Minutes of the Meeting of JGB Market Special Participants
(87th Round)

1. Date: Thursday, April 30, 2020
2. Place: Held in writing
3. Gist of Proceedings:

1. Changes in the issuance amount of Inflation-Indexed Bonds in the April-June 2020 quarter

▶ The Financial Bureau gave the following explanation about the changes in the issuance amount of Inflation-Indexed Bonds in the April-June 2020 quarter:

・ As shown on page 3, following the discussion in this meeting in March, the Financial Bureau has decided that Inflation-Indexed Bonds will be issued four times a year for the amount of ¥300 billion per each time in the JGB Issuance Plan for FY2020 (Revised on April 20) while stating that "the issuance amount may be adjusted in a flexible manner in response to market circumstances and demands of investors, which will be determined based on discussions with market participants." In addition, as shown on page 4, it is stipulated about Buy-Back Auctions that "detailed methods will be determined by considering market circumstances based on discussions with market participants." At today's meeting, we would like to hear your opinions about the amounts of issuance in the April-June once again, considering the current market environment.

・ In the April-June quarter, as shown on page 5, in addition to conducting an auction of issuance for the amount of ¥300 billion in May, we decided to conduct Buy-Back Auctions for the amount of ¥50 billion every month and an additional Buy-Back of ¥300 billion in March in order to improve the balance of supply and demand of Inflation-Indexed Bonds.

The results of the Buy-Back Auctions and Outright Purchases of JGBs by the Bank of Japan (BOJ) are shown on page 6. The results of the additional Buy-Back conducted on March 25 have resulted in generally similar level as the market rates. We have recognized that the Buy-Back Auction has contributed to the improvement in the subsequent balance of supply and demand by having absorbed a considerable amount of existing stock.

On the other hand, the Buy-Back Auction and the Outright Purchase of JGBs by the BOJ conducted after April have shown a significant decrease in price compared to the closing price of the prior business day.

・ The situation of the secondary market is as shown on pages 7 to 9. According to pages 7 and 8, there has been a significant detachment in movements from the trend globally, including Japan.

The details are shown on page 9. Since the crude oil prices have dropped significantly, even trading into the negative price recently, the BEI in Europe and the United States have also been falling. The BEI in Japan, which improved temporarily after the implementation of the additional Buy-Back in March, has also been bearish like in Europe and the United States. It has been moving at around -0.2%.

・ In such circumstances, we asked for opinions from market participants in advance. Some of them stated that the supply will likely to exceed the demand significantly if Inflation-Indexed Bonds are issued for an amount of ¥300 billion in May since the balance of supply and demand has deteriorated with the drop in liquidity and the decline of crude oil prices in addition to the risk-off sentiment due to the spread of the new coronavirus infection.

・ In light of this situation, the proposal of the Financial Bureau is shown on page 10.

For the April-June quarter, we are considering issuing Inflation-Indexed Bonds in the amount of ¥200 billion for each auction while issuance of ¥300 was decided after the Meeting of JGB Market Special Participants in March. In addition, we are considering conducting Buy-back Auctions in the amount of ¥50 billion every month. We would like to explain our intension of reducing the issuance amount in order to avoid inviting suspicion about the future continuity of Inflation-Indexed Bonds, which was pointed out by some of the market participants. The reduction in the amount of issuance on this occasion is for the purposes of continuing a stable issuance of Inflation-Indexed Bonds, considering the current market situation. We believe that it is important to continuously issue Inflation-Indexed Bonds in the future and such continuity may be adversely affected by the situation of the market where the prices are deviated from product value and fundamentals due to temporary changes in the balance of supply and demand.

We will keep a close watch on the market environment and other factors and take appropriate responses flexibly according to the situation.

・ This is the explanation of the situation of the Inflation-Indexed Bonds market and our proposal.

The development of the Inflation-Indexed Bonds market is an important goal of the debt management policy. We would like to hear your opinions once again to decide regarding matters following the discussion at today's meeting.

▶ Summarized below are the views and opinions submitted:

・ We support the proposal of reducing the amount of issuance of Inflation-Indexed Bonds to ¥200 billion in May.

