Economics & Strategy

DBS Focus

Japan: 10 questions about JGB and JPY

Economics/growth/monetary/fiscal

Group Research

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We address 10 key questions on the JGB market and the yen, reflecting recent concerns and offering a medium-term macroeconomic view:

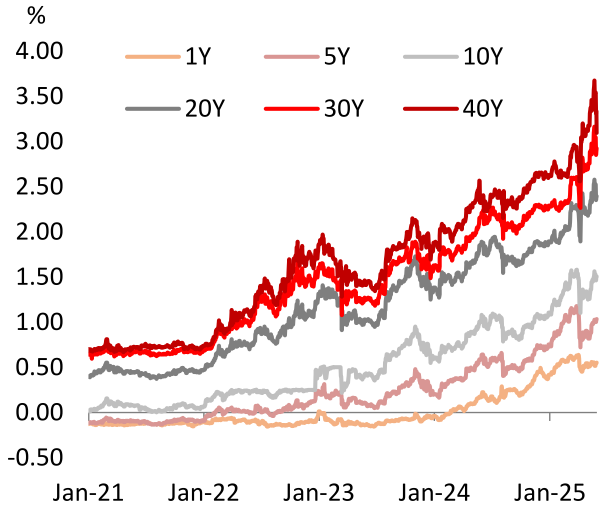
1. *Is the JGB market under significant pressure?*
2. *Is the BOJ's quantitative tightening too aggressive?*
3. *Are domestic investors selling JGBs?*
4. *Are foreign investors reducing JGB exposure?*
5. *Is Japan's inflation becoming unmanageable?*
6. *Is Japan's fiscal outlook a major concern?*
7. *Could rising JGB yields trigger yen carry trade unwinding?*
8. *Are Japanese investors selling US Treasuries?*
9. *Will the yen continue to strengthen?*
10. *Who loses most from rising yields and a stronger yen?*

#1 Is the JGB market under significant pressure?

The recent rise in JGB yields has been concentrated in super long-term maturities. Yields on 30- and 40-year JGBs climbed around 50 bps between May 1 and May 22, briefly peaking at 3.2% and 3.7%, respectively. In contrast, the 10-year yield rose more moderately — up 30 bps to 1.5% — still below the Bank of Japan's 2% inflation target. The 1-year yield remained stable at 0.5%, near the BOJ's policy rate.

Despite the spike in long-term yields, the yen has held steady and the stock market has remained resilient. The USD/JPY has hovered around 145, while the TOPIX has stayed comfortably above 2,700.

JGB yields



Sources: Bloomberg, DBS

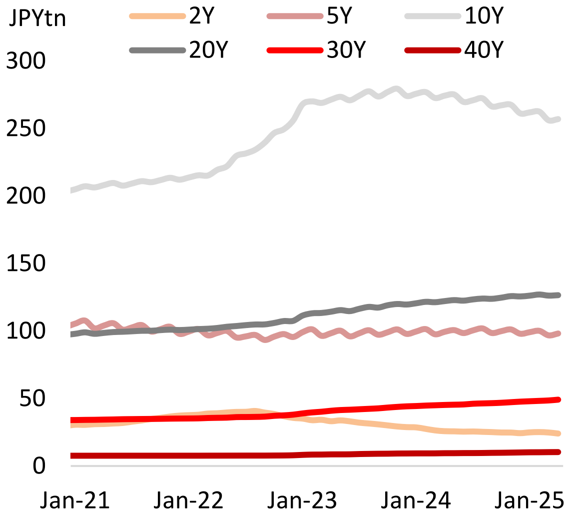
#2 Is BOJ's quantitative tightening too aggressive?

The BOJ remains the largest holder of JGBs, owning roughly half of all outstanding bonds. In its July 2024 meeting, it announced a gradual quantitative tightening (QT) plan, reducing JGB purchases by JPY 400 billion per quarter with a target of JPY 3 trillion in monthly purchases by March 2026.

