Japan – what the rise in yields means

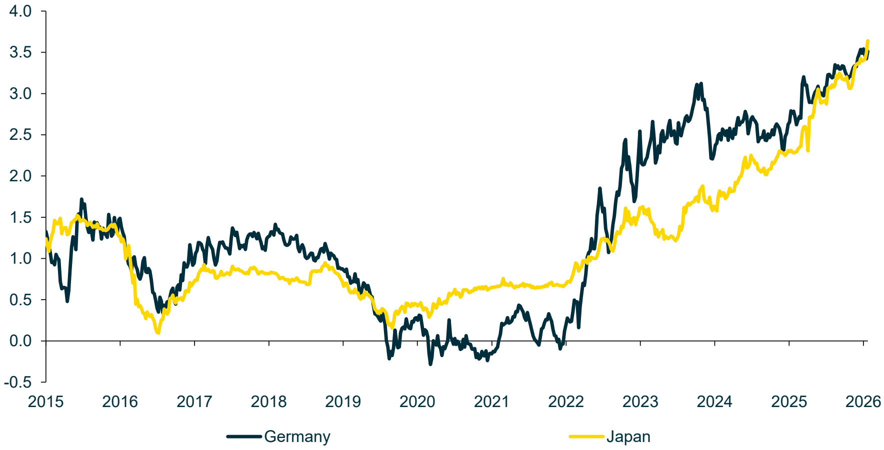
Long-term interest rates in Japan have risen sharply. What is going on? Does the rise in interest rates threaten the sustainability of debt? Is there a risk of turmoil on the global financial markets?

Bernd Weidensteiner [AC]
Dr. Christoph Balz [AC]

Yields significantly higher and yen weaker, ...

The Japanese financial markets had a turbulent start to the new year. Interest rates on 30-year government bonds shot up by almost 40 basis points in the week leading up to January 20, before the market calmed down again. These securities are currently yielding slightly higher than their German counterparts (Chart 1). The yen was also under pressure for a long time until it recently stabilized due to rumors of intervention. What is behind these violent market movements?

Chart 1 - Long-run bond yields higher in Japan than in Germany
30-year government bond yield, weekly data in %



Source: Bloomberg, Commerzbank Research

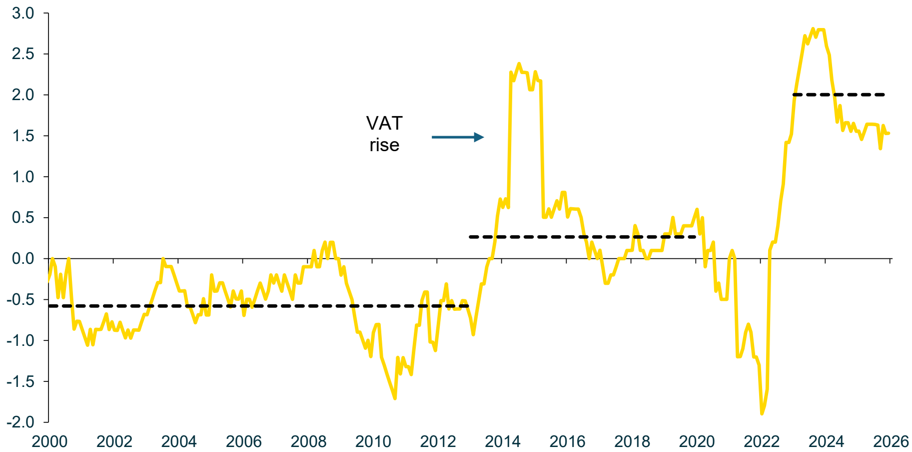
... because inflation has returned ...