Since it is necessary to explore new investment demand for Inflation-Indexed Bonds every time they are issued, the balance of supply and demand is likely to deteriorate. Flexible responses are required when the price falls significantly below the fair price. In this regard, the Financial Bureau implemented sufficient measures, including the additional Buy-Back of 300 billion, the reduction in the amount of issuance by ¥100 billion and the increase of ¥30 billion in the amount of Buy-Back Auctions every month. However, given the recent unprecedented crash of the energy market and the situation where Inflation-Indexed Bonds are being sold again in detachment from the fair value, such measures are not sufficient anymore. Therefore, the proposal of the Financial Bureau of reducing the amount of issuance is appropriate.

・ We agree to the proposal of the Financial Bureau. The market returned to normal temporarily owing to the Buy-Back for the amount of ¥300 billion carried out by the Financial Bureau in March. However, considering that the price continues to be below the floor value of ¥100 and the global deterioration of sentiment for Inflation-Indexed Bonds, it is desirable to stabilize supply and demand by further reducing the amount of issuance to ¥200 billion.

・ We support the proposal of reducing the amount of issuance to ¥200 billion in May while keeping the amount of Buy-Back Auctions. In addition to the deterioration of fundamentals such as a significant decline of crude oil prices, the number of market participant working from home has continued to increase, resulting in low liquidity of Inflation-Indexed Bonds. The BEI has been moving a lot lower than zero though the floor value has been set for the Inflation-Indexed Bonds. Since the fact that the BEI remains at this level may suggest that the supply and demand environment is unbalanced, we support the reduction in the amount of issuance. In addition, we understood the intention of the Financial Bureau that the reduction in the amount of issuance on this occasion is for the purposes of continuing a stable issuance of Inflation-Indexed Bonds in light of the current market situation.

・The degree of uncertainty over domestic price trends in future is very high owing to various factors, such as the BEI being in the negative range, a concern over a prolonged economic downturn due to the spread of the new coronavirus infection and the sharp decline in the crude oil prices. Under the circumstances, the demand for investment in the future will likely be decreased further. Therefore, it is appropriate that the amount of issuance be reduced to ¥200 billion from the perspective of stable issuance.

・ Since the change of the amount of issuance of Inflation-Indexed Bonds is in line with the market environment and will contribute to the market growth in the future, we agree to the proposal of the Financial Bureau.

・Considering the current situation, the reduction in the issuance amount is appropriate as proposed by the Financial Bureau. In addition, we have no objection to the frequency and amount of Buy-Back Auctions.

・ The environment surrounding the Inflation-Indexed Bonds market has deteriorated further, including the sharp decline in the crude oil prices. In addition, it is unclear that when the declaration of a state of emergency is lifted in Japan and concerns over a stable issuance among market participants cannot be eliminated. We support the reduction in the issuance amount from the previous ¥300 to ¥200 billion.

・ Since the Monetary Policy Meeting on April 27 at which the BOJ decided to eliminate the upper limit of purchase amount, the JGB market has become more stable in terms of the overall yield curve. However, the liquidity of Inflation-Indexed Bonds has remained low and the price movements have been fluctuating. A decline in investment demand is expected due to a prolonged remote work by investors and securities companies associated with the spread of the new coronavirus infection and the decline in the crude oil prices. Therefore, we suggest a further reduction in the issuance amount by about ¥100 billion from ¥300 billion, which was decided after the last meeting, and a further increase in the amount of Buy-Back Auctions from the monthly ¥50 billion. These measures will provide market participants with a degree of reassurance and help explore a potential demand in the future.

・ We agree to the proposal of the Financial Bureau. Considering the current liquidity of the market and the risk tolerance amount, the reduction of the issuance amount to ¥200 billion is appropriate as an emergency measures.

We agree to the proposal that the amount of Buy-Back is left unchanged at ¥50 billion even after the reduction in the issuance amount, considering the fact that there are still needs for sale according to the current situation of bidding and successful bid. However, the net amount absorbed, including the Outright Purchase of the BOJ, is expected to be large. Therefore, it is important to make a flexible decision to reduce the amount of Buy-Back in order to maintain the liquidity of the market when a significant improvement is observed in bidding and successful bids, including a decrease in bidding amount and a short price-tail.

・ We agree to the proposal of the Financial Bureau to reduce the issuance amount in May to ¥200 billion.

The additional Buy-Back of ¥300 billion was carried out in the latter half of March, but any remarkable reaction was hardly seen and the BEI of the on-the-run issue has remained at around -20 bps. Although new buyers was expected to appear entering the new fiscal year due to the fact that their interest rate had been higher than that of nominal 10-Year Bonds and it was positive, there has been hardly any demand from overseas and domestic investors for a month. Considering the situation that it is expected that the CPI may temporarily register below zero percent and no significant rebound in the crude oil market is expected in a few months, a temporary reduction in the issuance amount is appropriate.

