Minutes of the Meeting of JGB Market Special Participants
(90th Round)

1. Date: Friday, September 25, 2020
2. Place: Held in writing
3. Gist of Proceedings:

1. Issuance size of Inflation-Indexed Bonds in the October – December 2020 quarter

▶ The Financial Bureau gave the following explanation about the issuance size of Inflation-Indexed Bonds in the October – December 2020 quarter:

・ As shown on page 3, according to the JGB Issuance Plan for FY2020 (after the second supplementary budget), there will be issuance of Inflation-Indexed Bonds four times a year for the amount of ¥200 billion per each time while it is stated that “The issuance size 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 program that “Buy-back program in FY2020 is planned to be implemented based on market conditions and through discussions with market participants.” Today, we would like to hear your opinions about those amounts in the October – December quarter.

・ In the July – September quarter, as shown on page 5, we conducted an auction of issuance for the amount of ¥200 billion in August and decided to conduct Buy-back Auctions for the amount of ¥50 billion every month in order to balance the supply and demand in the Inflation-Indexed Bonds market. The result of the auction of issuance in August was as shown on page 6.
The results of the Buy-back Auctions and Outright Purchase of JGBs by the Bank of Japan (BOJ) are shown on page 7.

・ The situation of the secondary market is shown on pages 8 to 10. The BEIs in advanced economies fell sharply in March to April and then are increasing as a whole. However, if examined in detail, the Japanese BEI which had remained almost at zero since the last meeting has started to fall again from September.

・ In such circumstances, we asked for your opinions in advance and found that many of you were in favor of leaving unchanged the issuance size of Inflation-Indexed Bonds and the amount of Buy-back Auctions in the October – December quarter in view of the situation that unstable balance between supply and demand for the existing bonds would continue and that the balance for the current bonds which had been in a recovery phase has been getting worse with a heightened concern over the commodity price trends in the future.

・ In light of this situation, our proposal is shown on page 11. We are considering an auction for the amount of ¥200 billion and carrying out a Buy-back Auction in the amount of ¥50 billion every month in the October – December quarter, which is the same amounts as the July – September quarter.

We will keep watching the market environment and other factors closely and take appropriate actions flexibly.

・ As above, we explained the situation regarding the Inflation-Indexed Bonds market and our proposal on those amounts in the October – December quarter. We believe that the development of the Inflation-Indexed Bonds market is an important issue in Debt Management Policy. We will make a decision based on the contents including today's meeting as to our proposal on Inflation-Indexed Bonds in the October – December quarter, and we will hear your opinions again.

▶ Summarized below are the views and opinions submitted:

・ In the wake of the speculation over the new Cabinet's policies such as expectations for a future reduction in mobile phone rates and the current risk-off sentiment in macroeconomics, in addition to the recent decline in the inflation rate due to the impact of the Go To Travel campaign, the market for Inflation-Indexed Bonds has been bearish and the BEI of the current bonds has fallen into the negative range. Currently, Inflation-Indexed Bonds seem underpriced considering those floor value. Further, the results of the latest Outright Purchase of JGBs and Buy-back Auctions have continued to be weak and it appears that the ratio of currents bonds has particularly increased. As a result, it appears that the market stock has been shifted from off-the-run bonds to current bonds, and its volume has been increasing. Given a decrease in the indexation coefficient due to seasonality and the unwinding of positions by hedge funds toward the end of year, there is a possibility that the current poor environment for supply and demand will get worse toward the beginning of next year. Therefore, as proposed by the debt management office, we believe it appropriate that at least the current issuance size and the amount of Buy-back Auctions should be maintained and additional measures such as an emergency Buy-back Auctions be taken when the aforementioned concern becomes a reality.

・ Since the latest auction (August) was sluggish, it can be seen that the investors' demand at the prices and BEI at the time of the auction was poor. In addition, existing bonds were sold on and off to apparently unwind the position and there are no signs of improvement in the supply-demand environment for both current and existing bonds. In view of these circumstances, we wish that the current status quo of both the issuance size of ¥200 billion for each quarter and buyback of ¥50 billion monthly to be maintained, respectively.