Between July 2024 and April 2025, BOJ holdings fell by approximately JPY 13 trillion, with the reduction focused entirely on the 10-year segment. Holdings of 30- and 40-year JGBs have remained largely stable, with a slight increase.

The BOJ has pledged to respond if long-term yields rise too sharply during QT — either by increasing JGB purchases or conducting fixed-rate operations. An interim review of the QT program is scheduled for June 2025. Should the recent surge in super long-term yields extend to 10-year bonds, intervention appears likely.

Outstanding JGBs held by BOJ



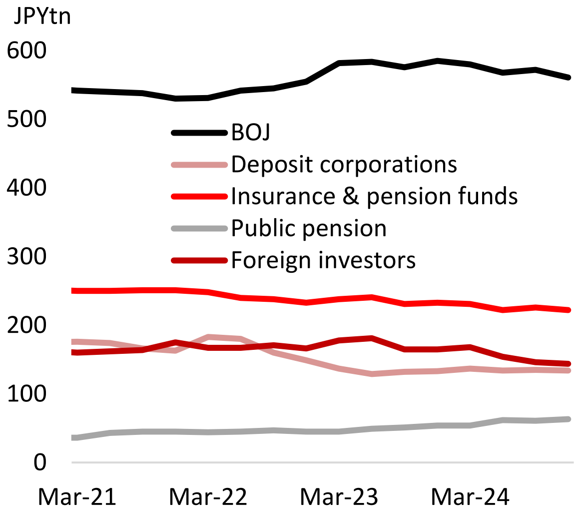
Sources: CEIC, DBS

#3 Are domestic investors selling JGBs?

Domestic private investors are major holders of JGBs, second only to the BOJ. As of end-2024, deposit-taking institutions held 11% of outstanding JGBs and T-bills, while insurance companies and pension funds held 18%. This compares to the BOJ's 46% share and 5% held by public pension funds.

From June to December 2024, holdings by deposit institutions, insurers, and pension funds remained highly stable. Despite BOJ rate hikes, QT, and expectations of rising interest rates, regulatory requirements on liquidity and asset-liability management continue to support demand for JGBs among banks and insurers.

JGB and T-bill holdings, by investor



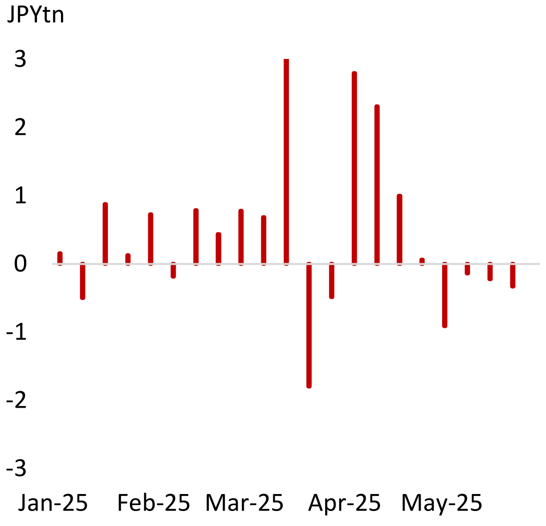
Sources: Bloomberg, DBS

#4 Are foreign investors reducing JGB exposure?

Foreign investors hold approximately 12% of outstanding JGBs and T-bills. Since the BOJ began QT in July 2024, foreign investors have been the primary sellers, cutting holdings by around JPY 10 trillion between June and December 2024. This reflects concerns over BOJ rate hikes, QT, and expectations of rising JPY interest rates.

More recently, high-frequency data show that foreign net investment in JGBs turned negative again in early May, following a strong April inflow linked to the US reciprocal tariff announcement. It appears foreign investors are now unwinding positions established during April's tariff-driven bout of global risk aversion.

