

Minutes of the 22nd Round of the "Bond Market Group" Meetings

1. Outline

(1) Date	Commercial banks group	May 20 at 3:45 pm
	Securities firms group	May 20 at 5:30 pm
	Buy-side group	May 21 at 4:00 pm

(2) Place The Head Office of the Bank of Japan

(3) Participants

- Persons in charge of bond market issues in financial institutions including those who participate 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) recent developments in the financial markets and market operations, (2) liquidity in the JGB market, and (3) the results of the "Bond Market Survey," and presented (4) participants' views collected before the meeting.

3. Views provided by participants

- The Bank asked participants their views on (1) recent trends in and the functioning of the JGB market given the reduction of the Bank's purchase amount of JGBs thus far, (2) the current plan for the reduction, (3) the Bank's JGB purchases from April 2026, and (4) other related issues. Views provided by participants, including those collected prior to the meeting, are as follows.

Recent trends in the Japanese government bond market

- JGB yields rose toward the end of March, due to the policy rate hike by the Bank and the reduction in its purchases of JGBs. Under these circumstances, it was

observed on some occasions that investors held back on purchasing in the bond market, citing uncertainty over the terminal policy rate and fiscal year-end factors, leading to a worsening of supply and demand conditions.

- After the start of April, triggered by the announcement of the U.S. tariff policy, expectations for policy rate hikes by the Bank receded, amid concerns over an economic slowdown. As a result, the yields on JGBs with residual maturities of up to 10 years declined significantly.
- In the medium- to long-term zone, supply and demand conditions have been tight, because investors, such as domestic banks, have been purchasing bonds in this zone since the beginning of this fiscal year.
- In the super-long-term zone, supply and demand conditions deteriorated markedly, and interest rates rose significantly. This was led by the unwinding of asset swaps and flattener positions triggered by the announcement of the U.S. tariff policy, while the structural market change has also been taking place in terms of reduced demand from life insurance companies. Regarding supply and demand conditions in this zone, attention should also be paid to the impact of investors' speculations over fiscal policy.

Functioning of the Japanese government bond market

- With the Bank's gradual reduction in its JGB purchases, market functioning has been improving, in terms of market liquidity and more market-driven interest rates.
- Owing to the reduction of the Bank's repurchase amount of the cheapest-to-deliver (CTD) issues under the Securities Lending Facility (SLF), the liquidity of the CTD issues has improved compared with a while ago.
- Amid increased volatility, market participants' risk tolerance decreased after the beginning of April. Market liquidity accordingly declined, especially in the super-long-term zone, where supply-demand imbalances were significant. Although the overall market liquidity has been recovering recently, the liquidity in the super-long-term zone has yet to improve.
- Market participants have been particularly concerned about the significant decline in market liquidity in the super-long-term zone, and a sort of market fragmentation has occurred between the short- to long-term zone and the super-

long-term zone. Under these circumstances, it has become difficult to effectively hedge against risks in the super-long-term zone through, for example, 10-year JGB futures.

- There is a significant difference in the Bank's holding share between JGBs with residual maturities of up to 10 years and those with residual maturities of more than 10 years. This has also acted as a factor that brought about the steepening of the yield curve and the market fragmentation since the start of April.
- With the stock effects of the Bank's JGB holdings remaining, the rise in interest rates has been muted relative to the levels justified by expectations for the Bank's policy rate hikes and by economic fundamentals. In this situation, investor demand for JGBs has not been sufficiently stimulated, and the improvement of market functioning is still only halfway accomplished.

The current plan for the reduction of the Bank's purchase amount of JGBs

- Since the reduction has been gradual, the Bank's holding share of JGBs with residual maturities of up to 10 years has remained high; this has made the amount of JGBs in the secondary market insufficient to meet investors' demand and has caused distortions in the yield curve. This situation indicates that market functioning has not improved sufficiently. The Bank should therefore amend the plan to aim at a significant reduction done at once of its purchase amount of JGBs, especially JGBs with residual maturities of up to 10 years.
- The Bank should further reduce its purchases of JGBs to address the market fragmentation and improve market functioning as soon as possible. In doing so, the Bank should amend the plan to accelerate the pace of the reduction, rather than to reduce the purchase amount by a significant size all at one time.
- Given the recent developments in the JGB market, the reduction may have an adverse impact on market liquidity; the Bank should change the pace of the reduction to a more gradual one.
- It is undesirable for the Bank to change the current plan for the reduction, because accelerating the pace of the reduction could rather lead to a deterioration in market functioning, given that risk tolerance in the overall market has declined due to increased volatility and supply and demand conditions have deteriorated. Meanwhile, slowing the pace of the reduction in the middle of the current plan is also inappropriate. This is because we recognize that the reduction is a part of

the normalization of monetary policy and such amendment to the plan will send a misleading signal to the market.

