Daiwa's View

Implications of major investor's new JGB portfolio restructuring policy

- Historical significance of similar de facto bond conversion characteristics
- Reduced BOJ *rinban* operations and start of YCC dismantling

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Historical significance of similar de facto bond conversion characteristics

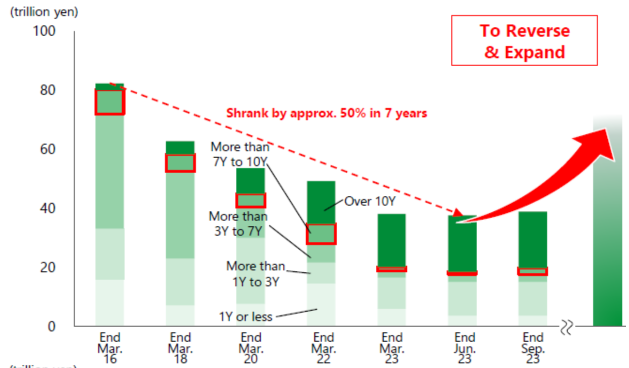
◆ Major bank's new JGB portfolio restructuring policy

On 15 November, Japan Post Bank released materials for its 1H FY23 investors meeting. These materials included plans for restructuring its JGB portfolio by reversing and expanding its balance of JGBs. Here, we will discuss this development as we believe it could impact the JGB market overall.

Japan Post Bank (non-consolidated) boasts Y226.8tn in assets under management and Y194tn in savings as of end-September 2023. So, it goes without saying that Japan Post Bank is a well-known major investor in Japan. Before the BOJ introduced its unprecedented monetary easing in 2013, Japan Post Bank accounted for around 15% of the total JGB balance. However, this balance declined sharply after the BOJ introduced negative interest rates in 2016. Currently, Japan Post Bank's share of the JGB balance is only about 3% (roughly Y40.0tn).

At this investors meeting, Japan Post Bank clearly stated that Y63.0tn in "deposits" held on its non-consolidated balance sheet as of end-September 2023 constituted a "large amount of standby funds available for investment," indicating its intention to expand its holdings of JGBs (total amount of Japan Post Bank's existing JGB holdings and deposits is over Y100tn, which is in step with its ordinary deposits of Y108tn). The BOJ's monetary policy tweaks in July and October of this year created room for Japan Post Bank to significantly increase its JGB holdings. Japan Post Bank said (investors meeting materials) this was a factor that prompted its decision to expand its JGB holdings.

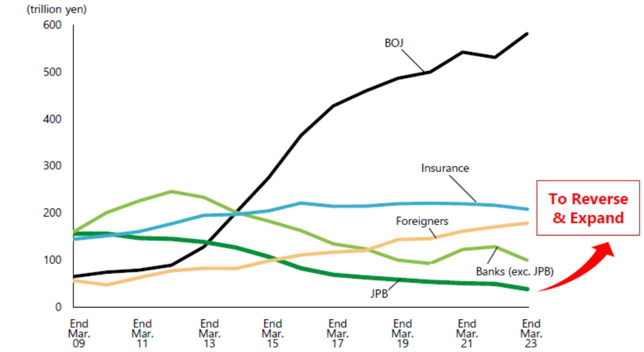
Balance of JGBs Held by Japan Post Bank



(trillion yen)	End Mar. 16	End Mar. 18	End Mar. 20	End Mar. 22	End Mar. 23	End Jun. 23	End Sep. 23
JGB Balance	82.2	62.7	53.6	49.2	38.1	37.6	38.9
More than 7Y to 10Y	8.1	5.8	4.6	6.5	1.3	0.7	1.5

Source: Excerpts from materials provided at Japan Post Bank's 1H FY23 investors meeting.

Balance of JGB Holdings by Business Type



	End Mar. 09	End Mar. 11	End Mar. 13	End Mar. 15	End Mar. 17	End Mar. 19	End Mar. 21	End Mar. 23
BOJ's share	8%	8%	13%	26%	39%	43%	44%	47%
JPB's share	19%	16%	14%	10%	6%	5%	4%	3%

Source: Excerpts from materials provided at Japan Post Bank's 1H FY23 investors meeting.

◆ Historically significant of similar de facto bond conversion

On the surface, this is just an investment shift in step with the recovery of JGB feasibility as an investment. If JGB yields were to decline excessively in response to this announcement, Japan Post Bank would likely put its JGB portfolio restructuring plans on hold (= not talking about a kind of unilateral decline in JGB yields). However, if we take a macroscopic view of this development based on the bank's potential to impact the JGB market, we can see the historical significance of characteristics similar to the end of the Fed's bond price support policy and bond conversion in the history of America's yield curve control policy of the 1940s.

As Daiwa Senior Economist Kenji Yamamoto pointed out in the 20 December 2022 edition of this report ("History and implications of the US version of yield curve control (YCC) in the 1940s"; Japanese only), a spike for long-term bond yields during the process in which a central bank abandons its interest rate peg could result in capital losses for private banks and threaten the stability of the financial system. Naturally, this is also one of the main issues in the BOJ's YCC exit strategy. In this sense, the JGB portfolio restructuring policy hammered out by Japan Post Bank this time does not involve a large-scale process like the "accord" between the Fed and the US Treasury in March 1951. Rather, this suggests that the BOJ may be able to successfully transfer some of its JGB holdings to the private sector, which will be necessary when implementing an exit strategy.

Accord in US

The 1951 "Accord" in the U.S.

-- 1951 Accord --

"The Treasury and the Federal Reserve System have reached full accord with respect to debt-management and monetary policies to be pursued in furthering their common purpose to assure the successful financing of the Government's requirements and, at the same time, to minimize monetization of the public debt."

Changes in Monetary Policy after the Accord

	Before Accord	After Accord
Policy Implementation	• Maintain the cap of the bond yield	• Stabilize prices
Involvement in Government Bond Market	• Purchase the short-term government bonds at a specific rate • Maintain the cap of the long-term bond yield	• Bills Only Policy • Interest rate structure is formed by market forces
Balance Sheet	• Shift from the gold reserve to the government bond holding	• Keep holding mainly the government bonds at the same amount

Source: Excerpted from "History and Theories of Yield Curve Control" by Masayoshi Amamiya (2017).

◆ Reduced *rinban* operations and start of YCC dismantling

Of course, the current short-term interest rate manipulation by central banks in the US and Japan has shifted to policies for guiding rates by attaching interest to reserve deposits based on the existence of ample bank reserve deposits. Also, the BOJ does not necessarily need to return all of its current JGB holdings to the private sector. Nevertheless, everyone agrees that a certain reduction is required considering that the BOJ's current balance is equivalent to about half of the total JGB market, or more than 100% of GDP. This means that a good opportunity has arrived.

If the BOJ is too reluctant to reduce its regular long-term JGB purchasing operations (*rinban* operations), JGB yields could fall excessively and an opportunity to smoothly transfer JGB balances from the BOJ to the private sector would be missed. Of course, that risk is not zero. Still, on 15 November, the BOJ reduced its JGB market *rinban* operations for the first time in a long time (reduced by Y50bn for JGBs with residual maturities of more than 1 year and up to 3 years and by Y100bn for those with residual maturities of more than 5 years and up to 10 years). Coincidentally, that was the same day that Japan's largest deposit-taking institution (Japan Post Bank) announced a new policy for restructuring its JGB portfolio. Should we view this as just a coincidence? Actually, it seems like the YCC dismantling process may have started.

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