July 19, 2024
Financial Markets Department
Bank of Japan

Minutes of the 20th Round of the "Bond Market Group" Meetings

1. Outline

(1) Date	Commercial banks group	July 9 at 3:45 pm
	Securities firms group	July 9 at 5:30 pm
	Buy-side group	July 10 at 4:30 pm

(2) Place The Head Office of the Bank of Japan

(3) Participants

- Persons in charge of bond market issues in financial institutions including those who participate in the "Bond Market Survey"
- Director-General of the Financial Markets Department, Head of Coordination and Market Analysis Division, Head of Market Operations Division, Head of Market Infrastructure Division

2. Introduction by the Bank of Japan

- The Bank explained to each group the background and purpose of this meeting and participants' views collected before the meeting.

3. Views provided by participants

- The Bank asked participants their views on (1) the amount and pace of the reduction in its JGB purchases, (2) the guidance on the reduction, (3) how to proceed with the reduction in each maturity segment, and (4) other related topics. Views provided by participants, including those collected prior to the meeting, are as follows.

Views on the amount of the reduction

- ➢ The Bank should reduce the amount of its purchases of JGBs to zero, considering that JGB purchases are no longer its primary policy tool and its balance sheet has become unprecedentedly large.
- ➢ The Bank should conduct JGB purchases as a means of providing growth

currency, getting back to its original practice. It is desirable for the Bank to reduce the amount of its monthly purchases to about one to two trillion yen, the level before the Bank greatly increased the purchase amount.

- In light of precedents of QT by overseas central banks, it is desirable for the Bank to reduce the amount of its monthly purchases to about two to three trillion yen.
- Considering JGB holding capacity of investors, an interim target of the Bank's monthly purchase amount should be about three trillion yen, the level before the introduction of Quantitative and Qualitative Monetary Easing (QQE).
- If the Bank reduces the amount of its monthly purchases to about three trillion yen, that will be a clear message that it is committed to significant reduction. Besides, the share of the Bank's JGB purchases in the issuance amount is likely to decline considerably and bond market functioning is expected to improve.
- Given that demand for bonds from domestic banks is expected to be limited due to constraints mainly associated with the IRRBB, it is appropriate for the Bank to reduce the amount of its monthly purchases to about four trillion yen.
- Considering that an excessive reduction could result in a supply-demand imbalance and lead to a deterioration in the functioning of the bond market, it is appropriate for the Bank to reduce its monthly purchase amount to about four trillion yen.
- We would like to suggest that the Bank initially reduce the amount of its monthly purchases to about five trillion yen and thereafter consider further reductions, taking into account market developments such as supply and demand conditions of JGBs.
- The Bank should decide the amount and the pace of reduction in its JGB purchases, taking into account the issuance amount in each maturity zone and market volatility.

<u>Views on the pace of the reduction</u>

- In order to restore market functioning and stimulate investor demand by fostering market confidence that no more reductions are anticipated in the near future, the Bank should swiftly reduce the amount of its purchases of JGBs to its target level originally set to be achieved over around two years.

- Initially reducing the purchases by a significant amount and then implementing incremental reductions could prevent formation of investors' vigilance against the reduction and expectations for further interest rate increases. This would enable the Bank to proceed with the reduction while stimulating investor demand for JGBs. A prompt recovery in bond market functioning could also be expected.

- Even if the Bank initially reduces its purchases of JGBs by a significant amount, an excessive rise in interest rates is unlikely to occur, thanks to the continued stock effects brought about by its still large JGB holdings.

- A rapid reduction might result in an increase in volatility, thus reducing investor demand with deterioration in market functioning and decreased risk-adjusted return. It is desirable for the Bank to reduce the amount of its purchases of JGBs in a stepwise manner.

- When making decisions regarding JGB investments, the prospect for the future course of the policy rate is also an important factor. Thus, it is uncertain whether investors demand will increase significantly by facilitating market confidence that no more reductions are anticipated in the near future. We believe that gradual reductions would be more desirable.

- It is highly uncertain to what extent depository financial institutions can bear interest rate risk. This is because their risk-bearing tolerance depends on various factors, including their investment stance on foreign bonds and developments in domestic loans and deposits. The Bank should cautiously proceed with the reduction.

- A rapid reduction could hamper the stable issuance of JGBs by unnecessarily increasing market volatility and lowering risk tolerance of financial institutions, including regional ones, that are exposed to interest rate risk. Therefore, the Bank should reduce the amount of its purchases of JGBs in a stepwise and predictable manner in the course of about two years.

- The situation faced by each regional financial institution greatly varies, depending on, for example, their risk management policies. We would like to ask the Bank to take into account such divergence.

