BOJ to Conduct More Bond Purchase Operations to Stem Volatility
2013-05-30 09:00:07.333 GMT

By Toru Fujioka and Masahiro Hidaka

May 30 (Bloomberg) -- The Bank of Japan will increase the number of its monthly government bond purchases after market participants yesterday asked for the move to tame volatility in debt prices.

The central bank will purchase Japanese government bonds about 8 to 10 times a month starting June, compared with the current pace of around 8 times, according to a BOJ statement today in Tokyo. In a meeting with central bank officials yesterday, most market participants agreed to a proposal to boost such operations.

The BOJ is trying to steady a debt market where volatility has risen to the highest in four years in the wake of unprecedented monetary easing steps last month. Yesterday's gathering with bond market players is the third under the tenure of Governor Haruhiko Kuroda, who last week reiterated a pledge to improve communication on central bank policy.

"The bank has allowed excessive volatility to remain in the JGB market for as much as seven weeks," Shogo Fujita, the chief Japanese bond strategist in Tokyo at Bank of America Merrill Lynch, one of the 24 primary dealers obliged to bid at government auctions, said before yesterday's meeting. "The situation doesn't raise Kuroda's credibility so far."

The yield on the benchmark 10-year Japanese government bond jumped to a more than one-year high of 1 percent last week, even after the BOJ pledged to double bond purchases to end 15 years of deflation in the world's third-largest economy. Kuroda indicated this week that Japan can weather an increase in yields if it occurs alongside an economic recovery.

Debt Burden

Japan's Topix share index has surged more than 50 percent since the middle of November amid optimism for expanded fiscal and monetary stimulus under Prime Minister Shinzo Abe and Kuroda at the central bank. Even so, rising JGB yields threaten the sustainability of what's already the world's largest debt burden and undermine the government's aim to stoke growth through low borrowing costs.

The five-year JGB yield was at 0.385 percent today and earlier this month reached a two-year high of 0.455 percent. That's almost five times the record low of 0.095 percent reached in March ahead of Kuroda's appointment as governor.

Participants at yesterday's meeting said the BOJ should increase buying of one-to-five year notes to reduce volatility, and suggested smaller purchases at each operation, according to an official who asked not to be named, citing the central bank's policy. The average duration of bond purchases now is about seven years, the official said.

Attendees at the meeting didn't think the BOJ should set a rigid target for bond buying or give notice for each operation as the Federal Reserve does, the official told reporters.

Auction Demand

Implied volatility of Japan's 10-year note futures, a measure of expected moves used to price options, climbed to 7.96 percent yesterday, the highest since November 2008, according to data compiled by Bloomberg. A sale of 20-year debt this week drew the lowest demand since August 2012.

The 10-year JGB yield rose three basis points to 0.935 percent yesterday, the highest close since April 2012. The rate has almost tripled from the record low 0.315 percent reached on April 5. It was at 0.89 percent today.

After meetings with market representatives last month, the BOJ revised its monthly bond purchases to "approximately 7+ trillion yen" ($69.5 billion) per month from an earlier estimate of 7.5 trillion yen.

BOJ policy board member Ryuzo Miyao said this week that the central bank's bond buying will "strongly support" growth by keeping interest rates lower even when improved economic prospects put upward pressure on borrowing costs.

'Healthy Sign'

So far, policy makers are getting the opposite results. As JGB yields climbed, the benchmark lending rate for large corporations, known as the prime rate, rose 10 basis points from its record low to 1.25 percent on May 10, according to Mizuho Corporate Bank Ltd. Rates for 35-year home loans inched higher to 1.81 percent this month from an all-time low of 1.8 percent in April, data from the Japan Housing Finance Agency show.

For supporters of Abenomics like Jesper Koll, JPMorgan Chase & Co.'s head of equity research in Tokyo, the rise in JGB yields is a "healthy sign" that the economy is improving and investors are seeking riskier assets. For J. Kyle Bass, whose Hayman Advisors LP made $500 million amid the U.S. subprime crisis and is now betting on a fiscal collapse in Japan, it means the BOJ will have to "dramatically" increase bond-buying efforts to counteract investor selling.

'BOJ Dominates'

“The BOJ dominates asset markets for better or worse,” Bill Gross, who runs the world’s biggest bond fund at Pacific Investment Management Co., said in a post on Twitter. “Watch JGBs, the yen and the exodus from each.”

Japan’s outstanding debt was 991.6 trillion yen at the end of March, a ministry report showed this month. It’s projected to reach 245 percent of gross domestic product this year, according to an International Monetary Fund estimate, the highest ratio in the world.

Minutes released this week of the BOJ’s April 26 meeting showed divisions on the policy board, where “a few” members see difficulties meeting a 2 percent price goal by the end of March 2016. One member said the bond market could become unstable again, while others said that swings in financial markets had been triggered by perceptions that the BOJ had conflicting goals -- trying to push down interest rates while pursuing inflation.

There are no signs investors have “excessively bullish expectations,” Kuroda said in Tokyo on May 26. He cited an April BOJ report indicating rates could rise by between one and three percentage points in an improving economy without causing financial instability. In parliament today, he said he sought to reduce volatility to make the central bank’s policy effective.

Kuroda’s BOJ has shown it will step into bond markets to stem volatility. When JGB yields touched 1 percent on May 23 and a plunge in bond futures set off a circuit breaker on the stock exchange, the central bank supplied 2 trillion yen to the financial system, its second such market-calming infusion this month.

For Related News and Information:
Bass to Koll Bearish on JGBs From Opposing Corners: Japan Credit
FIFW NSN MNFMF16K50XW <GO>
BOJ Target at Risk as Spreads Show Tame G-7 Prices: Japan Credit
FIFW NSN MN6KN66JIJUS <GO>
World’s Biggest Volatility Jump Spurs Fund Outflow: Japan Credit
FIFW NSN MN31Z26K511U <GO>
Currency forecasts: FXFC <GO>
Bond yield forecasts: BYFC <GO>
World bond performance: WBIS <GO>

--With assistance from Yumi Ikeda in Tokyo. Editors: Ken McCallum, Rocky Swift

To contact the reporters on this story:
Toru Fujioka in Tokyo at +81-3-3201-2158 or
tfujioka1@bloomberg.net;

Masahiro Hidaka in Tokyo at +81-3-3201-3564 or
mhidaka@bloomberg.net

To contact the editor responsible for this story:
Rocky Swift at +81-3-3201-2078 or
rswift5@bloomberg.net