Minutes of the Meeting of JGB Market Special Participants

(74th Round)

・Date: Thursday, December 14, 2017 (4:00 p.m. to 4:45 p.m.)
・Place: Special Conference Room 3, Ministry of Finance
・Gist of the Proceedings

1. Completing its review of the regulatory treatment of sovereign exposures (see Annex 1)

▸The Financial Services Agency gave the following explanations about the completion of its review of the regulatory treatment of sovereign exposures:

・On December 7, 2017, the Group of Central Bank Governors and Heads of Supervision ("GHOS"), which is the oversight body of the Basel Committee on Banking Supervision ("Basel Committee"),met and approved the finalization of "Basel III" as an international regulatory framework for the capital adequacy ratio applicable to banks. At the same time, GHOS also decided to complete its review at the Basel Committee of regulatory treatment of sovereign exposures without modifying the existing regulation that permits banks to apply zero credit risk to government bonds issued in their own currencies. Thus, GHOS completed the series of global post-crisis regulatory financial reforms.

・In light of the consciousness that the existing regulatory treatment of sovereign exposures may have deepened the eurozone debt and banking crisis, since January 2015 the Basel Committee has conducted its review in a careful, holistic and gradual manner to consider the necessity to review the current regulation and the measures that should be taken in case of its revision.

・As the result of such deliberation, it was announced the Basel Committee had not reached a consensus on making any changes to the regulatory treatment of sovereign exposures and that the Basel Committee had completed its review of this issue, deciding thereby to maintain the existing regulatory treatment of sovereign exposures. At the same time, the committee published discussion papers that outline the potential ideas taken up for deliberation (which is an act that opinions will be invited but not for public comments at the Basel Committee).

2. Issuance amount of Inflation-Indexed Bonds in the January - March 2018 quarter (see Annex 2)

▸The Financial Bureau gave the following explanation about the issuance amount of Inflation-Indexed Bonds in the January - March 2018 quarter:

・As regards Inflation-Indexed Bonds the JGB Issuance Plan for FY2017 says on page 7 that "the debt management office flexibly adjust issuance amounts taking into consideration opinions exchanged with JGB market participants, the market environment and investment demands" for making four issuances in the year by the per-issuance amount of ¥400 billion. Therefore, today we would like to hear your opinions about the issuance amounts in the January - March 2018 quarter.

・For the October - December 2017 quarter, as shown on page 8, we conducted the auction for the issuance amount of ¥400 billion in October, and Buy-back Auctions in the amount of ¥20 billion in October and in December, respectively. Page 9 shows that the October auction continued to successfully end, showing the bid-to-cover ratio of 3.09. Buy-back Auctions and the Bank of Japan **(BOJ)**'s Outright Purchase showed generally successful results as shown on page 10. The secondary market has continued to be stable over the past months with the BEI around 0.5% as shown on page 11.

・In such circumstances, we asked for your opinions beforehand and found that many of you are concerned about the continuing limited expansion of the investor base for Inflation-Indexed Bonds, therefore being of the opinion that the debt management office should desirably maintain for the January - March quarter the current issuance amounts of Inflation-Indexed Bonds and of Buy-back Auctions.

・In view of such a situation, as shown on page 12, we are considering issuing Inflation-Indexed Bonds in the January - March quarter in the amount of ¥400 billion and carrying out Buy-back Auctions in the amount of ¥20 billion in the even-numbered month of February, in the same amount as the October - December quarter.

・On page 13 we show opinions provided by you about a desirable auction schedule for Inflation-Indexed Bonds. Currently, we hold auctions for the bonds in April, August, October and February, at irregular intervals. Many of you expressed an opinion in favor of issuances at equal intervals to avoid a disproportionate demand-supply balance.

For issuance of Inflation-Indexed Bonds in and after the next fiscal year the debt management office is considering to change auction schedules at equal, three-month intervals in May, August, November and February for the purpose of the stable issuance. If in carrying out this planned revision we have difficulty in conducting auctions on our traditional two-times-a-week basis, we may hold auctions three-times-a-week, on Monday, Wednesday and Friday, with the bonds of smaller issuance amounts being auctioned at the beginning or end of a week.

