December 26, 2019
Financial Markets Department
Bank of Japan

Minutes of the 10th Round of the "Bond Market Group" Meetings

1. Outline

(1) Date	Commercial banks group (23 firms)	December 6 at 4:00 pm
	Securities firms group (24 firms)	December 6 at 5:45 pm
	Buy-side group (21 firms)	December 9 at 4:45 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 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>

- Up through early September 2019, Japanese interest rates declined mainly reflecting the heightening of expectations for monetary easing in the United States and Europe and uncertainties over U.S.-China trade negotiations. Since mid-September, Japanese interest rates have increased as expectations for global economic recovery and progress in the U.S.-China trade negotiations have spread and market expectations that the Bank would lower the policy rates have subsequently diminished.

- Excessive downward pressure on interest rates has eased partly because fund inflows from foreign investors have decreased.
- While the Bank continued to reduce its purchases of JGBs, yields on super-long-term JGBs increased due in part to the governor's remarks in a press conference that an excessive decline in yields on super-long-term JGBs would not be desirable. However, downward pressure on super-long-term interest rates remains high reflecting strong demand among investors.
- Looking at market developments since the last meeting, JGBs generally have underperformed the U.S. and European bonds. This seems to be mainly because the Bank of Japan has merely revised its forward guidance while the Federal Reserve has cut the federal funds rate by 75 bps in total and the European Central Bank has decided to restart its asset purchase programme in addition to the rate cut by 10 bps.

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

- With more flexibility in the Bank's market operations including adjustments of the amount of JGBs to be purchased and the measures to relax the terms and conditions for the Securities Lending Facility (SLF), the functioning of the Japanese bond market has improved.
- Prices of JGBs in all maturity zones have shown some movements, and this is a favorable environment for market makers. However, in terms of market depth, the improvement of market functioning has been not enough such that it has been difficult to trade in large lots.
- While the market functioning for newly issued JGBs has shown some improvements, liquidity is still low for off-the-run issues of which the Bank holds a large share as a result of previous purchases.
- Measures that exclude newly issued 20-year and 30-year JGBs from outright purchases of JGBs have contributed to the easing of supply and demand conditions amid strong demand for newly issued super-long-term JGBs. Meanwhile, there were some temporary rises in lending fees for newly issued 20-year JGBs in the SC repo market. However, these fees are expected to stabilize gradually as the number of investors increases, and in the long run,

these measures are considered to contribute to improving the functionality of the SC repo market.

- While yields on long-term JGBs have remained in negative territory, yields on bonds other than JGBs did not sufficiently reflect creditworthiness, and their prices were formed in such a way that considered the absolute level of yields as a key factor. However, due to the recent rise in interest rates, price formation that rather reflects credit spreads has been seen mainly in long-term bonds other than JGBs.

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

- Given the recent supply and demand conditions, the frequency and amount of JGB purchases are currently balanced in each maturity zone.
- We would like to ask the Bank to stop purchasing super-long-term JGBs and let the market determine prices, given the strong demand from investors.
- While yields on long-term JGBs have remained in negative territory, some investors have shifted their funds to super-long-term JGBs, and this consequently has exerted downward pressure on yields on super-long-term JGBs. Given this situation, we would like to ask the Bank to continue reducing the amount of purchases of long-term JGBs as well as super-long-term JGBs.
- If long-term interest rates turn positive, the number of investors will increase, and the price discovery function of the market will improve. Therefore, even if long-term interest rates rise to positive territory, we would like to ask the Bank not to immediately increase the amount of JGB purchases, but to let the market determine prices to some extent.
- In the repo market, the GC repo rates have recently risen somewhat, and some have pointed out that this has led to the recent weakness observed in the short- and medium-term JGB markets through the rise in funding costs of securities firms. We would like to ask the Bank to consider the use of JGB purchases with repurchase agreements while taking into account developments in repo rates.
- We would like the Bank to note that, in the corporate bond market, there are some cases where the supply and demand conditions of individual issues are

affected by whether these issues are eligible for the Bank's purchases or not.

- When long-term interest rates declined significantly this summer, the pace of reduction in the purchases of JGBs seemed to be slightly faster than before. In such a situation, we would like to ask the Bank to thoroughly communicate with market participants with regard to the Bank's operations.