Although the strength of the recent rise in yields was exceptional, the upward trend is not new. In fact, yields have been trending upward for several years. The reason for this is likely to be found in the return of inflation. For many years, Japan was considered by many to be a prime example of an economy trapped in deflation. Excluding food and energy, the inflation rate remained almost exclusively in negative territory for the first 13 years of this millennium, averaging -0.5% per year (Chart 2). Two economic shocks brought this phase to an end:

- In 2013, then-Prime Minister Abe initiated a drastic change of course in economic policy to halt the decline in consumer prices. In doing so, he focused in particular on an aggressive monetary policy, while the budget deficit actually tended to decline under his leadership. The Bank of Japan (BoJ) kept key interest rates close to zero until 2024. Above all, however, it purchased large quantities of government bonds worth around 100% of gross domestic product (GDP), making these purchases far more extensive than those in the US or the eurozone. Entrenched inflation expectations began to change. Wages, which had fallen by around 0.7% per year since the turn of the millennium, began to rise slightly again. The inflation rate was slightly positive from 2013 to the end of 2019, even when adjusted for the effects of the significant VAT increase in 2014.
- The Japanese government responded to the coronavirus pandemic and the resulting strain on the economy with an extremely expansionary fiscal policy, which caused the primary deficit – i.e., the budget balance excluding interest payments on existing government debt – to jump from around 3% to around 9% of gross domestic product. This was accompanied by an expansionary monetary policy. Because the macroeconomic demand thus stimulated met with a coronavirus-induced contraction in the supply of goods and services, the core inflation rate climbed to almost 3% by the end of 2024 and then settled at around 1.5%. [1]

Chart 2 - Inflation is now reliably positive

CPI excl. Food/energy, annual rate of change in %, monthly data. Dashed lines: average inflation rate in respective periods; 2013-19 average has been corrected for VAT rise



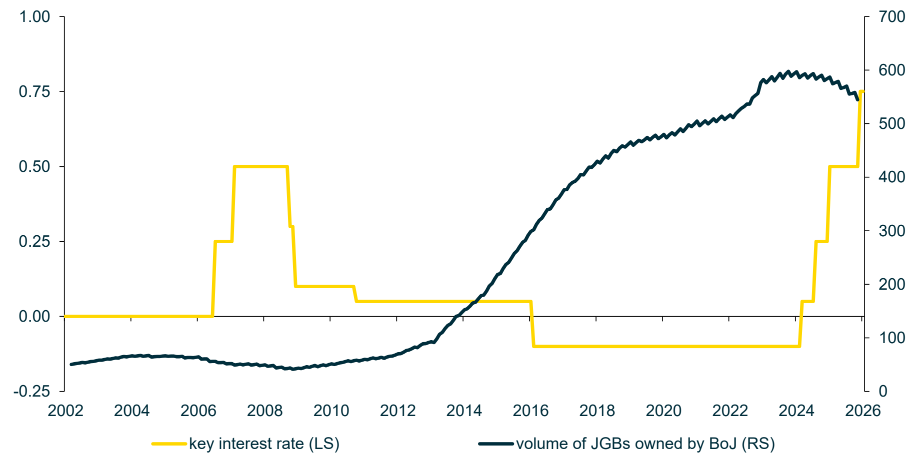
Source: S&P Global, Commerzbank Research

… monetary policy was normalized, …

This normalization of inflation was followed by a normalization of monetary policy. The Bank of Japan (BoJ) raised its key interest rate from -0.1% to 0.75% and signaled further steps. It has also significantly reduced its purchases of government bonds, which is why the central bank's enormous government bond portfolio has shrunk in recent months due to bond maturities (Chart 3).

Chart 3 - Bank of Japan normalizes monetary policy

Policy rate in % and BoJ's holdings of Japanese government securities in trillion yen, monthly data



Source: BoJ, Commerzbank Research

… and now there is also the threat of significantly higher budget deficits

Rising prices and the resulting higher inflation expectations, as well as the change in monetary policy, have caused bond yields to rise significantly in recent years. However, the latest jump in yields was triggered by an emerging shift in fiscal policy. While the primary deficit has fallen significantly in recent years and has recently approached zero, there is now a threat of a significant deterioration in the budget situation. The new Prime Minister Takaichi has announced tax cuts and higher government spending, not least on defense. For example, she wants to suspend VAT on food.

