December 25, 2018
Financial Markets Department
Bank of Japan

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

1. Outline

(1) Date	Commercial banks group (24 firms)	December 5 at 4:00 pm
	Securities firms group (23 firms)	December 6 at 4:00 pm
	Buy-side group (21 firms)	December 7 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>

➢ With more flexibility in market operations after the Bank's announcement to strengthen its policy framework this July, volatility in the JGB market has somewhat risen and transactions thus have become more active than before.

- We feel that Bank's changes to market operations such as its refrainment from making purchases excluding those of certain maturities on the first business day after JGB auctions by the Ministry of Finance and the reduction in the frequency of purchases and in purchase size have encouraged market participants to adjust their positions according to the external environment and supply-demand conditions, thereby leading to a more adaptable formation of interest rates.
- With JGBs still unattractive due to the persistently low interest rates under yield curve control, the number of investors actively trading in large lots has been limited.
- Under the Bank's continued large-scale JGB purchases, we observe an imbalance in supply-demand conditions among different issues and notably the supply-demand conditions of cheapest issues have tightened.
- T-Bills are seeing tight supply-demand conditions, as the widening of USD/JPY basis spreads has spurred a renewed appetite among foreign investors and demand for collateral has been growing on the domestic side before the end of the year. This has also put downward pressure on 2-year JGB yields.

Functioning and liquidity of the Japanese bond market

- The degree of functioning and liquidity of the bond market remained low for some time but since the Monetary Policy Meeting this July, they have gradually started to show some signs of improvement such that JGB yields have fluctuated in tandem with yields overseas.
- Market participants are still focusing much of their attention on the Bank's market operations, and developments in Japanese economic activity and prices only possess limited influence on the JGB market. The degree of market functioning thus has remained low.
- Although indicators such as bid-ask spreads might seem to suggest an improvement in liquidity, we are still facing difficulty to trade in large lots so much that we are not always able to trade issues with an intended dealing lot or price even when sufficient liquidity is expected to be available, such as on the business day following JGB auctions by the Ministry of Finance.

- In the repo market, liquidity has remained low for certain issues for which the Bank has gained a large share. Against this background, securities firms with difficulty to cover their short positions in the repo market have failed to actively respond to orders from investors, and have faced constraints on their market-making ability.
- Since the relationship between the spot price of JGBs and the futures price of long-term JGBs has been unstable, it is difficult to hedge against interest rate risks.

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

- We expect the Bank to strive to conduct market operations in an even more flexible manner so that the degree of market functioning will recover further.
- While we forecast that with stock effects of the Bank's JGB purchases, the amount of JGB purchases necessary for yield curve control will eventually become smaller in the medium to long term, we would like to ask the Bank to proceed with the reduction in the amount of purchases at a higher speed in order to improve the degree of market functioning and liquidity and to address tightening supply-demand conditions.
- We believe that in order to enhance the market's price discovery function, it might be a good idea to boost the transparency of the Bank's market operations to the next level by announcing the schedule of its purchases months ahead of the auctions and narrowing the range for its purchase size so that the attention of market participants will shift to developments in Japanese economic activity and prices from the Bank's market operations.
- Since quite a few issues have become scarce in the market as a result of the Bank's large-scale JGB purchases, we as market makers are having more difficulty to fully respond to orders from our customers, depending on market conditions. Although we recognize that the Securities Lending Facility is a backstop facility, we believe that it might facilitate improvements in the degree of market functioning if the Bank relaxes its conditions including the upper limit to the amount of sales to further enhance its availability.
- We would like to suggest that the Bank, amid the tight supply-demand conditions of cheapest issues, consider measures to improve market liquidity including sales of its JGB holdings.

Other topics

- It seems that effective communication between the Bank and market participants has contributed to easing the market's anxiety over the Bank's market operations. We would like to ask the Bank to continue to thoroughly communicate with market participants.
- Although the degree of market functioning and liquidity have somewhat improved, the JGB market has not yet become attractive in terms of profitability. With such a trend continuing, financial institutions will have no choice but to cut human resources allocated for the market. It should be noted that such a trend in human resources might not be noticeable but could have an accumulative impact in the future.