

## JGB Insight

### BOJ's JGB purchase reduction: caution needed for timing

- ✓ Going forward, the BOJ is expected to continue to trim its JGB purchase amount under the framework of the YCC policy. However, as the latest trimming unexpectedly intensified the trend of yen appreciation, the BOJ may hesitate to cut the purchase amount especially in the near term.
- ✓ Due to the cut in the purchase amount in the 10-25Y zone, possible reduction in the 5-10Y zone has now come in sight. As JGB market participants are still puzzled by this week's BOJ action, caution would persist about the BOJ's purchase trend for the time being, including the targeted zones where the purchase amount is cut.

Strategic Memorandum DSTE209  
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### Reduction timing and reactions in overseas market gave us surprise

This week, there was a moment when government bond yields sharply rose around the globe. That was triggered by the BOJ's purchasing smaller-than-expected JGBs in both the 10-25Y and the over-25Y zones at a scheduled auction on January 9. Since the BOJ shifted its policy target from a particular quantity of JGBs to interest rates by the introduction of the yield curve control (YCC) policy in September 2016, it has been occasionally trimming its JGB purchases in measured steps by paying close attention to the market trend, the shape of the yield curve, and the supply/demand balance in JGBs. In the JGB market, many market participants appear to understand that the BOJ's trimming in JGB purchases under the framework of the YCC policy does not imply or signal any change in the central bank's current monetary policy stance. Also given the JGB issuance in FY2018, which is expected to be much smaller than that in FY2017, JGB market participants were anticipating near-term reductions in the central bank's JGB purchases especially last December. However, the BOJ maintained its offer size ranges in respective targeted zones in *Outline of Outright Purchases of Japanese Government Securities for January 2018*, announced on December 28, 2017, from those announced at the end of November. Therefore, in the environment where the 10Y JGB yield stays steady and the yield curve does not face strong flattening pressure, they started to think that "the BOJ is not in a rush to trim the purchase amount." Consequently, this week's trimming surprised JGB market participants in terms of its timing. What was more surprising was that the FX market and European/US government bond markets, which have recently been very sensitive to monetary policy normalization at central banks, reacted more than the JGB market. In the US Treasury market, the 10Y Treasury yield rose very close to 2.6% at one point. In addition, USD/JPY declined from around 113.10 at a time when the BOJ offered to buy JGBs on January 9 to around 111.00 in the overseas market on January 11. In the report dated on December 25, 2017, I wrote my outlook for the BOJ's JGB purchases as follows.

*The BOJ holding of JGBs at end-2017 is likely to be about 420 trillion yen, up only slightly less than 60 trillion yen from end-2016, partly because the central bank has intermittently reduced the amount offered in long-term JGB buying operations in 2017. Based on an estimation with the assumption that the BOJ maintains the current amounts of purchases in 2018, the Y/Y increase in the amount outstanding at end-2018 would be only 36 trillion yen. If the BOJ maintains the current purchase amounts in Jan-Mar but then decrease them from April and beyond in accordance with the planned reduction in JGB issuance in FY2018, the Y/Y increase would be just slightly over 30 trillion yen, the smallest increase since the BOJ adopted QQE. For the BOJ, the difference between 36 trillion yen and slightly more than 30 trillion yen is not a big one they should concern. If we assume the BOJ maintains its YCC policy, the 10Y JGB yield stays steady, and the yield curve does not come under excessive flattening pressure, the BOJ looks unlikely to adjust the amount of its purchases soon. We think that the BOJ will make adjustments in JGB purchase amounts, when they monitor the 10Y JGB yield and the shape of the yield curve in FY2018 and find they need to.*

