3 Debt Management Systems

(1) Redemption System

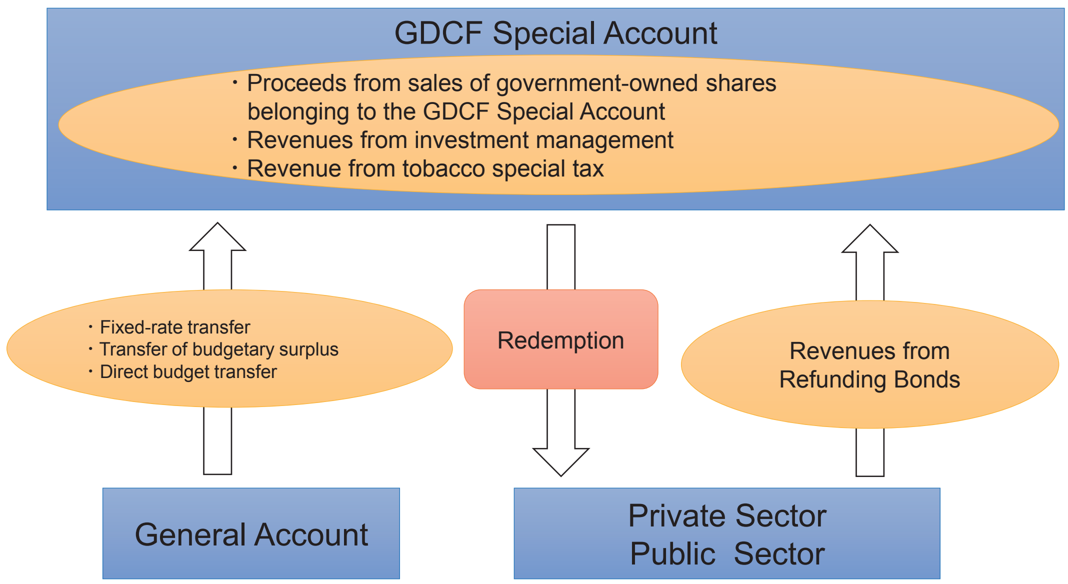
All the JGBs issued to fund a shortfall in General Account and Special Accounts of the national budget are redeemed through the Government Debt Consolidation Fund (GDCF).

To ensure stable redemption, redemption funds are transferred from each Account to the GDCF based on certain rules. In addition, revenues from Refunding Bonds, issued through the GDCF Special Account, are posted to the GDCF. Moreover, the proceeds from the sales of government-owned shares that belong to the GDCF Special Account are also transferred into the GDCF.

Simply put, fiscal resources for government bond redemption are all funneled through the GDCF—from reception and accumulation to disbursements.

This section explains applicable redemption methods and redemption resources for each JGB category with different legal grounds. Then, it also describes the GDCF Special Account.

Fig.2-19 Mechanism of Redemption



Note 1: Redemption System of JGBs belonging to the General Account.
Note 2: Proceeds from sales of government-owned shares of Tokyo Metro Co., LTD, and Japan Post Holdings Co., Ltd, etc. are appropriated for the redemption resources of Reconstruction Bonds.

A. Redemption Methods

When redeeming JGBs, redemption rules will be applicable as set forth in related legislations.

a. 60-Year Redemption Rule (Construction Bonds and Special Deficit-Financing Bonds)

The 60-year redemption rule is applicable to redeeming Construction Bonds and Special Deficit-Financing Bonds so that these JGBs, including Refunding Bonds, will be entirely redeemed in a 60-year period (☞①). Redemption of JGBs is financed with two revenue-

☞① The rule stands on the fact that the average economic depreciation period of the assets purchased by the construction bonds is about 60 years. Deriving from this rule is the 1.6% ratio for fixed-rate transfer for each fiscal year, which is about equivalent to one-sixtieth.

sources: cash from such sources as a fixed-rate transfer from the General Account and revenues from issuing Refunding Bonds in accordance with applicable rules. The 60-year redemption rule is maintained in this way. When redeeming Special Deficit-Financing Bonds, the government will "strive to redeem these bonds as soon as possible" as set forth in its governing law.

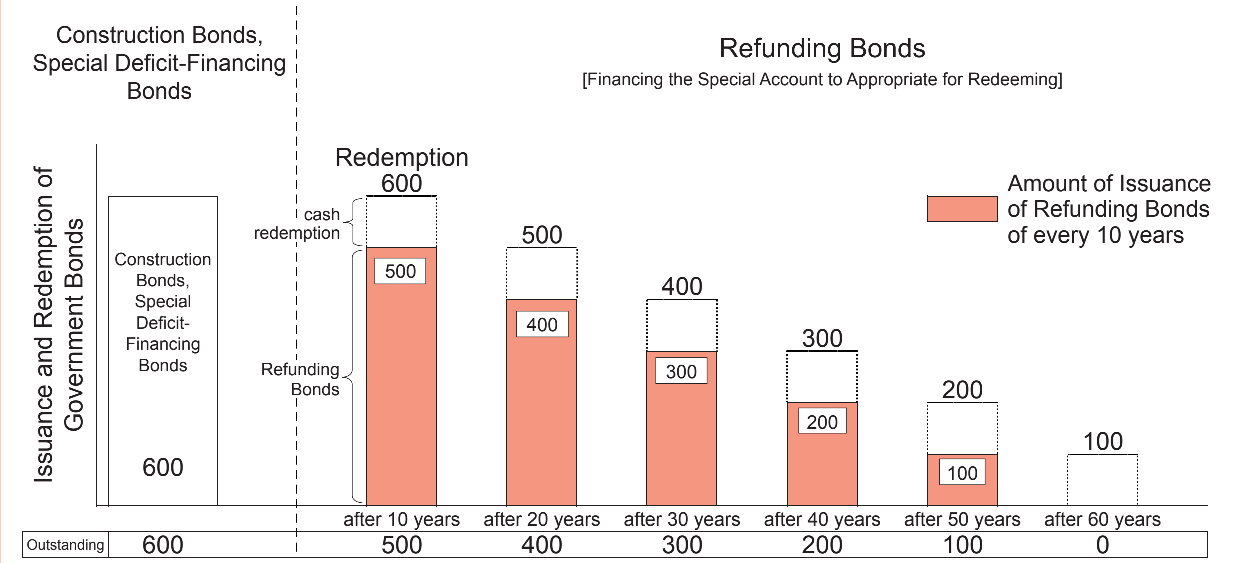
Fig. 2-20 will give you an idea about how the 60-year redemption rule works.

Suppose you issue 600 billion yen of debt in fixed-rate coupon-bearing 10-year bonds, at maturity (i.e., 10 years from now) you will redeem 100 billion yen of them in cash (☞②) -equivalent to 1/6 of 600 billion yen- while issuing Refunding Bonds to cover the remaining 500 billion yen. Assuming that these Refunding Bonds will also be issued in fixed-rate coupon-bearing 10-year bonds, then you will redeem 100 billion yen in cash -1/6 of the initial issue amount of 600 billion yen- in another 10 years. While issuing Refunding Bonds to cover the remaining 400 billion yen. Repeat this for four more times, then, you'll be able to complete the cash redemption in 60 years from the first issuance.