Foreign net investment in Japan bonds



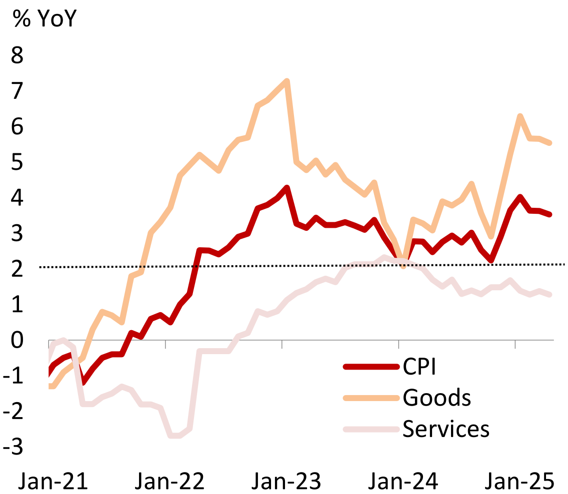
Sources: Bloomberg, DBS

#5 Is Japan's inflation becoming unmanageable?

Inflation expectations alone do not fully explain the recent spike in JGB yields. Inflation overshooting is not new in Japan — CPI inflation has stayed above 2% YoY since April 2022 and exceeded 3% for five consecutive months since December 2024. Goods inflation remains strong, driven by the lagged impact of yen depreciation and cost-push factors such as rising domestic rice prices.

However, services inflation — often seen as a better gauge of underlying price pressures — has remained modest, hovering around 1.5%. The BOJ continues to stress that while underlying inflation is approaching its 2% target, it has not yet been achieved in a stable and sustained manner. At its April 30-May 1 meeting, the BOJ pushed back its forecast for reaching the 2% inflation target by one year, now projecting achievement in FY2027.

Japan: CPI inflation



Sources: CEIC, DBS

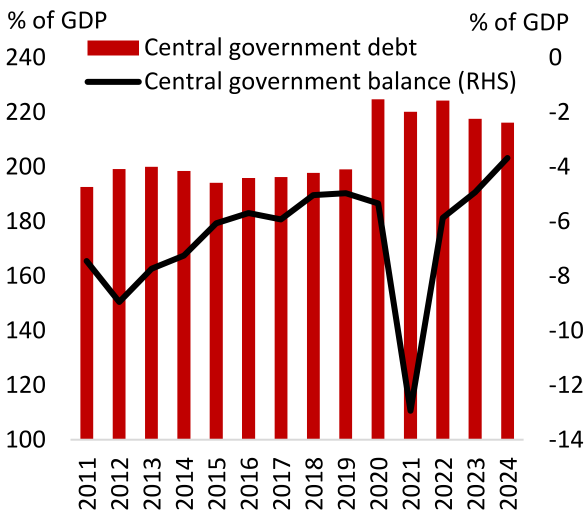
#6 Is Japan's fiscal outlook a major concern?

The recent surge in JGB yields may be better explained by a rising fiscal risk premium. In response to US tariffs, the ruling Liberal Democratic Party is considering a supplementary budget, while opposition parties are calling for a temporary consumption tax cut. The renewed tax cut debate has heightened concerns over fiscal sustainability, especially against the backdrop of US tax cuts and a recent sovereign credit rating downgrade.

That said, Japan's fiscal risks may be overstated. Prime Minister Ishiba has opposed cutting the consumption tax, citing its critical role in revenue generation and the potential destabilizing effects on public finances.

Japan's fiscal metrics have improved with reflation. Stronger inflation has lifted tax revenues, narrowing the central government's fiscal deficit to 3.7% of GDP in 2024 from 12.9% in 2021. Nominal GDP growth has also strengthened, bringing the central government debt-to-GDP ratio down to 216% in 2024 from a peak of 225% in 2020.