This has been met with great skepticism on the financial markets. Increasing deficits at the wrong time is problematic. The short-lived British Prime Minister Liz Trusts already had to learn this lesson when she stumbled over her plans for tax cuts in 2022 and was forced to quickly resign from office, not least due to rising yields. Ultimately, the recent rise in yields shows that the Japanese bond market is no longer characterized by a country-specific special situation, but is now behaving quite normally.

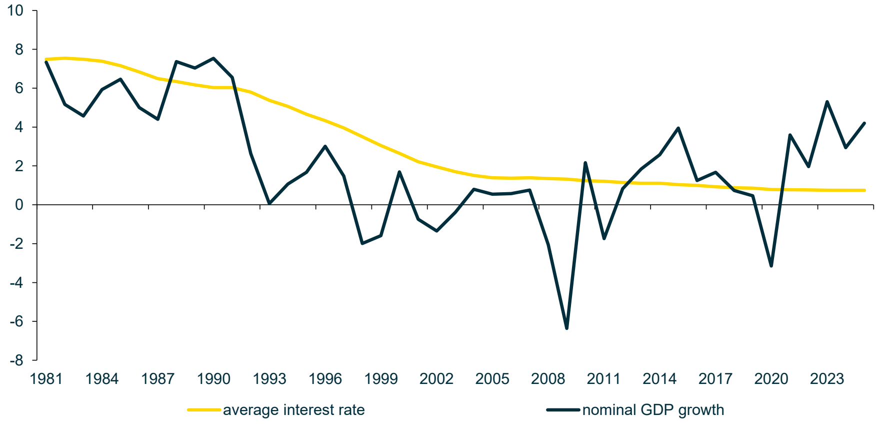
Can Japan even afford "normal" interest rates?

Even after the recent rise, Japanese yields are still not extreme, at least in international comparison. However, the pace of this latest increase is worrying. After all, Japan has been carrying an enormous debt burden for some time. Although the government debt ratio –

i.e., the ratio of government debt to gross domestic product – is no longer more than 250% as it was in 2020, at around 210% it is still by far the highest among advanced economies [2].

However, the interest burden for the Japanese government is likely to rise only slowly. This is because the higher interest rates only apply to new debt taken on to finance the budget deficit and the repayment of maturing bonds. Consequently, the average interest rate on outstanding government bonds, which is currently still below 1% as a result of the long period of low interest rates, is likely to rise only slowly. This means that the average interest rate is likely to remain lower than the growth rate of nominal gross domestic product in the coming years, so that even with the higher primary deficit planned by the government, the debt ratio is likely to continue to fall for the time being.

Chart 4 - Japan currently in sweet spot as nominal GDP growth exceeds average interest rate
Nominal GDP growth year-on-year, average interest rate on JGBs; in %



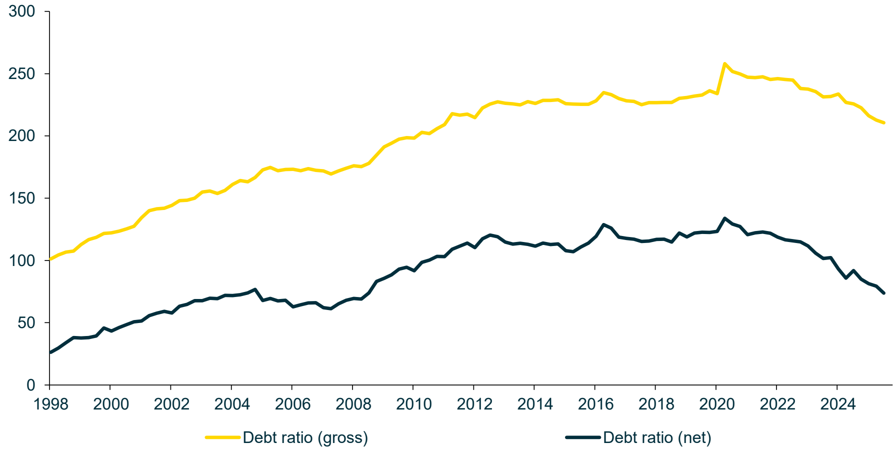
Source: S&P Global, Japan Ministry of Finance, Commerzbank Research

