management
(45rd Round)

1. Date: Wednesday, October 18, 2017 (10:00 a.m. to 11:30 a.m.)

2. Place: Ministry of Finance Special Conference Room 3

3. Gist of the Proceedings:

1. Current Debt Management Policy
   - ・Current Debt Management Policy (Material①)
   - ・Reference Material (Material②)
   - ・Member Yoshino's Opinion (Material③)
2. Shortening JGB Settlement Cycles (report)
   - ・Shortening JGB Settlement Cycles (Material④)

1. Current Debt Management Policy

▶ The MOF explained current debt management policy as follows.

(JGB issuance based on medium- to long-term (mid-long) market demands)

- Traditionally, the basic objectives of the debt management policy have been -"Implement secure and smooth issuance of JGBs" and -"Minimize medium to long term financing costs." In order to achieve them, the MOF aims to promote dialogue with the market and issues JGBs based on market demand. Although market demand-based issuance is important, excessive response to temporary demands may raise funding costs by harming predictability for market participants or causing distortions of the market. Therefore, it is important to aim at "more stable and predictable issuance of JGBs" considering medium-to-long term market demand.

- In this regard, the MOF analyzed expected supply and demand trends of JGBs in the mid-long term as follows. On the supply side, to reduce the interest rate risks in the future, the annual issuance amount of super-long-term bonds has increased in recent years, while that of short- and medium-term bonds has decreased under the low interest rate environment. As a result, the outstanding amount of super-long-term bonds has increased significantly and that of medium- and long-term bonds has increased slightly.

- If the current JGB maturity composition will keep unchanged, a considerable amount of super-long-term issuance would be supplied to the market over time, despite netting out of the redemption. On the other hand, the redemption amount of medium- and long-term bonds tends to exceed the issuance amount.

- On the demand side, the MOF analyzed investment trends in JGBs by banks, the main investors for short- and medium-term bonds, and by life insurance companies, the main investors for super-long-term bonds.

- Looking at banks, deposit inflows have increased under the quantitative easing policy. Meanwhile, loans have not increased drastically and the deposit ratio declined. Amid these circumstances, banks declined JGB holdings, resulting in an increase in their outstanding amount of the BOJ current deposit. Supply and demand of medium-and-long term JGB have balanced in recent years, while the outstanding amount of those term bonds have only slightly increased, as the main investors, which are the banks, have declined their JGB holding amount.

- However, JGB holdings of banks have seemed to stop declining. It has been pointed out that there is a limit to the decline of JGB holdings, due to collateral demand and other factors. It is important to understand how banks' asset composition changes, upon considering supply and demand of future medium-and-long-term zones.

- Additionally, both city and local banks have been seeking yields since 2014, increasing their possession of super-long-term bonds supported the supply and demand balance of super-long-term bonds. However, city banks have anticipated the interest rate risk regulations on bank accounts and are starting to lower their super-long-term bonds holdings, which local banks may also follow, one year later.

- Looking at life insurance companies, since 2008, increased JGB holdings, while replacing medium-and-long-term bonds of those short residual terms with super-long-term bonds.

- Behind the increase in outstanding amount of super-long term bonds in recent years, life insurance companies, the main investors of those term bonds, have supported that, by replacing their medium-and-long-term bonds with super -long-term bonds.

- However, since the past two to three years, the increase in JGB holdings and replacement of super-long-term bonds, which have both supported the increase in outstanding amount of super-long-term bonds have taken a break. In case they proceed the maturity matching of asset and liability under the low interest rate environment, negative spread may be fixed. In other words, if interest rates increases, there is a possibility of resuming replacement of their assets for lengthening the average maturity. However, in connection with the liability side, it is also necessary to hold a certain amount of JGBs with short residual terms. It is important to determine how the liability side of life insurance companies changes to consider the future supply and demand balance of super- long-term bonds.

- Annualized premium income of life insurance companies is growing smoothly. On the other hand, income and expenditures deducting insurance and other expenses are making progress at around 7 to 8 trillion yen. In addition, the FSA analyzed in its previous year's "Progress and Assessment of the Strategic Directions and Priorities" that core group of insurance subscriber, who are in their 30s and 40s, will decrease in numbers and may shorten the insurance premium volume or may switch the needs from whole life insurance to medical and nursing care security, due to the changes in future population composition. The liability side of life insurance companies may change hereafter, both in qualitative and quantitative ways.

- Thus, in recent years, life insurance companies increased their super-long-term bond holdings, while banks decreased JGB holdings, which resulted to the demand for super-long-term bonds to be on the same trend as the supply side in a significantly increased outstanding amount. However, this structure may change hereafter.

- To aim at "more stable and predictable issuance of JGBs," it is important to determine the change in market demand in the mid-long term and set the JGB maturity composition consistent with the change.