As shown in the figure below, because annual fixed-rate transfer is calculated based on the JGB outstanding amount at the beginning of the previous fiscal year, it decreases along with the decrease in the JGB outstanding amount. Therefore, fixed-rate transfer will be insufficient to finance bond redemption in cash. For this reason, bond redemption will also be complemented with a surplus fund, budget fund, and proceeds from sales of government owned shares.

☞②The term "cash" redemption in this context means that bond redemption is not financed with issuing Refunding Bonds. From the viewpoint of individual bond holders, their JGBs will always be redeemed with cash at maturity.

Fig.2-20 Redemption via Refunding Bonds - "60-Year Redemption Rule"



Fixed rate transfer	after 2〜11years 600 ×1.6% × 10=96	after 12〜21years 500 ×1.6% × 10=80	after 22〜31years 400 ×1.6% × 10=64	after 32〜41years 300 ×1.6% × 10=48	after 42〜51years 200 ×1.6% × 10=32	after 52〜61years 100 ×1.6% × 10=16	Total 336
Shortfall	4	20	36	52	68	84	Total 264

b. Redemption Methods for Reconstruction Bonds

Reconstruction Bonds, including their Refunding Bonds, will be entirely redeemed in FY2037 at the latest. The 60-year redemption rule will not be applicable to the redemption of Reconstruction Bonds. This is because "Basic Guidelines for Reconstruction in response to the Great East Japan Earthquake" states that the financial resources for recovery and reconstruction shall "basically be borne by the entire current generation, collectively sharing the financial burden by solidarity and not be left as cost of future generations" and redemption of these bonds will surely be financed with certain revenue resources.

Specifically, a portion of Reconstruction Bonds (including Refunding Bonds for Reconstruction Bonds) redeemable each year will be redeemed with cash to the extent of revenues from Special Taxes for Reconstruction and profit on sales of government-owned equities that are transferred to the GDCF Special Account as redemption resources, while the remaining portion will be entirely covered with Refunding Bonds. The government is planning to finish the redemption of Reconstruction Bonds by repeating cash-based redemption and Refunding Bond-based redemption every fiscal year by FY2037 at the latest.

c. Other Redemption Methods for JGBs

General Bonds subject to redemption methods other than those above include Special Deficit-Financing Bonds issued by FY1984, Gulf Special Deficit-Financing Bonds issued in FY1990, Tax Cut Special Deficit-Financing Bonds issued between FY1994 and FY1996 and Special Bonds for Covering Public Pension Funding issued in FY2012 and FY2013. As Special Deficit-Financing Bonds were prohibited from being redeemed with refinancing in the past, the 60-year redemption rule was not applicable to Special Deficit-financing Bonds issued up until FY1984. For this reason, the 60-year redemption rule did not apply to JGBs redeemable by FY1984 (☞①), but the rule becomes applicable to JGBs redeemable from FY1985 onward. In addition, Gulf Special Deficit-Financing Bonds got redeemed in 4 years ending in FY1994 as initially scheduled. Of Tax Cut Special Deficit-Financing Bonds, those set to be redeemed in 20 years (☞②) were all redeemed by FY2017. Special Bonds for Covering Public Pension Funding and relevant Refunding Bonds will be redeemed by FY2033.

Unlike ordinary JGBs that are redeemed with tax and other revenues, FILP Bonds are redeemed with such revenues as loan repayments to the Fiscal Loan Fund. In this case, the government transfers necessary redemption funds from the "Fiscal Loan Fund Special Account" to the GDCF Special Account every fiscal year to redeem FILP Bonds.

B. Redemption Resources

Redemption resources for JGBs are set forth in applicable laws. This section explains financial resources used for cash-based redemption.

a. Redemption Resources for Construction Bonds and Special Deficit-Financing Bonds

① Transfer from the General Account

For government bond redemption, there are three ways to transfer fiscal resources from the General Account to the GDCF Special Account.

☞① All JGBs redeemable in FY1984 were redeemed by cash and the 60-year redemption rule was not applied even though they could be redeemed with refunding based on the rule.

☞② Tax Cut Special Deficit-Financing Bonds were issued in line with special income tax reduction and other measures (excluding the abolition of special corporation and automobile consumption taxes) implemented between FY1994 and FY1996 and redeemed in 20 years from FY1998 and FY2017.

i. Fixed-rate transfer (1.6% of total government bond outstanding as of the beginning of the previous fiscal year)

The fixed-rate transfer is based on Article 42, paragraph (2) of the "Act on Special Accounts." Specifically, the amount equal to 1.6% of total government bonds (outstanding in face value) at the beginning of the previous fiscal year is transferred from the General Account to the GDCF Special Account on the basis of the 60-year redemption rule. Those subject to the fixed-rate transfer are limited to Public Bonds covered in the General Account (Construction Bonds, Special Deficit-Financing Bonds (excluding Special Bonds for covering Public Pension Funding)), and Borrowings (excluding Temporary Borrowings) and their Refunding Bonds (☞).

☞When calculating the outstanding amount of discount bonds, their issuance price is regarded as the face value (Article 42, paragraph (3) of the "Act on Special Accounts"). As to the difference between the issuance price and the face value (i.e., (the sum) equivalent to redemption profit), the difference divided by the number of years to maturity is additionally transferred to the GDCF Special Account every fiscal year (Article 42, paragraph (4) of the "Act on Special Accounts").

ii. Transfer of a budgetary surplus (A minimum of half of the surplus in the General Account as a result of the settlement of the fiscal year)

Pursuant to Article 6, paragraph (1) of the "Public Finance Act," when surplus is generated in the General Account as a result of the settlement, at least half the surplus must be transferred to the GDCF Special Account within two years from the said fiscal year in which the surplus was generated (☞).

☞An appendix to the "Reconstruction Funding Act" calls for using such surplus primarily for redeeming Reconstruction Bonds from FY2011 to FY2015.

iii. Direct budget transfer (A discretionary transfer specified by the General Account budget when necessary)

In addition to the above transfers, to ensure smooth redemption of government bonds, Article 42, paragraph (5) of the "Act on Special Accounts" prescribes that a discretionary transfer, which is specified by the budget can be made as needed from the General Account to the GDCF Special Account.

② Others

i. Proceeds from government-owned shares belonging to the GDCF Special Account

Proceeds from sales and dividends of government-owned shares that belong to the GDCF Special Account shall be set aside as a resource for redemption of JGBs.

A part of Nippon Telegraph and Telephone Corporation (NTT) shares, a part of shares of Japan Tobacco Inc. (JT), an equity stake in Teito Rapid Transit Authority (☞) and a part of the shares of Japan Post Holdings Co., Ltd. were transferred to the GDCF Special Account as the JGB redemption resources in FY1985, FY1985, FY1998 and FY2007, respectively. The MOF finished selling out NTT shares and JT shares (a portion held initially) in the GDCF Special Account in September 2005 and June 2004, respectively. Proceeds from the sale of shares currently belonging to the GDCF Special Account (including JT shares newly allocated to the GDCF Special Account in accordance with the "Reconstruction Funding Act") will be spent for redeeming Reconstruction Bonds.

