June 21, 2018
Financial Markets Department
Bank of Japan

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

1. Outline

(1) Date	Commercial banks group (23 firms)	June 6 at 4:00 pm
	Securities firms group (24 firms)	June 6 at 5:45 pm
	Buy-side group (22 firms)	June 7 at 5:45 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 Market Operations Division, Head of Market Infrastructure Division, Director of Coordination and Market Analysis 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 and its outlook</u>

- ➢ With yield curve control effectively functioning, yen yields remain stable while overseas interest rates and domestic and foreign stock prices fluctuated significantly at the beginning of the year.
- ➢ From this April onwards, the reduction in the amount of JGB issuance, in

addition to the stock effects of the Bank's JGB purchases, has put downward pressure on yen yields.

- There is not much room for the yields to rise as it has become difficult to invest in foreign bonds in line with an increase in the cost of currency hedging, and investment demand for JGBs remains strong.

- The low volatility environment in the JGB market has persisted for a long period. For investors, this may make it easy to conduct transactions. On the other hand, securities firms may view this situation as adverse since there are insufficient opportunities to earn profits.

- In regards to the outlook for the Japanese bond market, fundamentals and overseas market trends would have limited impact as long as the Bank continues with the current monetary policy. Therefore, market participants are paying attention only to the possibility and the timing of the Bank's monetary policy change.

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

- The functioning and liquidity of the JGB market have not changed significantly since the last meeting. Under the persistent low yield and low volatility environment, market sensitivity to changes in domestic fundamentals and overseas markets has declined and the price discovery function seems to have been lost.

- While we understand that yield curve control is a monetary policy that inevitably causes the price discovery function of the market to deteriorate, we suppose that the Bank should maintain the price discovery function at a certain level in order to avoid confusion in the "exit" phase.

- It seems that there is no major difficulty in trading on-the-run issues. On the other hand, supply and demand conditions of off-the-run issues are tight and it is getting more difficult to trade certain issues with expected dealing lots.

- Although the bid-ask spread seems to have tightened, this merely reflects intensified competition among securities firms against the backdrop of a decline in market volatility and a decrease in transaction volume. Therefore, we do not regard this as a sign of improvement in market liquidity.

- In terms of the number of market participants with varied views, market depth has been impaired significantly. We indeed feel that it is taking more time for the market to resolve the distortion after a large transaction is executed.

- Under the current market environment, market participants only need to pay close attention to the Bank's operations and pay much less attention to fundamentals and the appropriate shape of the yield curve which were considered to be important factors in making an investment decision. Against this background, participants in the JGB market are allocating less human resources to JGB divisions.

- Due to a decline in the expected return of the JGB business, investors' JGB portfolios are shrinking and the number of market participants, mainly securities firms, is decreasing. It is difficult for market participants to foresee an improvement in the profitability of the JGB market in this environment, and hence they feel reluctant to allocate their resources to hire and train new employees.

- We are concerned that if the current market environment persists, market-making skills and the pool of market participants involved in market-making would be lost, and the market would be unable to respond to investors' needs when interest rates start to fluctuate, causing confusion.

- The new liquidity indicators of the JGB market covering inter-dealer transactions seem to fit market participants' impression of the market. We feel that we are now able to deepen our understanding of what is happening in the market through analyzing those indicators in detail.

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

- The Bank conducts operations paying close attention to market trends and supply and demand conditions of JGBs. Moreover, we assess that the Bank has carefully communicated with market participants.

- However, in regards to the Bank's JGB purchases, we would like to ask the Bank to present more clearly its criteria for deciding changes in the amount of purchases.

- We would like the Bank to consider reducing the amount of T-bill purchases as its supply and demand conditions continue to be tight due to collateral needs.

- Keeping in mind the "exit" from the current monetary policy, we suppose that the Bank should avoid a situation in which market participants' know-how would be lost. From this perspective, we would like the Bank to carry out flexible market operations in such a way that interest rates fluctuate to some extent.

- In order to prevent supply and demand conditions of certain issues of JGBs from becoming too tight, we would like the Bank to consider making the Bank's Securities Lending Facility more accessible by changing its rules which include reviewing the upper limit on selling yields and the maximum number of days of consecutive use per issue.

Situation following the shortening of the settlement cycle of JGBs to T+1

- It has been approximately one month since the settlement cycle of JGBs was shortened to T+1 and transactions have been conducted without significant confusion thanks to careful preparations made by each market participant.

- In regards to repo transactions, we have set a rule to complete all transactions in the morning market session as the administrative workload in the back office division has somewhat increased. We will consider conducting transactions in the afternoon market session hereafter, taking into account market conditions such as liquidity in the afternoon session.

- In regards to GC repo transactions, there is a gap between rates for the traditional method and those for the Subsequent Collateral Allocation Method which was newly introduced. This has incentivized some market participants to conduct arbitrage transactions.

- In regards to the Subsequent Collateral Allocation Method GC Repo Transactions, although some market participants have not yet introduced such transactions, the transactions have been conducted more actively than initially envisaged. We expect this type of transactions to gain more popularity in the market.

- In regards to SC repo transactions, we feel that there has been some shortage of bond lenders in the afternoon session of the day before settlement dates following the shortening of the settlement cycle of JGBs to T+1. Hence, more market participants tend to borrow JGBs in the morning session.