18 March 2025

Fixed Income | Japan **Macro Information**

BOJ watch: Bank reluctant to intervene on JGB market, but how would it proceed if it did?

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Comments by Governor Ueda continue to suggest the BOJ is indifferent to the sharp recent declines in JGB prices (and the surge in the 10y bond yield). However, the impact of that stance on Japanese bond market psychology has been modest, at least when compared with the US, where equity investors were shocked by statements from President Trump and Treasury Secretary Scott Bessent indicating a willingness to allow the sharp declines in US stock prices to continue.

Bloomberg reported on 13 March that sources said the BOJ was reluctant to intervene in the bond market despite the recent rise in the 10y JGB yield. The article contained a number of relevant passages:

"Several sources say the BOJ, having abandoned its highly unusual policy of targeting the 10y JGB yield with yield curve control (YCC) last March, has no intention of intervening on the bond market barring the emergence of extreme volatility. The Bank believes that encouraging the free formation of interest rates will lead to a recovery in market functioning, which deteriorated during the long period of interest rate suppression. Intervention could refocus attention on specific interest rate levels."

"Although the 10y JGB yield recently climbed above the 1.5% level for the first time in some 16 years, this move falls within the range of healthy volatility and is not seen as being abnormal (or as being driven by abnormal factors). The Bank believes the market action reflects strong wage and price indicators and information, the resulting changes in the outlook for BOJ monetary policy, and recent movements in US and European rates, and it is said to be far from a situation where it would see the need to do something to curb the rise in yields."

"Sources say that BOJ officials do not have any specific interest rate levels or rates of change in mind when referring to 'exceptional circumstances.' However, they say the Bank might be required to act if market concerns escalated in response to, say, a shock that prompted an excessive widening of risk premia, a deterioration in market functioning sufficient to interfere with bond trading, or a dramatic rise in the 10y bond yield triggered by panic selling of JGBs."

Since scrapping the policy of yield curve control last March, the BOJ has shifted to a stance of refraining from intervention in the bond market as much as possible. Its basic view is that bond prices formed freely as the result of market transactions deserve to be respected.

In the event of a market panic or other extreme turmoil, however, the Bank could implement measures (such as an increase in its bond purchases) aimed at stabilizing the market and smoothing price action, much like the "smoothing operations" that are conducted in the forex market.

There is a standard process for intervening in the currency market. MOF officials first engage in more active “jawboning,” the authorities conduct “rate checks,” in which they request quotes from dealers in a prelude to actual intervention, and finally they enter the market and begin buying and selling currencies. What sort of steps would the BOJ take if it wanted to stabilize a bond market in turmoil?

The Bloomberg article noted above stated that “some say the Bank would not need to actually step up its bond purchases or take other concrete action but could instead accomplish its objectives via its dialogue with the market, including statements by the governor. The final option for curbing interest rates would be fixed-rate purchase operations, in which the central bank offers to buy an unlimited quantity of bonds at a fixed yield.”

That suggests that if the BOJ wanted to steady a shaky bond market, it would begin with market dialogue (jawboning), proceed by stepping up its JGB purchases, and, if necessary, conduct fixed-rate purchase operations. We suspect it would prefer to avoid the final option since that would anchor a specific level in the minds of market participants.

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This report was completed and first disseminated at approximately March 18, 2025, 10:20 (Japan Standard Time).

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