Japan: Public debt and fiscal balance

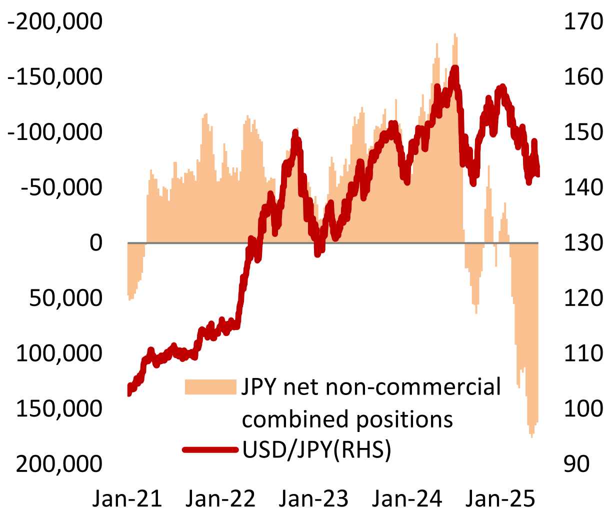


Sources: CEIC, DBS

#7 Could rising JGB yields trigger yen carry trade unwinding?

Carry trades typically involve borrowing in short-term yen at low interest rates and investing in higher-yielding assets abroad. Short-term JPY rates are still anchored by the BOJ. At its April 30–May 1 meeting, the BOJ signaled a slower pace of rate hikes by downgrading its economic outlook and postponing its forecast for achieving the 2% inflation target. This is in contrast to July 2024, when a surprise rate hike to 0.50% triggered a sharp unwinding of yen carry trades. Net non-commercial short positions in the yen — built up during the earlier Fed tightening cycle — have since been largely unwound, indicating a decline in carry trade activity.

JPY net non-commercial positions



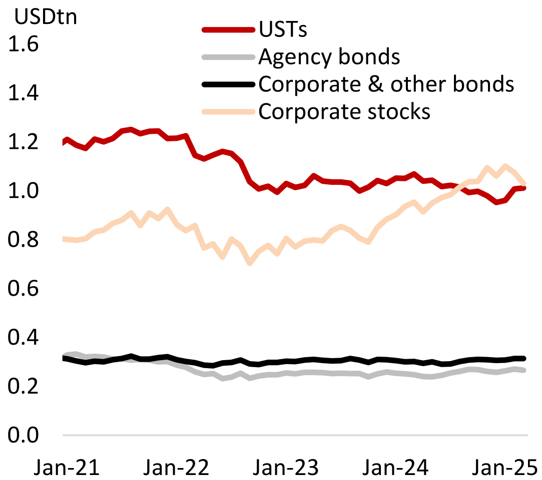
Sources: Bloomberg, DBS

#8 Are Japanese investors selling US Treasuries?

Japanese investors have been reducing their holdings of US Treasuries for some time. Between June 2024 and March 2025, Japan's long-term UST holdings fell by USD 5.6 billion, while investments in US agency and corporate bonds continued to grow. Rising JGB yields may be reducing USTs' relative attractiveness.

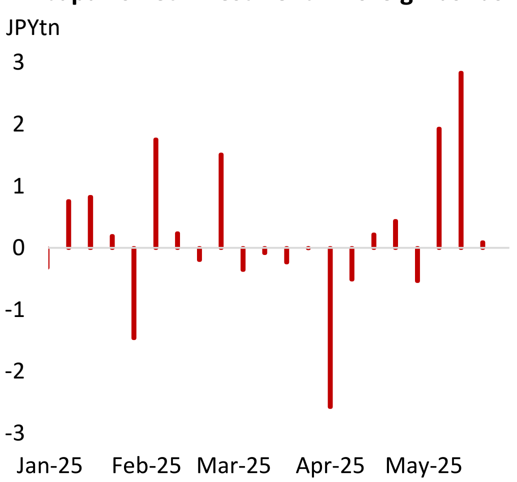
High-frequency data show that Japan's net investment in foreign bonds turned positive again in mid-May, indicating a possible readjustment of UST positions following the reciprocal tariff-related sell-off.

