

Are Surging JGB Yields Becoming a Global Risk Catalyst?

For years, Japan's monetary policy was extremely accommodative: negative short-term rates, massive JGB purchases, and Yield Curve Control (YCC) to cap long rates.

However, in recent years, Japan seems to be entering a new regime where **JGB yields & inflation are rising sharply**, the **yen is weakening**, and the Bank of Japan (BOJ) is slowly abandoning the ultra-easy policies that has kept rates artificially low for decades.

To understand today's rise, it helps to look back at a somewhat similar, though not identical, episode in 2006–08.

The JGB market has been historically low-yielding; even a change of 50–60 basis points is economically meaningful. In the first half of 2008, Japan's 10-year government bond yield climbed from roughly **1.25% in March to a monthly peak of 1.78% in May 2008**. The peak in May 2008 (about 1.78%) was high relative to the years immediately around it, but still low by international historical standards.

What pushed yields modestly higher during that period? Three mutually reinforcing forces:

- 1. Global inflation and commodity pressures** were high through early 2008, lifting long-term inflation expectations around the world and nudging government bond yields up in many economies (Japan included).
- 2. Japan had already moved away from ultra-easy policy by the mid-2000s**, lifting rates slightly above zero by 2006–07. With the policy floor no longer binding, long-term JGB yields became more sensitive to global rate movements in 2007–08.
- 3. Global markets were already repricing risk in early 2008**, creating volatility across major bond markets. As investors demanded higher compensation for uncertainty, Japanese yields moved up in line with this broader shift.

After the May high, yields eased a little through summer and then moved lower sharply after the Lehman collapse in mid-September 2008; by **December 2008 the 10-year yield had fallen to about 1.21%**.

Why did yield fall after September 2008?

- When Lehman Brothers failed in mid-September 2008 and the global panic intensified, **investors fled risky assets and reallocated into safe short- and long-term sovereign assets**. Demand for safe government paper (including JGBs) strengthened, putting downward pressure on yields in Japan as it did elsewhere.
- **The Bank of Japan cut its policy rate in late October 2008** (reducing the uncollateralized overnight call rate guideline from about 0.5% to 0.3% on **31 October 2008**) and undertook measures to ensure market functioning and bank funding.
- The global recession that followed Lehman **pulled down growth expectations and inflation prospects**. Lower expected future inflation reduces long-term yields.

What's Driving the Current Rise & How It's Different?

1. Policy Regime Shift

BOJ has removed its hard cap on long-term yields after inflation stayed above 2% for over a year, wages strengthened, and the deflation-era conditions that justified YCC faded. Defending the ceiling had also become increasingly costly as the BOJ was forced to buy large volumes of JGBs while markets repeatedly tested the limit. With the cap gone, long-term yields are now being priced more freely, leading investors to demand higher compensation for inflation, fiscal risk, and policy uncertainty that was previously suppressed.

2. Tapering of Central Bank Support

Although BOJ still purchases JGBs, it has cut back the maximum amounts it is willing to buy. This reduced support weakens the backstop that had long kept yields low. With less automatic demand from the central bank, bond prices become more sensitive to supply conditions, auction results, and investor sentiment.

3. Inflation & Growth Dynamics

Inflation in Japan is no longer seen as a temporary spike; core CPI has stayed above 2% for an extended period. When inflation becomes persistent, investors expect further policy tightening and therefore demand a higher “term premium” to hold long-dated bonds. This shift in expectations alone pushes long-term yields higher even before the BOJ adjusts rates. Over the past few years, Japan has seen steady nominal wage gains rising between 2% and 4% annually, with union-negotiated hikes exceeding 5% but real wages have remained negative for nine straight months, as inflation continues to outpace income growth.