Why a sovereign debt crisis is unlikely...

But even if the average interest rate on government debt were to rise above the nominal growth rate in the longer term, threatening another increase in the debt ratio, there are a number of factors that argue against a sovereign debt crisis in Japan:

- Japan has very little foreign currency debt, and foreigners hold only 12% of JGBs. A potential foreign buyer strike would not in itself trigger a sovereign debt crisis. And a government with debt denominated in domestic currency can prevent defaults thanks to its central bank, which can ensure that the sovereign debt is serviced at any time in the event of a crisis. Japan also has a current account surplus and is a net creditor to the rest of the world.
- In addition, the Japanese government has significant assets, which are held by the huge government pension fund and the central bank. Currently, the financial assets of the general government amount to over 135% of GDP. This capital, which is tied up in foreign stocks, for example, is difficult to mobilize in a crisis. However, it should be taken into account when comparing public finances internationally with countries where public pension obligations are hardly matched by assets. The Japanese government's net debt (i.e., financial liabilities minus financial assets) currently amounts to 74% of GDP, which is lower than the net debt of the US (approximately 100% of GDP).

Chart 5 - Japan - the government has high debt, but also significant assets
General government debt in % of GDP, gross and net (i.e. minus net financial assets), quarterly data



Source: BoJ Flow of Funds, Commerzbank Research

… even if some risks should not be ignored

Japan's fundamentals do not currently point to an impending crisis. Politicians should also have learned from the Liz Truss episode and shy away from irresponsible fiscal policy when market signals indicate this is worrying. However, there are still plenty of risks. It is difficult to predict at what point bond investors might get cold feet. A renewed severe economic downturn would also throw all financial planning into disarray and significantly increase budget deficits.

In recent years, the Japanese government has also benefited from investing cheaply raised funds in high-yield long-term investments such as domestic and foreign stocks. According to researchers at the St. Louis Fed, this has helped Japanese public finances considerably. In an **analysis**, however, they point to significant maturity and currency risks. Added to this are the considerable challenges posed by the aging of society in Japan.

What does this mean for the rest of the world?

Even if yields on Japanese government bonds do not spiral out of control, the higher levels could also lead to higher yields at the long end of other bond markets. With a total volume of US$1.2 trillion, the Japanese are the largest investors in US government bonds, and they also have a strong presence in the European market. Their largest exposure in Europe is in France, where they hold government bonds worth around €140 billion. In addition to the repatriation of Japanese holdings, the risks of contagion are also increasing, as international investors could further increase their exposure to Japan.

Furthermore, the Japan also offers some economic policy lessons. The Japanese economy was considered a prime example of zero inflation and zero interest rates because these phenomena had become entrenched there over decades. But even such seemingly unshakeable equilibria can be ended by major shocks such as the pandemic.

At the same time, Japan shows that mild deflation was only a symptom of economic weakness and not – as some economists claim – the cause. Between 2012 and 2019, a period with hardly any price increases, the Japanese economy expanded by an average of 0.9% per year. In the last three years, however, with prices rising sharply again, the economy grew by only 0.6% per year. A “deflation trap” is therefore far less problematic for the real economy than some economists portray it to be.

However, the example of Japan also shows that consolidating public finances in a deflationary phase accompanied by stagnating nominal GDP is hardly possible. This explains the country's long-standing attempts to break out of this fiscal trap.