**Caution would be needed for reduction timing and targeted zones**

Going forward, the BOJ is expected to continue to trim its JGB purchases under the framework of the YCC policy. However, as the latest trimming unexpectedly intensified the trend of yen appreciation, the BOJ may hesitate to trim the purchase amount especially in the near term. At the latest trimming, the BOJ cut the offer amount in the 10-25Y zone, including 20Y JGBs whose issuance amount in FY2018 will be unchanged from this fiscal year, and that was the first change in the purchase in the zone since February 10, 2017, despite the 20Y JGB yield staying steady similar to the 10Y JGB yield. Accordingly, market participants may become more cautious about a reduction, for example, in the 5-10Y zone. This is because, among the BOJ's targeted zones, only this zone corresponds to the followings: (1) the BOJ's purchase amount is higher than the MOF's issuance amount (on a monthly basis) and (2) the BOJ's purchase amount has been higher than the median of its offer range. In addition, the issuance amount of 10Y JGBs is to be cut in FY2018 from that in FY2017. JGB market participants are still puzzled by this week's BOJ action as it is difficult to find clear reasons why the BOJ decided to do it this week not in last December etc. Caution would persist about the BOJ's purchase trend for the time being, including the targeted zones where the purchase amount is cut.

**BOJ JGB Purchase and MOF Issuance**

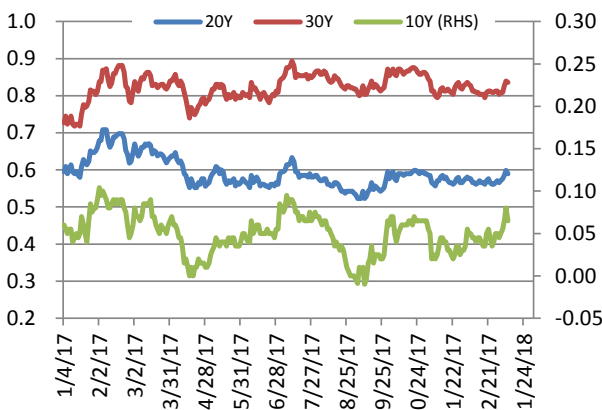
(billion yen)

	Offer size per operation		Number of Offers (per month)	Offer size as of Jan. 11	Monthly Total exp.	MOF issuance per month in FY2017	MOF issuance per month in FY2018
		Mid					
<b>JGBs ex Linkers and Floaters</b>							
Up to 1 year	About 10-100		55	about 2	50	100	-
Over 1 to 5 years	Over 1 to 3 years	About 200-300	250	6*	250	1,500	2,200
	Over 3 to 5 years	About 250-350	300		300	1,800	2,200
Over 5 to 10 years		About 300-500	400	6*	410	<b>2,460</b>	<b>2,300</b>
Over 10 years	Over 10 to 25 years	About 150-250	200	5*	<b>190</b>	950	1,000
	Over 25 years	About 50-150	100		<b>80</b>	400	800 - 1,300
<b>Linkers</b>		About 25	-	about 2	25	50	400***
<b>Floaters (in even months)</b>		About 100	-	1 (bimonthly)	100	100	-

\* Scheduled by BOJ \*\* 30Y JGBs to be monthly issued in 700 billion yen per auction, and 40Y JGBs to be bimonthly issued in 400 billion yen per auction in FY2018 \*\*\* JGB Linkers to be issued quarterly

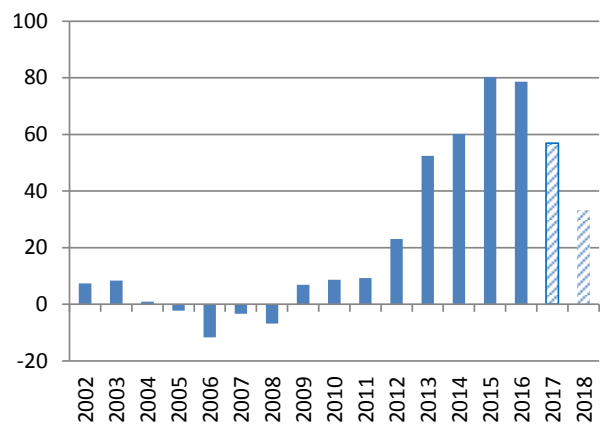
Source: Bank of Japan, Ministry of Finance, Daiwa Securities

**JGB 10Y, 20Y and 30Y Yields (%)**



Note: on-the-run close basis  
Source: Daiwa Securities.

**Y/Y Change in BOJ's Long-term JGB Outstanding (Yen trillions)**



Note: as of end-December; Daiwa forecast for 2017 and 2018  
Source: Bank of Japan, Daiwa Securities

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