・ We have no objection to the issuance size of ¥200 billion and the buyback of ¥50 billion monthly. If we look at the results of Buy-back Auctions and Outright Purchase of JGBs by the BOJ since April, it seems that the need to sell existing bonds has decreased. However, since the secondary market is still immature, we are of opinion that strong purchase program should be continued.

・ We wish that the current issuance size and buyback are maintained. Although excessive concern over the balance between supply and demand was dissipated over a period of several months, we consider it necessary to provide a strong purchase support exceeding its issuance.

・ Although the results of the auction with the BEI in a positive zone in August was sluggish, current bonds have been trading in its positive zone since the beginning of August against the background of high global stock prices and high crude oil prices. However this month, the BEI in the US, stock prices and crude oil prices have been falling, which results in current bonds trading with the BEI in a negative zone again. It seems that sales from overseas investors have passed the peak, but it is seen that the 23rd and 24th existing bonds whose prices rose along with the current bonds lately are sporadically sold. Since the bid-to-cover ratio is at a low level for the offer of ¥200 billion, we would like to see that the issuance size of ¥200 billion per auction (November) and the buyback amount of ¥50 billion (monthly) are maintained in the October – December quarter.

・ Since there is a distortion in the price formation between issues of Inflation-Indexed Bonds despite the response of the debt management office and the BOJ since the market adjustment phase seen in March 2020, we are aware that the situation continues to be difficult for market participants. In view of this situation, we assume that it is difficult to give a sense of security to market participants unless the supply-demand balance is improved steadily for the time being. Therefore, we continue to support the current levels of the issuance size and the amount of Buy-back Auctions.

・ Since the auction in August, the BEI level of existing bonds was corrected with those purchases which seemed to be underpriced against the 25th bonds. However this month, the supply and demand balance is worsened again. Since the liquidity of Inflation-Indexed Bonds still continues to be at a low level with the sluggish trading volume between traders, we would like to see that the issuance size and the buyback amount are maintained at the current levels in the October – December quarter.

・ We agree to the proposal of the debt management office. While the current BEI remains at around zero percent, we are of opinion that there is a high uncertainty about the global economy and domestic price trends due to concerns over the spread of the novel coronavirus infection.

Since investors' demand is low in such an environment, we consider it appropriate that the current level of issuance and buyback be carried out from the perspective of stable issuance.

・ Since the bid-to-cover ratio for the buyback auctions is more than three times, we would like that the current levels of issuance size and buyback amount be maintained. The tightened balance between supply and demand for the 25th bonds was defused on the second issuance and the BEI has declined for the lack of bids due to reversal of the situation. Therefore, we believe that it will take some time before the issuance size can be increased.

・ Because the product cannot be expected to be purchased in terms of ALM, we presume there will be occasions in which the price will fall again. We believe that when this occurs, the amount of buyback should be increased flexibly.

・ We would like that the issuance size of ¥200 billion be maintained in November from the perspective of market development and continuity.

However, the current situation is such that while CPI is expected to decline to a negative range for a while due to a large downward pressure and the investors' demand for Inflation-Indexed Bonds is poor, the number of investors who want to dispose of existing bonds has been increasing. Under this circumstance, we would like to see a flexible increase in the amount of purchase program. Specifically, we think that it is appropriate to purchase ¥90 billion monthly by increasing ¥40 billion monthly, which is equivalent to the expected increase in the amount of purchase by the BOJ.