Japan holdings of long-term US securities



Sources: Bloomberg, DBS

Japan's net investment in foreign bonds



Sources: Bloomberg, DBS

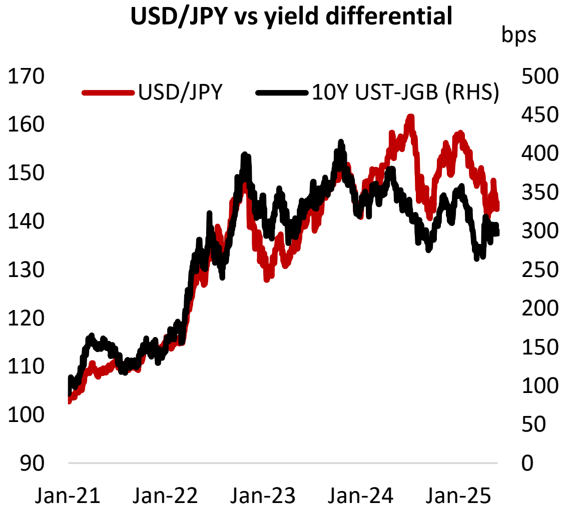
#9 Will the yen continue to strengthen?

Rising JGB yields, along with BOJ rate hikes and QT, have helped narrow the yield differentials with US Treasuries, encouraging repatriation of Japanese capital and supporting yen appreciation. Reflecting this trend, the USD/JPY exchange rate declined from around 160 in early July 2024 to 145 by the end of May 2025, in line with the narrowing UST-JGB yield spread.

In addition, expectations of yen strength and dollar weakness — amid ongoing Japan-US trade negotiations and concerns over the dollar's long-term credibility — may prompt Japanese investors to further reduce their exposure to US assets. As of March 2025, Japan holds approximately USD 2.6 trillion in long-term US securities, including USD 1 trillion in Treasuries, USD 0.3 trillion in agency bonds, USD 0.3 trillion in corporate bonds, and USD 1 trillion in US equities.

Japanese life insurers, who collectively hold about USD 0.7 trillion in foreign securities, currently hedge only around 50% of their FX exposure. An increase in hedge ratios could lead to substantial dollar selling.

USD/JPY vs yield differential



Sources: Bloomberg, DBS

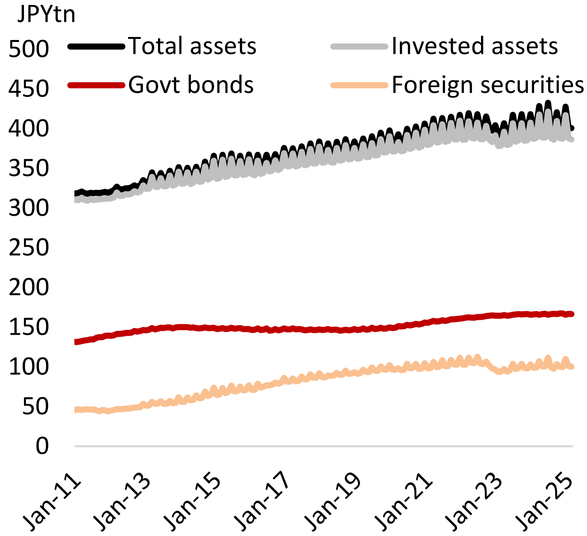
#10 Who loses most from rising yields and a stronger yen?

Higher yields and a stronger yen present challenges for the Japanese economy. Rising borrowing costs can suppress both public and private investment and consumption, while a stronger yen may weigh on exports. These risks are compounded by ongoing US tariff threats and stalled Japan-US trade negotiations.

However, bank lending rates — influenced mainly by short-term prime rates and 10-year JGB yields — remain relatively low and below inflation levels. Additionally, the yen's appreciation has coincided with gains in major Asian currencies, somewhat easing the impact on Japan's export competitiveness.

The rise in JGB yields, coupled with potential losses on USD assets, will likely lead to investment losses for Japanese financial institutions with significant domestic and foreign exposures. Life insurers may be the hardest hit in the short term: JGBs constitute 41% of their total assets, while foreign securities make up 25%. The combination of rising JGB yields, elevated UST yields, and a weaker dollar against the yen could pose a "triple threat" to Japanese life insurers.

Japan: Life insurers' assets



Sources: CEIC, DBS

Related reports:

[Eurozone & Japan: Navigating tariff headwinds]

[Chartbook: Tracking US tariff impacts on Asia]

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations)

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