December 20, 2024
Financial Markets Department
Bank of Japan

Minutes of the 21st Round of the "Bond Market Group" Meetings

1. Outline

(1) Date	Commercial banks group	December 5 at 3:45 pm
	Securities firms group	December 5 at 5:30 pm
	Buy-side group	December 6 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 (1) the results of the "Bond Market Survey," (2) liquidity in the JGB market, and (3) recent developments in the financial markets and market operations.

3. Views provided by participants

- The Bank exchanged views with participants on the above topics. Views provided by participants are as follows.

<u>Recent trends in the Japanese bond market</u>

- ➢ The plan for the reduction of the Bank's purchase amount of JGBs decided at the Monetary Policy Meeting held in July was in line with market expectations and thus did not cause substantial market moves. However, long-term interest rates increased slightly, in response to the rate hike decided at the same meeting.
- ➢ After the start of August, rising concerns over a slowdown in the U.S. economy

triggered a rapid spread of risk-off sentiment, leading to increased volatility in markets. Under these circumstances, Japanese long-term interest rates fell sharply with expectations for a rate hike by the Bank receding. Subsequently, Japanese long-term interest rates began to rise again, as expectations for a rate hike gradually picked up, along with the rise in U.S. long-term interest rates that reflected solid economic indicators and the result of the presidential election.

- The increased volatility and the decline in interest rates in August triggered a large-scale unwinding of short positions of investors in Japanese interest rate markets and a decline in the risk tolerance of these investors, which curbed a rise in interest rates.

- Yields on super-long-term JGBs have risen significantly compared to other maturity zones, amid concerns over a loosening of the supply and demand conditions. This is partly because life insurers have been in a wait-and-see mode with the regulatory-driven demand past its peak.

- While the Bank has been gradually reducing its JGB purchases since August, we have seen no signs of a significant change in the supply and demand conditions for JGBs resulting from these operations.

Functioning and liquidity of the Japanese bond market

- Even though the amount of the Bank's JGB purchases has been gradually decreasing, the pace of the reduction is only moderate, and the JGB market is still in the midst of normalization. In this situation, market liquidity is likely to improve at a moderate pace for the time being.

- With the effects of the reduction of the Bank's JGB purchases gradually emerging, the correlation between domestic and overseas interest rates is moderately strengthening. The thickness of the trading board, mainly for on-the-run issues, has been improving, and the tightening of supply and demand conditions resulting from the Bank's purchases has been gradually easing.

- As seen in the declined use of the Securities Lending Facility (SLF), market functioning and liquidity have improved somewhat. We recognize that the reduction of the Bank's JGB purchases and the increased predictability of its future purchase amount have contributed to the restoration of the price discovery function and market liquidity.

- The JGB issues of which the Bank holds a significant share are becoming the cheapest to deliver (CTD) in the futures market. In this situation, some investors, mainly overseas investors, have concerns over a short squeeze of the CTD issues.
- Thanks to the additional issuance in liquidity enhancement auctions and the reduction of the repurchase amount of the CTD issues under the SLF, the amount outstanding in the market of issue No. 366 of 10-year JGBs has increased. Whether the amount outstanding of the CTD issues in the market will continue to increase through the use of these measures largely depends on how market participants will assess the economic rationale of using them. That said, their function as a backstop has been confirmed, and concerns over the rollover of futures contracts have been eased somewhat.
- As long as the Bank maintains the current relaxed terms and conditions for the SLF for the CTD issues, a short squeeze of the CTD issues is unlikely to occur, and we have no particular concern over the functioning of the futures market. We would like to ask the Bank to thoroughly communicate these situations to the market, including overseas investors.

<u>The Bank's operations and others</u>

(Views on how to proceed with the reduction in each maturity segment)

- From the perspective of improving market functioning, it is reasonable that the Bank has been reducing its purchases of JGBs mainly in segments where the share of its purchases in the issuance amount is high.
- When deciding on the amount of the reduction in each maturity segment, we expect the Bank to take into account the share of the Bank's JGB holdings in each segment, as well as the share of its purchases in the issuance amount.
- It is desirable for the Bank to continue to proceed with the reduction mainly through reducing the purchases of bonds with a residual maturity of up to 10 years, because these bonds have a constant and steady demand from investors such as banks. On the other hand, the reduction in the super-long-term zone is a low priority, given the declining investors' demand.
- When the Bank starts a reduction in its purchases of JGBs in the zones where no reduction has been implemented thus far, such as the super-long-term zone, the market may perceive it as a surprise. Thus, we would like to ask the Bank to

thoroughly communicate with market participants to enhance the predictability of its market operations.

(Views on the Bank's purchases of inflation-indexed bonds)

- Although the share of the Bank's purchases in the issuance amount has been gradually declining for fixed-rate bonds, the share remains high for inflation-indexed bonds. Given that, it is natural for the Bank to gradually lower the share of its purchases of inflation-indexed bonds in the issuance amount.

- Taking into account buy-backs by the Ministry of Finance, the Bank has been purchasing almost all the issuance amount of inflation-indexed bonds. It is about time the Bank considered reducing its purchases of inflation-indexed bonds, aiming to leave price formation to the market mechanism. That said, the reduction should be carefully carried out, taking due account of the supply and demand conditions.

- While we believe that the Bank should reduce its purchases of inflation-indexed bonds at some point, the reduction could rather lead to a deterioration in market functioning, given the low market liquidity and the limited base of investors. Therefore, we expect the Bank to give careful consideration.

(Views on the SLF and others)

- The relaxation of the terms and conditions for the SLF for the CTD issues is crucial to ensure liquidity in the JGB futures market, so we expect the Bank to continue with it in next year onward. We also expect the Bank to make thorough communication when it makes changes to these measures.

- The Bank could further improve bond market functioning by setting the minimum fee rate for the SLF at a relatively low level for certain JGB issues of which the Bank holds a significant share.

- The Bank may be able to encourage an increase in the amount outstanding in the market of the JGB issues of which it holds a significant share, by reducing the fee for the reduction in the amount of the CTD issues repurchased by the Bank under the SLF and conducting "operation switch," a set of selling and purchasing of JGBs.