(Increasing liquidity of JGB market)

- Liquidity of the JGB Market is another important issue. According to the BOJ's "Bond Market Survey," the JGB market function continues to be evaluated as low (or not very high).

- Also, the supply-demand balance of specific JGB issues may become tightened. The supply-demand balance of some JGB issues may be unbalanced, as one of the causes of this is that the BOJ purchases issues broadly including off-the-run issues by market operations, while the MOF mainly supplies on-the-run issues by auctions.

- The MOF has focused on conducting “Auctions for Enhanced-liquidity,” to supply off-the-run issues that are short of liquidity structurally or due to rising demand. The annual issuance amount of this auction has increased in recent years, and the scope of eligible issues has expanded. With regard to “Auctions for Enhanced-liquidity,” issuance amounts of each zone are determined in every quarter, in response to the market environment, based on discussions with market participants. It is considered that this flexible measure will become more important to enhance the market liquidity by the MOF.

► Summary of opinions and such from the members (put together by the MOF) are as follows.

- Arguments on monetary policy’s tapering may be premature at the present stage, but FRB and ECB have already stepped toward tapering, which Japan should always bear in mind that tapering will come at any timing. The current financial market situation is being paralyzed, due to the BOJ’s QQE and yield curve control, however, Japan will experience second phase of interest rate liberalization and commercialization, in a different meaning of that in the 1980s, upon QQE tapering.
  As being explained by the MOF, JGB’s holdings structure may change dynamically in the future, such as financial institutions being controlled by IRRBB. Hence, it is important to discuss how to deal with such changes on an occasion like the Advisory Council on Government Debt Management. In addition, a framework enabling the MOF, the BOJ and the market to prepare as one is required in order to tackle any contingent situations.

- Increase in super-long-term bonds are remarkable in the future estimation of outstanding amount of JGB by maturity types in material①, but there are various viewpoints of the actual situation. For example, this may show a different aspect, if you see material②, where analyzed by remaining maturity.
  There are redemption funds, besides insuring income and expenditures, regarding operating capital of life insurance companies, so the scale of operation seems to be similar to annualized premium.
  In addition, it is obvious that demand for products with a savings component is expected to increase, while that of products providing protection of life insurance companies is expected to decrease as stated in the FSA’s analysis, under the aging society with declining population. However, there are whole life type products in products with a savings component, and a different form of investment demand may

appear, if the mortality rate continuously declines. Therefore, it is not always the case that liability duration will be shortening on a large scale. Moreover, the current structure of life insurance companies is that liability duration is longer than that of assets, and there is a certain demand for super-long-term bonds, under the current low interest environment, from the point of view to fill the duration gaps, as interest rate risk will actualize if interest rate tends to decline.

- It can be estimated that the BOJ's JGB holdings ratio will exceed 50% in 2019 with the current BOJ's JGBs purchasing pace. Considering that the holdings ratio of central banks in postwar foreign countries was around 20% at the most, the situation of current Japan has been unprecedented. Therefore, it is necessary to consider at a level different from that of conventional on how to tackle future monetary policy, if drastically changed.
  Although this matter is supposed to be considered at each financial institution level, we should deal this matter in this meeting as well.

- BOJ Governor Kuroda stated that liquidity of JGB market seems to be rather improving at an interview after the monetary policy meeting on September 21. Please explain the point of his statement.

  → (Explanation by the BOJ) BOJ is hearing opinions, concerning a reduction in liquidity from market participants. On the other hand, some of the various indicators of liquidities, which our bank is referring to, seem to be rather improving. The statement has been made with intention that BOJ will observe indicators closely, as the sense of market participants and the actual data may diverge, along with conversing with market participants properly, based on these facts.

- Until recently, there had been some advantages to lengthen the average maturity of government debt, to control refunding risks for government, and also to fulfill demands of investors seeking higher yield. However, the presence of foreign investors and HFT (High Frequency Trading) have increased in recent years, as opposed to domestic demand which is expected to decline hereafter under the declining population. The time to change the debt management policy towards well-balanced issuance is expected to come.
  In addition, what is important as the debt management policy toward the normalization of monetary policy is to restore fiscal consolidation. Not only is the market function being paralyzed, but also tone on emphasizing fiscal discipline has been reduced in current days, which seems to be a serious issue.

- There is no sense of discomfort on the analysis that banks started to retain their holding amount of JGBs for collateral use, but it should be noted that collateral demand of the bank, including cross currency repos are mainly covered by JGBs with terms less than 2-year, and there are few cases covered by 5-year bonds.

  In addition, trades in the current JGB's holdings structure, where more than 90% is held by domestic investors, tends to lean to one-way, so "globalization" of JGBs should be promoted from the point of view to enhance holdings ratio of foreigners.

  Moreover, JGB's reuse value may raise and can be covered stably by foreign investors by solving challenges, such as settlement cycles and how to deal as eligible collateral.