4. Super-Long Bond Risks

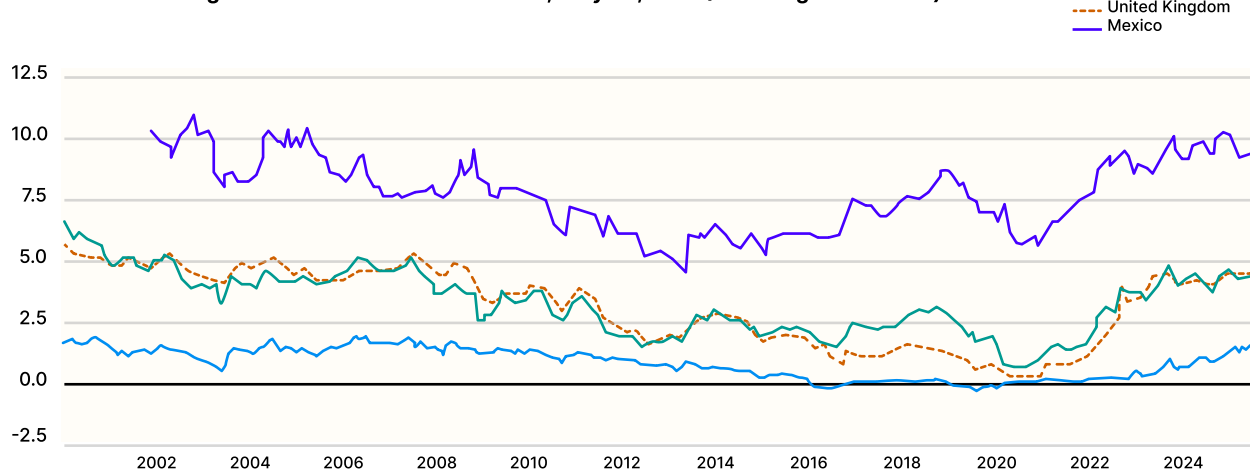
The sharp rise in yields on 20- to 40-year JGBs, including the 30-year approaching 3.2%, reflects growing vulnerabilities at the long end of the curve. BOJ operations are far less predictable in these maturities, and domestic institutional buyers such as insurers and pension funds who traditionally anchor demand for super-long JGBs have turned increasingly cautious amid higher inflation, elevated duration risk, and uncertainty around the BOJ's policy path.

With the BOJ stepping back as a reliable buyer and structural demand weakening, long-dated bonds are now far more sensitive to shifts in inflation expectations, fiscal concerns, and supply conditions. As a result, super-long JGB yields are adjusting more aggressively and disproportionately to incoming data and policy signals.

5. Fiscal Uncertainty

Japan's extremely high public debt means even small increases in yields raise the government's interest burden. Investors are factoring in this fiscal risk, which contributes to higher required yields.

Interest Rates: Long-Term Government Bond Yields, 10-year, Main (Including Benchmark)



Source: Organization for Economic Co-operation and Development via FRED

At the same time, global capital flows are becoming more influential: a weaker yen, changing rate differentials, and potential carry-trade unwinds all feed volatility and lift term premia.

6. Currency Dynamics

The yen's depreciation itself is adding upward pressure on JGB yields. A weaker currency makes imports costlier, lifts inflation, and strengthens expectations of further BOJ tightening. As markets price in this policy response, long-term yields rise, making yen weakness a contributing driver of the current yield uptrend.

What are the pain points in current situation?

1. International Investment Position

Japan's investors remain deeply positioned abroad, with the latest data showing they hold more than \$1.18 trillion in U.S. Treasuries the largest foreign stake in the world.

Country	2025 - 09	2025 - 08	2025 - 07	2025 - 06	2025 - 05	2025 - 04	2025 - 03	2025 - 02	2025 - 01	2024 - 12	2024 - 11
Japan	1189.3	1180.4	1151.4	1147.6	1135	1134.5	1134.5	1125.9	1079.3	1061.5	1087.1
United Kingdom	865	904.3	899.3	857.9	809.4	807.7	807.7	750.3	740.2	722.8	766.9
China, Mainland	700.5	701	696.9	732.7	732.7	743.6	743.6	784.3	760.8	759.0	768.6
Canada	475.8	443.7	381.4	438.2	430.1	368.4	368.4	406.1	350.8	378.8	372.4
Belgium	466.8	454.3	428.2	433.4	415.5	411.0	411.0	394.7	377.7	374.6	361.3

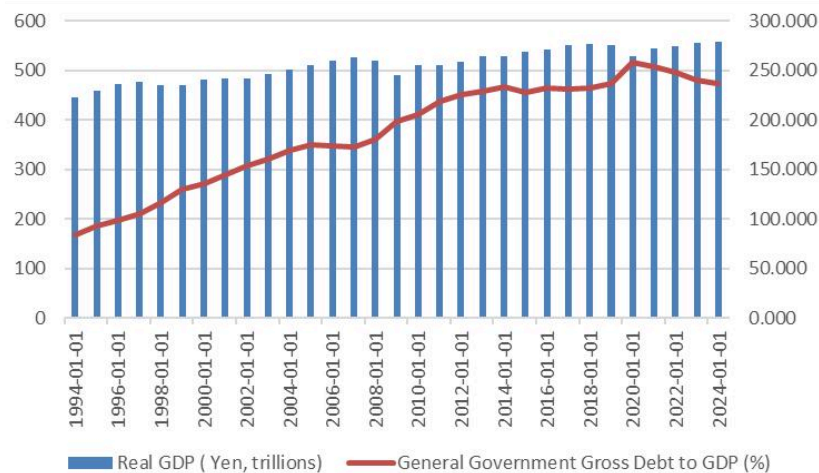
Even though there have been small monthly reductions over 2024–25, the overall picture is clear: a huge pool of Japanese savings has been deployed outside the country, largely because domestic yields were suppressed for decades. This external asset buildup reflects years of low domestic returns, persistent fiscal deficits, and a system where households, insurers, and pension funds sought stable income offshore.