The experience in Japan thus also confirms the ECB's decision to set a *symmetrical* inflation target of 2%. This is because falling short of the target for many years does not pose any greater risks than consistently exceeding it.

Yen: Real interest rates and political risks weigh on the currency

In recent months, the Japanese yen (JPY) has come under heavy pressure despite the significant rise in nominal interest rates. Most recently, the USD/JPY exchange rate threatened to rise above 160 again, even though the US dollar was also weak.

One reason for this may be that real interest rates in Japan have risen less sharply than in other regions due to rising inflation. The real key interest rate (key interest rate minus inflation) was even lower for a long time than it was when nominal key interest rates were negative. Only in recent months has a slowdown in inflation caused the real key interest rate to rise, but it is still lower than in the other G-10 countries.

In addition, political risks have weighed on the Japanese yen in recent months. The market reacted nervously to the announcement by the new Prime Minister Takaichi of a very expansionary fiscal policy and an end to what she called the “excessive austerity” of recent years, given the high gross debt of the Japanese government, as described above. In the upcoming elections on February 8, Takaichi's Liberal Democrats could gain ground, enabling the prime minister to better implement her ideas. Many in the market then expect a noticeably more expansionary fiscal policy.

In fact, a very strong showing by the Liberal Democrats could weigh on the yen. However, we believe it is more likely that lower political risks and the recent rise in real interest rates will cause the yen to appreciate this year.

---

[1] The temporary decline in prices in 2021/22 was partly due to a special effect, namely the sharp reduction in telecommunications charges initiated by the government. (back to text)

[2] We use data from the Japanese Flow of Funds, provided by the Bank of Japan, to calculate the debt ratio. (back to text)

Research contacts (E-Mail: firstname.surname@commerzbank.com)

Chief Economist
Dr J rg Kr mer
+49 69 136 23650

Economic Research

Dr J rg Kr mer (Head)
+49 69 136 23650

Dr Ralph Solveen (Deputy Head; Germany)
+49 69 9353 45622

Dr Christoph Balz (USA. Fed)
+49 69 9353 45592

Dr Vincent Stamer (Euro area, World trade)
+49 69 9353 45800

Dr Marco Wagner (ECB, Germany, Italy)
+49 69 9353 45623

Bernd Weidensteiner (USA, Fed)
+49 69 9353 45625

Tung On Tommy Wu (China)
+65 6311 0166

Interest Rate & Credit Research

Christoph Rieger (Head)
+49 69 9353 45600

Michael Leister (Head Rates)
+49 69 9353 45610

Rainer Guntermann
+49 69 9353 45629

Hauke Siem en
+49 69 9353 45619

Ted Packmohr
(Head Covered Bonds and Financials)
+49 69 9353 45635

Marco Stoeckle
(Head Corporate Credit)
+49 69 9353 45620

FX & Commodities Research

Ulrich Leuchtmann (Head)
+49 69 9353 45700

Antje Praefcke (FX)
+49 69 9353 45615

Tatha Ghose (FX)
+44 20 7475 8399

Charlie Lay (FX)
+65 63 110111

Michael Pfister (FX)
+49 69 9353 45614

Volkmar Baur (FX)
+49 69 9353 26854

Thu-Lan Nguyen (FX, Commodities)
+49 69 9353 45617

Carsten Fritsch (Commodities)
+49 69 9353 45647

Barbara Lambrecht (Commodities)
+49 69 9353 45611

Tung On Tommy Wu (China)
+65 6311 0166

Other publications (examples)

Economic Research:	Economic Briefing (up-to-date comment on main indicators and events) Economic Insight (detailed analysis of selected topics) Economic and Market Monitor (chart book presenting our monthly global view)
Commodity Research:	Commodity Update (comment and news on commodities markets, two times per week) Commodity Spotlight (detailed analysis and forecasts of commodities markets)
Interest Rate & Credit Research:	Ahead of the Curve (flagship publication with analysis and trading strategy for global bond markets European Sunrise (daily comment and trading strategy for euro area bond markets) Rates Radar (ad-hoc topics and trading ideas for bond markets) Covered Bonds Weekly (weekly analysis of the covered bonds markets)
FX Strategy:	Daily Currency Briefing (daily comment and forecasts for FX markets) FX Hot Spots (ad hoc analysis of FX market topics)

To receive these publications, please ask your Commerzbank contact.

