

## RISING SUN, RISING YIELDS: WILL JAPAN TRIGGER THE NEXT GLOBAL SHAKE UP?

While global headlines fixate on rising U.S. Treasury yields, why one should be even more worried about Yields rising in Japan?

Recently, Yields on Japanese Government Bonds (JGBs) – especially longer tenors – have spiked to levels not seen in decades:

- JGB 10Y: ~1.75% (All time high)
- JGB 30Y: ~3.31% (All time high)
- JGB 40Y: ~3.68% (All time high)

This surge marks a dramatic reversal from the near-zero yields Japan sustained for years. Crucially, the ripple effects of Japan's yield spike could be seismic – potentially more destabilizing to global markets



### BOND YIELDS AT AN ALL TIME HIGH



Source: Bloomberg

### Japan: A Highly Leveraged Hedge Fund?

Japan is the world's largest creditor nation, with global investments of ≈\$3.3 Tn a record 84.3% of GDP (as of end-2023), this despite struggling with a sky high Debt to GDP of ~263%.

This puts Japan in a precarious situation and to understand the gravity of this issue, one must grasp **Japan's debt profile and leverage**:

- ▲ **Government Debt: -263% of GDP** Japan's government debt stands at more than \$10 trillion. Notably, roughly half of Japan's government bonds are held by its own central bank, the BoJ, (BoJ holdings ~43%-52% of outstanding JGBs). This extraordinary central-bank ownership has kept borrowing costs artificially low for years.
- ▲ **Corporate Debt (Non-Financial): -115% of GDP**, reflecting heavy borrowing by Japanese companies. Corporate Japan Took advantage of the historically cheap capital to invest globally.
- ▲ **Bank and Financial Sector:** Japan's banks and insurers are huge players in both domestic and global markets. They hold trillions in JGBs (exposed to interest-rate risk) and, in the case of life insurers and pension funds, trillions in foreign bonds. Japanese banks have **over \$3 trillion in overseas loan** and bond exposure, effectively participating in the yen-funded carry trade.



In effect, Japan Inc. has been borrowing cheaply at home and investing like a global macro fund overseas.

This configuration carries echoes of *a highly leveraged fund: it works until it doesn't.*

Taken together, these figures depict an economy with **total debt on the order of 4× GDP (public + private)** and an international balance sheet of unparalleled scale. It is as if Japan the nation has levered itself and gone long on the world.

The “**yen carry trade**” – borrowing yen at near-zero rates to buy higher-yield assets elsewhere – has been a pervasive strategy. It's employed not just by global hedge funds but by Japan's institutions (retail investors, banks, insurers) on a massive scale. Before the recent turbulence, estimates put yen-funded **FX carry trades at around >\$250 billion** in notional terms.

History offers a cautionary parallel with multiple hedge fund busts such as Amaranth Advisors, Lehman Brothers, LTCM, Bear Stearns, among others. They operated with extreme leverage, borrowing cheaply to invest in higher-yield assets. When confidence faltered and funding was withdrawn, the whole edifice collapsed with shocking speed.

**Now, a sudden spike in cost of capital in Japan, could trigger selling of overseas assets in turn triggering a contagion!!!**

### **How did we reach here - Three Decades of Ultra-Easy Policy**

Japan's current predicament is the culmination of a long history of **economic stagnation met with aggressive fiscal and monetary stimulus**. After the spectacular late-1980s asset bubble collapsed in 1990, Japan entered a prolonged slump (the “Lost Decades”). In response, policy makers unleashed round after round of easing:

Key milestones in Japan’s monetary policy since 1990.