☞As Teito Rapid Transit Authority was privatized and renamed Tokyo Metro Co., Ltd. in April 2004, Tokyo Metro shares were distributed to the government free of charge in proportion to the government's equity stake in Teito Rapid Transit Authority. Therefore, the equity stake has been replaced with shares.

ii. Proceeds from allocation

The surplus of the GDCF can be invested into JGBs or deposited to the Fiscal Loan Fund. The MOF pursue efficient allocation of these government bonds, while taking into account the need to secure adequate levels of liquidity in order to ensure smooth implementation of large-scale redemption and refunding. Proceeds from the allocation are credited to the GDCF Special Account to be included in its revenues.

b. Redemption Resources for Reconstruction Bonds

① Revenues from Special Taxes for Reconstruction

As tax measures to finance restoration and reconstruction from the Great East Japan Earthquake, the government created Special Taxes for Reconstruction that are additional income and corporation taxes for limited durations (Special Income Tax for Reconstruction and Special Corporation Tax for Reconstruction).

Specifically, the Special Income Tax for Reconstruction is a limited-duration measure from January 2013 to December 2037 to impose an additional 2.1% income tax. The Special Corporation Tax for Reconstruction is a limited-duration measure from FY2012 to FY2014 to impose an additional 10% corporation tax. However, the special corporation tax was terminated one year ahead of schedule under the FY2014 tax reform to encourage corporations to use earnings for raising wages.

② Non-tax Revenues

i. Utilizing Reserves in the Special Account for the FILP

From reserves in the Fiscal Loan Fund Account of the FILP Special Account, an amount designated in the annual budget could be used for redeeming Reconstruction Bonds from FY2012 to FY2015. From revenues from assets in the Investment Account of the FILP Special Account, an amount designated in the annual budget can be used for the same purpose from FY2016 to FY2022.

ii. Proceeds from government-owned shares

Regarding JT shares (excluding the government's mandatory shareholding (☞①)), shares of Tokyo Metro Co., Ltd. (☞②) and shares of Japan Post Holdings Co., Ltd. (excluding the government's mandatory shareholding (☞③)) belonging to the GDCF Special Account, proceeds generated from the sale of those shares no later than FY2027 will be spent for redeeming Reconstruction Bonds.

③ Utilizing Settlement Surplus

The supplementary provisions of the "Reconstruction Funding Act" stipulate that, if settlement surplus in the General Account revenues and expenditures from FY2011 to FY2015 is utilized to finance redemption of Public Bonds or repayment of borrowings, the government is supposed to put a higher priority on redemption of Reconstruction Bonds.

c. Redemption Resources for Other JGBs

① Special Tobacco Tax Revenues

The government has created the Special Tobacco Tax in accordance with the "Act on Special Measures for Securing Necessary Financial Resources Incidental to Transfer of Debt to General Account" in order to cover a cost increase for the General Account to take over the Japanese National Railway (JNR) Settlement Corporation's long-term debt and the National Forest Service's accumulated debt. Special Tobacco Tax revenues are directly transferred to the GDCF Special Account to repay principals and interests of the JNR Settlement Corporation's long-term debt and the National Forest Service's accumulated debt.

☞① According to the "Reconstruction Funding Act," the mandatory government's shareholding in JT has been reduced from "1/2 or more" of the total shares outstanding to "more than 1/3". As a result, during the period from February to March 2013, the government sold a portion that could be sold (1/6 of the shares outstanding). (The amount of net proceeds from the sale is approximately 973.4 billion yen.)

☞② The government holds 53.4% of the total outstanding shares (as of the end of March 2020).

☞③ In November and December 2015, a total of about 880 million shares were sold (net proceeds at about 1,411 billion yen). In September 2017, about 1.06 billion shares were sold (net proceeds at about 1,398.5 billion yen). The government holds 56.9% of the total outstanding shares (as of the end of March 2020). The government is required to hold more than one-third of the total outstanding shares.

② **Others**

Among General Bonds, Special Bonds for Covering Public Pension Funding are set to be redeemed with a tax revenue increase through the implementation of the revised Consumption Tax Act from FY2014.

Among the other bonds, FILP Bonds are redeemed with the collection of Fiscal Loan receivable.

C. GDCF Special Account

Ref: "FILP Report"

The GDCF Special Account is an independent account created for the purpose of clarifying the status of the country's total debt management, centered on the government debt issued under the General Account. It is a special account for the payment of the principals and interests of JGBs, funded through fiscal transfers from the General Account and other special accounts.

A portion of funds transferred to the GDCF Special Account from other accounts at a fixed rate is accumulated as the GDCF, which serves as a sinking fund to finance the redemption of JGBs.

a. Basic roles

To redeem Construction and Special Deficit-Financing JGBs, which account for most of JGBs, and their Refunding Bonds in accordance with the 60-year redemption rule, the GDCF temporarily accumulates resources for secure redemption. In addition, by making sure steady redemption, the fund also plays a role in maintaining market confidence in JGBs.

b. Secondary roles

The GDCF plays the secondary roles as follows.

① **Contributing to financing the National Treasury**

The GDCF serves for smoothly financing the National Treasury by underwriting Financing Bills.

② **Compensating for deficit in the General Account**

The GDCF will compensate for deficits in the General Account by transferring some funds to the Account Settlement Adjustment Fund. If the GDCF transfers some funds to the Account Settlement Adjustment Fund, the funds will be transferred back to the GDCF from the General Account by the first fiscal year after the fiscal year including the day for the transfer, avoiding any JGB redemption resource shortage.

D. Recent Measures for GDCF Special Account

Recent measures for the GDCF Special Account are explained below:

a. Reducing GDCF Balance

The GDCF is annually accumulated in the GDCF Special Account under a certain framework to respond to lags of redemption and transfer such as fixed-rate transfer from the General Account (1.6% of the total JGB outstanding at the beginning of the previous fiscal year).

The GDCF balance had been maintained at approximately 10 trillion yen using issuance amount of approximately one week (☞) as a guide in order to prepare for operational risks and other emergencies (possibilities that Refunding Bonds cannot be issued due to reasons such as large-scale disasters or system failure) until FY2012.

The FY2013 JGB Issuance Plan stated that the government was allowed to use temporary borrowings from the BOJ for covering operational risks. As a result, the government in FY2013 reduced the GDCF balance to 3 trillion yen equivalent to the level prepared for accidental underbidding in JGB auctions, which cannot be covered by such borrowings, and used residual 7 trillion yen for redeeming JGBs to cut Refunding Bond issuance. The government plans to keep the GDCF balance at 3 trillion yen in FY2020.

☞Maximum issuance amount of JGBs: 9.6 trillion yen per day, 9.9 trillion yen per week (both figures current as of September 2011).

