

1st discussion group meeting regarding 10-year JGB Futures specifications

Tokyo Stock Exchange, Inc. (TSE) held discussion group meeting among some of TSE trading participants regarding modification of 10-year JGB Futures specifications on February 27th, 2002.

(Consideration on specifications of 10-year JGB Futures: <http://www.tse.or.jp/english/option/jgbf/jgbf12.html>)

Most of the discussion group members insist maturity of deliverable bonds and notional coupon rate should not be revised while some argue the revision of the specifications.

A summary of the opinions at the meeting is shown below:

< Summary of opinions >

1. Maturity of deliverable bonds

(1) Not necessary to revise

- 10-year JGB Futures are the important benchmark for 7 years interest rate while JGBs with remaining maturity of 5 years and JGBs with remaining maturity of 10 years are the benchmarks for 5 and 10 years interest rates respectively. Therefore, if TSE revises the specification, liquidity of 10-year JGB Futures might be affected.
- Investors' needs are not only for hedging newly issued 10 year JGBs. Since the duration of the portfolios composed based on bond index is about 5.5-6 years, current 10-year JGB Futures suit for hedging whole the portfolios.
- 10-year JGB Futures are effectively used as hedging tool for both JGBs with remaining maturity of 10 years and for these with 5 years remaining maturity. There is no merit to revise the specifications.
- If minimum maturity of deliverable bond is raised, participation of various investors like speculators and arbitrageurs may not be expected. Consequently, the outstanding liquidity of 10-year JGB Futures would be threatened.
- If minimum maturity of deliverable bond is raised, 10-year JGB Futures could not be used as a hedging tool for JGBs with 5 years remaining maturity. In consideration of inferior liquidity of 5-year JGB Futures, it is uncertain that the 5-year JGB Futures are functioning as the hedging tool alternatively.

(2) Necessary to revise

- Not necessary to revise immediately. However, it should be changed in the future to match the price movement of futures and cash JGBs with remaining maturity of 10 years.
- Since issuing amounts of 5-year and 10-year JGBs are increasing and interest rate may rise some time in the future, it is desirable having hedging tools for each 5 and 10-year interest rates.

2. Coupon rate

(1) Not necessary to revise

- Delivery option is not favorable and it affects on the liquidity of JGB Futures trading.
- Since delivery option discourages arbitrageurs participation, there is no need to change the coupon rate at this moment.
- JGBs that are being CTD in the future are issued in sufficient amount. Therefore, there is no need to change the coupon rate.

(2) Necessary to revise

- Since there is a possibility that the unmatched price movement of JGBs with remaining maturity of 10 years and 10-year JGB Futures might be spreading in the future, the coupon rate should be lowered.
- If maturity of deliverable bonds is changed to 9-10 years, the coupon rate may be lowered.

This summary is not a final version. It may be modified later.