Minutes of the Meeting of JGB Market Special Participants
(100th Round)

1. Date: Wednesday, September 28, 2022, 4:00 p.m. - 4:45 p.m.
2. Place: Special Conference Room 3 at the Ministry of Finance
3. Gist of Proceedings:

1. Issuance size of Inflation-Indexed Bonds in the October-December 2022 quarter

▶ The Financial Bureau gave the following explanation about the issuance size of Inflation-Indexed Bonds in the October-December 2022 quarter.

・ As shown on page 3, according to the JGB Issuance Plan for FY2022, it is stipulated that there will be issuance of Inflation-Indexed Bonds four times a year at a size of ¥200 billion each time while it is stated that "the issuance may be adjusted in a flexible manner in response to market circumstances and demands of investors, which determined based on discussions with market participants." In addition, as shown on page 4, it is stipulated about Buy-back Auctions that "to be implemented based on market conditions and through discussions with market participants." Therefore, we would like to hear your opinions about the size of issuance in the October-December quarter at today's meeting.

・ In the July-September quarter, as shown on page 5, we conducted an auction of issuance for the amount of ¥250 billion in August and conducted Buy-back Auctions for the amount of ¥20 billion every month by considering market circumstances and exchanging opinions with market participants. The results of the issuance auction and Buy-back Auctions are shown on pages 6 and 7, respectively.

・ The situation of the secondary market is shown on pages 8 and 9. Looking at trends over the last six months, BEI has been rising, affected by global trends, and it has remained at a high level, albeit with some swings. Looking at trends by issue, although there continues to be wide variation, BEI is at a high level compared to the past for all issues.

・ Under these circumstances, we asked for your opinions in advance, and some participants commented that the expected inflation standards would continue to be a focus of attention and the results of issuance auctions indicated that the demand for the on-the-run issue seems good, even though the size of issuance was increased by ¥50 billion in the July-September quarter. On the other hand, other participants also commented that improvements in liquidity remain limited and that the investor base has not yet been expanded. All participants, including these, gave the opinion that it is advisable to maintain the status quo, since the current size of issuance and Buy-back Auctions are balanced.

・ Based on these circumstances and the opinions of participants, the proposals of the Financial Bureau are shown on page 10. Regarding the October-December quarter, as in the July-September quarter, we are considering a Buy-back Auction for the amount of ¥20 billion each month and conducting an issuance auction for the amount of ¥250 billion.

・ As stated above, we explained the situation about the Inflation-Indexed Bonds market and our proposal based thereon.
Regarding the issuance size for the October-December quarter, we will make a comprehensive decision based on the contents of today’s meeting, and we will ask your opinions again.
We believe that the development of the Inflation-Indexed Bonds market is an important issue for the Debt Management Policy. Therefore, we will continue to consider and make decisions carefully based on the auctions and other situations, market conditions, and your opinions.

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

・ Although the Inflation-Indexed Bonds market is stable at present, it is necessary to wait and see how long the situation will remain stable. Therefore, it is desirable to maintain the current issuance size of ¥250 billion and the current size of Buy-back Auctions for a certain period.

・ While global inflation concerns have been a theme, we can confirm that the Japanese Inflation-Indexed Bonds market is attracting more attention from foreign investors at our over-the-counter. We feel that the Inflation-Indexed Bonds market is becoming more active. Although the market temporarily collapsed due to profit-taking by investors who had held the bonds for a long time, new investors are buying large amounts of the bonds, especially those with a shorter remaining maturity than with the on-the-run issue. There are relatively few transactions between traders. However, in reality, transactions are made in the background by connecting investors each other. On the other hand, we are concerned that the on-the run issue is not selling well. There are virtually no auction orders.
Based on such factors, we believe it is desirable to maintain the current issuance size of ¥250 billion with monthly Buy-back Auctions of ¥20 billion for the October-December quarter as well.

・ The Inflation-Indexed Bonds market has been balanced. Strong domestic CPI and movement with the dollar/yen has caused expectations for short-term inflation to rise considerably. On the other hand, we are also of the view that expectations for long-term inflation are on a slight downtrend because commodity prices are falling and the global BEI is now unlikely to rise further. In this context, the transaction volume for buying and selling has increased, which has drawn global attention.

The main problem when it comes to handling Inflation-Indexed Bonds is poor liquidity. Recently, the dollar has become strong. As a result, for customers who consider trading in dollars, their transaction volume increases greatly when converted to yen. It is 1.4 times higher than when the dollar/yen rate was at ¥100. Under the difficult situation to trade in poor liquidity market, it is difficult to mitigate the increased risk that comes with increased client trading volume. Based on this situation, while we believe that the market dependency will improve when events for issuance and purchasing both increase, if Buy-back Auctions are considered a temporary measure, we believe it is good to maintain the status quo.