Fig.2-21 Changes in outstanding amount of GDCF

FY2017 (Actual)	FY2018 (Actual)	FY2019 (Estimate)
3,007.4 billion yen	3,005.9 billion yen	3,002.7 billion yen

b. Revised Act on Special Accounts

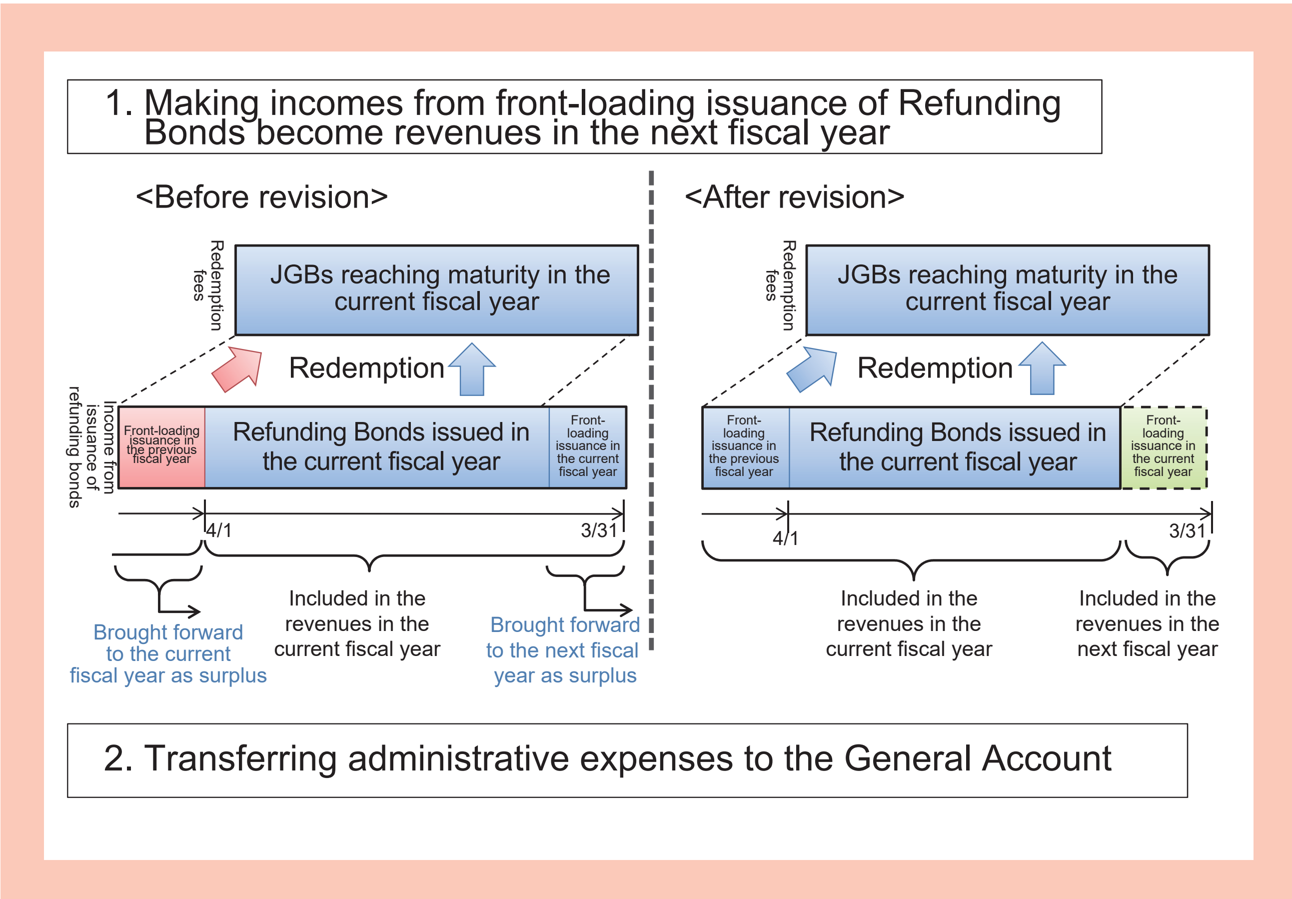
Ref: Chapter 1 1(1) A (Reference) Front-loading issuance of Refunding Bonds (P39)

Based on a report on special account reform (as compiled by the Administrative Reform Promotion Council on June 5, 2013), the government submitted to the Diet a bill to revise part of the “Act on Special Accounts” on October 25, 2013, and won its passage through the legislature on November 15, 2013. The revision allows the government:

① To book revenues from the front-loading issuance of Refunding Bonds for the next fiscal year rather than for the issuance year instead of booking such revenues for the issuance year and carrying over them as a surplus to the next fiscal year, and

② To transfer relevant administrative costs to the General Account from FY2014 budget.

Fig.2-22 Changes in the GDCF Special Account through the revision of the Act on Special Account



(2) Liquidity Enhancement Auctions

Liquidity Enhancement Auctions reopen existing JGB issues, which have structural liquidity shortages or temporary liquidity shortages due to expanding demand, in order to facilitate JGB trading and correct JGB market distortions to maintain and improve JGB market liquidity and stabilize the JGB market for holding down the fundraising costs.

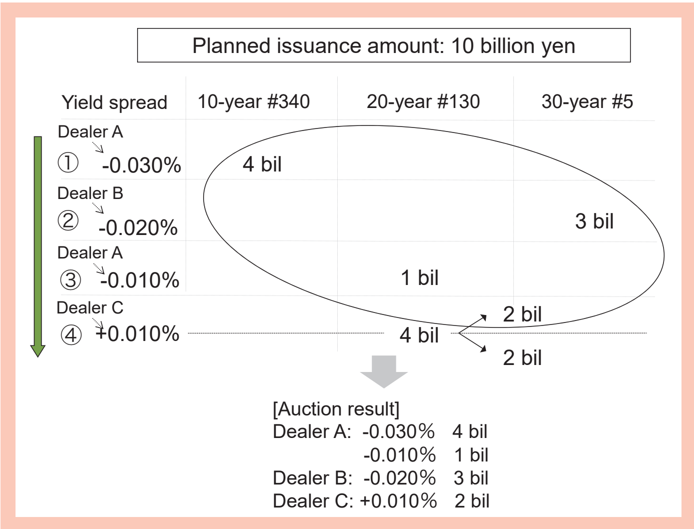
The yield-spread-competitive auction under the conventional method for JGB Market Special Participants alone is used for Liquidity Enhancement Auctions. In the auction, a bidder submits a bidding yield's spread with a standard yield (☞①) (a bidding yield-spread (☞②)) and a bidding amount for each issue subjected to reopening. In principle, regardless of issues, the bidding amounts are allocated with priority placed on smaller bidding yield-spreads (☞③). Bids whose bidding amounts are allocated before the planned issuance amount is reached are successful (Fig. 2-23).

☞①Standard yield means the average simple yield cited in the Reference Statistical Prices [Yields] for OTC Bond Transactions published by the Japan Securities Dealers Association on the auction day.

☞②A bidding yield-spread may be positive or negative. If a bidding yield is 1.030% against a standard yield of 1.000%, the bidding yield-spread is plus 0.030%. If a bidding yield is 0.970% against a standard yield of 1.000%, however, the bidding yield-spread is minus 0.030%.

☞③If bidding yield-spreads are positive, priority is placed on smaller absolute values. If bidding yield-spreads are negative, however, priority is placed on larger absolute values.