2. Liquidity Enhancement Auctions in the October – December 2020 quarter

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

Auctions for the October – December 2020 quarter:

・ As shown on page 13, according to the FY2020 JGB Issuance Plan (after the second supplementary budget) regarding Liquidity Enhancement Auctions,
(1) while it is assumed that a total of ¥11.4 trillion will be issued in a year, including ¥3.0 trillion for those remaining maturities of 15.5 - 39 years and ¥2.4 trillion for those with remaining maturities of 1-5 years, the same amount as in FY2019, and ¥6.0 trillion for those with remaining maturities of 5-15.5 years, a reduction of ¥1.2 trillion from FY2019, and
(2) finally, "the details will be flexibly adjusted in view of the market environment and investment needs."

Today, in response to this plan, we would like to hear your opinions regarding the amount for each maturity zone for the October – December quarter.

・ As shown on page 14, as assumed in the FY2020 JGB Issuance Plan, we issued ¥400 billion of bonds in the odd-numbered months of July and September with remaining maturities of 1-5 years, ¥500 billion of bonds every month with remaining maturities of 5-15.5 years and ¥500 billion of bonds in the even-numbered month of August with remaining maturities of 15.5-39 years in the July – September quarter,

・ The results of the recent Liquidity Enhancement Auctions are shown on pages 15 to 17. The results have been generally stable in each maturity zone.

・ Under the circumstances, we asked your opinions about the Liquidity Enhancement Auctions for the October – December quarter in advance and found that many of you were of the opinion that since there is no significant change in the supply and demand situation in each zone, it was appropriate to maintain the current amount.

・ In response to this, we prepared our draft plan for the amount for each maturity zone in the October – December quarter, as shown on page 18. We are proposing the idea of issuing ¥400 billion of bonds in the odd-numbered month of November with remaining maturities of 1-5 years, ¥500 billion of bonds every month with remaining maturities of 5-15.5 years and ¥500 billion of bonds in the even-numbered months of October and December with remaining maturities of 15.5 -39 years.

・ Regarding the amount for each maturity zone for Liquidity Enhancement Auctions for the October – December quarter, we will make a decision based on the contents including today's meeting, and we will ask your opinions again.

▶ Summarized below are the views and opinions submitted:

・ There are demands from overseas investors especially for off-the-run bonds even in the super-long-term zone. We agree with the issuance size proposed by the debt management office.

・ There is no particular problem with the Liquidity Enhancement Auctions and we wish that the status quo be maintained.

・ We agree to the proposal of the debt management office.

The amount in each maturity zone is distributed in a well-balanced manner, and since auctions are carried out stably supported by short covering of securities companies and investors' demand, we consider it appropriate to distribute amounts in the same manner as the current allocation.

・ Since the current issuance size seems to contribute to the improved liquidity, we support the issuance size proposed by the debt management office.

・ There is no problem with the current amount.

・ We wish that the status quo be maintained in the October – December quarter. Since the increase in issuance in July this year, 30-year bonds are issued for the amount of ¥900 billion per month and 40-year bonds for the amount of ¥500 billion every other month and it has become evident that the supply and demand balance for the 40 year bonds has been tight with around 1bps of the spread between the 30 year bonds and the 40 year bonds since August. For this reason, the environment is such that there may be a request to add the 13th 40-year bonds to eligible issues from the October – December quarter. Since it is unlikely that the supply and demand environment will change significantly with its addition to the eligible issues, we have no objection to the eligible issues proposed by the debt management office.

・ We believe that the issuance size and frequency for each maturity are generally in line with the current supply and demand environment, and we also support the maintained issuance size for the October – December quarter. However, we can say that since there are some issues in the short-term zone with very tight supply and demand balance, we would like the debt management office to consider the possibility of an increase in the amount.

・ We agree to the proposal of the debt management office.

Large-scale issuance of government bonds has started since July and the environment is such that a further increase in the issuance size could be expected depending on the additional supplementary budget. Therefore, the need for changing the amount of Liquidity Enhancement Auctions at the current stage is small.

Provided, however, that since it is seen that there is a constant shortage of bonds with remaining maturities of 3-4 years, we believe that it is necessary to consider increasing the amount of Liquidity Enhancement Auctions for the short-term zone in addition to the current bonds when an increased issuance is considered.

