

## JGB Insight

### BOJ will control yield uptrend by fixed-rate purchase operation

- ✓ Given an uptrend of the 10Y US Treasury yield to the 2.6% level, the anticipation of a higher yield appears to be intensifying even in the JGB market. If the 10Y JGB yield rises to 0.1% or above in the near term, we think that the BOJ will offer a fixed-rate operation with the target of 0.110% as it did previously.
- ✓ Over the medium/long term, the 0.110% target of the fixed-rate purchase operation could be raised under the current long-term interest rate guideline of “around 0%,” though it would be extremely challenging for the BOJ to step into such an operational adjustment.

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This week, the JGB futures (on the lead contract basis) edged down to the lowest level since October 2017, and the 10Y JGB yield temporarily rose to 0.090% on an intraday basis. Given an uptrend of the 10Y US Treasury yield to the 2.6% level, the anticipation of a higher yield appears to be intensifying even in the JGB market. We wonder now what action the BOJ will take in the case of the 10Y JGB yield rising to 0.1%. Possible options for the BOJ can be to increase in the JGB purchase amount for JGBs with over 5 to 10 years left to maturity, offer a fixed-rate purchase operation, or offer those at the same time, and we think that the BOJ will offer a fixed-rate purchase operation.

### Tough to curb upward pressure in yield by increasing purchase amount alone

When the 10Y JGB yield rose to the 0.1% level during late January-early February 2017, the BOJ increased the offer amount for JGBs in the 5-10Y zone in its purchase operations (from 410 billion yen to 450 billion yen) to curb the yield uptrend, which led the yield down below 0.1% (Jan. 27). However, the Outline of Outright Purchases of JGBs for February, announced at end-January, implied a reduction in the offer amount in the zone (from 450 billion yen to 410 billion yen), which again pushed up the 10Y JGB yield to the 0.1% level. On February 3, just after the BOJ announced to buy about 450 billion yen of JGBs in the 5-10Y zone, which was the same amount with that on January 27, the 10Y JGB yield surged to 0.150%. Immediately after the surge, the BOJ offered a fixed-rate purchase operation with the 0.110% target on the 10Y JGB yield. Also on the following business day, the central bank irregularly offered to buy about 450 billion yen of JGBs in the same zone to stabilize the market. It appears that the BOJ was struggled hard to control the yield upward pressure with the quantity, as witnessed by the fact that the total amount of JGBs bought was seen eventually greater than the BOJ initially expected (e.g., the purchase amount via the fixed-rate purchase operation exceeded 700 billion yen). After that, the offer size in the zone was unchanged (at 450 billion yen) until July. Learning a lesson from the previous case, the BOJ coped with the uptrend of the 10Y JGB yield to the 0.1% level in July by offering both (1) an increase in the offer amount in the 5-10Y zone (from 450 billion yen to 500 billion yen) and (2) a fixed-rate purchase operation with the 0.110% target at the same time on the same day. After that, the BOJ scaled back the offer amount in the zone to 410 billion yen, the amount the BOJ offered in late January, step by step just in about one month.

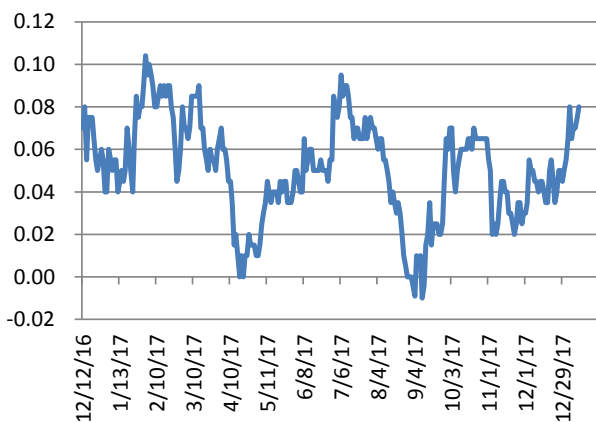
### Once the offer amount is raised, it would need to be reduced

Once the offer amount is raised, it would need to be reduced. As last week's trimming in the purchase amount of JGBs with over 10 years left to maturity caused unexpected side effects such as substantial appreciation of the yen, it seems difficult for the BOJ to trim the purchase amount in a short span of time even if it is aimed at adjusting the increased amount. In addition, it appears that the offer amount needs to be raised by around 40-50 billion yen (per operation) in order to control the upward pressure on yields. If the 10Y JGB yield rises to 0.1% or above in the near term, the BOJ will highly likely offer a fixed-rate purchase operation with the 0.110% target as it did at the previous cases. The fixed-rate purchase operation will be symbolic for the yield curve control policy and be easily understood in the market as the BOJ shows its commitment to the current policy.

**The fixed-rate target could be raised at some time under the guideline of “around 0%,” though it would be extremely challenging for the BOJ to step into it**

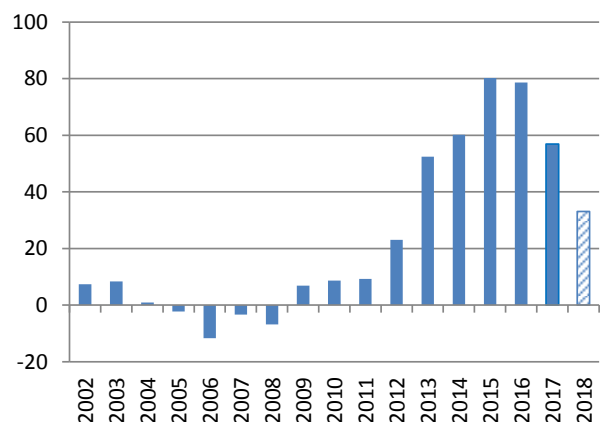
Regarding the 0.110% target of fixed-rate purchase operations on 10Y JGBs, it may be gradually raised, for example, to 0.115%, then 0.120% etc., over the medium/long term. We think that it will be highly possible for the BOJ to take such an action even under the current yield curve control framework with the long-term interest rate guideline of “around 0%”. In the policy statement, for example, the BOJ has been keeping the quantity guide of “an annual pace of about 80 trillion yen,” though it is not a policy directive, despite the fact that the outstanding of the BOJ’s JGB holding increased just only about 58 trillion yen y/y in 2017. Given the yardstick, the BOJ may insist that even 0.110% or 0.2% can be still within the “around 0%” range. In terms of communication with the markets, however, it will be extremely challenging for the BOJ to step into such an operational adjustment in the environment where market participants pay close attention to the global normalization trend in monetary policies.

**JGB 10Y Yield (%)**



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 2018  
Source: Bank of Japan, Daiwa Securities

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