・ We would like to support the proposal, which is an issuance of ¥250 billion and Buy-back Auctions of ¥20 billion.

Some people mentioned that they were traded in negotiated transactions, but our hope is to have transactions in the same way as with other government bonds. In other words, we want to sell when we want to sell, and purchase at the time we want to purchase. Based on indication information from Japan Bond Trading, there are essentially no transactions, and the situation seems unchanged over the past year. Even if there are transactions, the amounts are only around ¥500 million to ¥1 billion. Therefore, it seems impossible for us to buy/sell ¥10 billion yen in one day even if we desire to do so. There are many opinions on the function level of coupon-bearing bonds. However, the fact remains that the status of the Inflation-Indexed Bonds is even more severe.

Of course, we must consider future inflation, but we believe that a BEI of 90bps is relatively cheap while the core CPI is over 3%. Currently, the only way to trade is through the issuance auctions, Outright Purchase of JGBs, and Buy-back Auctions. Therefore, rather than increasing the issuance size now, we believe it would be better to maintain both the issuance size and the size of Buy-back Auctions, and then wait to see how the market matures.

2. Liquidity Enhancement Auction Size in the October-December 2022 quarter

▶ The Financial Bureau gave the following explanation about the Liquidity Enhancement

Auction Size for the October-December 2022 quarter:

・ As shown on page 12, according to the FY2022 JGB Issuance Plan regarding Liquidity Enhancement Auctions,

(1) while it is assumed that JGBs in a total of ¥12.0 trillion will be issued for the year, including ¥3.0 trillion for bonds with a remaining maturity of 1 to 5 years and for bonds with a remaining maturity of 15.5 to 39 years, and ¥6.0 trillion for bonds with a remaining maturity of 5 to 15.5 years,

(2) finally, "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."

Today, in response to this plan, we would like to hear participant's opinions regarding the size of issuance for each maturity zone for the October-December quarter.

・ As shown on page 13, in the July-September quarter, we decided to issue ¥500 billion each in July and September of odd-numbered months for bonds with a remaining maturity of 1 to 5 years, monthly for bonds with a remaining maturity of 5 to 15.5 years, and in August of even-numbered months for bonds with a remaining maturity of 15.5 to 39 years. These results are as shown on pages 14 to 16.

・ Under these circumstances, we asked for your opinions on the Liquidity Enhancement Auctions for the October-December quarter in advance, and while only a few participants pointed out that bonds with a remaining maturity of 15.5 to 39 years should be increased since there are several issues where the balance between the supply and demand has tightened, almost all participants agreed that it was appropriate to maintain the size of issuance at the current level.

・ In response to this, we prepared the proposal of the issuance size for each maturity zone in the October-December quarter, as shown on page 17. We are considering issuing ¥500 billion each in November of odd-numbered months for bonds with a remaining maturity of 1 to 5 years, monthly for bonds with a remaining maturity of 5 to 15.5 years, and in October and December of even-numbered months for bonds with a remaining maturity of 15.5 to 39 years.

・ Regarding the issuance size for each zone for Liquidity Enhancement Auctions for the October-December quarter, we will make a comprehensive decision based on the contents of today's meeting, and we will ask your opinions again.

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

・ We understand that Liquidity Enhancement Auctions are an important part of the operations conducted by the debt management office. This is because these auctions have contributed to improving market functions and liquidity by satisfying demands of investors for the off-the-run issues and the short covering demands of market special participants. Additionally, large-scale Outright Purchase of JGBs has recently started, and operations have been diversified including Fixed-Rate Purchase Operations. Therefore, we believe that Liquidity Enhancement Auctions are essential for maintaining market functions and liquidity. The auction results have varied somewhat, but in general, the results have generally been consistent with or close to market expectations. Therefore, we would support the maintaining of the current size of issuance.

・ We agree with the proposal. At this time, impact from the Outright Purchase of JGBs is increasing, especially from Fixed-Rate Purchase Operations. Therefore, the market volume of some issues, such as those around the Cheapest-to-Deliver issue (the CTD issue) and the three on-the-run issues of 10-year bonds has significantly decreased.
In addition, although we do not think there is any particular movement at this time, if the Bank of Japan (BOJ) should raise the target for the yield curve control in the future, we would believe the amount of bids for the Outright Purchase of JGBs is likely to increase. This means the market volume of such issues is likely to decrease. Therefore, we believe that Liquidity Enhancement Auctions will become more important than ever.
Based on auction results, we believe that there is good balance of supply and demand. Although there are some zones where the supply and demand for some issues is very tight, we believe that the size of issuance does not need to be increased. Therefore, we request to maintain the status quo.