・ While we have the impression that existing bonds are more popular than newly issued bonds with an increase in the issuance size from July, there seems to be a growing need for Liquidity Enhancement Auctions in all zones. Therefore, when increasing the issuance of government bonds in the future, we believe that it will be more appropriate that not only the issuance size of current bonds is increased, but also the issuance size of Liquidity Enhancement Auctions is increased.

・ We would like to see the same amount as in the July - September quarter. We are of the opinion regarding Liquidity Enhancement Auctions that there is a suitable demand for each zone and there is no need for changing the issuance size at present. Provided, however, that since it is assumed that there will be an imbalance in secondary market between current bonds and existing bonds in the future in the wake of the increase in the issuance size of JGBs from July, we are of the view that it will be necessary to shift the issuance of current bonds partly to the issuance for Liquidity Enhancement Auctions in the future in order to form an appropriate yield curve.

・ In the short-term zone, the decrease in the market functionality has been confirmed with the repo rate remained high. However, in the long-term zone, there is hardly seen a case of the prolonged high repo rate anymore thanks to the BOJ's measures to stop purchasing the cheapest issue through Outright Purchase of JGBs. Therefore, we propose an increase to ¥600 billion per auction for the short-term zone and a decrease to ¥400 billion per auction for the long-term zone.

3. Latest JGB market situation and outlook in the future

▶ Summarized below are the views and opinions submitted:

・ Despite caution against interest rate rise due to the increase in JGB issuance, the market rate has remained stable at a low level. Domestic investors are strongly motivated to buy based on the overseas factors or when interest rates rise temporarily just before an auction. We believe that this trend will continue.

・ Since the increase in JGB issuance in July, issues for each maturity have been steadily financed in the market. In addition, with the backdrop of stable interest rates worldwide, the JGB market remains at a relative narrow range in each zone amidst low volatility. Since it is expected that the effect of the novel coronavirus infection will continue worldwide in the future, we believe that interest rates in Japan will continue to remain at the current level for the time being.

・ The interest rates in Japan continue a downward trend due to overseas factors such as receded expectations for additional fiscal measures and a respite in rising stock prices in the US as well as domestic factors such as the sharp decline in CPI in Japan and the steady finance for increased issuance of JGB from July. Although we believe that it is unlikely that the 10-year bond interest rate will fall significantly into the negative interest rate amidst an increase in the Macro Add-on Balance, we expect it is difficult for the interest rate to rise for the time being.

・Although some fluctuations were observed in the market when Prime Minister Abe announced his resignation, market stability has been restored in view of the expectations that the basic fiscal and monetary policies will be maintained under new Prime Minister Suga. It is highly likely that a gradual steepening trend will continue with the loosening the balance of supply and demand in the ultra-long-term zone. The BEI is the focus of attention in other countries. However, with the likelihood that the core CPI at the beginning of next year may drop to -1 percent compared to the previous year in Japan, the BEI will continue to be unfavorable.

・ After three months since the increase in JGB issuance in July, the market is in an extremely stable environment due to the increase in amount and frequency of Outright Purchase of JGBs by BOJ. At the end of September, however, we are of the view that the number of Outright Purchase of JGBs by BOJ with remaining maturity of 10 years or less should be decreased again in sight of the decreased market function with the very low volatility being in a downward trend.

・ The world as a whole is in monetary easing state and interest rates will continue to be low and stable in the future.

・ After the increase in JGB issuance in July, we think it is a common view that the issuance as a whole has been stably financed.

Provided, however, that since the phenomenon defined as the “winner’s curse” discussed in the discussion paper of Policy Research Institute regarding the auctions for the 20-Year Bonds, 30-Year Bonds and 40-Year Bonds has started to be conspicuous particularly in the ultra-long term zone, we think that it is necessary to pay attention in this regard in future auctions. Under the circumstances, we continue to propose that the auction for the ultra-long term zone should be shifted to the uniform price auction.

