【Fixed Income Commentary】

Intriguing RV graphs: Lessons from Europe on what follows behind-the-curve concerns

(original Japanese report issued on August 17, 2026)

Key points

- We examine path of super-long JGB market after concerns about BoJ falling behind the curve recedes, based on case studies of Germany and Italy
- Lessons are that super-long government bond yields (1) may decline if behind-the-curve concerns ease, but (2) may rise if asset swap spreads widen due to fiscal concerns
- (3) Even if both concerns subside, yields are unlikely to enter downtrend as long as terminal rate uncertainties persist

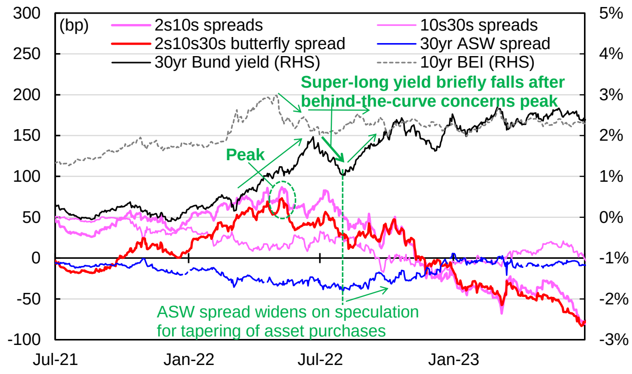
Based on lessons from Europe, predicting super-long JGB market following concerns about BoJ lagging

In this report we examine relative value (RV) graphs of 30-year government bond yields, inflation expectations (10-year break-even inflation rate [BEI]), the 2s10s and 10s30s yield spreads, the 2s10s30s butterfly spread, and the 30-year asset swap (ASW) spread (= government bond yield – fixed swap rate) in Germany and Italy (Graph 1, 2).

Since the coordinated US-Japan yen-buying intervention at the end of July, concerns of risks that the BoJ could fall behind the curve have subsided. The 2s10s JGB yield spread, which had been widening, has recently narrowed slightly. 10-year BEI has also been holding steady. Whether concerns about falling behind the curve will continue to subside is debatable. However, assuming that concerns continue to ease, will JGB yields, particularly those on super-long issues, decline or rise? This point is not necessarily self-evident. Some believe that if interest rates are raised early or if the pace of rate hikes are accelerated, the JGB yield curve will flatten, in line with textbook expectations. Would that take the form of bear-flattening or a twist-flattening? To begin with, is the notion that an early rate hike or an acceleration of rate hikes will lead to a flattening of the yield curve a valid assumption? As the JGB yield curve has been bear-steepening/flattening with a rise particularly around the 10-year zone, there is a possibility of a reversal from this move. Furthermore, even if concerns about falling behind the curve continue to subside, concerns about fiscal expansion could resurface. In that case, would super-long JGB yields generally rise or fall?

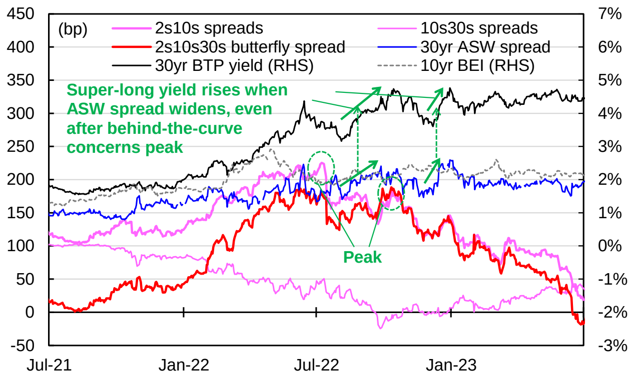
In this report, we analyze the super-long JGB market trends subsequent to the retreat of behind-the-curve concerns through case studies of two major countries that have previously experienced such concerns, specifically Germany and Italy.

Graph 1. Germany: 30yr government bond yields, BEI, and various spreads



Source: MUMSS, from Bloomberg

Graph 2. Italy: 30yr government bond yields, BEI, and various spreads



Source: MUMSS, from Bloomberg

Why Germany and Italy? Distinguishing between "falling behind" and "fiscal" concerns

Why are we focusing on Germany and Italy? Amid the post-pandemic inflationary pressures, these two countries, despite being in a similar eurozone environment, have had different experiences. While both countries were experiencing concerns about falling behind the curve, concerns about fiscal expansion also began to surface in Italy at around the same time. Meanwhile, in Germany, such concerns had not emerged. As such, by comparing the experiences of these two countries, we can distinguish between (1) the impact of concerns about falling behind the curve and (2) the impact of concerns about fiscal expansion.

Germany: With easing fears about lagging amid absence of fiscal concerns, super-long bund yields declined

First, in Germany, following the COVID-19 pandemic, inflation expectations (10-year BEI) rose, partly due to supply chain disruptions and the impact of the war in Ukraine, and the 10-year bund yield also rose (Graph 1). Amid growing expectations for an interest rate hike, yields on 2-year bunds also rose, but the upward momentum for inflation expectations showed no signs of slowing. As a result, the 2s10s yield spread widened and concerns about falling behind the curve surfaced. Meanwhile, the 10s30s spread narrowed. In other words, Germany experienced a rise in government bond yields, mainly the 10-year bunds, similar to Japan's recent experience. During that time, the super-long ASW spread narrowed. Concerns about fiscal expansion had not become particularly apparent. However, around May 2022, inflation expectations halted their rise and began to level off. Widening of the 2s10s spread and butterfly spreads with 10-year bodies, which had continued until then, began to reverse course. The 30-year bund yield rose sharply amid growing concerns about falling behind the curve. However, the yield declined sometime after such concerns receded. A downtrend continued until the ASW spread began to widen on speculations regarding the ECB's tapering of asset purchases.