・ We request an increase in the issuance size of Liquidity Enhancement Auctions for the ultra-long-term zone. Currently, in the ultra-long-term zone, it appears that the balance between supply and demand is often different for each issue due to investor preferences. Of course, looking at the ultra-long-term zone as a whole, bear steepening is progressing under the situation where the future is uncertain. However, the low demand for on-the-run issues is very noticeable, and the difference in the supply-demand balance between off-the-run and on-the-run issues is clear. Therefore, we believe the liquidity of the overall market could be improved by equalizing the supply-demand structure by reducing issues with a declining demand and supplying issues with tight demand.
Since liquidity and price stability functions are declining in the current market, few investors try to correct it, and we feel it is a little difficult for market makers including us.

・ We request to maintain the status quo. As we stated in the past, we believe that Liquidity Enhancement Auctions are truly important, and therefore, we request the debt management office to continue these without changing the size of issuance.

・ The issuance size are well allocated for each maturity zone, and we believe that the issuance size of Liquidity Enhancement Auctions is appropriate given the balance with the size of issuance for newly issued bonds. In addition, since it is possible to discover the demands of potential investors at this time or when the interest rates increase, we believe that the current proposal is good.

3. Latest JGB market situation and outlook in the future

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

・ Since each central bank have been in a rush to raise interest rates mainly as a result of inflation, yields on government bonds in other countries are rising. Because of this, an upward shift pressure is being applied to the yield curve in Japan. On the other hand, the BOJ maintains current monetary easing measures such as yield curve control, which suppresses such pressure. However, this suppression is mainly on remaining maturities of 5 to 10 years, which is represented by Fixed-Rate Purchase Operations for 10-year Bonds at 0.25%. Therefore, the amount of the Outright Purchase of JGBs in the ultra-long-term zone is relatively small, and yields are now clearly increasing in this zone.
Generally, a sustained increase in yields in the ultra-long-term zone would be avoided by arbitrage position between barbell strategy and bullet strategy. However, the reality is that overpriced 10-year bonds were not corrected, and the yield curve distortions have been ignored. In addition, with a recent increase in yields and volatility, the risk tolerance of investors and others has decreased, and we believe they are refraining from various non-arbitrage purchases in the ultra-long-term zone even though the absolute level of interest rates is attractive. In other words, because overpriced 10-year bonds, which are the bullet, have not been corrected, earnings have not been created, and long position in the ultra-long-term zone, which is one side of the barbell, is being greatly damaged. The so-called term structure has basically become just an impractical theory, and the market has lost efficiency. We believe that under these circumstances, it is quite natural that the number of market participants would inevitably decrease.
Unfortunately, this market situation has had a certain impact on JGB auctions. The 20-year Bond auction on the 15th had a long tail, and there was a record-breaking bad result. The remaining

maturities of 5 to 10 year zone is well protected by the BOJ, but the ultra-long-term zone seems to be free. Therefore, the correlation between 10-year JGB futures and the ultra-long-term zone has faded considerably. Of course, there are other tools in addition to futures. However, we believe that difficulty in using futures as a hedge was a reason for the sluggish auction this time.
In the future, we believe that the current market condition will continue because of the situation outside Japan. If market participants decrease even more, and if what happened with the 20-year Bond auction this time occurs repeatedly, the possibility of problems with the digestion of government bonds cannot be denied. However, we personally believe that there is a high probability that we can expect interest rates outside Japan to fall sharply due to concerns over global recession, which will correct the distortion and correct the market back to normal.
Overseas Investor Relations (IR) activities were suspended because of COVID-19, but has it resumed around this spring? If we consider the situation where foreign investors are the main sellers, we feel it is necessary to actively promote overseas IR activities in the future.

・ As for the recent JGB market, when viewed as a whole, the volatility is smaller than in other countries, which may indicated that it is relatively controlled. However, on the other hand, a closer look indicates that, except for with on-the-run 10-year Bonds, volatility is extremely high including with the ultra-long-term zone and swaps, which are not really supported by the BOJ. We believe that this reveals the negative impact of the monetary policy. On the other hand, since this is the direction of monetary policy, there is basically nothing that the debt management office can do at this point if they accept this as a given. For the time being, it has thus far been necessary to accept the situation, including volatility, new ways of forming the yield curve, and the ineffectiveness of the hedging function of 10-year JGB-Futures.
Foreign investors determine the transaction amounts according to the dollar risk unit. Therefore, in this kind of foreign exchange market, we feel that foreign investors' transactions come to have a major impact on the market. In such circumstances, it is natural for foreign investors to carefully focus on future monetary policies and how exchange intervention will be handled in the future. Therefore, we believe that JGB market will transition according to this in the future.
As mentioned previously, there is basically nothing that the debt management office can do at this time, and we believe that the most important thing is to establish a system that can respond flexibly through countermeasures when the market changes drastically.