As the explanation of the Financial Bureau that “the reduction in the amount of issuance on this occasion is for the purposes of continuing a stable issuance of Inflation-Indexed Bonds,” a further reduction in the issuance amount and increase in the amount of Buy-back Auctions will require a due prudence from the perspective of maintaining the stability of the market.

・ A highly unpredictable situation has been continuing since the sharp deterioration of the market environment from March. We request the Financial Bureau to conduct Buy-Back Auctions appropriately for a necessary amount to stabilize the market when the balance of supply and demand suddenly changes in the future.

・ We support the proposal of the Financial Bureau to reduce the issuance amount to ¥200 billion. We understand that this is aimed to support the low liquidity market in an emergency state.

・ Due to the restrictions on a business environment affected by the spread of the new coronavirus, the market liquidity has declined significantly. Such effect is especially great on Inflation-Indexed Bonds with relatively low liquidity. The prices of some issues of Inflation-Indexed Bonds are below the theoretical minimum price in terms of the floor value, which indicates that the imbalance of supply and demand has deteriorated significantly. Therefore, the reduction in the issuance amount with the aim to alleviate the effect of the issuance are appropriate. In addition, an increase in the amount of Buy-Back Auctions is desirable if remarkable improvements cannot be observed in the balance of supply and demand for Inflation-Indexed Bonds since it seems that there is a demand to sell off-the-run issues in the market in light of the results of the most recent Outright Purchase of JGBs and issues of Buy-Back Auctions.

・ We agree to the proposal of the Financial Bureau to reduce the issuance amount to ¥200 billion and in response to the recent decline in demand. We also agree to the proposed amount of Buy-Back. On the other hand, the BEI of the bond #24, which is on-the-run issue, has been at high levels compared to the off-the-run issues. If the BEI differential between the bonds #24 and #25 and other issues is fixed or deviates even further due to the reduction in the issue amount of the new issue, we request the Financial Bureau to flexibly select subject issues for Buy-Back Auctions.

・ The issuance amount of ¥300 billion is more appropriate than ¥200 billion. Since new issue will be built up in May, a certain amount of the outstanding balance is necessary to maintain the liquidity in the secondary market and develop the market. Although the balance of supply and demand of Inflation-Indexed Bonds has deteriorated and the BEI has declined significantly, investors bought the dip of the on-the-run issue, leading to a better balance between supply and demand compared to off-the-run bonds. An issuance in the amount of ¥300 billion in May will be absorbed because a purchase demand is expected for the purpose of changing the composition of the portfolio from off-the-run issues to on-the-run issues from the theoretical perspective, including the Indexation Coefficient level. On the other hand, it is desirable to increase the amount of Buy-Back by ¥20–30 billion since there would be a further deterioration in the balance of supply and demand if off-the-run issues are sold for the purposes of changing the portfolio composition.

If the issuance amount per auction is reduced to ¥200 billion, it should be started from the auction in August in which reopening will be applied, in consideration of the future supply and demand environment.

・ We suggest that the issuance be canceled and Buy-Back Auctions remain unchanged at the current level. In addition, we propose that the bond #25 is excluded from Buy-Back Auctions in consideration of the outstanding amount of JGBs in the market.

In addition to their limited domestic demand, the CPI is likely to stand at -1% compared to the last year. In such situation, Inflation-Indexed Bonds are traded or marked at a level that is not supported by actual demand, which is the nature of the problem. Even if the issuance amount is reduced to some extent, the trading environment will not improve significantly. If the emphasis is placed on the market function, the Financial Bureau should leave the market situation as it is to make an environment which is favorable for buyers, considering the floor value, by accepting a significant fall in the BEI. However, it means that the issuer will be burdened with higher costs. The issuance should be stopped for the time being until there is a strong demand from domestic inventors.

2. Latest JGB market situation and outlook for the future

▸ Summarized below are the views and opinions submitted:

・ With a further increase in the number of people working from home due to the declaration of a state of emergency and the extension of the subject area, the market liquidity after the start of the new fiscal year has not recovered and fallen further down. However, owing to efforts of market participants and changes in the JGB purchasing policy of the BOJ, trading in the secondary market has been sustained at a certain level and there has been no major problem in JGB auctions. Although the JGB issuance amount will be increased further in line with the supplementary budget for FY2020, since the Financial Bureau has maintained dialogue with the market and paid a close attention to the distribution of maturity of JGBs, there was hardly any adverse effect.

