Minutes of the Meeting of JGB Market Special Participants
(79th Round)

・Date: Thursday, December 13, 2018 (4:00 p.m. to 4:55 p.m.)
・Place: Special Conference Room 1208, 12th Floor, Central Common Government Offices No.4
・Gist of Proceedings

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

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

・As regards Inflation-Indexed Bonds the JGB Issuance Plan for FY2018 says on page 3 that "the debt management office flexibly adjust issuance amounts taking into consideration opinions exchanged with JGB market participants, the market environment and investment demands" for making four issuances in the year by the per-issuance amount of ¥400 billion. Therefore, today we would like to hear your opinions about the issuance amounts in the January - March quarter.

・For the October - December quarter, as shown on page 4, we planned to conduct the auction for the issuance amount of ¥400 billion in November, and Buy-back Auctions in the amount of ¥20 billion in October and December, respectively.
Page 5 shows that the November auction were carried out without any problem, showing the bid-to-cover ratio of 3.70.
While we saw some wavering of the bid-to-cover ratio with regard to Buy-back Auctions and Outright Purchase of JGBs, the results generally conformed to market yields (page 6).
Regarding the secondary market, page 7 indicates that the BEI has fallen into the 0.3% range since the beginning of December, following a decline in interest rates for nominal bonds.

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

demand-supply trend due to the recent market environment.

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

・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.

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

・We agree to the proposal. From the viewpoint about the developing of the market for Inflation-Indexed Bonds, it is desirable to keep the issuance amount unchanged at the current ¥400 billion per auction.

・We see no problem with the proposal to set the issuance amount of Inflation-Indexed Bonds at ¥400 billion per auction and the Buy-back Auctions of at ¥20 billion per auction. It is not only in Japan but also in the US and Germany that the BEI has recently declined steeply. As this is a move reflecting the market conditions, we think that there is no problem with maintaining the current issuance amounts.

・We agree to the proposal. In our view, it is appropriate to maintain the issuance amount at ¥400 billion per auction and the amount of Buy-back Auctions at ¥20 billion per auction. At one time, the BEI level was in the 40bps - 50bps range, but it has recently fallen slightly. However, as this is considered to be an adjustment linked with the downtrend of the BEI abroad, it may be unnecessary to revise the current issuance amount in response to the recent adjustment.

・We agree to the proposal. As the BEI's decline, trading participants increased, albeit slightly, and leading to an expansion of the investor base. However, attention should be paid to the point that investors are strengthening their wait-and-see stance because the BEI is trending downward due to the excessive speed of the recent interest rate decline for

nominal bonds. We request the debt management office to pay attention to the overall market so that necessary measures can be taken when the market shows major movements in order to make it possible for investors to engage in trading without worries.

・Basically, we agree to the proposal. However, as the current demand-supply environment is not good, the BEI has fallen into the 30bps range, therefore we request the debt management office to consider holding Buy-back Auctions every month. If the demand-supply balance deteriorates in the future, the prices may record a discontinuous drop. From our past experiences, if that situation continues, a steep drop may suddenly occur. Therefore, it is necessary to consider measures to support the demand-supply balance.

・We agree to the issuance amount of ¥400 billion per auction, but in consideration of the current demand-supply environment, we request the debt management office to hold Buy-back Auctions every month in the amount of ¥20 billion per auction.

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

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

・As shown on page 10, the FY2018 JGB Issuance Plan states the following about the Liquidity Enhancement Auctions:
(1)While the operating assumption is that the total annual issuance amount will be ¥12.6 trillion (¥3.0 trillion for the 15.5 - 39 - remaining - year zone, ¥7.2 trillion for the 5 - 15.5 - remaining -year zone, and ¥2.4 trillion for the 1 - 5 - remaining - year zone),
(2)ultimately, "based on discussions with market participants, the issuance amount for each zone would be adjusted flexibly manner in response to the market environment and investment demands".
Accordingly, we request you to discuss the issuance amount for each zone in the January - March quarter.

・Page 11 shows that issuance for the October - December quarter went according to the JGB Issuance Plan; ¥400 billion in November (odd-numbered month) for the 1 - 5 - remaining - year zone, and ¥600 billion in each month for the 5 - 15.5 - remaining - year

zone, and ¥500 billion in October and December (even-numbered months) for the 15.5 - 39 - remaining - year zone, as in the FY2018 JGB Issuance Plan.

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

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

・In view of such a situation, we have prepared our proposal for each zone's issuance amount during the January - March quarter (see page 15). We are considering issuing ¥400 billion in January and March (odd-numbered months) for the 1 - 5 - remaining - year zone, ¥600 billion each month for the 5 - 15.5 - remaining - year zone, and ¥500 billion in February (even-numbered month) for the 15.5 - 39 - remaining - year zone, just as we did in the October - December quarter.