・ Despite the increase in JGB issuance started in July, we feel that the recent JGB market has been generally stable. However, since there is a risk that the market will fluctuate significantly due to future changes in the status of the novel coronavirus infection, changes in global market trends associated with it, and the JGB issuance plan for the next fiscal year in Japan, we will continue to keep an eye on the monetary policy stance of the BOJ in response to such a risk.

・The yield of 10-Year Bonds continues to be in a slightly positive range. However, it is currently approaching 0 percent due to concerns about the re-spread of the novel coronavirus infection in the world and a decline in the stock market prices resulting therefrom. Even so, the 0 percent poses a strong resistance level, and it seems that there is no momentum for the yield to plunge into the negative zone and decline further. In order to avoid an excessive flattening of the yield curve, the BOJ has not increased the purchase of JGBs with maturities over 10 years since the increased issuance of JGBs in July and the yields in the ultra-long-term zone have remained high, which causes the yield of the 10-Year Bonds not to fall. In addition, the long-term range appears to discourage market participants looking for capital gain.

We have a strong feeling that the market will continue to depend on the status of the novel coronavirus infection. Although global economic recovery in the second half of the year has been taken for granted, it is not unlikely that the economic recovery may be slowed down due to concerns about re-spread of the infection in Europe and the “fiscal cliff” in the United States. Furthermore, if stock price adjustments take a longer time, there will remain the possibility that yen will be appreciated in an accelerated manner in line with the risk-off sentiment. Therefore, if we look through to the end of March next year, we expect that the yield of JGBs will be stable at a low level and the yield of 10-Year Bonds will fall into the negative range from time to time. We believe that when this occurs, the yield in the ultra-long term zone will be more likely to fall due to yield hunting by investors. It will be difficult for the BOJ to reduce the amount of purchases for the purposes of stopping the flattening tendency of the yield curve based on the assumption that the situation of the world economy will deteriorate.

・The bear steepening trend continued until the beginning of July because of concerns about a significant increase in issuance. However, due to the stable issuance of JGBs and a significant decrease in interest rates overseas, the interest rate of 10-Year Bond fell temporarily to around zero percent at the beginning of August. We have the impression, however, that since August, the effect of the increase in JGB issuance has started to be felt gradually because the results of most of the auctions were weaker than those in July with 10-Year Bonds being traded at 0.055 percent at the end of August, partly due to reopening issuance in addition to an increase in interest rates in overseas market since August.

In the wake of the adjustment in the global stock market and the appreciation of yen against the US dollar from the beginning of September, interest rates have been on a downward trend since the second week of September and the interest rate of 10-Year Bonds is moving toward zero percent again. However, this is not a repeat of the bull flattening seen in the latter half of July and the latter half of August, but this is caused by a decrease in interest rates mainly in the medium- and long-term zones in September, and a tight supply and demand balance in the ultra-long-term zone ahead of the end of the first half of the fiscal year has not been felt.

Since new current bonds will be issued from next month, we expect that there will be a certain amount of demand in the auction. However, the market is subject to a wide variety of uncertainties overseas, such as the situation surrounding the US-China trade conflict, the US presidential election, the vaccine approval, and the UK / EU trade negotiations. Therefore, we expect that it will gradually become difficult to take a position from the latter half of October to the end of the year and we believe that the market will be very volatile.

・ Since August, some of the auctions have been unsuccessful and we are concerned about that liquidity is declining also in the secondary market. Since it is highly likely that the JGB issuance will continue to increase in the future, we believe it desirable that the auction method is changed to the uniform price auction for ensuring stable issuance.

・ The large increase in JGB issuance did not have much effect until the auction in August, but the results have continued to show some tail since the beginning of this month. Although the market is not in a situation where it will collapse due to the auction results, since the supply and demand balance of current bonds continues to be loose compared to existing bonds, we believe it is necessary to pay attention to the trends in the future.

