

Liquid Insight

Impact of a potential BoJ shift to a single-tier IOER structure post-NIRP

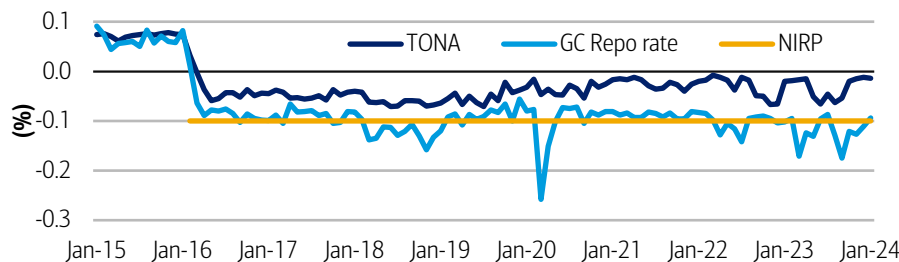
Key takeaways

- Recent comments by BoJ Deputy Governor Uchida and others raise expectations for a single-tier IOER structure post-NIRP
- A single-tier structure would likely bring TONA and GC repo rates into the 0%-0.1% range
- Rising expectations for reduced Rinban operations could cause steepening of the 2yr10yr curve

By Tomonobu Yamashita and Shusuke Yamada

Chart of the day: TONA, GC repo rate and NIRP (monthly averages)

Opting for a single-tier structure after exiting NIRP would push short-term rates into positive



Source: Bloomberg, BofA Global Research

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Impact of a shift from three-tier to single-tier

Comments made by BoJ Deputy Governor Shinichi Uchida in a speech on 8 February about the potential NIRP end¹ and a 3m3m forward rate slightly below 0.1% have raised expectations that the BoJ will end its negative interest rate policy (NIRP) and shift from its current three-tier IOER structure to a single-tier structure at its Monetary Policy Meeting (MPM) on 18-19 March or the following MPM on 25-26 April. In this report, we present the likely impact of a change to a single-tier structure on short-term interest rates, BoJ finances, and the JGB market.

Single-tier structure's cost benefits

The greatest benefit of switching to a single-tier IOER structure would be the simplification of the BoJ's complex current account deposit system. On the other hand, the major negatives would be an after-the-fact shift in incentives for lending operations currently in use and a sharp increase in the BoJ's interest payments (see: [Japan Rates Viewpoint: Post-NIRP IOER tiering structure and market implications 23 October 2023](#)).

¹ https://www.boj.or.jp/en/about/press/koen_2024/ko240208a.htm "The first question is how to set the short-term policy interest rate if the Bank terminates its negative interest rate policy. Before introducing this policy, the Bank applied a 0.1 percent interest rate to the excess reserves in current accounts held by financial institutions at the Bank"

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Refer to important disclosures on page 5 to 7.

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TONA likely to rise to slightly below 0.1%

If the BoJ shifts to a single-tier IOER structure with a +0.1% interest rate after ending NIRP, we would expect the Tokyo overnight average call rate (TONA) to move from its current negative rate into positive territory at around 0.05-0.10% (Chart of the day). This is because Japanese banks would likely engage in arbitrage borrowing of funds on the call market from investment trusts and other lenders at rates below the IOER rate and then deposit those funds in their current accounts with the BoJ. Domestic banks, securities companies, and money market brokers have current accounts with the BoJ but investment trusts and insurance companies do not. However, all are active in the call market.

GC repo rate likely to rise to around 0–0.05%

While quarter-end spikes in collateral demand can push the Tokyo repo rate more deeply into negative territory, the overnight GC repo rate remains at around -0.1%, several basis points below TONA. TONA and GC repo rates were generally around the same level prior to NIRP, but bond borrowing fees rose mainly on a decline in JGB market liquidity caused by the BoJ's excessive purchases of JGBs. As a result, the Tokyo repo rate has trended below TONA. Accordingly, if the BoJ exits NIRP at its March or April MPM and shifts to a single-tier IOER structure, we think the GC repo rate will rise to around 0.00–0.05%.

