

## Investment & Research View: Views on Japan's Recent Increase in Interest Rates

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Last week, on Monday, January 19, and Tuesday, January 20, Japanese government bond yields rose sharply. The 10-year yield increased by 16 basis points over the two days, to 2.34% as of the close on January 20. By maturity, the rise was particularly pronounced at the long end of the curve: the 30-year yield climbed 39 basis points over the two days, to 3.87%, the highest level since the issuance of 30-year JGBs began in 1999 (based on the Japan Securities Dealers Association OTC government bond reference prices on January 20). Yields moved lower later in the week, recovering slightly more than half of the two-day increase by the weekend.

We attribute the rise in yields mainly to the Bank of Japan's gradual normalization of monetary policy, including expectations of rate hikes and a reduction in bond purchases, together with a marked increase in market concern about fiscal expansion in Japan. With the lower house election scheduled for February 8, both ruling and opposition parties are campaigning for cuts to the consumption tax, raising worries that fiscal spending will expand regardless of the election outcome. Although the government bill for fiscal 2026 (adopted by Cabinet decision on December 26) showed a primary balance returning to surplus for the first time in 28 years in the initial budget, which temporarily eased concerns about fiscal expansion under the Takaichi administration that took office last October, Prime Minister Sanae Takaichi's subsequent dissolution of the lower house and consideration of a two-year zero rate on consumption tax for food—now being considered as a Liberal Democratic Party pledge—have revived those concerns.

In response to the sharp rise in yields, Finance Minister Satsuki Katayama stated in a January 20 interview that the government "has taken measures to stabilize the market and can promise to continue to do so." The Bank of Japan (BOJ) Governor, Kazuo Ueda, has previously said that the Bank would act flexibly if there were exceptional movements in long-term rates that differed from normal behavior; however, the BOJ's policy meeting on January 23 did not announce enlargements in bond purchases. Going forward, uncertainty is likely to persist around the election outcome, the parliamentary deliberation and approval process for the fiscal 2026 budget, and BOJ policy in response to any further yen weakness. We therefore expect the JGB market to remain relatively volatile in the near term.

In the foreign exchange market, concern about fiscal expansion briefly pushed the yen toward 160 yen per U.S. dollar on Friday, January 23, but after reports that U.S. and Japanese authorities conducted rate checks—seen as pre-intervention measures—the yen strengthened and the dollar weakened.

The recent rise in yields has, from a medium- to long-term perspective, increased the attractiveness of Japanese bonds. While we expect short-term market instability to continue, we will aim to manage risks carefully and endeavor to identify investment opportunities to deliver superior returns.

The commentary is based on personal views and does not necessarily reflect the house view.

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