

Current Situation and Future Challenges of Debt Management Policy
— Discussion Paper —
(Summary)

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【General Discussion】

- The recent Debt Management Policy can be appreciated as having basically functioned well responding to the financial crisis through several measures including conducting “dialogue with the market.” In order to flexibly respond to possible crisis in the future, the issuing authorities should grasp economic and financial conditions appropriately and deliver relevant information in a timely manner.
- Securing the credibility of the Japanese Government Bonds (JGBs) is an indispensable premise for appropriate implementation of Debt Management Policy.
- For the fundamental goals of Debt Management Policy which consist of the achievement of stable and smooth financing and the minimization of medium-to-long term financing costs, JGB issuance plan should be formulated in line with the fundamental principles such as predictability, transparency and flexibility.

【Specific Discussion】

1. Dialogue with the Market

- Dialogue with the market for the accurate grasp of the market trends and needs plays primary roles in Debt Management Policy.

2. Diversification of the JGB Products and Investor Base

- A large proportion of JGBs are currently held by deposit taking financial institutions. It is, thus, important to further encourage various types of investors who have different investment behaviors to hold JGBs.
- Product designs of JGBs and their diversification should flexibly respond to the changing market trends and needs. In providing new products, it is important to make them simple and plain.
- A certain demand of insurance companies and pension funds for the super long-term bonds is expected. With these products, the issuing

authorities have the merit of reducing future refunding risk. It is necessary to further develop the super long-term bond market continuously.

- As for the inflation-indexed bonds (issuance has been suspended), it is necessary for the issuing authorities to seek out an appropriate timing of the resumption of issuance. Towards the future resumption of issuance, the issuing authorities should consider such measures as the introduction of products with principal guarantee (floor) and of products with longer maturity, taking into account the needs of potential investors.
- As for the floating-rate bonds (issuance has been suspended), it is necessary for the issuing authorities to examine the potential market needs or the possibility of product redesign, taking into account that the existing products are not internationally common and there are some views suggesting that they have complicated and difficult risk profiles.
- Preparation for introducing the 3-year fixed-rate bond for retail investors should be facilitated. Furthermore, to further encourage retail investors to hold JGBs, it is important to consider various options such as reviewing profiles of existing retail products and introducing new retail products.
- Overseas IR activities are expected to develop potential investor base and to establish and maintain a communication network with these investors. In considering new IR destinations, long-term investors like pension funds, who are likely to hold government bonds more stably, should be focused on, while provision of information through the network established through IR to date should be continued.

3. Liquidity Enhancing Measures in JGB Markets

- Liquidity in the JGB secondary market should be maintained and enhanced by autonomous function of the market which is activated by active transactions among the market participants. The issuing authorities should support it by implementing appropriate measures in the primary market. In addition, the issuing authorities are allowed and expected to take supplementary measures direct to the secondary market as far as such measures contribute to achieving fundamental goals of Debt Management Policy.
- As for the auctions for enhanced-liquidity, the issuing authorities

- The buy-back program has been implemented for specific policy objectives of Debt Management and also as liquidity enhancing measures. The program for liquidity enhancing measures could be either for crisis management or ordinary support to the market. In either case, the issuing authorities should carefully conduct the program so that it would not result in excessive intervention to the market.
- Facilitation of smoother transaction in the secondary market is also desirable for the issuing authorities. Therefore, it is preferable for the issuing authorities to support the discussion on secondary market reforms made under market participants' initiative and to take appropriate measures on its own.

4. Sophisticated Debt Management Measures

- To make Cost-at-Risk analysis more reliable, the issuing authorities should endeavor to select the analysis period that can meet an objective of analysis while noting that the reliability of a scenario predicting future interest rate paths can be affected to some extent by the selection of the period.
- To reduce the interest rate risk at the time of JGBs refunding, the issuing authorities are expected to make use of increasing the amount of super long-term bonds rather than conducting the interest rate swap transactions which have been subject to limited operational opportunities. Therefore, the issuing authorities should consider a possible direction of the interest rate swap in the future based on the conditions and developments of both swap market and JGB market before engaging in a new transaction.
- The issuing authorities plan to initiate provision of the interest rate information (expected to start during FY2009) on a constant maturity basis, which is expected to make it convenient for research institutions to obtain relevant interest rate data and also to be utilized by investors in their investment decisions.