Fig.2-23 Image of Liquidity Enhancement Auctions



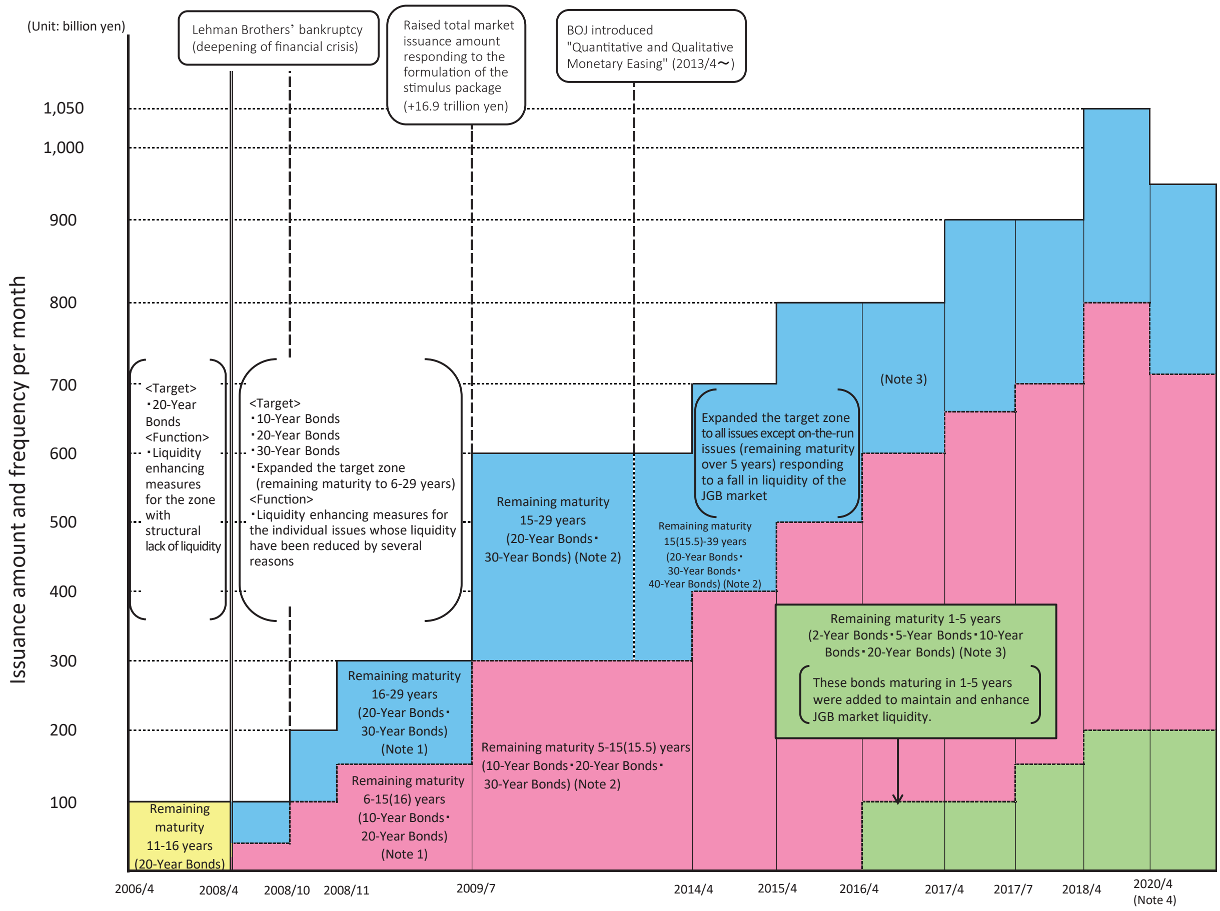
Liquidity Enhancement Auctions were launched in April 2006 to issue 100 billion yen worth of bonds a month for small 20-Year Bond issues with 11-16 years remaining to maturity that structurally lacked liquidity. Later, the range of JGB issues, issuance amounts and frequency for Liquidity Enhancement Auctions have been gradually expanded to counter a remarkable decline in the JGB market's liquidity following the global financial crisis (Fig. 2-24). Subject to Liquidity Enhancement Auctions at present are all 2- to 40-Year JGB off-the-run issues (☞④), which are divided into three zones by remaining maturity range – 1-5 years, 5-15.5 years, and 15.5-39 years.

☞④However, Liquidity Enhancement Auctions cover on-the-run issues for which other additional issuances (including reopening issuances but excluding new over-the-counter sales) have been finished as of the first day of each Liquidity Enhancement Auction month.

The FY2020 JGB Issuance Plan sets the amount for Liquidity Enhancement Auctions at 11.4 trillion yen, cutting auctions by 1.2 trillion yen for JGBs maturing in 5-15.5 years for which demand has declined. Specifically, the plan sets the issuance amount through Liquidity Enhancement Auctions at 2.4 trillion yen for 2-, 5-, 10- and 20-Year Bonds maturing in 1-5 years, at 6.0 trillion yen for 10-, 20- and 30-Year Bonds maturing in 5-15.5 years and at 3.0 trillion yen for 20-, 30- and 40-Year Bonds maturing in 15.5-39 years, publishing planned zone-by-zone issuance amounts to improve the transparency of the auctions. Actual zone-by-zone issuance amounts will be adjusted flexibly in response to the market environment and investment needs, based on discussions with market participants.

For Liquidity Enhancement Auctions in the April-June 2020 quarter, the government decided to issue 500 billion yen in each month for 10-, 20- and 30-Year Bonds with 5-15.5 years remaining to maturity, 500 billion yen each in April and June for 20-, 30- and 40-Year Bonds with 15.5-39 years remaining to maturity, and 400 billion yen in May for 2-, 5-, 10- and 20-Year Bonds with 1-5 years remaining to maturity, based on discussions at the Meeting of JGB Market Special Participants and the Meeting of JGB Investors.

Fig.2-24 Transition of Liquidity Enhancement Auctions



Note 1: In FY2008, durations to maturity had been divided into two groups -- 6-15 years and 16-29 years. In the April-June 2009 quarter, durations to maturity had been differently classified into two groups -- 6-16 years and 16-29 years.
Note 2: From the July-September 2009 quarter to the April-June 2013 quarter, durations to maturity had been differently divided into two groups: 5-15 years and 15-29 years. In the July-September 2013 quarter, durations to maturity had been differently classified into two groups: 5-15 years and 15-39 years. Since the October-December 2013 quarter, durations to maturity have been differently classified into two groups: 5-15.5 years and 15.5-39 years. Since the April-June 2014 quarter, 30-Year Bonds have been added to the coverage of the 5-15.5-year zone.
Note 3: Liquidity Enhancement Auction for JGBs maturing in 1-5 years or 15.5-39 years (since FY2016) takes place every two months. In the figures are issuance amounts per month.
Note 4: Details of Liquidity Enhancement Auctions such as the allocation of issuance amount for each zone may be adjusted in a flexible manner in response to market environment and investor demands, based on discussion with market participants.

(3) Buy-back Program

Buy-back is defined as a scheme for the government as the issuer of JGBs to retire debt by purchasing existing bonds at a price agreed upon with the respective holders willing to take part in the deals prior to maturity of the bonds (☞①).

For the Buy-back Program, the price-spread-competitive auction under the conventional method for JGB Market Special Participants is used with the government clarifying a planned Buy-back amount in advance. In the auction, a bidder submits a bidding price's spread with a standard price (☞②)(a bidding price-spread(☞③)) and a bidding amount for the name and code of each target JGB issue. In principle, the bidding amounts are allocated with priority

☞① Pre-maturity redemption, same as a scheme to retire debt, differs from Buy-back in that the government reserves an option to redeem existing bonds at the face value. The Ministry of Finance has stated on its website its vow not to implement the pre-maturity redemption of JGBs.

placed on a smaller bidding price-spread (☞④) until the Buy-back amount is reached.