- The Bank should maintain predictability and avoid causing market shocks that can rather impede the reduction of the purchase amount of JGBs. Therefore, the Bank should continue with the current plan without making any modification, such as accelerating the pace of the reduction and reducing the purchase amount by a significant size at one time.
- If the liquidity of the JGB market significantly declines in specific maturity zones, as recently observed in the super-long-term zone, the Bank needs to carefully consider how it allocates the reduction amount of its JGB purchases across maturity segments. That said, it is important for the Bank to maintain the predictability of the total amount and pace of the reduction, and thus the current reduction plan itself should not be changed.
- Under the current reduction plan, the amount of the Bank's JGB purchases has been steadily reduced without causing significant market volatility. This, coupled with the measures implemented by the Bank regarding the SLF, has led to a moderate recovery in market functioning. We appreciate such developments and believe that it is appropriate for the Bank to execute the current plan without any modification.
- The recent decline in market liquidity has been caused by U.S. tariff policy, a factor not related to the Bank's reduction in its JGB purchases. The Bank should proceed with the reduction as planned.

The Bank's purchases of JGBs from April 2026: the pace of its JGB purchases

(Views on the pace of the reduction in the amount of the Bank's monthly JGB purchases)

- In order to increase the amount of JGBs in the secondary market and ensure that interest rates are allowed to move more freely as soon as possible, the Bank should accelerate the pace of the reduction from the current pace of reducing the amount of its monthly JGB purchases by 400 billion yen per calendar quarter.
- Market participants have adapted to the current pace of the reduction without major disruption. There is no problem with the Bank maintaining the current pace of the reduction and continuing to reduce its monthly purchase amount by

400 billion yen per calendar quarter.

- From the viewpoint of predictability, the Bank should maintain the current pace of the reduction.
- The Bank should indicate the desirable amount of its monthly JGB purchases and continue to proceed with the reduction at the current pace until such level is reached.
- To continue to proceed with the reduction while taking into account the risk that supply and demand conditions will become more likely to deteriorate when markets are volatile, the amount of the reduction per calendar quarter should be lowered to around 200 billion yen.
- Given the difficulty of identifying the optimal level of the Bank's JGB holdings, it is necessary for the Bank to take a cautious approach in proceeding with the reduction by taking due account of market reactions. It is desirable for the Bank to decrease the reduction amount to about 200 billion yen per calendar quarter.
- The pace of the reduction should be slowed down, taking into consideration that the Bank's purchase amount of JGBs will decrease to a certain level even under the current plan.
- There is a risk that further reduction in the Bank's JGB purchases could heighten concerns over supply and demand conditions, resulting in investment in JGBs being held back; the Bank should consider a temporary suspension of the reduction as an option.
- The Bank should end the gradual reduction in its JGB purchases and instead reduce the purchase amount by a significant size at one time.

(Views on the way to present the guideline for the Bank's JGB purchases)

- It is desirable for the Bank to present a plan for the next two years or so, as with the current plan formulated in July 2024, by extending the current plan by one year.
- The Bank should announce a stance by committing to reducing the amount of its JGB purchases to a desirable level within one year from April 2026 and maintaining that level thereafter.

The Bank's purchases of JGBs from April 2026: the amount of monthly purchases and others

(Views on the amount of the Bank's monthly JGB purchases at the end of the new planning period)

- The Bank should continue to proceed with the reduction until the amount of its JGB purchases reaches zero, so that interest rates are allowed to move freely in the market.
- The Bank should maintain the current pace of the reduction for one year and reduce the amount of monthly purchases until it reaches about 1 trillion yen. At this level of the purchase amount, the stock effects of the Bank's JGB holdings would not rapidly diminish and the Bank could continue to meet the demand for central bank reserves for the foreseeable future.
- The amount of the Bank's monthly purchases of JGBs should be reduced to about 1 to 2 trillion yen, the level before the Bank greatly increased the purchases. From the viewpoint of market liquidity, maintaining such a level of JGB purchases is more desirable than reducing the purchase amount to zero, because that would afford opportunities for market participants to sell issues with low liquidity to the Bank.
- It is desirable for the Bank to continue to proceed with the reduction at the current pace until the amount of its monthly purchases reaches about 1.5 to 2 trillion yen.
- To enhance market functioning through the reduction while taking into account the JGB holding capacity of domestic investors, it is desirable for the Bank to continue to carefully proceed with the reduction until the amount of its monthly purchases of JGBs reaches about 2 trillion yen.
- It is desirable for the Bank to maintain its monthly purchases of JGBs at about 3 trillion yen for a while. With this level of JGB purchases, it is unlikely that the supply-demand balance will be disrupted and that the financial system will become unstable. The Bank's JGB holdings will also gradually decrease. If the Bank decides to further reduce its monthly purchases of JGBs, it needs to assess the holding capacity of banks faced with constraints related to the IRRBB, as well as of other investors.