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

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

・We agree to the proposal. Although there are issues for which the market-held balance is small among issues around the cheapest ones in the 5 – 15.5 - remaining - year zone, issues purchased through the Liquidity Enhancement Auctions are not concentrated in some particular issues compared with in the past, and the cheapest issues are issued additionally. Therefore, it is appropriate to maintain the current issuance amount.

**3. JGB Issuance Plan for FY2019**

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

・Explained below is how the Financial Bureau is now discussing and considering the JGB Issuance Plan for FY2019.

・Shown on the left side of page 17 is the breakdown of the issuance amount by legal grounds or by purpose. The size of issuance of Newly-issued bonds and Reconstruction Bonds will be decided in the budget formulation process while Fiscal Investment and Loan Program Bonds (FILP Bonds) is decided in the process of formulating the Fiscal Investment and Loan Program plan. At this moment, we are not in a position to say anything certain about the issuance amount of such bonds.

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

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

・On pages 18 and 19 we organized opinions presented at last month's Meeting of JGB Market Special Participants and of JGB Investors relating to the maturity composition of the JGB market issuance amount.

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

・With respect to the zone of 10 or shorter years zone, the participants generally agreed that the debt management office may reduce issuance amounts to some degree, but regarding

2-Year Bonds and T-Bills, some attendees requested the debt management office to give consideration to banks' needs for JGBs as collateral and to foreign investors' strong needs.

・As for 1-Year T-Bills, only Treasury Bills (known as TBs) are included in the JGB Issuance Plan, but from the viewpoint of securing foreseeability in the market, the total issuance amount of 1-Year T-Bills, including Financing Bills (known as FBs) as well, is indicated in a marginal note of the JGB Issuance Plan. Therefore, we also inform you that when the issuance amount of 1-Year FBs is revised from the viewpoint of cash management of the National Treasury, a marginal note to that effect is placed in the JGB Issuance Plan.

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

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

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

・We expect that there is room for a decrease in the issuance amounts of 2-Year, 5-Year, 10-Year and 20-Year Bonds. As for T-Bills, if the issuance amount is to be reduced, there is room for a decrease in the issuance amounts of 6-Month and 1-Year T-Bills, excluding 3-Month T-Bills, for which there is demand from foreign investors. Regarding the Liquidity Enhancement Auctions, as there is stable demand in each zone, we request the debt management office to maintain the current issuance amount.

・With respect to the super long-term zone, it would be rather undesirable from the viewpoints of investor needs and the demand-supply balance to reduce the issuance amount for two consecutive years from the current fiscal year, therefore it is appropriate to reduce the issuance amount of 20-Year Bonds, for which the issuance amount was not reduced in the current fiscal year. In addition, from the viewpoint of supplying liquidity, we think that the best option for the overall market is aiming to achieve stable supply and stable issuance by continuing to issue JGBs in similar issuance amounts over the long term.

・It is not desirable either to reduce the issuance amounts of 30-Year and 40-Year Bonds, or to reduce the issuance amount for all T-Bills. On the other hand, regarding 2-Year to 20-Year Bonds, we expect that even if investor demand grows in the next fiscal year and beyond, the demand-supply balance is unlikely to become extremely uneven because of the adjustment of the BOJ's purchase amount, therefore it may be possible to reduce the issuance amounts somewhat. Meanwhile, demand for the Liquidity Enhancement Auctions is growing because the market-held balance of issues that were newly issued around the time when the BOJ's purchase amount was large is small. In consideration of the current situation in which the BOJ's purchase amount has decreased compared with in the past, it is desirable to maintain the current issuance amount although an increase is not necessary.

・With respect to 2-Year to 40-Year Bonds, we think that it is appropriate to maintain the current issuance amounts from the viewpoint of maintaining market liquidity. On the other hand, if reduction is necessary, reducing the issuance amount of 3-Month T-Bills, whose issuance amount is large, will create no particular problem. Conversely, we think that it is not desirable to sharply reduce the issuance amount of 1-Year T-Bills, for which there is demand for use as collateral.

## 4. Latest JGB market situation and outlook for future

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

・Since the revision of the BOJ's monetary policy at the end of July, many investors have been concerned over the expansion of the range of long-term interest rates, and as investors' attention focused too much on how the BOJ moves, they have lost a global perspective. In this situation, concerns have grown over the future course of the economy around the world, resulting in a steep drop in U.S. interest rates. Unexpected market movements like this have led to a steeper-than-expected recent decline in yen interest rates and the flattener of the yield curve. The future course of the global economy is expected to become a major theme next year, but if concerns over the economy subside, the market will once again worry about the BOJ's moves, including the expansion of the range of interest rates and the raising of the long-term interest rate target.

