

Can BOJ control yield curve?

- Market participants are increasingly getting interested in how BOJ would control yield curve going forward.
- JGB's yield curve has steepened as BOJ reduced purchase of JGB in October and differed purchasing super long-term government bond for the time being.
- However, effectiveness of yield curve control will possibly differ by the rising or falling phase of interest rate.

Market participants are increasingly getting interested in how BOJ would control yield curve going forward

BOJ introduced “Yield Curve Control” (manipulation of short and long term interest rate) as one of a new monetary policy framework on 21st September 2016. After the introduction, market is increasingly focusing on whether BOJ can really control yield curve or not. In this report, we would like to think through how BOJ will control yield curve by referring to its JGB purchase plan announced recently.

Meanwhile, there is a column titled “Q&A to learn about BOJ’s monetary control” on BOJ’s web site and its question number 6 is “Wouldn’t BOJ manipulate long-term interest rate?”. The answer is “It is important to let market decide long-term interest rate as it is influenced significantly by future inflation rate forecast by market participants”. However, according to BOJ, they are now in the process of reviewing this column as it was last revised a while ago.

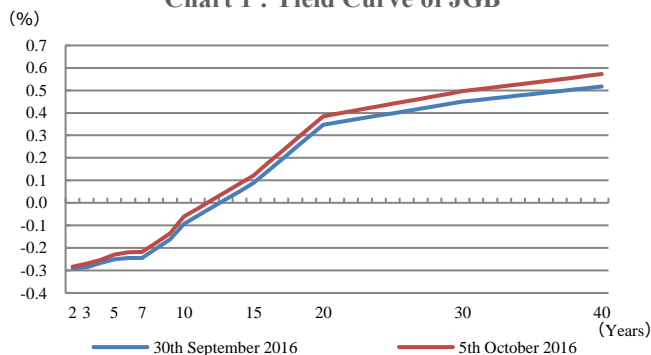
“Table 1: BOJ’s Monthly Purchase Plan of JGB”

(JPY Billion)

Year to Maturity	September (First Allotment)	October (First Allotment)	Amount Changed
Less than 1 year	Approx. 70	Approx. 70	0
Over 1 year and less than 3 years	Approx. 400	Approx. 400	0
Over 3 year and less than 5 years	Approx. 420	Approx. 420	0
Over 5 year and less than 10 years	Approx. 430	Approx. 410	-20
Over 10 year and less than 25 years	Approx. 200	Approx. 190	-10
Over 25 years	Approx. 120	Approx. 110	-10

(Note) Only fixed rate government bond (inflation-linked bond and floating rate note are excluded). (Source) SMAM, based on Bloomberg L.P. data.
 (Source) SMAM, based on BOJ’s information.

“Chart 1 : Yield Curve of JGB”



(Note) Yields of i) 10 years to 15 years, ii) 15 years to 20 years, iii) 20 years to 30 years and iv) 30 years to 40 years are based on time distribution.
 (Source) SMAM, based on Bloomberg L.P. data.

JGB's yield curve has steepened as BOJ reduced purchase of JGB in October and differed purchasing super long-term government bond for the time being

BOJ announced plan of JGB purchase amount in October in the evening of 30th September and indicated a reduction in purchase volume. In concrete, (i) reduce JPY 20 billion per purchase of JGBs with year to maturity “over 5 years and less than 10 years” and (ii) reduce JPY 10 billion per purchase for those of “over 10 years and less than 25 years” and “over 25 years” (Table 1). Market was focusing on the change of October's JGB purchase amount. Their overall assessment on reduction amount seems to be less than expected.

Although BOJ implemented funds-supplying operations on 3rd and 5th October, it differed purchase of super long-term government bond (JGB with yield to maturity of over 10 years). Currently, yield curve is steepening in the wake of a series of market operations which is in line with BOJ's intention (Chart 1). However, we need to take note that long-term interest rate hike of Europe and US due to (i) possible tapering of monetary easing by European Central Bank (ECB) and (ii) strong US economic data, is also influencing JGB's yield hike in a way.

However, effectiveness of yield curve control will possibly differ by the rising or falling phase of interest rate

BOJ announced funds-supplying operations of JGB in the morning of 30th September. Purchase amount of JGB with yield to maturity of “over 5 years and less than 10 years” was reduced to JPY 410 billion from their usual purchase amount of JPY 430 billion. View of negative 0.1% as a lower limit of 10-year JGB's yield is spreading in the market, as BOJ reduced JGB's purchase amount before the announcement of its October number scheduled in the evening of the same day.

Meanwhile, effectiveness of yield curve control will possibly differ by the rising or falling phase of interest rate. In the phase of rising interest rate, BOJ seems to be able to significantly lower interest rate by (i) fixed-rate purchase operation and (ii) fixed-rate funds-supply operation of period of 10 years. On the other hand, in the phase of falling interest rate, if BOJ reduces its JGB purchase amount aiming at raising interest rate and market takes it as a tapering of monetary easing, JPY will appreciate. This will lower anticipated inflation rate, which might push down interest rate further.

*** Please note that this report is a translation of Japanese report written on 6th October, 2016.**

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