In the past, Buy-back program used to be implemented on very limited occasion: when JGBs are paid in kind to the government in accordance with the "Inheritance Tax Act"; or when JGBs deposited with the government pursuant to the "Public Office Election Act" are confiscated with the candidate's election loss. However, the June 2002 amendment to the "Government Bond Securities Buy-back Act" including the following relevant preparation entitled the issuing authorities to flexibly implement Buy-back program. Buy-back program has been conducted according to the respective objectives under Debt Management Policy as well since February 2003.

Specifically, Buy-backs for specific purposes in debt management namely to level off the concentration of JGB maturities in FY2008 and to compress the outstanding debt through transfers from the FILP Special Account were implemented. Furthermore, Buy-backs were implemented for 15-Year Floating-Rate Bonds and old Inflation-Indexed Bonds (issued in and before August 2008 without deflation floor) since the second half of FY2008 to correct the supply-demand balance to support liquidity when JGB market liquidity declined remarkably in the wake of the global financial crisis.

When Inflation-Indexed Bonds (issued in and after October 2013 with deflation floor) were issued in October 2013, additional buying (additional Buy-backs) of old Inflation-Indexed Bonds up to an Inflation-Indexed Bond issue amount was implemented to meet demand for switching from outstanding issues to new ones. Such Buy-backs were carried out until January 2015.

In FY2015 and FY2016, Buy-backs of old Inflation-Indexed Bonds and of 15-Year Floating-Rate Bonds for which selling needs had declined were suspended based on discussions at the Meeting of JGB Market Special Participants and the Meeting of JGB Investors, respectively. However, Buy-backs started for Inflation-Indexed Bonds to improve the supply-demand balance and liquidity as market participants pointed out that a persistent supply-demand imbalance was seen and that liquidity premiums were expanding.

From October 2019, the government switched from a bimonthly Buy-back to a monthly Buy-back for Inflation-Indexed Bonds after discussions at The Meeting of JGB Market Special Participants. Since February 2020, Inflation-Indexed Bond supply and demand have remained unstable as JGB market liquidity has declined due to the global expansion of the COVID-19 outbreak. In response, an additional Buy-back worth 300 billion yen was implemented in March 2020.

While the government plans to implement JGB Buy-backs as necessary based on market conditions and discussions with market participants, many market participants voice hopes to have Buy-backs continued for Inflation-Indexed Bonds. Considering that the development of the Inflation-Indexed Bond market is a key challenge for future JGB Management Policy, the government has set the planned Buy-back amount at 150 billion yen for the April-June quarter of 2020, based on market conditions.

☞② Standard price means the average price cited in the Reference Statistical Prices [Yields] for OTC Bond Transactions published by the Japan Securities Dealers Association on the auction day.

☞③ A bidding price-spread may be positive or negative. If a bidding price is 101.30 yen against a standard price of 101.00 yen, the bidding price-spread is plus 0.30 yen. If a bidding price is 100.70 yen against a standard price of 101.00 yen, however, the bidding price-spread is minus 0.30 yen.

☞④ If bidding price-spreads are positive, priority is placed on smaller absolute values. If bidding price-spreads are negative, however, priority is placed on larger absolute values.

Fig.2-25 Mechanisms for Liquidity Enhancement Auctions and Buy-backs

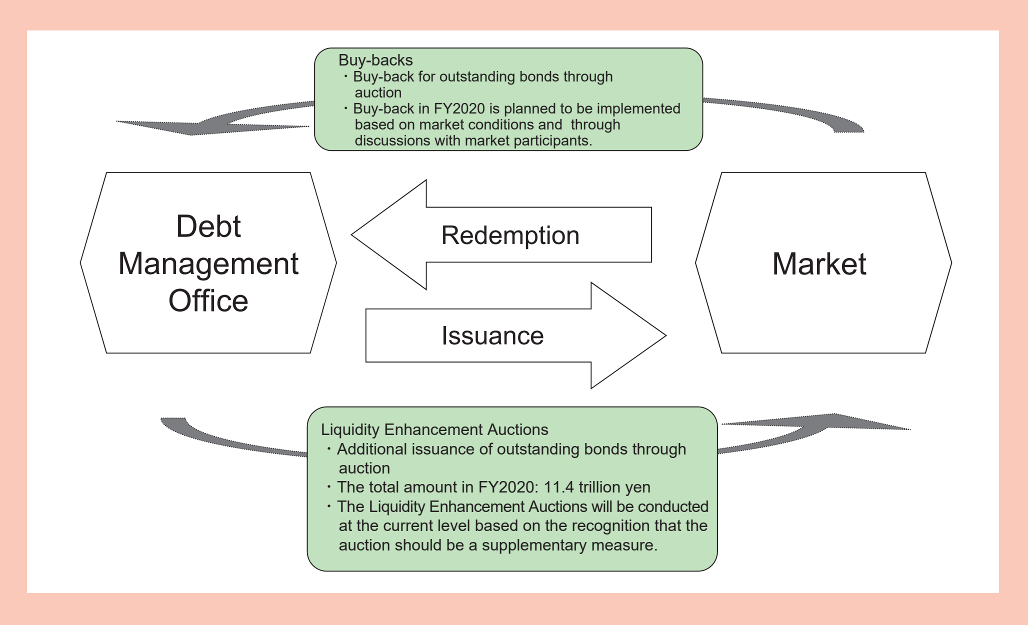
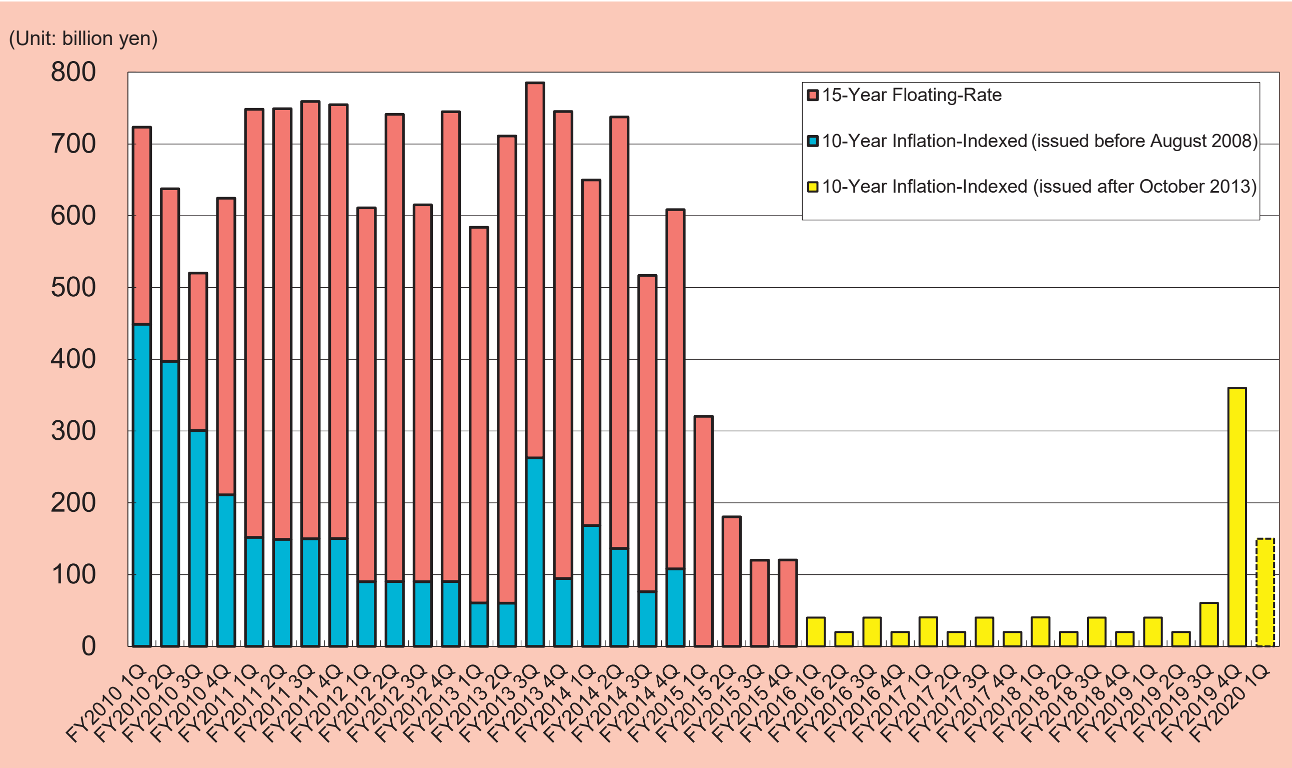