The liquidity will be gradually restored when the declaration of a state of emergency is lifted. However, since it is expected that the state of emergency will be extended for another one month, the current market situation will not change basically. The economic recovery progresses simultaneously with the restoration of the liquidity on the assumption that the declaration of a state of emergency will be lifted eventually, which will be pressure for interest rate rise. However, since it has been confirmed that the pressure for interest rate rise will be suppressed by the BOJ through monetary policy by the enhancement of monetary easing decided on April 27, it is difficult to assume that interest rates will continue to rise. This composition will not change even if the JGB issuance amount is further increased in the future. Finally, the expected risks are considered to be the second wave of the spread of the new coronavirus infection and the prolongation of the sluggish crude oil prices.

・ With an increase in the number of market participants working from home after the declaration of a state of emergency, the auction of issuance and the Outright Purchase of JGBs are becoming more important. Currently, the extension of the declaration of a state of emergency is under debate. Under the circumstance, there will possibly be a need for an additional issuance of JGBs associated with additional stimulus measures. Even if this is not the case, an economic stimulus policy will likely be discussed in the future depending on the state of economic recovery from June. In addition, the issuance amount of Treasury Discount Bills (T-Bills) has increased far greater than the expectations by the increase in the amount of Financing Bills. Although the issuance amount of T- Bills will possibly decrease in future due to the payment of taxes that have been postponed, the market may change drastically temporarily.

We request the Financial Bureau to strengthen communication with market participants including JGB Market Special Participants to have a broad view of the supply and demand environment, including collateral demand by domestic investors, demand by overseas investors, and the Outright Purchase of JGBs by the BOJ. Following the discussion in the Meeting of JGB

Market Special Participants last year, we understand that the JGB Issuance Plan may be revised flexibly within the current fiscal year. We would like this meeting and the Meeting of JGB Investors to be used as a place for exchanging opinions.

・ Under the Yield Curve Control, the JGB market is expected to continue to move within a limited range. However, the ratio of auctions of issuance and Outright Purchases of JGBs with respect to total transactions have been increasing and there is a risk of an increase in volatility before and after that.

・Since the declaration of a state of emergency by the government due to the spread of the new coronavirus infection, the number of people working from home has increased in securities companies and investors. The daily trading volume of 10-year JGB futures did not reach even ¥1 trillion in most of the days in April. In such circumstances, decline of the liquidity was apparent. Due to these factors, the interest rate on 10-Year Bonds moves in a very narrow range since the start of the new fiscal year between around -0.01% and 0.015%. However, after a strong commitment to purchase JGBs, in addition to CP and corporate bonds, was shown at the Monetary Policy Meeting of the BOJ on April 27, the interest rate on 10-Year Bonds has fallen to around -0.05%.

Since there is a concern over an increase in the issuance amount of JGBs in July onwards, it is hard to expect a significant decrease in interest rates. However, the 10-Year Bonds that maintained positive interest rates for some time is likely to fall into negative interest rates for at least the next 1-2 months. Also, it seems that an increase in interest rates in the super long-term zone will be suppressed under the present environment. It is expected that the interest rates on 10-Year Bonds, 20-Year Bonds and 30-Year Bonds will move in a very narrow range of around -0.05%, 0.3% and 0.4%, respectively until the end of June when the issuance amount of JGBs will be increased.

・ With an increase in the number of market participants working from home after the issuance of the declaration of a state of emergency, the daily transaction volume has decreased significantly. The trading of off-the-run issues has been very difficult. Although there is a concern over an increase in the issuance amount of JGBs from July onwards this year, the supply and demand environment will not be destabilized due to the support of strong Outright Purchase of JGBs.

・ While an increase in the planned issuance amount of JGBs associated with the formulation of a supplementary budget in FY2020 suppress the rise of prices of JGBs, the interest rate on 10-Year Bonds has moved around 0%. The prices of JGBs have been supported by frequently conducted Outright Purchase of JGBs in April and the demand for the accumulation of bonds mainly by domestic investors after the start of the new fiscal year. Responding to the spread of the new coronavirus infection, the BOJ published the “Enhancement of Monetary Easing” on April 27 and declared aggressive purchases of JGBs as a part of it, leading to a decrease in interest rates. In the next two months, interest rates are expected to decline further, coupled with a decline in volatility.