Period	Policy Measures	Key Details
<b>1990s</b>	Fiscal stimulus & zero rates	Huge public works spending; 1999: BoJ adopts Zero Interest Rate Policy (0% short-term rate) to fight deflation.
<b>2001-2006</b>	Quantitative Easing (QE) – Round 1	2001: BoJ shifts from rate targeting to quantitative easing,
<b>2008-2010</b>	Rate cuts & credit easing	2008: BoJ cuts policy rate from 0.5% to 0.3%, then 0.1% amid Lehman crisis 2010: launches limited asset-buy program (including ETFs) with rates back to ~0%
<b>2013-2015</b>	“Quantitative and Qualitative Easing” (QQE)	2013: Under PM Shinzo Abe’s “Abenomics,” BoJ Governor Haruhiko Kuroda targets 2% inflation with a massive QQE program
<b>2016</b>	Negative Rates & Yield Curve Control (YCC)	Jan 2016: BoJ cuts deposit rate to -0.1% (negative rates)reuters.com. Sep 2016: Introduces Yield Curve Control – targeting 10-year JGB yield ~0% (initially 30.0%)
<b>2018-2022</b>	YCC tweaks	2018: BoJ allows 10-year yield 30.1% range 2021: widens YCC band to 30.25% and tapers ETF purchases Dec 2022: widens band to 30.5%
<b>2023-2024</b>	Policy pivot begins	Jul 2023: New BoJ chief Kazuo Ueda makes YCC more flexible, effectively allowing 10Y yields up to -1.0% 2024: BoJ ends negative rates and begins tapering JGB purchases (QT), as inflation climbs above target.

BoJ = Bank of Japan; QE = quantitative easing; YCC = yield curve control.

The government ran persistent deficits to stimulate the economy and expanded social welfare benefits (pensions, healthcare). **Every time growth faltered, Tokyo unleashed new spending packages.** These efforts, combined with chronically low tax revenues, drove public debt to its current astronomical level. Even today, Japan’s primary budget deficit remains around 6% of GDP, reflecting the difficulty of curbing spending or raising taxes in a stagnant economy.

Japan’s ultra-easy policies kept borrowing costs near zero for decades facilitating the yen-funded carry trade. In effect, Japan exported deflationary capital, suppressing global yields. BoJ became the buyer of last resort for JGBs.

**Two structural issues compounded the challenge:** demographics and export dependence. Japan’s population is the oldest in the world. Meanwhile, Japan’s economy relies heavily on exports of high-value goods (cars, electronics) meaning the BoJ has historically engineered to keep the currency low. In summary, by 2023 Japan had devised an equilibrium of sorts:

- ▲ zero rates and yield control kept debt service manageable,
- ▲ the government kept spending,
- ▲ households and banks kept buying JGBs (a captive audience); and
- ▲ excess savings flooded overseas.

It was stable – until inflation reared its head and global rate regimes shifted. Now that equilibrium is wobbling.

### **2024–2025: The Tipping Point – Inflation, Unwind, and Market Strain**

Several forces have converged recently to finally push Japanese yields upward, testing the system like never before:

- ▲ **Rising Inflation Erodes the Zero-Rate Regime:** After decades of deflation/low inflation, Japan is seeing its highest inflation since the early 90s. Overall CPI hit **3.6%** and core (ex-food) ~3.2% in early 2025, well above the BoJ's 2% target and deeply negative in real yield terms.
- ▲ **BoJ Tapering and Reduced Support:** As part of normalization, the BoJ has pared back its bond purchases and allowed longer yields to rise. By early 2025, the BoJ even started selling small amounts of JGBs – a sea change in a market used to the BoJ as a constant bid.
- ▲ **Carry Trade Unwind and Yen Volatility:** In mid-2024, cracks appeared in the yen carry trade. In August 2024, the BoJ surprised markets with a hawkish tilt (interpreted as a possible future rate hike), at the same time the U.S. Fed remained cautious. This caused a sudden surge in the yen's value and a global sell-off in carry-trade positions. Though markets later stabilized, this episode exposed how sensitive global markets are to a yen carry reversal.
- ▲ **Trade and External Headwinds:** Japan's export engine is facing challenges that compound the domestic woes. By 2024, the country's trade surplus had eroded (exacerbated by high import costs for oil/gas and supply chain shifts). On top of that, in early 2025, the U.S. announced "reciprocal tariffs" on various imports (a policy stance by President Donald Trump) – a move that directly threatens Japan's export markets. The recent aggression from China is also having a negative impact on Japanese economy, not making things easier.
- ▲ **Political Pressure and Uncertainty:** Japan is currently experiencing a period of significant political instability, marking a departure from its traditionally stable post-war political landscape dominated by the Liberal Democratic Party (LDP). This instability is characterized by a minority government, a "revolving door" of prime ministers, and the rise of populist opposition parties. The recent quick succession of prime ministers (Shigeru Ishiba, Fumio Kishida, Yoshihide Suga) following Shinzo Abe's long tenure has raised concerns about a return to an era of short-lived leaders, making long-term policy implementation difficult.



