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Current large-scale asset purchases by the Bank of Japan, one element of its unconventional monetary policy, has had serious side-effects, including erosion of fiscal discipline and a negative impact on financial institutions, which raises concern of risk of a new financial crisis. To avoid such an unfavorable consequence, the BOJ should embark on exit from its asset purchases at a measured pace as follows. First, the 2% inflation target should be re-shaped to be flexible and which can be met in the long run. Then, yield curve control should be abolished and tapering conducted in a similar manner to that of the Fed. But, the BOJ does not need to raise its policy rate so soon after. In order to facilitate an orderly change in market expectations, it is important that the BOJ have good communication with market participants.

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This article briefly reviews channels through which unconventional US monetary policy might affect the bond market. We also examine changes in interest rates and asset prices around the time of Federal Reserve announcements regarding the stance of monetary policy since 2008 and discuss how US monetary policy normalization might influence bond yields.

Monetary Policy and Government Bond Liquidity in the case of Bank of Japan: Impact on cash, repo, and futures markets .... *Jun Uno/Reiko Tobe* 29

We examined changes in liquidity under the Bank of Japan (BOJ)'s quantitative and qualitative easing (QQE). Liquidity indicators for the cash and repo markets indicate a deterioration in liquidity as the BOJ's holding share of government bonds increases. Introduction of yield curve control policy reduced the daily number of transactions in the futures market by 32%. Worsening of the functionality of these markets suggests the necessity of early policy adjustment.

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Influence of Monetary Policy Normalization on Emerging Markets
…… *Osamu Takashima, CMA* 40

The normalization of monetary policy by the Fed and other central banks could impact emerging market economies negatively, as has been the case in the past. The Latin American markets were depressed during the 1980s and 90s when the Fed tightened its policy—Mexico's Tequila crisis in 1994 being a typical case. In the late 1990s a crisis in Asia triggered by the Fed's tightening and yen depreciation generated a vicious spiral that hit Russia and Brazil and eventually destroyed the currency board system in Argentina in 2001.

In this current cycle, China is the country we need to watch most closely given its increased corporate debt while other emerging economies look healthier than they did in the past. Nevertheless, the Chinese government appears to have sufficient fiscal capability to solve the problem, and the debt burden there will not intensify while the US dollar is weak and market expectations for yuan devaluation diminish as they have done over the past year.

Considering prospects for further policy firming by the Fed and other central banks, however, we need to be cautious of the risk of dollar appreciation recurring, which could prompt investment funds to flow out from China again and trigger another vicious cycle in China and other emerging markets. Of course, the monetary authorities recognize this risk as indeed evidenced last October when Fed Governor Jerome Powell stressed the risk of increased corporate debt in China. The best way to avoid such turmoil must be for the ECB to engage in monetary policy normalization to ease upward pressure on the dollar stemming from the Fed's rate hikes.

That said, overly hawkish tightening by the ECB includes risk of a global yield surge that would also be a negative for the emerging markets in addition to an overly strong dollar. The process of policy normalization by the central banks of advanced economies will continuously face difficulties.

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Constructing a Factor Risk Parity Portfolio for the Japanese Stock Market
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We verify the effectiveness of factor risk parity (FRP) strategy which equalizes risk contributions among factors by constructing FRP portfolios for the Japanese stock

market. The four factors which are considered to be effective in the Japanese stock market are selected in the portfolio construction. The resulting FRP portfolio returns outperform those of the market capitalization average (MVA) portfolio since the FRP strategy can successfully acquire factor risk premiums in equity investment.

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