Analysts

Dr. Jörg Krämer AC
Chief Economist
+49 69 136 23650
joerg.kraemer@commerzbank.com

Bernd Weidensteiner AC
Senior Economist
+49 69 9353 45625
bernd.weidensteiner@commerzbank.com

This report was completed 30/1/2026 07:11 CET and disseminated 30/1/2026 07:11 CET.

This document has been created and published by the Group Research department (GM-R) within the Group Management division of Commerzbank AG, Frankfurt/Main or Commerzbank's non-US branch offices mentioned in the document.

Analyst Certification (AC): The author(s), denoted by AC at the beginning of this report, individually certifies that the views expressed in this report accurately reflect their personal views about the subject securities and issuers; and no part of their compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or views expressed by them contained in this document.

It has not been determined in advance whether and in what intervals this document will be updated. Unless otherwise stated current prices refer to the most recent trading day's closing price or spread which may fluctuate.

Conflicts of interest

Disclosures of potential conflicts of interest relating to Commerzbank AG, its affiliates, subsidiaries (together "Commerzbank") and its relevant employees with respect to the issuers, financial instruments and/or securities forming the subject of this document valid as of the end of the month prior to publication of this document*:

Please refer to the following link for disclosures on companies included in compendium reports or disclosures on any company covered by Commerzbank analysts: **https://commerzbank.bluematrix.com/sellside/Disclosures.action***

*Updating this information may take up to ten days after month end.

Disclaimer

This document is for information purposes only and has been prepared for recipients who, like professional clients according to MiFID II, have the experience, knowledge and expertise to understand information related to the financial markets. The document does not take into account specific circumstances of any recipient and the information contained herein does not constitute the provision of investment advice. It is not intended to be and should not be construed as a recommendation, offer or solicitation to acquire, or dispose of, any of the financial instruments and/or securities mentioned in this document and will not form the basis or a part of any contract or commitment whatsoever. Investors should seek independent professional advice and draw their own conclusions regarding suitability of any transaction including the economic benefits, risks, legal, regulatory, credit, accounting and tax implications.

The information in this document is based on public data obtained from sources believed by Commerzbank to be reliable and in good faith, but no representations, guarantees or warranties are made by Commerzbank with regard to accuracy, completeness or suitability of the data. Commerzbank has not performed any independent review or due diligence of publicly available information regarding an unaffiliated reference asset or index. The opinions and estimates contained herein reflect the current judgement of the author(s) on the date of this document and are subject to change without notice. The opinions do not necessarily correspond to the opinions of Commerzbank. Commerzbank does not have an obligation to update, modify or amend this document or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

In order to address potential conflicts of interest Commerzbank's Research department operates independently of other business units of the bank. This is achieved by way of physical and administrative information barriers and separate reporting lines as well as by written internal policies and procedures.

This communication may contain trading ideas where Commerzbank may trade in such financial instruments with customers or other counterparties. Any prices provided herein (other than those that are identified as being historical) are indicative only, and do not represent firm quotes as to either size or price. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. Any forecasts or price targets shown for companies and/or securities discussed in this document may not be achieved due to multiple risk factors including without limitation market volatility, sector volatility, corporate actions, the unavailability of complete and accurate information and/or the subsequent transpiration that underlying assumptions made by Commerzbank or by other sources relied upon in the document were inapposite.