Italy: Concerns about lagging eased, but super-long bond yields rose due to wider ASW spreads driven by fiscal uncertainty

Next, we turn to Italy. Similar to Germany, Italy has experienced a rise in government bond (BTP) yields, particularly the 10-year sector, driven by concerns about falling behind the curve (Graph 2). As inflation expectations rose, the yield on 10-year BTPs rose more sharply than that on the 2-year zone. The 10s30s yield spread also narrowed, as was the case in Germany. What sets Italy apart from Germany is the movement of super-long ASW spreads. While spreads in Germany continued to contract, those in Italy continued to expand. This was because fiscal instability continued to smolder amid speculation surrounding the resignation of the Draghi administration at that time. From mid-2022 onward, speculation about the ECB tapering its asset purchases also contributed to the widening of the ASW spreads. Looking at the 30-year BTP yield during that period, even after the rise for inflation expectations had paused and the widening of the 2s10s yield spread and the butterfly spread with a 10-year body had peaked, yields still rose during periods when the ASW spread widened. In other words, even after concerns about falling behind the curve subsided, super-long BTP yields rose during periods of heightened fiscal concerns.

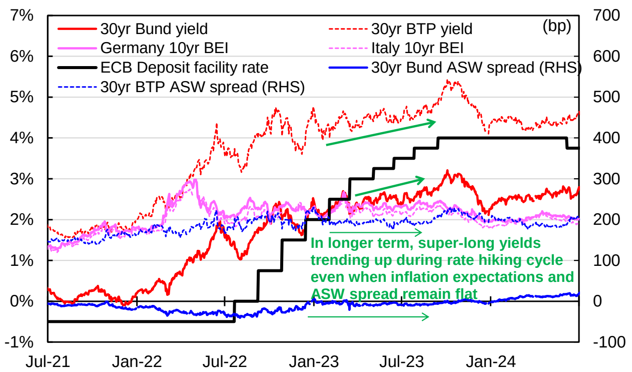
Two lessons learned from experiences in Germany, Italy

There are two lessons to be learned from the two case studies provided above. First, yields on 30-year government bonds could decline, albeit temporarily, once concerns about falling behind the curve subside. That said, even if concerns about falling behind the curve subside, super-long government bond yields could rise should ASW spreads widen reflecting concerns about fiscal expansion.

Even if both concerns retreat, super-long government bond yields unlikely to trend downward if terminal rate uncertainty persists

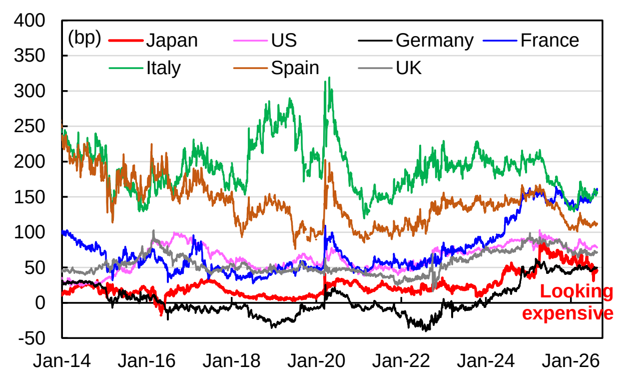
Looking at the experiences of these two countries over a slightly longer period of time, another lesson emerges; even if concerns about both falling behind the curve and fiscal expansion subside, super-long government bond yields may still struggle to trend downward as long as uncertainty surrounding terminal rates persists. Revisiting these examples provided by Germany and Italy, we see that even after inflation expectations and ASW spreads stabilized, the 30-year government bond yields continued rising until the ECB's policy interest rate peaked (Graph 3). This suggests that investor appetite for buying bonds may remain subdued until the end of the rate-hiking cycle comes into view.

Graph 3. Germany and Italy: 30yr government bond yields, ASW spreads, BEI, and ECB policy rates



Note: Deposit facility rate shown as ECB policy rate.
Source: MUMSS, from Bloomberg

Graph 4: 30yr government bond ASW spreads



Source: MUMSS, from Bloomberg

Yields on super-long JGBs unlikely to decline for now

The lessons provided above suggest that super-long JGB yields are unlikely to decline for now. As concerns about falling behind the curve ease, super-long JGB yields may decline over the near term, albeit briefly. However, with fiscal concerns likely to smolder towards the end of the year due to discussions over next fiscal year's budget and, considering that ASW looks expensive in global comparison (Graph 4), a sustained and significant decline in super-long JGB yields seems unlikely. Given that uncertainty surrounding the BoJ's terminal rate appear to persist, we should not assume that super-long JGB yields are about to enter a downtrend.

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8:00 JST, August 17, 2026

Appendix A

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