

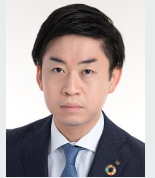
Daiwa's View

Policy choices for BOJ's quantitative tightening

- Reorganization of policy perceptions behind tapering review argument

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Reuters report indicates preference for “stopping or slowing” QT

In a 29 May report, Reuters (English edition) cited BOJ sources as saying that the Bank may consider stopping or [slowing](#) its reduction of JGB purchases, known as tapering, starting next year. Under the current plan, the BOJ is set to slow its pace of JGB purchase reductions to approximately Y200bn each quarter from April 2026 through March 2027, eventually scaling these JGB purchases back to a level of Y2.1tn per month. However, several options for how to operate beyond that point are being taken into account. Specific operations include (1) Proposal to stop reductions starting in FY27 and maintain monthly level of Y2.1tn, (2) Proposal to slow the pace of reductions to Y100bn per quarter, and (3) Proposal to maintain current pace of Y200bn.

Reuters reports that, among these options, stopping or slowing the pace of reductions is emerging as a leading possibility. This suggests that the focus of policy is shifting slightly away from maintaining the status quo. Against this backdrop, there is a shared recognition among BOJ officials that there is no need to rush to reduce the balance sheet during periods of market instability. In fact, while some sources have suggested, “The Bank’s holdings of JGBs have declined significantly and, from the perspective of providing sufficient liquidity to the market, there is room to pause tapering.” Several sources have also indicated that, “If market volatility persists, a slowdown or temporary halt cannot be ruled out.”

This recognition is viewed as consistent with the results of the “Bond Market Group” meeting held on 21-22 May. At that meeting, there were some calls for stopping or slowing down JGB purchase reductions starting in April 2027.

Actually, a Jiji Press article released on 26 May titled “BOJ Mulls Stopping QT; Interim Review of JGB Purchases at June Meeting” also reported that there are, relatively speaking, many cautious views regarding future JGB purchase reductions and that the possibility of temporarily halting the program in March 2027, when the current plan is set to end, is under consideration. Based on these reports, it appears that, at the very least, the prevailing argument among market participants and policy authorities entails a situation that can be viewed as a shift toward stopping or slowing the reduction of JGB purchases, rather than maintaining the reductions.

Institutional realities underlying policy decisions and their relationship with the government

However, any debate over tapering cannot be understood separate from the reality of quantitative tightening. JGBs accumulated by the BOJ during past monetary easing phases are beginning to reach maturity. Some have estimated that even if monthly purchases are maintained at Y2.1tn per month, it is estimated that the balance of JGB holdings (minus redemption amounts) will decline at a rate of approximately Y40tn to Y50tn each year.

A BOJ official also noted that, “In light of the redemption amounts, even if the reduction varies by hundreds of billions of yen, there will be no significant difference in the pace at which the balance declines.” This suggests a clear discrepancy between the purchase amount (flow effect) and the balance adjustment (stock effect). In other words, the suspension of tapering does not constitute a resumption of quantitative easing. Rather it is merely a re-setting of the tapering adjustment pace.

At the same time, policy decisions are also positioned in relation to the government operations. One government official indicated, **“The goal of avoiding higher 10-year JGB yields is shared by the BOJ and the Prime Minister’s Office.”**

The recommendations of the Council on Economic and Fiscal Policy, which state, [“We expect the BOJ to implement appropriate monetary policy while also paying attention to supply/demand conditions for various funds in the market.”](#) include references to the BOJ’s policy management. Regarding this wording, a senior Cabinet official explained, “It refers to not only to the decision to raise interest rates, but also to the reduction in JGB purchases ahead of the BOJ’s interim assessment.” This official went on to say, “We can see a clear trend toward increasing JGB issuance going forward. We hope the BOJ will consider the pace for reducing JGB purchasing amount while taking into account changes for supply/demand conditions for JGBs.” The administration of Prime Minister Sanae Takaichi is growing increasingly wary of rising 10-year JGB yields and a senior Cabinet official indicated his understanding that, “As the BOJ reduces its holdings of JGBs, supply/demand conditions are shifting, which is one factor driving up 10-year JGB yields.”