Fig.2-26 Transition of the Buy-back Program



Note: Figures are based on actual amount. (FY2020 1Q; estimated amount)

(4) Interest Rate Swap Transaction

An interest rate swap transaction is a transaction in which different types of interest payments (e.g., floating-rate and fixed-rate) are exchanged for a specific period of time.

Interest rate swap transaction in connection with JGBs became possible under the "Act for the Special Account for the GDCF," as amended in June 2002. In the "New Promotion of JGB Management Policy" (published in December 2003), it was stated that the government would utilize swap transactions (starting in FY2005) in order to control the duration of the outstanding JGBs, thereby managing interest rate risk.

In consideration of the above, the MOF has worked to upgrade the relevant systems, and entered into a master agreement with counterparties, most of which are JGB Market Special Participants, pursuant to the guidelines issued by ISDA (the International Swaps and Derivatives Association, Inc.). Since February 2006, swap transactions have been started. Transaction results are published on a semi-annual basis on the MOF website (in April and October).

No new transactions have been implemented since the second half of FY2009.

(5) Dialogue with Market Participants

In order to secure stable financing and to implement appropriate policies to enhance market liquidity of JGBs, the MOF Financial Bureau aims to promote the dialogue with market and boost confidence in Debt Management Policy through various forums including the following:

A. The Advisory Council on Government Debt Management

Since November 2004, the MOF has convened the Advisory Council on Government Debt Management to receive opinions and advice from private sector experts with a high degree of insight on public debt management with a focus on Debt Management Policy from a medium to long-term perspective.

The council compiled "Current Situation and Future Challenges of Debt Management Policy —Discussion Paper—" (December 16, 2009) and another report (June 18, 2014) and has widely discussed the fiscal situation, monetary policy and financial regulations involving government debt.

B. The Meeting of JGB Market Special Participants

Since the introduction of the JGB Market Special Participants scheme in October 2004, the MOF also has hosted the Meeting of JGB Market Special Participants to exchange opinions between members and the MOF concerning important topics relating to the bond market.

The MOF hosts the meeting every quarter to deal mainly with methods for implementing Liquidity Enhancement Auctions and Buy-backs and JGB market trends. In addition, the MOF calls the meeting to receive opinions from market participants for formulating and revising an annual JGB Issuance Plan.

C. The Meeting of JGB Investors

The MOF has hosted the Meeting of JGB Investors since April 2002, to directly and continually share ideas with JGB investors. This meeting consists of major institutional investors such as banks and life insurance companies.

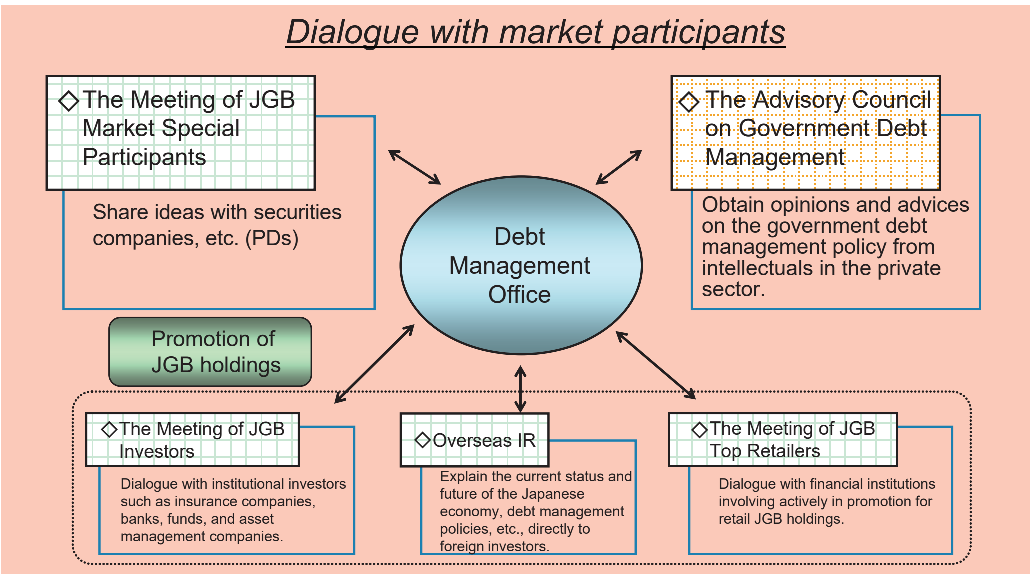
Usually, the MOF convenes the meeting to receive opinions from investors for formulating and revising the annual JGB Issuance Plan.

D. The Meeting of JGB Top Retailers

From the perspective of promoting bond ownership by retail investors, in June 2007 the MOF began to hold meetings with top JGB retail brokers to express their appreciation of the performance achieved and efforts made by financial institutions that aggressively make offerings to and solicit subscriptions from retail investors. The meetings also allow for a mutual exchange of views and opinions between JGB selling agencies and the MOF on the further promotion of JGB sales to retail investors.

Since the first meeting in June 2007, the MOF has convened the meeting once or twice a year. It also publishes top sellers of JGBs for retail investors and the new OTC sales system by business category every six months.

Fig.2-27 Dialogue with the Markets



Column 7 Liquidity on the JGB Market

❶ Recent JGB Market Liquidity Conditions and Responses

Liquidity means the ease with which assets are traded on the market. In the state of being highly liquid, market participants can quickly trade assets at prices close to market prices in the quantities they want. When liquidity is low, massive buy or sell orders could move prices, leading market participants to buy them at higher prices or sell assets at lower prices than market prices before orders, or to remain unable to buy or sell them. Increasing liquidity is a key challenge for the JGB market. It is desirable for market liquidity to be maintained and improved through trading by financial institutions, including JGB Market Special Participants, and investors through autonomous market functions. The MOF closely consults with market participants and adequately implements Liquidity Enhancement Auctions for maintenance and improvement of JGB market liquidity that are expected to contribute to holding down fundraising costs over a medium to long term.