Concerns about BoJ finances

A move to a single-tier IOER structure after the BoJ exits NIRP could raise more concerns about the central bank's finances than a two-tier structure. Current account deposits with the BoJ now exceed ¥500tn. Shifting the balance of deposits in the negative interest rate tier to the zero interest rate tier would increase the BoJ's annual interest burden to about ¥210bn. Applying a +0.1% interest rate to all BoJ current account deposits would add another ¥310bn to that burden, bringing the central bank's annual interest payment on current deposit accounts to ¥520bn.

However, the BoJ reported ¥3.2tn in operating profit in FY22, and shifting to a single-tier IOER structure will not immediately lead to an operating loss. On the other hand, the market may perceive the lack of any accounting rules for BoJ losses makes a hurdle for hiking a single-tier policy rate to 0.5-0.6% and above high (see [Japan Watch: Impact of potential BoJ rate hikes \(part 3\): Effect on BoJ finances 10 October 2023](#)).

Additional rate hikes may not be priced in too soon

In a speech on 8 February, BoJ Deputy Governor Uchida said that “even if the Bank were to terminate the negative interest rate policy, it is hard to imagine a path in which it would then keep raising the interest rate rapidly. The Bank would, I think, maintain accommodative financial conditions.” Our economists forecast that the BoJ will raise its policy rate to 0.25% in Oct-Dec 2024 and again in Apr-Jun 2025, bringing its policy rate to 0.5% by mid-2025 (see [Japan Watch: BoJ Watch: Eyes on April 11 January 2024](#)). 18m x 1m OIS trades at 0.44% so the market also almost prices in two additional hikes by mid-2025.

Considering the Deputy Governor Uchida's recent comments, the market may not rush to price in more hikes than currently priced. Accordingly, although short-term rates are rising on heightened expectations for a shift to a single-tier IOER structure, we think there may be little room for further rises in the near-term.

2yr10yr JGB yield curve could steepen

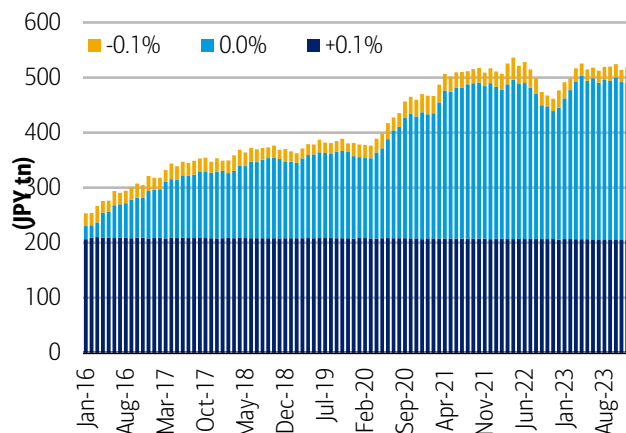
Shifting to a single-tier structure could raise investor expectations for a reduction in the BoJ's bond purchases, i.e., a de facto start of quantitative tightening (QT). As noted above, from the perspective of the BoJ's finances, the more than ¥500tn of current account deposits on its balance sheet may hinder additional rate hikes. The BoJ's current monthly purchases of JGBs are generally equivalent to the ¥5.9tn in scheduled average monthly redemptions of its current holdings during 2024. Accordingly, if the BoJ were to

reduce its Rinban operation for outright purchases of JGBs it would amount to a de facto start of QT that over the longer-term would reduce the central bank's current account deposits and its interest payments.

According to our most recent FX and Rates Sentiment Survey (see [FX and Rates Sentiment Survey: Self confident 09 February 2024](#)), investors expect the yield on 10yr JGBs to exceed 1.0% after the BoJ exits NIRP and its yield curve control (YCC). We think those expectations point to a possible steepening of the 2yr10yr curve (see [Japan Rates Watch: Growing expectations for BoJ pivot could steepen 2yr10yr curve 01 February 2024](#)).