Commerzbank and or its affiliates may act as a market maker in the instrument(s) and or its derivative that has been mentioned in our research reports. Employees of Commerzbank and or its affiliates may provide written or oral commentary, including trading strategies, to our clients and business units that may be contrary to the opinions conveyed in this research report. Commerzbank may perform or seek to perform investment banking services for issuers mentioned in research reports.

Neither Commerzbank nor any of its respective directors, officers or employees accepts any responsibility or liability whatsoever for any expense, loss or damages arising out of or in any way connected with the use of all or any part of this document.

Commerzbank may provide hyperlinks to websites of entities mentioned in this document, however the inclusion of a link does not imply that Commerzbank endorses, recommends or approves any material on the linked page or accessible from it. Commerzbank does not accept responsibility whatsoever for any such material, nor for any consequences of its use.

This document is for the use of the addressees only and may not be reproduced, redistributed or passed on to any other person or published, in whole or in part, for any purpose, without the prior, written consent of Commerzbank. The manner of distributing this document may be restricted by law or regulation in certain countries, including the United States. Persons into whose possession this document may come are required to inform themselves about and to observe such restrictions. By accepting this document, a recipient hereof agrees to be bound by the foregoing limitations.

Additional notes to readers in the following countries:

Germany: Commerzbank AG is registered in the Commercial Register at Amtsgericht Frankfurt under the number HRB 32000. Commerzbank AG is supervised by both the German regulator, Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), Graurheindorfer Strasse 108, 53117 Bonn, Marie-Curie-Strasse 24-28, 60439 Frankfurt am Main and the European Central Bank, Sonnemannstrasse 20, 60314 Frankfurt am Main, Germany.

United Kingdom: This document is not for distribution to retail customers and has been issued or approved for issue in the United Kingdom by Commerzbank AG, London Branch, which is authorised and regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and the European Central Bank. Authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

United States: This research report was prepared by Commerzbank AG, a company authorized to engage in securities activities in Germany and the European Economic Area (EEA). Commerzbank AG is not a U.S. registered broker-dealer and is therefore not subject to U.S. rules regarding the preparation of research and associated rules pertaining to research analysts. This document is not for distribution to U.S. retail customers. Any distribution of this research report to U.S. investors is intended for “major U.S. institutional investors” in reliance on the exemption from registration provided by Rule 15a-6(a)(2) of the U.S. Securities Exchange Act of 1934, as amended (the “Exchange Act”). Any U.S. recipient of this research report seeking to effect transactions to buy or sell securities, or related financial instruments based upon the information provided in this research report, may only do so through a Financial Industry Regulatory Authority (FINRA) registered broker-dealer. Commerz Markets LLC (CMLLC) is a U.S. registered broker-dealer and wholly owned subsidiary of Commerzbank AG. Commerzbank AG is a registered derivatives swap dealer with the Commodity Futures Trading Commission (CFTC), in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act. U.S. Person(s) and related Dodd-Frank relevant investors seeking to effect transactions in non-security based swaps based upon the information provided in this research report, may only do so through a CFTC registered swap dealer.

Canada: The information contained herein is not, and under no circumstances is to be construed as, a prospectus, an advertisement, a public offering, an offer to sell securities described herein, solicitation of an offer to buy securities described herein, in Canada or any province or territory thereof. Any offer or sale of the securities described herein in Canada will be made only under an exemption from the requirements to file a prospectus with the relevant Canadian securities regulators and only by a dealer properly registered under applicable securities laws or, alternatively, pursuant to an exemption from the dealer registration requirement in the relevant province or territory of Canada in which such offer or sale is made. Under no circumstances is the information contained herein to be construed as investment advice in any province or territory of Canada and is not tailored to the needs of the recipient. In Canada, the information contained herein is intended solely for distribution to Permitted Clients (as such term is defined in National Instrument 31-103) with whom Commerzbank AG and/or Commerz Markets LLC deals pursuant to the international dealer exemption. The information contained herein is not permitted to reference securities of an issuer incorporated, formed or created under the laws of Canada or a province or territory of Canada, as Commerzbank AG and Commerz Markets LLC operates under the international dealer exemption pursuant to National Instrument 31-103. No securities commission or similar regulatory authority in Canada has reviewed or in any way passed upon these materials, the information contained herein or the merits of the securities described herein and any representation to the contrary is an offence.