・The development of the market for Inflation-Indexed Bonds, is an important issue related to the Debt Management Policy. Therefore, we would like to hear your opinions, on the direction of our policy related to the issuance amounts in the January - March quarter, the auction schedule at equal intervals, etc.

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

・We have no objection to the proposal. Given the stability of the market of the Inflation-Indexed Bonds, it is desirable to maintain the current amounts for both their issuance and their Buy-back. At present, there are such irregular intervals between auctions that the demand and supply condition between one auction and another is distorted to a greater extent, substantially affecting the formation of the prices of Inflation-Indexed Bonds. Even if the debt management office decides the schedule for carrying out auctions three–times-a-week the benefit to be derived from conducting auctions for Inflation-Indexed Bonds at equal intervals will prove to be substantial for the stable issuance as well as the formation of their prices.

・We agree to the proposal. Given an appropriate balance between the issuance amount of Inflation-Indexed Bonds and the amount of their Buy-backs we believe maintaining the current amount of their issuance and Buy-back is reasonable. The auction interval, if made equal, may serve to prevent irregular price fluctuations.

・We have no objection to the proposal. With respect to the issuance amount of the Inflation-Indexed Bonds and the amount of their Buy-back we believe the current balance provided by the per-auction issuance amount of ¥400 billion and the bimonthly Buy-back amount of ¥20 billion is preferable. With respect to their issuance schedule, if auctions for the bonds are carried out at regular intervals it will better help the BEI to be formed in accordance with the movement of the CPI. Therefore, we agree that auctions are held at equal intervals in

May, August, November and February.

・With respect to the issuance amounts of the Inflation-Indexed Bonds and the amount of their Buy-backs, we see no problem. With respect to the regularization of auction intervals, we agree to the proposal because it will contribute to the bond's price formation in conformity to CPI movements and further because we see no particular problem with three-times-a-week auctions.

・With respect to the issuance amount of Inflation-Indexed Bonds and the amount of their Buy-back in the January-March quarter, we see no problem with the authority's proposal. Particularly relating to the amounts of their issuance, the debt management office should not make any further decrease, although we do not see the new investor base in a circumstance where issued Inflation-Indexed Bonds have yet to be redeemable. We expect a moment will come in the next fiscal year when the debt management office should consider to conduct Buy-back Auctions on a monthly basis as a next step to be taken in a circumstance where their demand-supply balance worsens little by little. Of course, there is a possibility that the demand of Inflation-Indexed Bonds may improve in a globally inflationary trend to such an extent that no such monthly Buy-back is required. Therefore, the debt management office should decide whether to conduct Buy-back Auctions of the bonds on a monthly basis depending upon the then prevailing circumstance. We are not particularly opposed to the bonds' issuance at regular intervals, but the debt management office should not adhere so much to the auction at equal interval considering the disadvantages of three-times-a-week basis.

・While we do not expect that any disadvantage will be presented by three-times-a-week auctions an alternative idea will be to maintain current auction months unchanged, conduct auctions at the end of April and of October and at the beginning of August and of February. As a result, it will be possible to set auction schedules that permit the number of their Buy-backs and of BOJ's Outright Purchase of the bonds that are conducted between their auctions to be almost equal. We are not proposing the idea in an aggressive manner; we are suggesting such an auction method from the perspective of avoiding three-times-a-week auctions.

3. Liquidity Enhancement Auctions for the January - March 2018 quarter (see Annex 3)

▸The Financial Bureau provided the following explanations regarding the Liquidity Enhancement Auctions for the January - March 2018 quarter:

・Regarding the Liquidity Enhancement Auctions, as shown on page 15, the FY2017 JGB Issuance Plan stipulated that an annual amount of ¥10.8 trillion would be issued, and that "based on discussions with market participants, the issuance amount for each zone would be adjusted flexibly manner in response to the market environment and investment demands". Today, we request you to discuss the issuance amount for each zone in the January - March quarter.

・As shown on page 16, in the October - December quarter we issued ¥300 billion in November for the 1 - 5 - remaining - year zone, and ¥550 billion in each month for the 5 - 15.5 - remaining - year zone, and ¥400 billion in October and December for the 15.5 - 39 - remaining - year zone, as in the July - September quarter.

・Page 18 shows the results of the Liquidity Enhancement Auctions. Although the December auction is yet to be carried out, each zone was generally stable.