・ The current financial market trend has progressed from the stage of confirming the stance of the central banks in each country to increase interest in response to inflation, to the situation where turbulence is spreading in the form of pressure to sell general financial assets. As for the situation in Japan, monetary easing has been maintained by the BOJ resulting in relatively little turbulence.

However, there is impact on the ultra-long-term zone, which received little support from monetary easing.
Currently, interest rates are moving up and down significantly without trading. Not only in phases of rising interest rates, but also in phases of falling interest rates, where interest rates fluctuate quickly and market liquidity is very often perceived to be low. Interest rates on the CTD issue and 10-year Bonds are approaching the level offered at the Fixed-Rate Purchase Operation, which makes it difficult to use these as a hedge. Therefore, we at securities companies who provide liquidity are acutely aware that hedge tools are insufficient, and we feel that this will lead to a decrease in liquidity and expanded price movement in the ultra-long-term zone. It will soon be the second half, and we cannot expect things to change during that period. If interest rates drop temporarily, that is, if interest rates on the CTD issue and 10-year Bonds fall significantly below the level offered at the Fixed-Rate Purchase Operation, it would be possible to use these as hedge tools. However, to us, it seems difficult for this to happen based on the current outside environment. We expect the price movement to remain rough, especially in the ultra-long-term zone. We believe that interest rates will not continually go up, and when they go down, they will go down very quickly. We are highly concerned about this situation because this will lower the risk tolerance, and we believe that this is partly caused by the BOJ's monetary policy, and it is difficult to find a clear solution for the situation right now. Therefore, we believe that the turbulence of the price movement will continue for a while after the start of the second half.

・ While policy interest rates have risen significantly with bond markets outside Japan in response to rising commodity prices, and they are expected to rise even further in the future, interest rates have been rising in the market, mainly in the short- and medium-term zone, and the yield curve has become significantly bear-flattened. On the other hand, in the domestic bond market, there is little expectation of correction to the yield curve control policy or of early policy interest rate hikes, and the interest rate hikes in the short- and medium-term zones and 10-year Bonds have been very limited, while futures and bonds in the ultra-long-term zone have been sold. As a result, the yield curve remains steepened.
For this fiscal year, interest rate hikes outside Japan and yen depreciation seem to consistently lead to selling pressure on futures and on the ultra-long-term zone. In this month as well, large short futures positions were rolled during the contract month changing, and there was a historically big tail with the 20-year Bond auction, and the UK shock from the end of last week to the end of this week caused interest rates to significantly rise globally. Continuing from June, the basis in the futures market is expanding, and theoretical futures prices again began trading at over 0.25%.
We believe that the primary factor in the major rise in interest rates for the ultra-long-term zone

and for lowering market functionality is the great increase in volatility. It is not unusual to see movement of 3bps and 5bps in one day, and the order book is very thin. Since it is not possible to use futures and the medium- to long-term zones to hedge risk, it became necessary to hedge the ultra-long-term zone with the ultra-long-term zone. Therefore, we feel that the sentiment is such that price action is greatly amplified, including significant flattening prior to the 20-year Bond auction and adjustments of over 15bps prior to the 40-year Bond auction.

Secondly, we believe that the balance between the supply and demand has not improved despite interest rate hikes. Temporary flattening has been observed this year, but this has not resulted in continued flattening. Additionally, because of the prospect of higher interest rates on US and European bonds in the future, and the decrease in market liquidity, the speed of rising interest rates has quickened, and conversely, this makes investors cautious.

As for the future outlook, since the beginning of the next year, we cannot deny the possibility that the landing points of the interest rate hikes in each country will become somewhat clear, and we also believe that the effects of repeated policy interest rate hikes may led to low inflation and a global recession. However, at least during the October to December quarter, we believe it is difficult to expect improvements with the previously mentioned factors. At the media conference held by the BOJ governor, it was mentioned that "for the moment" refers to two or three years and not a few months. It is difficult to imagine that large-scale selling will take place in the short- and medium-term zones and 10-year Bonds. To put it another way, we believe that futures and the ultra-long-term zone must continue to reflect the rises in interest rates outside Japan. Therefore, we cannot deny the possibility of further steepening of the yield curve and amplified distortions in the yield curve, including futures basis, in the second half of fiscal year. We continue to expect a volatility in both the yield curve and interest rate level, especially for the ultra-long-term zone during the second half.

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