As for the JGB Issuance Plan for the next fiscal year, we believe that ultimately, the point of discussion is to which level the amount of the front-loading issuance of Refunding Bonds should be reduced as a background for the reduction of the amount of market

issuance, but our impression is that it has not become clear to which level the amount of the front-loading issuance of Refunding Bonds will be reduced. If the amount of market issuance is to be reduced, we believe that it is also important to make clear the rough level to which the authority is considering reducing the amount of the front-loading issuance of Refunding Bonds.

・Since dovish remarks made by FRB Vice Chairman Clarida last month, expectations of an interest rate hike in the United States have receded significantly, and expectations that no interest rate hike may be implemented next year have emerged, leading to a decline in U.S. interest rates. The decline in yen interest rates since November, including a drop in the interest rate for 10-Year Bonds well below 0.1%, is a trend considered to be consistent with such interest rate movements abroad, and this may be the only achievement of the revision of the BOJ's monetary policy at the end of July. On the other hand, now that the linkage between yen interest rates and overseas interest rates has been restored, it is difficult to imagine the BOJ reducing the purchase amount in order to stop the decline in JGB interest rates.

Going forward, the key point of attention will be whether or not the BOJ will keep its Outright Purchase of JGBs unchanged and tolerate a negative interest rate for 10-Year Bonds even if overseas interest rates decline further. If the BOJ refuses to tolerate that and reduces the purchase amount in a phase of an interest rate decline for 10-Year Bonds, the linkage with overseas interest rates, the only achievement of the revision of the monetary policy that was mentioned earlier, will be lost. In any case, if nothing is done, the very strong stock effect will lower interest rates, and once the BOJ allows the interest rate for 10-Year Bonds to fall into negative territory, it may become necessary to make a very significant revision and, depending on the circumstances, to shrink the balance sheet when the BOJ tries next time to pull the interest rate back into positive territory.

・Amid the end-of-year risk-off trend, it is notable at the end of this year that investors and securities companies have been too weak to take opposite positions worldwide. As awareness about low inflation and a turning point in the economic cycle has grown, the prolonging of the low interest rate environment has been strongly reflected in the market, and the perceptions concerning another adjustment of the monetary policy by the BOJ and the move toward an exit have changed drastically. In addition, as the economy has been supported by large-scale monetary easing policy measures, we expect that next year and later, it will become very important to discuss what can be done in the next recessionary phase.

・Due to the deterioration of the economic environment and a change in the FRB's stance on interest rate hikes, U.S. interest rates have recently been trending downward because the market has started to think about at which timing the current round of interest rate hikes will be halted next year, therefore yen interest rates have also declined in line with the global economic environment. Going forward, in consideration of the downward revision of global economic forecasts and the difficulty for market participants, such as banks and life insurance companies, to further reduce the balance of JGBs held by them, we assume that it will be rather difficult for interest rates to rise close to 0.2%, the upper limit of the range of long-term interest rates.

However, the BOJ has steadily implemented flexible measures since the monetary policy meeting at the end of July under the outline of Outright Purchase of JGBs announced at the end of each month, and we expect that the BOJ will continue to proceed with flexibilization in terms of three points—schedule, purchase amount, and frequency. Through these measures, we expect that the market's function will recover, not fully but bit by bit, under the yield curve control.

・As for the most recent JGB market situation, because of a change in the outlook on overseas monetary policies, expectations of a rise in yen interest rates, which persisted after July, have receded, and interest rates have dropped steeply. In addition, due to a change in the implementation method of the Outright Purchase of JGBs, market activity is returning to its original form—managing inventories while hedging risks in response to the flow of trading by customers—rather than simply selling JGBs through the BOJ's Outright Purchases the day after an auction. Under the yield curve control, the situation is far from the normalization of the market, but compared with the first half of this year, interest rates have started to move around, albeit within a narrow range, and the correlation with the movements in overseas markets is also increasing.

From the standpoint of the investment side, it is difficult to further reduce the balance of investments in JGBs, therefore the needs for investment in JGBs may grow. However, if investor demand materializes or if investors return to JGBs, the stock effect associated with the high ratio of JGBs held by the BOJ will start to kick in. In that situation, we have the sense that it will be rather difficult to stop an interest rate drop through the reduction of the amount of JGB purchases alone. Therefore, the monetary authority may face difficulty in policy management, so we would like to prevent a decline in the market's liquidity while giving the debt management office accurate feedback on the situation.