July 5, 2017
Financial Markets Department
Bank of Japan

Minutes of the Fifth Round of the "Bond Market Group" Meetings

1. Outline

(1) Date	Commercial banks group (22 firms)	June 20 at 4:00 pm
	Securities firms group (25 firms)	June 20 at 5:30 pm
	Buy-side group (21 firms)	June 21 at 4:00 pm

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

(3) Participants

- Persons in charge of bond market issues in financial institutions, participating 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 Japanese Bond market</u>

- ➢ Yield curve control is functioning effectively, and the yen yield remains stable.
- ➢ Amid the Bank's growing presence in the market, it has become rare for the yen yield to move except when the Bank carries out operations or when overseas interest rates fluctuate.

- Long-term JGB yields stick to a low level. With regard to super-long-term JGBs, 30-year JGB yield remains below 1%, which is viewed as a benchmark for investments by domestic life insurance companies. Investors are reluctant to invest in JGBs since neither capital gains nor profits from carry trades are sufficient.

- Short- to mid-term JGB yields are rising due to a decrease in the amount of the Bank's JGB purchases and a decline in overseas demand following a narrowing cross-currency basis.

- With regard to short- to mid-term JGB yields that have been adjusted moderately upward, we assess that the yield curve is gradually taking on an appropriate shape.

- Although short- to mid-term JGB yields have risen moderately, investors are not yet capable of investing in them due to their negative yields. In addition, there are less trading opportunities for securities firms, reflecting the decrease in the amount of the Bank's JGB purchases. Moreover, overseas investors buy less JGBs as a cross-currency basis has narrowed. With these, the number of market participants is on the decrease.

<u>Functioning and liquidity of the Japanese Bond market</u>

- As volatility, especially in the long-term zone, has declined since the introduction of yield curve control, a sense of ease has spread in the market regarding price of JGBs.

- Although the lower market volatility may seem to be an improvement, the reality is that it has led to a decline in market functioning through a decreasing transaction volume and exits of market participants.

- The market at present is stable under the Bank's control. However, in an environment where both the level of yields and volatility are extremely low, the variety of participants in the JGB market has been decreasing due to exits of market participants.

- Although the Bank is controlling the market appropriately, the price discovery function of the Japanese bond market seems to have been lost. It is not at its healthy state as long-term yields show little response in a situation where stock prices have risen and the state of the Japanese economy as a whole has improved.

- The results of the Bond Market Survey show that the functioning and liquidity of the JGB market remain unchanged at a low level. However, the actual condition is that they are worsening as the days go by. While we understand that the purpose of the Bank's monetary policy is to achieve the price stability target, the Bank should also consider market functioning.

- In the future when the Bank leaves the interest rate to be determined in the market, we are concerned that volatility would rise suddenly because the depth of market participants is insufficient. We understand that the depth and the variety of market participants are important indicators of market functioning, and request the Bank to keep it in mind continuously.

- Assuming the present market functioning is insufficient, we are concerned that the market would not react appropriately when the interest rate actually gets volatile. The Bank might need to consider allowing a wider range in the policy interest rate through its market operations.

- As a market maker, it is getting more difficult to satisfy customers' demand since a large number of issues are becoming scarce as a consequence of the Bank's large JGB purchases. With respect to this point, we suppose that the Bank is capable of improving market functioning by supplying those issues more actively in the market.

<u>The Bank's Operations</u>

- The JGB market is stable under the current framework since market participants have become accustomed to yield curve control and the Bank has started to pre-announce its operation schedule.

- Prior to discussing Japan's economic outlook and consumption taxes, it is important for the price discovery function in the Japanese bond market to be demonstrated appropriately. Therefore, it is desirable to carry out market operations in such a way that market functioning works as much as possible under yield curve control. In this respect, the super-long-term zone is especially important.

- While the pace of the monetary base expansion is slowing down, an increasing number of participants are wondering about the Bank's intention to leave the term "80 trillion yen" in its guideline for market operations.

- Although we feel a sense of reassurance about yield curve control, under which the Bank secures high transparency and appropriate communication, it is becoming difficult for investors to form a mid- to long-run outlook for monetary policies, including that for the "exit" from the current policy. We would like the Bank to share its outlook for the monetary policy with market participants when approaching the "exit".

- We understand that the prime purpose of yield curve control is to maintain the real interest rate at a low level in order to exert effects on the economy and prices. If so, the Bank does not necessarily need to suppress price fluctuations to this extent. We would rather like the Bank to consider a policy framework under which some volatility is allowed while the interest rate is maintained at a sufficiently low level.

Impacts of financial regulations

- The application of the regulation related to the interest rate risk of banking accounts in Japan is a large issue for the banking sector. Banks will need to screen investment targets as the regulation prevents banks from freely expanding their balance sheets. Under these circumstances, JGBs are less attractive compared to other investment options due to the low volatility and the low level of yields.

- If regulations on bond holdings for regional financial institutions are enacted, the number of domestic participants in the Japanese bond market might decrease further and the weight of overseas participants might heighten.

- We understand that the United States is moving towards relaxing financial regulations under the new regime. Therefore, we expect that some foreign affiliated financial institutions would expand business using the balance sheet.

Outlook for the Japanese Bond market

- It will remain unattractive to invest in JGBs if the yield and volatility continue to be at this low for a prolonged period.

- We are paying close attention to future developments in prices. If prices rise in line with the Bank's projections, we would review our investment stance towards JGBs while taking a balance between JGBs and foreign bonds.

- T-bills are affected heavily by overseas investors' actions which reflect the cross-currency basis. The future demand of these investors will be one of important points for the T-bill prices.