- Issuance amount of refunding bonds, which is currently showing a declining trend, is expected to increase after 5 or 10 years. The banks may still be available to purchase a certain amount under IRRBB control, but there will be no option but to rely on foreign investors, that supposed to require certain additional returns, to cover the issuance amount at tapering phase.

  In addition, new approach is required to create demands, if funds gathered to life insurance companies are expected to decrease, due to changes in population composition. Individuals have funds after all, so promoting JGB holdings in retail market may be worth considering.

- I agree to the MOF's explanation that predictability in the JGB market is very important. The ECB and the FRB are making efforts, such as to announce the principles in advance to enhance predictability. It is necessary that Japan strives to enhance predictability as well.

- This may be a bit unreasonable argument, but the status quo is that the BOJ is purchasing most of the JGBs issued by the MOF with its current deposit as capital, which is nothing but circulating funds within the same government. Thus, even if lengthening the average maturity is promoted, the situation of the average maturity is not sought, seeing as a whole government including the BOJ.

  Since life insurance companies currently have strength to cover super-long-term bonds, increasing super-long-term bonds issuance, while promoting fiscal consolidation is rather preferable.

- I totally agree to the MOF's policy that issuance by regular auctions at calendar base should be made stably, while using the Liquidity Enhancement Auctions to deal with the market environment changes.

  Even if the interest rate returns to the original level with it, consideration should be

made, taking into account that there are some sectors which do not return to the JGB demand, as a result of environment changes, including introduction of IRRBB.
Demand survey that seizes the structural changes of each investor group, such as foreign and individual investors and pension funds is required.
In addition, although it was mentioned to aim “investment rather than saving”, low risk and low return products to be provided to individuals are no longer available with the current low interest rate environment. It is necessary to consider the way of taking risks of individuals and what kind of products can be sold.

- It is important to discuss the debt management policy from a mid-long-term perspective, as the MOF explained. It may appear to be contradictory but at the same time, it is also important to secure flexibility to continue stable issuance. For the flexibility, it was mentioned that active use of Liquidity Enhancement Auctions continues to be favorable.
  Fundamental risk of JGB market is fiscal confidence. It is important to achieve fiscal consolidation when the BOJ step towards tapering in the future. Even if the achievement time of fiscal consolidation target is to be changed, it is necessary to maintain the policy of achievement itself and to show concreate ways to achieve the target clearly.

- It is important to discuss government’s debt duration policy considering the market when Japan defeat deflation and the BOJ’s monetary policy is to change.
  Since improvement in productivity is required to achieve fiscal consolidation, effects on productivity with the duration policy need also be considered. For example, capital efficiency needs to be enhanced, if the interest rate increases, so increase in interest rate may have positive impact on labor productivity in the present situation.
  In addition, there were many opinions in today’s discussion that lengthening the average maturity may currently possible, but it has to be shortened in due course. Since I have been receiving more inquiries on Japan’s fiscal discipline from foreign investors, regarding this point, policy of lengthening the average maturity of government’s debt needs to be reviewed from now, if it is to be shortened in the future.

- JGB is acting as a benchmark role for private corporate bonds and such, in a way acting as public goods, by meeting various needs of investors, while being issued all over the yield curve. Assistant Treasury Secretary Gensler of the US had mentioned “the promotion of efficient capital markets” ,in addition to “sound cash management” and “achieving the (medium to long term) lowest cost financing for the taxpayers” listed on P2 of Material①, as the basic targets of the debt management policy from this sort of point of view.

In addition, in a situation where concerned opinion on public finance is not reflected into interest rate, the meaning to conduct lengthening the average maturity of government's debt should be considered. It could be seized as a signal that the government has abandoned fiscal consolidation if lengthening the average maturity of government's debt is opportunistically conducted under current low interest rate.

2. Shortening JGB Settlement Cycles (report)

▶ In conclusion, the MOF explained the Shortening JGB Settlement Cycles as follows.

- We will briefly report the results of review on shortening JGB settlement cycles, as explained in the last meeting of the Advisory Council (May).

- First, we will explain the environment of this examination. This has been reviewed, following the request to shorten JGB settlement cycles from the point of view to reduce settlement risk, regarding JGB which term from auction to issuance is being long, as shown in P1 of Material④.

- This review is planned to be implemented from May 2018 to coincide with the review in the secondary market of JGB, as shown in the upper right part of the figure in P3. Specific system design, as shown in the thick frame, is to issue 5-to-30 year bonds, which are issued in March, June, September and December, at T+1 in accordance with the principle. That is to issue them on the next business day of the auction, 2-year bonds will be issued on the first day of the following month of the auction, based on the setting condition of the current auction.

- The MOF would like to implement the shortening JGB settlement cycles smoothly in cooperation with market participants.