December 28, 2023
Financial Markets Department
Bank of Japan

Minutes of the 18th Round of the "Bond Market Group" Meetings

1. Outline

(1) Date	Commercial banks group	December 7 at 3:45 pm
	Securities firms group	December 7 at 5:35 pm
	Buy-side group	December 8 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, 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.

Recent trends in the Japanese bond market

- After the Bank increased the flexibility in the conduct of yield curve control (YCC) at its Monetary Policy Meetings held in July and October, long-term interest rates became more likely to reflect movements of overseas interest rates and developments in wages and prices.
- Under these circumstances, long-term interest rates fluctuated significantly for

the past months. While the rates kept rising until October mainly reflecting an increase in overseas interest rates and speculation over the Bank's policy stance, they turned downward in tandem with overseas interest rates after November.

Functioning and liquidity of the Japanese bond market

- Since the Bank increased the flexibility in the conduct of YCC, the functioning of the JGB market has been improving. Distortions in the yield curve and other side effects of YCC observed last year have reduced. Long-term interest rates have become more aligned with developments in overseas interest rates and domestic prices.

- Trading of on-the-run JGB issues in the secondary market has increased to some extent. That said, with the amount of JGBs in the secondary market being small under the Bank's large-scale purchases of JGBs, liquidity is still low for the off-the-run issues of which the amount of the Bank's purchases was large. The functioning of the JGB market would improve only gradually.

- In the SC repo market, supply and demand conditions have tightened substantially for some JGB issues of which the Bank's holding share has been high. The spreads between GC and SC repo rates offered when investors actually trade in the market seem to be wider than those provided by data vendors.

- With the amount of JGBs in the secondary market being small, if the Bank scales back the current relaxation of the terms and conditions for the Securities Lending Facility at the timing of any policy changes, the liquidity of the JGB market might decline significantly.

- Amid speculation over a change in the Bank's policy stance, investors' prospects for interest rates have not converged much, and this has led to a widening of the price tail at the auctions of certain JGB issues.

- We are interested in how the Bank assesses the functioning of hedging tools including JGB futures.

The Bank's operations and others

- The Bank has conducted nimble market operations taking into account supply and demand conditions in the JGB market. Specifically, it carried out unscheduled JGB purchases and the Funds-Supplying Operations against Pooled Collateral with longer duration of loans in the face of a rise in interest rates, whereas it reduced the amount of its scheduled JGB purchases amid a decline in interest rates. The Bank's such operations have contributed to stabilizing the formation of interest rates.

- We are paying attention to the possibility that the Bank's "inflation-overshooting commitment" could hamper the reduction in its purchases of JGBs in the future.
- Given that long-term interest rates are far lower than the upper bound of YCC, the Bank might as well consider it an option to reduce the amount of its JGB purchases.
- The Bank's nimble JGB purchase operations have effectively contained excessive volatility in the market. However, they have also increased volatility in the market by lowering the predictability of the Bank's operations. We expect the Bank to make its conduct of market operations as predictable as possible.
- The Bank's unscheduled bond purchases on the previous day of JGB auctions are effective to prevent an excessive rise in interest rates. The Bank, however, should avoid conducting such operations because they trigger short covering by market makers adjusting their positions beforehand, possibly leading to weak auction results.
- We are interested in how the insights from the workshop the Bank held on December 4 as part of "Review of Monetary Policy from a Broad Perspective" would influence its future conduct of market operations.
- The market conditions for Japan Climate Transition Bonds, which would be eligible for the Bank's JGB purchases, could largely be affected by the Bank's market operations, given the bonds' small issuance amount. Depending on the results of the Bank's operations, the liquidity of the market may decline significantly and the price formation may be distorted. We have yet to see the actual impacts since the bonds' issuance has not started, but we will pay attention to market developments including bids for the Bank's purchases.

<u>Views and risks on the outlook for the Japanese bond market</u>

- We expect to see a solid JGB market for the time being, against the background that the Bank keeps its purchases of JGBs and the uptrend in overseas interest rates seems to reach an end. Going forward, we will pay attention to wage and price developments, the Bank's conduct of JGB purchase operations, and developments in overseas interest rates and exchange rates.

- We expect interest rates to follow an uptrend amid speculation over a change in the Bank's policy stance. The rise in interest rates, however, is expected to be only moderate with domestic investors likely increasing their investments in JGBs in the case of the interest rate rise.
- Some market participants seem to be overly dependent on the Bank's large-scale JGB purchase operations. We are concerned about whether they can well adapt to changes in market environments in the future.