(Other issues)

- As for the guideline for the Bank's JGB purchases from April 2026, flexibility should be maintained by, for example, conducting an additional interim assessment.
- When announcing a long-term plan for its JGB purchases, the Bank can enhance predictability by indicating its view on its balance sheet, including the optimal level of excess reserves.
- The Bank should assess whether supply and demand imbalances of super-long-term JGBs will continue, before it discusses the guideline for its JGB purchases from April 2026.

Views on other related issues

(Views on the amount of the Bank's JGB purchases by maturity segment, approach to defining maturity segments, and the conduct of nimble JGB purchase operations)

- Market liquidity in the super-long-term zone has declined significantly. The Bank should consider making flexible responses for this zone by, for example, suspending the reduction in its JGB purchases, increasing the amount of its JGB purchases, and consolidating the maturity segments for JGBs with residual maturities of (a) more than 10 years and up to 25 years and (b) more than 25 years. At the same time, since the share of its holdings of JGBs with residual maturities of up to 10 years is high, the Bank should place priority on reducing its purchases in this zone, focusing on the maturity segments with tight supply and demand conditions.
- If the Bank consolidates the maturity segments for JGBs with residual maturities of more than 10 years, the Bank can purchase JGBs in a way that better reflects supply and demand conditions, and this can contribute to improving market liquidity in the super-long-term zone.
- The consolidation of the maturity segments for JGBs with residual maturities of more than 10 years is not an option at this point, but will rather be an option at some point in the future when the Bank's purchase amount of JGBs becomes much smaller. If the Bank were to consolidate the segments now, the Bank might end up buying more JGBs with longer residual maturities, thereby leading to an unintended extension of the duration of JGBs the Bank purchases.

- If maturity segments are consolidated when the amount of the Bank's JGB purchases in the super-long-term zone is still large, the price formation in this zone can suddenly change and market participants may perceive it as an unexpected shock. The consolidation should be carefully considered.
- Market developments in the super-long-term zone may spill over and adversely affect the medium- to long-term zone. It is desirable for the Bank to continue to pay close attention to market functioning and liquidity and not to eliminate room for making flexible responses as necessary by, for example, conducting unscheduled purchases of JGBs and/or modifying the amount of its JGB purchases in each maturity segment.
- It is undesirable to increase the amount of the Bank's JGB purchases in the super-long-term zone, because that will lead to lower predictability and higher uncertainty. There is a risk that a hasty increase will make market expectations uncontrollable and impede future reductions. In principle, the Bank should focus on carefully assessing the timing of further reductions.
- The deterioration in supply and demand conditions in the super-long-term zone is due to a structural factor that demand from investors is weak relative to the issuance amount. There is thus limited room for the Bank to address the root cause.
- When deciding on the amount of its JGB purchases in each maturity segment, the Bank should take into account the share of its JGB holdings in the outstanding amount, in addition to the share of its purchases in the issuance amount.
- The Bank should examine the optimal maturity structure of its JGB holdings and reflect it in the Bank's guideline for JGB purchases.
- Since the purchase size per auction will decline as the Bank proceeds with the reduction, it might be necessary for the Bank to review the current frequency and maturity segments of its JGB purchase operations.

(Views on the SLF and others)

- The prices of certain JGB issues with a residual maturity of five to seven years of which the Bank holds a significant share have constantly remained relatively high. In order to reduce distortions in the yield curve, the Bank should consider

taking flexible measures, such as increasing the upper limit on the reduction of the repurchase amount of JGBs under the SLF and expanding the issues applicable to the relaxed conditions for the SLF.

- Increasing the upper limit on the reduction of the repurchase amount of JGBs under the SLF and expanding the issues applicable to the relaxed conditions for the SLF will improve the effectiveness of hedges with JGB futures. In addition, the Bank could improve market functioning by implementing the following measures: (1) setting the minimum fee rate for the SLF at a relatively low level for certain JGB issues of which the Bank holds a significant share and (2) modifying its JGB purchase operations, given that the difference in daily changes in yields on JGBs with coupons is widening between when calculated on a simple yield basis and on a compound yield basis.