European Economic Area: Where this document has been produced by a legal entity outside of the EEA, the document has been re-issued by Commerzbank AG, London Branch for distribution into the EEA. Commerzbank AG, London Branch is authorised and regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and the European Central Bank. Authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

Switzerland: This document is generally not for distribution to retail clients. Neither this research report nor the information contained herein should be regarded as personal recommendations for transactions in financial instruments within the meaning of the Financial Services Act.

Singapore: This document is furnished in Singapore by Commerzbank AG, Singapore branch. It may only be received in Singapore by an institutional investor, an accredited investor or an expert investor as respectively defined in section 4A of the Securities and Futures Act, Chapter 289 of Singapore (“SFA”) pursuant to section 274 or section 275 (as applicable) of the SFA. Nothing in this document constitutes accounting, legal, regulatory, tax, financial or other advice and/or recommendations to the recipient of this communication. Further, the communication/information provided herein does not constitute a “financial advisory service” within the meaning of the Financial Advisers Act, Chapter 110 of Singapore (“FAA”) and therefore, the regulatory requirements and duties that may be owed to a client pursuant to or in connection with the FAA are not applicable to the recipient in connection with this communication. Recipients are advised to seek independent advice from their own professional advisers about the information contained discussed herein.

Japan: This information and its distribution do not constitute and should not be construed as a "solicitation" under the Financial Instrument Exchange Act (FIEA) of Japan. This information may be distributed from Commerzbank international branches outside Japan solely to "professional investors" as defined in Article 2(31) of the FIEA and Article 23 of the Cabinet Ordinance Regarding Definition of Article 2 of the FIEA. Please note that Commerzbank AG, Tokyo Branch has not participated in its preparation. Not all financial or other instruments referred to in this document are available within Japan. Any instruments referred in this report cannot be introduced by the Branch. You should contact the Corporate Clients division of Commerzbank AG for inquiries on availability of such instruments.

Australia: Commerzbank AG does not hold an Australian financial services licence. This document is being distributed in Australia to wholesale customers pursuant to an Australian financial services licence exemption for Commerzbank AG under Class Order 04/1313.

Commerzbank AG is regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) under the laws of Germany which differ from Australian laws.

People's Republic of China (PRC): This document is furnished by Commerzbank AG and is only intended for eligible entities in the PRC. No-one else may rely on any information contained within this document. The products and services in this document only apply to entities in the PRC where such products and services are permitted to be provided by PRC laws and regulations. For any person who receives this document, the information in this document shall neither be regarded as promotion or solicitation of the business nor accounting, legal, regulatory, tax, financial or other advice and/or recommendations to the recipient of this communication, and the recipient is advised to seek independent advice from its own professional advisers about the information contained herein and shall understand and abide by PRC laws and regulations while conducting any related transactions.

Frankfurt	**London**	**New York**	**Singapore**
Commerzbank AG	Commerzbank AG	Commerz Markets LLC	Commerzbank AG
DLZ - Gebäude 2, Händlerhaus	PO BOX 52715	225 Liberty Street, 32nd floor,	128 Beach Road
Mainzer Landstraße 153	30 Gresham Street	New York,	#17-01 Guoco Midtown
60327 Frankfurt	London, EC2P 2XY	NY 10281-1050	Singapore 189773
Tel: + 49 69 136 21200	Tel: + 44 207 623 8000	Tel: + 1 212 703 4000	Tel: +65 631 10000