・ We think that the 10-year bond interest rate will continue to remain at around 0 percent against the backdrop of the BOJ's aggressive purchase of JGBs. Since the issuance size has increased significantly in the middle of this fiscal year amid the expectations of a further increase in government spending, however, we believe that investors are wary of an increase in interest rates focused on the ultra-long zone.

・ Currently, there is a strong uncertainty about the additional fiscal policy of the US government, and the upward pressure on interest rates has been lost. With speculation that there would be an additional easing by the ECB, overseas interest rates are stable at a low level, and the interest rate of 10-Year Bonds and 30-Year Bonds will likely to remain at 0 percent and 0.60 percent respectively in the JGB market. There is a speculation of an early Diet dissolution and election in Japan. Since the uncertainty is high about the holding of election in the midst of the Covid-19 Pandemic, however, the market has not been able to put the premium on it. While it is possible that interest rates will rise if speculation about additional public spending in the US and additional fiscal measures in line with a Diet dissolution and election in Japan materializes, speculation of interest rate cuts due to the pressure for yen appreciation cannot be completely eliminated. As a result, currently, there is a strong uncertainty with a possibility that interest rates go either way in the future.

Regarding the customer trend, the number of "auction trades" has been increasing, which consist of selling the issue before the auction to build a short position and buying at the auction. The trade itself is aimed at short-term profits and does not set the direction of the long-term market. However, this affects the operation of successful bidders, and an increase in the number of orders at the average winning bid price on the day of the auction makes it difficult to execute orders in the discriminatory price auction.

For example, this trading method generates short covering trades unnecessarily on the day of the auction and increases uncertainty in bidding. As a result, there is concern that a sense of wariness about the auction may spread to final customers who participate in the auction for the purpose of long-term holding. The number of customers who buy JGBs at the auction has been increasing with an increase in remote work in the midst of the Covid-19 Pandemic, and it is extremely important to smoothly execute orders at the auction. With this view in sight, we wish that the uniform price auction which enables secure execution of orders will be adopted in all maturities.

We believe that the uniform price auction is beneficial also for the issuer in the sense that it can reduce the tail risk of undelivered issues. It has also been confirmed that 40-Year Bonds was issued at a lower yield than the expected yield on the day of the auction, which may make sense in terms of reducing issuance costs. In addition, since the United States adopts the uniform price auction, orders at the average winning bid price is common for overseas investors and we believe that this will increase the presence of overseas investors in the JGB market.

We believe that the introduction of uniform price auction system will be beneficial for both market participants and the issuer amid the growing importance of the auction and we earnestly ask the debt management office to consider this.

・ Since the lifting of the declaration of the state of emergency by the government, the market has regained its activity gradually and we are of the view that the market has improved in terms of liquidity and functionality. Although the increased JGB issuance started in July has been absorbed without much difficulty apparently at the moment, it seems that the degree of wariness with respect to each auction is higher than before. Therefore, we are of the view that the volatility of the market may increase again depending on the communication of the BOJ who is purchasing JGBs. Since a close cooperation among the debt management office, the BOJ and market participants as one is an indispensable requirement in order to overcome the current situation, we would like to see that the debt management office will continue to maintain close cooperation and communication with the market.

・ The government bond auctions in the July – September quarter were generally safely financed and it seems that the effect of the large-scale increase in the issuance size has been absorbed by a moderate upward adjustment of ultra-long-term interest rates. However, there is a possibility that interest rates will fluctuate significantly until the end of the year due to many factors which include prospect of an additional supplementary budget, a Diet dissolution and election in Japan, the US presidential election and the BREXIT negotiation deadline, the underlying recession in the midst of the Covid-19 Pandemic, and the decrease in the liquidity of the derivatives market due to the abolition of LIBOR. Under the circumstance, we believe that a closer communication between the debt management office and primary dealers is required.

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