Now, with JGB yields rising, the question shifts from *why the money left* to *whether and how fast it comes back*. And given the sheer scale of these holdings and the liquidity required to unwind them, any repatriation will likely be slow, uneven, and globally disruptive if it accelerates.

For instance, a similar pattern played out during the 2008 crisis, when a sudden unwinding of yen-funded carry trades triggered sharp yen appreciation where **it gained about 15% against the dollar in H2 2008**, peaking at **¥ 87.10/\$**. Japan's benchmark TOPIX index also plunged Overall, Japan's rising yields have become an important global focal point, with both domestic policy choices and international capital flows shaping the next leg of market direction. How the BOJ manages this transition will determine whether the adjustment remains orderly or spills into broader financial instability., marking the steepest annual decline in its history.

2. Increasing Fiscal Debt

Japan's real GDP has stayed effectively range-bound, oscillating between 500–600 trillion yen for roughly two decades.



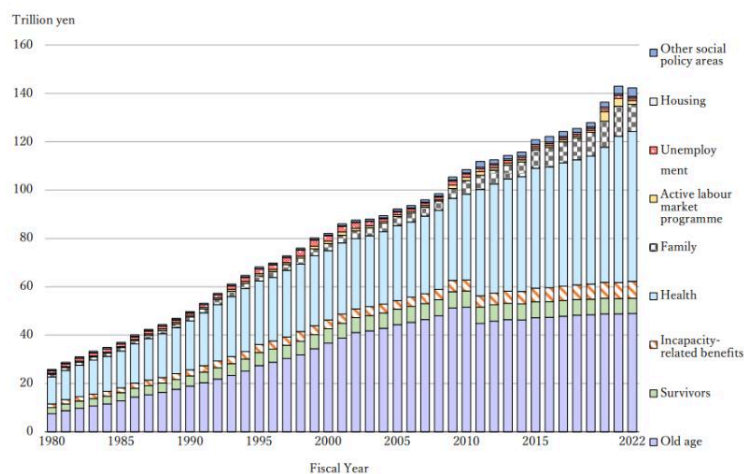
Source: Investing.com, Organization for Economic Co-operation and Development via FRED

Public debt, however, has continued to accumulate, now exceeding 200% of GDP one of the highest ratios in the developed world. The underlying issue is that **economic output has remained range bound while fiscal obligations have expanded**, leaving the government increasingly dependent on sustained, large-scale bond issuance. This widening gap implies that in future, **Japan may need to refinance a larger debt stock in an environment where both debt levels and yields continue to climb** if current yield sustains or rise.

3. Nature of Government Expenditure:

Japan's real GDP has stayed effectively range-bound, oscillating between 500–600 trillion yen for roughly two decades.

Trends of Social Expenditure by policy area



Source: Investing.com, Organization for Economic Co-operation and Development via FRED

With just **58.4%** of the population in the working-age bracket, Japan carries a **total dependency ratio of 71.2**, driven largely by an exceptionally high **elderly dependency ratio of 50.4**.

This ageing shift naturally alters the balance between those contributing to the system and those drawing benefits. Over time, this has made age-related social security spending a steadily more significant component of public expenditure. over 1/3rd of the budget goes to social security for the elderly, a powerful voting bloc.

What Could Happen Next?

Case 1: Yields keep rising



Case 2: BOJ decides to intervene at early stage

Yields move too fast / market becomes unstable → BOJ decides to act

Possible actions:

- **Increase JGB purchases** (target specific maturities) to stabilize prices
- **Fixed-rate operations** to cap yields temporarily
- **Stronger forward guidance** to signal preferred yield levels
- **Adjust policy tone** (slower normalization or hint of tightening support)

Overall, Japan's rising yields have become an important global focal point, with both domestic policy choices and international capital flows shaping the next leg of market direction. How the BOJ manages this transition will determine whether the adjustment remains orderly or spills into broader financial instability.