In sum, there is very low confidence among investors, with the government struggling to raise capital through long dated bonds.

This is a far contrast from where we were just a few years ago, when in 2019, the government of Austria managed to sell the infamous Austria Century Bond (100Y bond) at 0.9%.



Today, **we are at a critical inflection point, witnessing the first true stress test of Japan's** ability to finance itself without full central bank backstop. The system hasn't broken but strain is evident: rapidly rising yields, volatile auctions and financial market tremors

### **.What Can Be Done? Potential Responses and Global Ripples**

Confronted with this situation, Japanese policymakers have the following unpleasant options –

- 1. Fiscal Tightening:** In practice, this is exceedingly difficult. The Japanese government just reduced taxes so increasing them immediately is out of question. Cutting government spending is challenging, over 1/3<sup>rd</sup> of the budget goes to social security for the elderly, a powerful voting bloc. Discretionary spending has been squeezed for years; any significant cuts would meet resistance and could weaken growth. Further, current tariff wars have aggravated the entire situation. Thus, meaningful austerity is unlikely in near-term.
- 2. Devaluing the Yen:** Though Japan would claim most of the debt is domestic, that domestic debt also needs to be serviced which is becoming a difficult task by the day. The only solution might be devaluing the Yen, massively.
- 3. Renewed Monetary Support (BoJ Re-intervention):** Another route is for the BoJ backtracking on tightening. The BoJ so far has resisted reversing course, wary of undermining their inflation-fighting credibility. However, if disorderly bond moves persist, the BoJ could conduct emergency buying operations. Such actions would likely stabilize JGBs in the short run, but at the cost of sacrificing the inflation goal.
- 4. Use of Japan's Foreign Assets ("Repatriation"):** Japan sits on massive foreign exchange reserves (second largest in the world at ~\$1.4 trillion) and even larger private foreign asset holdings (over \$10 trillion). If Japan dumped even a portion of its ~\$1.1 trillion in U.S. Treasuries to stabilize its own markets, it could drive up global yields, potentially hurting U.S. and European bond markets. As per a Bloomberg intelligence report (Jan 2023), a \$100 Bn (<10% of Japanese holdings) selloff of US T-bills, could move 10-year yields by 5–15 bps.

***A slow repatriation has begun.*** Should it intensify, global markets will feel it. Emerging markets are particularly vulnerable: Japan has been a major financier in Asia (through bonds and direct investment). An ASEAN+3 report warned that a yen carry trade reversal poses risks to Asian economies, potentially leading to capital outflows and currency pressure.

**In short, Japan could stabilize its own finances by drawing back its foreign investments, but that might transmit stress outward**

**Conclusion: No Imminent Collapse, but a Critical Risk to Monitor**

Japan's long-standing reliance on loose fiscal and monetary policy is reaching a critical juncture. Globally, waning confidence in fiat currencies is driving investors toward alternatives like gold and cryptocurrencies, which in turn restricts central banks' ability to simply print money to solve economic challenges.

**While a catastrophic collapse is not inevitable, the interplay of rising yields, constrained monetary policy, and shifting global dynamics signal significant headwinds for asset prices worldwide.**



How Japan chooses to respond—whether by tightening policy, liquidating foreign assets, or allowing currency adjustments—remains uncertain.

**One thing is certain: the path ahead demands vigilance and a recalibration of assumptions about Japan's role in global finance.**



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