<u>Views on the guidance on the reduction</u>

- In order to ensure some flexibility, we would like to ask the Bank to announce the planned amount of JGB purchases per quarter in a range form. We would also like to ask the Bank to indicate the amount of reduction by lowering the median of the range.

- While announcing the planned amount in a range form is deemed appropriate, it is desirable for the Bank to narrow the range in order to enhance the predictability of its market operations.
- It is desirable for the Bank to pinpoint a specific amount of planned JGB purchases. This is because setting a range for the planned amount could trigger market speculation in various circumstances and make the Bank's regular operations market events, thus leading to increased volatility.
- It is desirable for the Bank to pinpoint a specific amount of planned JGB purchases, while keeping options available, such as unscheduled JGB purchases and fixed-rate purchase operations, to enable the Bank to respond to a rapid rise in interest rates in a flexible manner.
- The frequent conduct of unscheduled JGB purchases and fixed-rate purchase operations will decrease the predictability of the Bank's market operations. Therefore, such operations should be conducted sparingly only when the adverse impact on the financial system is concerned.
- If the criteria for deciding the use of operations such as unscheduled JGB purchases and fixed-rate purchase operations is clear, it is unlikely that the existence of such operations will increase volatility. Rather, such measures might contribute to suppressing volatility in such a situation where they need to be implemented.
- The Bank should decide and announce the planned amount of JGB purchases for the next two years at the upcoming Monetary Policy Meeting. Meanwhile, the planned amount in each maturity segment should be quarterly determined by the Financial Markets Department from the viewpoint of ensuring flexibility.
- The Bank should announce the planned amount of JGB purchases for the next two years in each maturity segment as well as the total monthly purchase amount.

<u>Views on how to proceed with the reduction in each maturity segment</u>

- From the viewpoint of suppressing market volatility, the Bank should proceed with the reduction mainly in the short- to medium-term zone.

- The Bank should reduce the amount of its purchases of JGBs mainly in the medium-term zone, where foreign investors have constant demand.
- If depository financial institutions are to be assumed as alternative JGB holders to the Bank, reducing the purchase amount mainly in the medium- to long-term zone would likely prevent a worsening of the supply and demand conditions.
- In order to lower the share of the Bank's JGBs holdings and improve the functioning of the futures market, the Bank should place priority on reducing purchases of JGBs in the long-term zone.
- The Bank should place priority on reducing purchases of JGBs with residual maturity of up to 10 years, because the shares of the Bank's JGB purchases in the issuance amount and its holdings in the amount outstanding of JGBs are high in that segment.
- In order to shorten the duration of its JGB holdings, the Bank should place priority on reducing purchases of JGBs in the super-long-term zone.
- The reduction in the super-long-term zone is not a priority. This is because, in that zone, the supply and demand conditions have been loose, and the share of the Bank's JGB purchases in the issuance amount is lower than in the maturity zone of up to 10 years.
- It is desirable for the Bank to proceed with the reduction so that the reduction amount in each maturity segment would be proportionate to the current purchase amount in that segment.
- The Bank's current JGB purchases are imbalanced in terms of maturity; it purchases a larger weighting of JGBs with residual maturities of up to 10 years and a smaller weighting of JGBs with maturities of more than 10 years. Since such imbalance has caused distortions in the yield curve, the Bank should review its conduct of JGB purchases so that it will become more market-neutral.

Others

- Certain JGB issues of which the Bank holds a significant share are expected to become the cheapest to deliver (CTD) in the futures market. We expect some measures to restore the liquidity of these issues to be implemented.
- In order to restore the liquidity of off-the-run issues, we would like to ask the

Bank to conduct outright sales of its JGB holdings in addition to the reduction in the purchase amount.

- Now that the framework of yield curve control (YCC) was terminated, we would like to suggest that the Bank consider simplifying the current maturity segments and purchase JGBs from the following three segments in the same manner as before the introduction of QQE: (1) up to 1 year; (2) more than 1 year and up to 10 years; and (3) more than 10 years, from the perspective of letting interest rates be further determined by the market mechanism.
- The consolidation of the current maturity segments should be avoided. If segments are consolidated, the duration of JGBs the Bank purchases will fluctuate significantly depending on the yield curve of the day of its purchase operations, thus causing unnecessary market volatility.
- The consolidation of the current maturity segments will likely be desirable in the future, but it should be envisaged only when the Bank has fairly proceeded with the reduction.
- Given the current situation where the Bank's large-scale holdings of JGBs have led to concerns among some overseas investors over the fiscal soundness of Japan, it is desirable for the Bank to announce not only a plan for the reduction over the next one to two years, but also a more ambitious one over a longer-term horizon.
- It is desirable for the Bank to set a certain target for the amount of its JGB holdings on a stock basis and adjust the purchases accordingly.
- It is desirable for the Bank to announce the target for the duration of its JGB holdings and proceed with the reduction accordingly.