ECOWEEK

No. 19-37, 11 October 2019

Japan: moving to yield curve slope control?

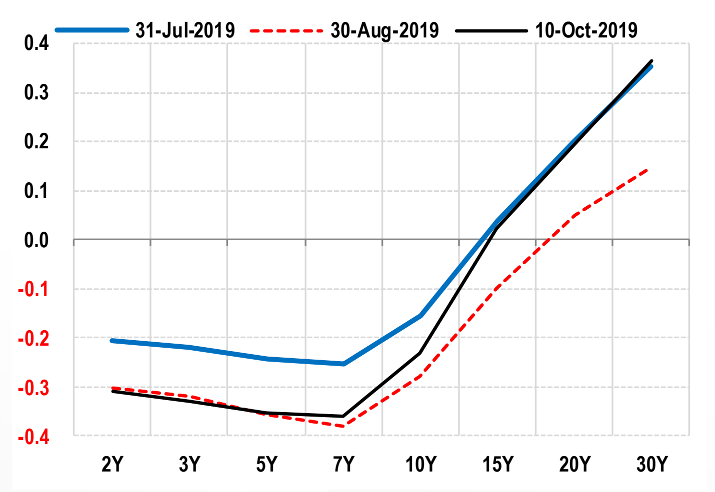
■The Japanese government bond yield curve has been flattening in recent months, with very long maturities coming dangerously close to 0%. This is creating concerns amongst institutional investors with long-dated liabilities (insurance companies, pension funds) ■Bank of Japan Governor Kuroda has argued that an excessive decline in super-long-term interest rates could negatively impact economic activity This has raised expectations that the central bank could shift to a policy of controlling the slope as well as the level of the yield curve. ■This could influence bond yields abroad. In the eurozone it would intensify the debate about the impact of ECB policy on pension funds and insurers.

Fixed income investors are starved for yield. Reluctantly, they take more risk but, considering that everybody is adopting the same approach, this doesn't stop yields from dropping below zero. This week, Greece has been able to issue 3 month treasury bills at a negative rate of 2 basis points. Back in August, Germany sold EUR 824 million of a new 30 year bond with an average yield of -0.11%[1]. The phenomenon of declining bond yields is global because of the synchronised global slowdown but also because of international capital flows which create huge correlation amongst bond markets. Japanese institutional investors are actively contributing to this development by buying long-dated paper abroad on a currency-hedged basis. They are doing this because in Japan yields have been moving down as well.

As shown in the chart, the Japanese government bond (JGB) curve has been flattening in recent months, with very long maturities coming dangerously close to 0%. This is creating concerns amongst institutional investors with long-dated liabilities (insurance companies, pension funds). In a recent speech, Bank of Japan (BoJ) Governor Kuroda[2] has shown that he is very much aware of the issue: *"an excessive decline in super-long-term interest rates could lower the rates of return such as on insurance and pension products, and this may exert a negative impact on economic activity through a deterioration in people's sentiment."*

…/…

JAPANESE GOVERNMENT BONDS: YIELD CURVE



Source: Datastream, BNP Paribas

[1] *Germany sells new 30-year bond with negative yield, a first*, Reuters, 21 August 2019
[2] *Japan's Economy and Monetary Policy*. Speech at a Meeting with Business Leaders in Osaka, Haruhiko Kuroda, Governor of the Bank of Japan, 24 September 2019

Eco WEEK

ECONOMIC RESEARCH DEPARTMENT

BNP PARIBAS

The bank for a changing world

These comments make the BoJ meeting at the end of this month more important than usual. It could lead to a policy of 'yield curve slope control', whereby the central bank not only seeks to maintain a grip on the level of interest rates across the curve (yield curve control) but also on the difference between e.g. the 40 year yield and yields for maturities of 10 year or less (control of the slope of the yield curve). To this end, JGB purchases could be concentrated at the shorter end of the spectrum, leaving room for yields on very long maturities to rise, or at least not to decline. Whether that would actually happen remains to be seen and is even doubtful: yield hungry investors might be keen to seize the buying opportunity as soon as long-dated yields become slightly more attractive.

Should the BoJ decide to move in that direction, this would also be important for the rest of the world. Firstly, because decisions taken in Japan can have knock-on effects abroad. When the BoJ published its October schedule for bond purchases, it caused a rise in US treasury yields because it indicated there would fewer purchases than normal at the longer end of the maturity spectrum[3]. Secondly, it will be watched carefully in Europe. With interest rates solidly in negative territory, even for long maturities, in many eurozone countries and inflation stuck well below the ECB target, the thesis that the eurozone is going down the path of Japan (Japanisation or Japanification) has been gaining popularity: *"if you want to know where the eurozone will be in a couple of years, look where Japan is today*". From this perspective, were the BoJ to move to a policy of 'yield curve slope control', it would intensify the debate in the eurozone about the unintended consequences of ECB policy for pension funds and insurance companies.

William De Vijlder

[3] 10-year Treasury note yield logs biggest monthly increase since last September, MarketWatch, 30 September 2019