In this context, there are suggestions within the BOJ and among former BOJ officials that a review of JGB purchase reductions could be included as part of a policy package to alleviate concerns that interest rate hikes might push up 10-year JGB yields. A former BOJ official stated that, “When the BOJ informs the government of its intention to raise interest rates in June, a smaller reduction for JGB purchases could serve as a bargaining chip.” That official suggested that combining a review of JGB purchase amounts with measures to alleviate concerns over rising JGB yields (via rate hike) could be a realistic option. Some voices within the BOJ seem to support this scenario.

Tension between “market functions” and “fiscal financing”

However, the BOJ’s quantitative tightening was presumably intended to be carried out “automatically,” separate from this policy environment and these policy instruments (policy interest rate as active tool). Actually, the BOJ officially cites the restoration of market functions as the criterion for reducing its JGB purchases.

BOJ Deputy Governor Ryoza Himino also commented on the BOJ’s interim assessment at the upcoming June meeting, stating, “We want to inspect 10-year JGB yields, trends within the JGB market, and market functionality.” This makes it clear that policy decisions are based on market functions. A BOJ official said, “If we act in accordance with the government’s fiscal policy guidelines, it will amount to fiscal financing.” This official stressed that the pace of JGB purchase reductions will be determined based on the extent to which market conditions improve. “If the BOJ uses JGB purchases to curb rising JGB yields during the current phase, criticism of fiscal financing would be inevitable,” the official said.

However, JGB purchase adjustments have become a policy variable that is linked not only to 10-year JGB yields, but also to exchange rates and inflation expectations. As a result, multiple policy objectives (such as restoring market functions, keeping 10-year JGB yields in check, maintaining fiscal discipline, and ensuring exchange rate stability) coexist simultaneously, creating a situation where their compatibility is not necessarily self-evident.

Dual nature of signal sent by suspension of tapering

Considering the above points, it is highly likely that halting or slowing down tapering will contribute to stabilize market supply/demand conditions over the near term. During a phase in which the 10-year JGB yield rises rapidly, revising the pace for reducing JGB purchase can help to alleviate market participants' concerns about supply/demand conditions. In particular, if tapering is suspended, that could contribute to a short-term improvement in supply/demand conditions, aided by the announcement effect.

Meanwhile, if such measures are perceived as a direct response to rising JGB yields, they could give rise to the view that the central bank's policies are subordinate to market conditions and fiscal circumstances. Actually, [at this juncture, the decline for Japan's inflation expectations has been relatively slower compared to the decline for crude oil prices, a trend influenced by uncertainty surrounding the conduct of fiscal and monetary policy \(concerns about reflationary policies\)](#).

In fact, there are some market participants who support maintaining the JGB purchase amount reductions. At the recent "Bond Market Group" meeting, there were comments such as "JGB market functions are gradually returning to normal and rising JGB yields is a natural development" and "There are concerns that adjusting the pace of JGB purchase reductions could reduce predictability and increase market volatility." A BOJ official also said, "Surprisingly, there were many calls to maintain the JGB purchase reduction approach." We likewise often hear such sensible comments from investors.

Also, on 29 May Reuters cited a BOJ official who likewise indicated recognition that, "If the current rising yield trend reflects fundamentals such as investors' views on fiscal and monetary policy, this would be evidence that the market is functioning normally and does not necessarily need intervention." This view sees the continuation of JGB purchase reductions, or the absence of policy intervention itself, as a result of the restoration of market functions and the normalization of price formation.

The suspension of tapering could serve as a positive signal for liquidity and supply/demand dynamics over the near term. Meanwhile, over the medium to long term, this could also serve as a signal prompting the market to reassess the lag in policy effects and the relationship with fiscal policy. In particular, in a state of endogenous inflationary pressures, where the volume and risk associated with private-sector capital investment and bank lending are expanding, [the prolonged persistence of excess reserves could not only influence perceptions regarding the sustainability of inflation from the perspective of expectations formation, but also entails risks related to credit creation](#). It would probably be a healthy sign that even within the government, a sense of caution is being expressed that "if the BOJ slows the pace of its JGB holdings reduction, the absorption of excess liquidity will also be delayed, leading to an acceleration of the yen's depreciation."

The issue here is not necessarily the amount of JGB purchases itself. Rather, the crux of the matter lies in whether the rising 10-year JGB yield reflects inflation expectations and fiscal risks, or whether it is an adjustment in response to delays in policy action and the rationale that the BOJ is using as its response. The argument over tapering is entering a phase that goes beyond the operation of monetary policy to also reflect the very process of building policy credibility.

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