Since the BOJ introduced the Quantitative and Qualitative Monetary Easing in April 2013, the central bank has continued to purchase JGBs. Its JGB holdings now account for more than 45% of the total outstanding JGBs (see Part I, 4 "Diversification of JGB Investor Base" (P28)). Since the BOJ's introduction of Yield Curve Control in September 2016, JGB price fluctuations have become very narrow. As a result, JGB market participants voiced concern that market liquidity was declining as it became difficult to procure bonds of some issues held heavily by the BOJ or as trading volume decreased due to narrower price fluctuations.

In response, the MOF took such measures as expansion of Liquidity Enhancement Auctions (Fig. c7-1). The BOJ for its part decided on "Strengthening the Framework for Continuous Powerful Monetary Easing" in July 2018 (Note). It also took measures regarding the Outright Purchases of JGBs and Securities Lending Facility. These measures led market participants to point out that JGB market volatility had improved from excessively low levels and that tightening of the supply-demand balance for cheapest-to-deliver issue was improved.

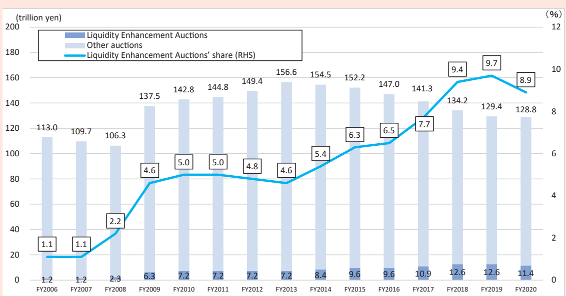
Note: The BOJ then said that interest rates could fluctuate to some extent in response to economic and price situation changes. At a press conference after the decision, BOJ Governor KURODA Haruhiko said that interest rates would deviate upward and downward at about double the range of around plus or minus 0.1 percent.

❷ Impacts of the Novel Coronavirus Outbreak Expansion

In late FY2019, JGB market participants' risk tolerance substantially declined as the market was destabilized due to rapid deterioration of the financial environment amid expansion of the Novel Coronavirus (COVID-19) outbreak. After the Japanese government declared a state of emergency for seven prefectures on April 7 and for the whole of Japan on April 16, trading on the JGB market had become inactive as market participants' risk tolerance fell further due to the spread of split operations and working remotely (Fig. c7-2).

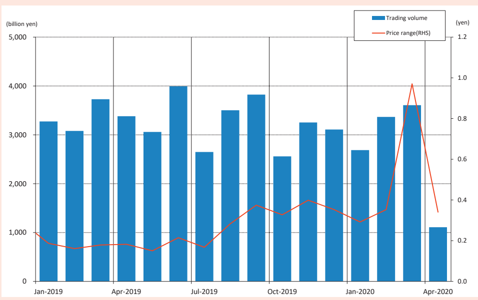
The MOF continues efforts to maintain and improve JGB market liquidity for the market's stable absorption of JGBs while monitoring market conditions and investor trends and consulting with market participants.

(Fig.c7-1) Trend of JGB Issuances through Liquidity Enhancement Auctions



Note: Up to FY 2019: Supplementary budget basis, FY2020: Initial budget basis
(Source) Ministry of Finance

(Fig.c7-2) Trends of 10-Year JGB Futures Trading Volume and Price Range



Note: Night session trading is included.
(Source) Japan Exchange Group

Column 8 Public Relations Ads Promoting Retail Investors' JGB Holdings

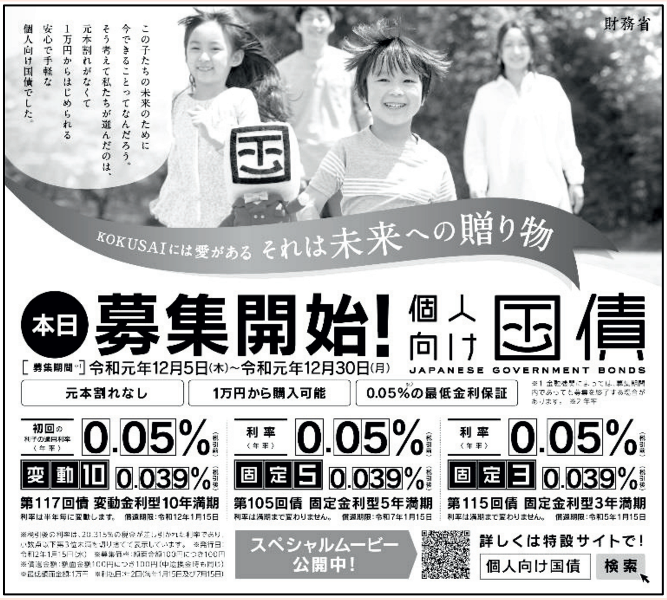
❶ Ads for JGBs for Retail Investors

To expand the range of retail investors in JGBs over a medium- to long-term, the MOF focuses on internet ads to promote JGBs to the working generations (including women and young people) seeking stable investment.

❷ Ads in FY2019

In FY2019, the MOF provided banner, YouTube and other internet ads, video ads on trains, digital signages at major train stations and other outdoor ads, magazine and newspaper ads, posters and brochures, featuring "Kokusai Sensei" ("JGB Teacher") as an image character. The MOF also offered regional ads and participated in regional events mainly in Miyagi and Kumamoto prefectures to promote JGBs.
"Kokusai Sensei" took part in regional events and newspaper-planned and other events for people raising children, playing a role in increasing the event participants' awareness of JGBs for retail investors.
The MOF has also enhanced information transmission using social networking sites such as Twitter and Facebook, offering not only information on monthly interest rate decisions but also event participants' information and relief topics.

(Fig. c8-1) Newspaper ads

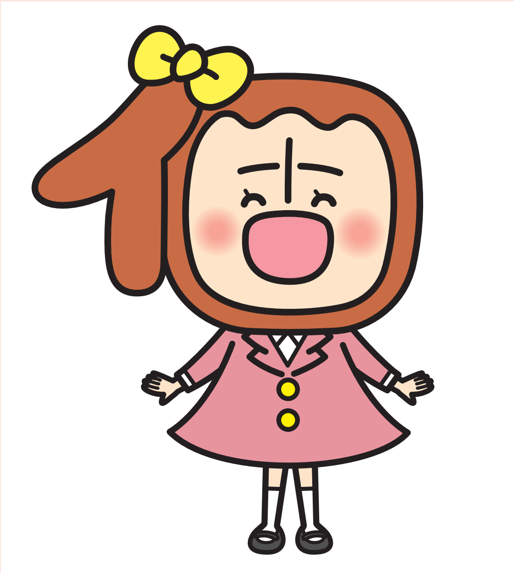


(Fig. c8-2) Kokusai Sensei's Twitter messages

❸ FY2020 Plans

In FY2020, “Kokochan” as a new image character will be added to “Kokusai Sensei.”
“Kokochan” represents an image of a young woman among working people as the JGB ad target. The MOF will enhance SNS-based information transmission using the catch copy “Watashimuke Kokusai (JGBs for me)” to lead mainly young women to become aware of JGBs for retail investors and their attractiveness along with “Kokochan.”

(Fig. c8-3) New character “Kokochan”



(Fig. c8-4) Posters and Leaflets