Exhibit 1: BoJ current account deposits

BoJ's current account deposits exceed ¥500tn

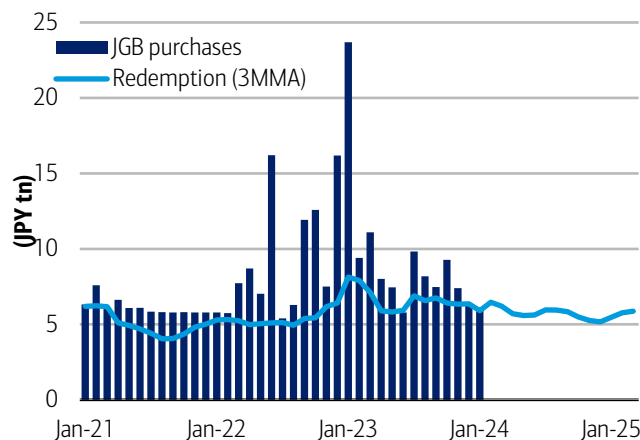


Source: Bank of Japan, BofA Global Research

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Exhibit 2: BoJ JGB purchases and scheduled JGB redemptions

Recent purchases largely in line with future redemption amounts



Source: Bank of Japan, Bloomberg, BofA Global Research

Note: Redemption amount is a 3-month moving average

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Exhibit 3: Ratios of BoJ holdings of outstanding JGBs (as of 9 Feb)

BoJ holding ratios particularly high for maturities up to 10 years

2Y	Current Ratio	5Y	Current Ratio	10Y	Current Ratio	20Y	Current Ratio	30Y	Current Ratio	40Y	Current Ratio
JN457	3.2%	JS165	0.0%	JB373	16.7%	JL187	1.0%	JX81	2.2%	JU16	8.0%
JN456	19.0%	JS164	27.9%	JB372	53.7%	JL186	8.4%	JX80	9.1%	JU15	17.0%
JN455	8.8%	JS163	51.3%	JB371	56.4%	JL185	10.4%	JX79	2.1%	JU14	0.8%
JN454	21.2%	JS162	51.9%	JB370	78.1%	JL184	24.7%	JX78	6.6%	JU13	0.9%
JN453	55.1%	JS161	48.5%	JB369	88.7%	JL183	22.6%	JX77	19.3%	JU12	7.9%
JN452	24.8%	JS160	60.4%	JB368	93.5%	JL182	14.1%	JX76	10.1%	JU11	19.3%
JN451	16.9%	JS159	40.4%	JB367	89.7%	JL181	8.8%	JX75	8.4%	JU10	34.4%
JN450	64.3%	JS158	56.9%	JB366	95.3%	JL180	3.0%	JX74	7.4%	JU9	38.7%
JN449	45.3%	JS157	46.6%	JB365	83.7%	JL179	2.5%	JX73	0.4%	JU8	53.3%
JN448	41.7%	JS156	79.9%	JB364	82.7%	JL178	3.8%	JX72	4.3%	JU7	49.5%
JN447	50.3%	JS155	69.6%	JB363	81.0%	JL177	4.0%	JX71	7.9%	JU6	42.7%
JN446	36.2%	JS154	67.4%	JB362	84.7%	JL176	17.3%	JX70	4.6%	JU5	8.7%
JN445	29.7%	JS153	65.0%	JB361	87.8%	JL175	7.5%	JX69	2.1%	JU4	14.5%
JN444	17.6%	JS152	58.2%	JB360	87.9%	JL174	8.8%	JX68	8.7%	JU3	17.2%
JN443	37.6%	JS151	60.7%	JB359	87.1%	JL173	11.6%	JX67	13.0%	JU2	7.0%
JN442	39.5%	JS150	70.3%	JB358	85.6%	JL172	6.1%	JX66	4.1%	JU1	34.4%
JN441	42.5%	JS149	73.7%	JB357	90.6%	JL171	8.8%	JX65	4.0%		
JN440	36.5%	JS148	80.0%	JB356	89.1%	JL170	24.5%	JX64	31.5%		
JN439	52.6%	JS147	77.2%	JB355	89.3%	JL169	23.8%	JX63	22.5%		
JN438	47.3%	JS146	76.2%	JB354	90.6%	JL168	29.2%	JX62	19.7%		

Source: Bank of Japan, Bloomberg, BofA Global Research

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