・ It seems that the decline in liquidity associated with business restrictions due to the spread of the new coronavirus infection poses the biggest issue in the current JGB market. However, in view of the improvement in market volatility and the number of investors, the liquidity has been improving gradually. As the increase in the issuance amount of JGBs from July onwards will be offset by the strengthening of monetary easing by the BOJ, the impact is expected to be limited. Currently, the yield curve in the super long-term zone has been steep to some extent. However, since it is increasingly likely that the interest rate on 10-Year Bonds will stay in the negative range for the time being, demand for positive interest rates in the super long-term zone will likely to be observed in the medium- to long-term. Therefore, unless an increase in the issuance amount in the super long-term zone continues, gradual bull-flattening of the yield curve is expected.

・ With a decrease in the number of market participants due to the promotion of split operations and remote work, the liquidity in the secondary market has declined significantly. While large price fluctuations before and after auctions are expected to continue, interest rates will not rise easily due to active Outright Purchase of JGBs by the BOJ.

・ In the circumstance that the declaration of a state of emergency will likely to be extended for about a month all over Japan, the trading frequency by market participants has remained low. On the other hand, the volatility and interest rate levels has been stably low for each term by the policies of the BOJ to increase the amount and frequency of the Outright Purchase of JGBs.

・ The trade volume in both futures market and spot market has declined since the declaration of a state of emergency with the effect of remote work. Currently the volatility remains stably low. However, if prices fluctuate in the market with a small number of participants, there is a possibility that the yield curve will be distorted by a balance of supply and demand of individual issues.

・ The market liquidity has slightly improved compared to before, including a decrease in Bid-offer spread. However, “thickness” of the market, trading volume and investors’ activities has been low. Therefore, the overall market liquidity will remain low in the future. Under the circumstance, the issuance amount of JGBs, including short-term JGBs, has started to be increased. As mentioned by other market participants, we should start discussing the usefulness of the Dutch-style auction method for a stable issuance of JGBs under the situation where the operational restrictions of market participants continues.

・The declaration of a state of emergency has strengthened the tendency that investors abstain from making a frequent trading in the secondary market and purchase the necessary amount only at a time of an auction, which has led to a stable issuance. While the BOJ has published the policy of "further active purchase of JGBs and T-Bills" in the recent Monetary Policy Meeting, the actual amount of increase in the Outright Purchase of JGBs by the BOJ and the balance with the increase in the issuance amount of JGBs starting in July may be a factor that destabilize the market.

・ The JGB market in April has been more stable than in March due to the success of aggressive purchases of JGBs by the BOJ and the fact that other markets, including the stock market and the foreign exchange market, regained some stability. In the meantime, the issuance amount of JGBs associated with the supplementary budget for FY2020 and a further increase in the amount due to an alteration in the supplementary budget has been steadily incorporated into the market price. On the other hand, the volume of trading in the JGB market has decreased significantly since the issuance of the declaration of a state of emergency and the trading volume of JGB futures has continued to be below ¥1 trillion every day. We can attribute the calmness of the market to fact that many securities companies and investors refrained from trading under the emergency declaration. Since the prolongation of the declaration of a state of emergency is expected, the low levels of trading due to a decrease in the number of market participants will continue. However, we must bear in mind the risk that the market may fluctuate significantly at any moment in one direction due to unexpected news or events.

・ Since the issuance of the declaration of a state of emergency by the government, the degree of risk tolerance of market participants has declined significantly because of physical restrictions imposed on market participants due to split operations and remote work. Although the bond market has temporarily regained stability due to the strong support by the BOJ, the market situation will depend on whether the BOJ will continue with the stance to actively purchasing JGBs or not in line with overseas major central banks such as FRB, in the circumstance that the issuance amount of JGBs will be increased from July onwards. In addition, in view of the fact that the bid-offer spread in the spot market is wide and JGB futures have not been functioning as a hedging tool, we should be wary of the market environment from the perspective liquidity and functionality. While the prolongation of the declaration of a state of emergency is expected to be announced during the consecutive holidays, the liquidity and functionality of the bond market will not likely improve soon. We request the Financial Bureau to continue to provide us with close communication.

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