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

・In view of such a situation, page 20 shows that for the January - March quarter, we have an idea of issuing the same amount for each zone as the October - December quarter, which involves ¥300 billion in January and March for the 1 - 5 - remaining - year zone, ¥550 billion each month for the 5 - 15.5 - remaining - year zone, and ¥400 billion in February for the 15.5 - 39 - remaining - year zone.

If we carry out JGB issuances in accordance with the plan the amount to be issued within the current fiscal year via the Liquidity Enhancement Auctions will amount to ¥10.9 trillion. So we are planning to modify the JGB Issuance Plan.

・Based on today's discussion, we will decide the issuance amount for each zone of the Liquidity Enhancement Auctions in the January - March quarter, and so we would like to ask for opinions.

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

・We have no objection to the proposal. We think that maintaining the current issuance amounts is most suitable, which is the consensus of the market.

・We agree to the proposal. A look at the present market environment shows that liquidity in the 1 - 5 - remaining - year zone continues to be felt most deteriorated, while seasonally in the January - March quarter investment demands are likely to rise in the super long-term zone. Consequently, many of JGB Market Participants may really want issuance to be increased in both the 1 - 5 - remaining - year zone and the 15.5 - 39 - remaining - year zone; however, it is not allowed to issue JGBs in amounts substantially larger than the amount planned in the JGB Issuance Plan. Thus, considering the overall balance, the proposal may be point of compromise.

・Basically, we agree to the proposal. In our view, bimonthly issuance in the amount of ¥300 billion in the 1 - 5 - remaining - year zone, monthly issuance in the amount of ¥550 billion in the 5 – 15.5 - remaining - year zone, and bimonthly issuance in the amount of ¥400 billion in the 15.5 - 39 - remaining - year zone are almost equal with current market trends and supply and demand trends. However, judging from the result of the latest auctions, there may be some room for increasing issuance in the 1 - 5 - remaining - year zone. On the other hand, we agree to the proposal presented today since there exists no obvious room for decreasing issuance in the other zones.

・We have no objection to the proposal. However, if possible, we would like to request the increase of the amount of issuance in the 1 - 5 - remaining - year zone for the reason that in the zone the bid - to cover ratios are very high and that the zone suffered a very tight supply and demand balance in March of this year. However, we see no problem with the proposal in consideration of the balance between the zone and the other zones.

・While not opposed to the proposal, we feel it is the most necessary to increase issuance amount in the 15.5 - 39 - remaining - year zone. We are also aware that JGBs in the 1 - 5 - remaining - year zone traded in the secondary market are insufficient. It is desirable to increase issuance amount in all the zones in the next fiscal year.

4.JGB Issuance Plan for FY2018 (see Annex 4)

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

・Explained below is how the Financial Bureau is now discussing and considering the JGB Issuance Plan for FY2018.

・Shown on the left side of page 22 is the breakdown of the issuance amount by legal grounds or by purpose. The size of issuance of Newly-issued bonds and Reconstruction Bonds will be decided in the budget formulation process while Fiscal Investment and Loan Program Bonds (FILP Bonds) is decided in the process of formulating the Fiscal Investment and Loan Program plan. At this moment, we are not in a position to say anything certain about the issuance amount of such bonds.

・With regard to Refunding Bonds, we have so far explained based on the figures given in the Budget Request submitted last August that we expect to decrease their issuance by ¥1.5 trillion exclusive of Reconstruction Bonds, and by ¥1.8 trillion including Reconstruction Bonds and Refunding Bonds; however, as noted in the lower left of page 22, we expect to decrease the issuance of Refunding Bonds by further ¥1.0 trillion due to the fiscal year-end adjustment of the balance of the Government Debt Consolidation Fund. As a result, the total JGB issuance amount is expected to decrease by a certain amount.

・Shown on the right side of page 22 is breakdown of the issuance amount by financing method. We are still carefully reviewing the amount of JGBs "for Retail Investors" and "for BOJ Rollover." The amount of "market issuance" will increase or decrease to some extent depending upon the result of the review. In addition, as we explained at our previous meeting, we think a decrease in the amount of market issuance in the JGB issuance plan for the next fiscal year will be necessary in consideration of additional revenue from issuance at a price above per value.

・On pages 23 and 24 we organized opinions presented at last month's Meeting of JGB Market Special Participants and of JGB Investors relating to the maturity composition of the JGB market issuance amount.

・With respect to super long-term bonds, many of JGB Market Special Participants were of the opinion that while decreasing issuance amount of 30-Year or 40-Year Bonds would be appropriate if the total JGB issuance amount is decreased, the amount of issuance of 20-Year

Bonds should desirably be maintained because of their broad investor base. We heard different opinions from JGB Investors. Many of them requested us to maintain the size of issuance including the issuance of 30-Year and 40-Year Bonds, some of them suggested we should reduce issuance amount principally of 30-Year and 40-Year Bonds.

・With respect to the zone of 10 or shorter years zone the participants generally agreed, that the Financial Bureau may reduce issuance amounts to some degree, with many of them being of the opinion that the issuance amount particularly of 5-Year Bonds may be decreased to a relatively substantial degree.

・With respect to Liquidity Enhancement Auctions, the participants agreed that it would be appropriate to increase issuance amount to some degree in consideration of the lowering liquidity of the off-the-run issues even when the total JGB issuance amount is reduced.

・In the coming days, we will decide the specifics of the JGB Issuance Plan for the next fiscal year in light of the above-mentioned opinions and publish it together with the budget for the next fiscal year as usual.

5. Latest JGB market situation and outlook for future

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

・Levels of interest rates and the yield curve are formed under the yield curve control policy adopted by the BOJ. Consequently, we should expect the current interest rate environment to continue for the time being unless the BOJ changes its monetary policy.

The 10-Year Bond's interest rate, we expect, is unlikely to be in negative territory continuing therefore to fluctuate in the 0%-0.1% range in a circumstance where the BOJ conducted two fixed-rate outright purchase of JGBs at a yield of 0.11%, which causes investors to be conscious of such level as an upper limit, and where interest rates are on an upward trend in the United States and Europe on the back of strong global economy.

Potential factors that may cause the BOJ to change its monetary policy is the continuation of the weak yen/strong dollar trend. If the FRB continues to raise interest rates, it will further widen the difference between U.S. and Japanese interest rates. The FRB's downsizing its balance sheet will likely cause the yen to weaken against the dollar because of the Japan-US monetary base ratio. If the dollar value rises to 120 yen level in the future and the yen

continues to be weak against the dollar, the JGB market participants may begin to discuss raising target interest rates.

In the coming year the BOJ governor and some of its deputy governors will complete their term of office, which may serve as an occasion for changing the bank's current framework of monetary policies. We may expect, therefore, that interest rates will move widening their range in the JGB market.

・Now that the worried-about change of contract months for JGB futures ended smoothly, JGB market participants are feeling at ease. The change of the contract months took place in a calm manner as the debt management office increased the issuance amount of Liquidity Enhancement Auctions while there are smaller amounts of the cheapest issues in the market. There remains a possibility, however, that as far as the current monetary policy continues, the change of contract months for JGB futures will surface as a problem, given the situation where there are small amounts of the cheapest issues in the market.

In my view, the environment where investors procure foreign currencies will become an important topic for domestic investors' portfolio management into the next year. The current rising cost of dollar procurement is more attributable to factors arising in the euro zone than to increasing demand among domestic investors for dollar funds. Future increases in costs of procuring dollars, euros or other foreign currencies may affect the JGB market.

・Over the recent weeks, the dollar LIBOR interest rate has risen and the U.S. yield curve has continued to be flattening. Domestic investors now find themselves in a situation where they have difficulty in earning revenue by investing in Treasuries because of the higher dollar procurement cost.

On the other hand, we see that in Europe the negative interest rate policy continues enabling euros to be procured at low cost. For such a reason there is a possibility for domestic investors to shift their investments to Europe although the interest rates on German bonds are staying at the lower limit of the range.

We should expect, however, that the ECB will end quantitative monetary easing in the course of the next year, and will start contemplating an interest rate hike in the year after next. Then, we may find ourselves in a situation where we will not earn any revenue from investments in European bonds either because of the rising cost of foreign currency procurement just as we will not in the United States. From such a longer perspective, we may see investments flowing back to JGBs, which is likely to cause the JGB yield curve to flatten.