Economics Focus

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Japan Q&A: long-term yield hits 3% for the first time in 30 years: is the US expecting the BoJ to raise rates?

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- **What is your view of the argument that concerns about fiscal deterioration caused by the Takaichi administration's proactive public finance are pushing up long-term interest rates?**
- **What is your view of the possibility that the BoJ may accelerate the pace of its rate hikes?**
- **What is your view of Treasury Secretary Scott Bessent calling on the BoJ to take action?**
- **Does the BoJ's independence mean that it should be independent only from the Japanese government?**

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Question 1: *The long-term yield has surpassed the key threshold of 3%, rising to its highest level since September 1996. Expectations that interest rates would rise further have strengthened globally amid concerns about accelerating inflation and fiscal expansion. With ministries' budget requests for the next fiscal year expected to total around JPY143trn, exceeding this fiscal year's JPY122trn, concerns are also spreading that the Takaichi administration's proactive public finance would lead to fiscal deterioration and push up long-term interest rates. What is your view?*

Our view: The perception that concerns about fiscal deterioration caused by the Takaichi administration's proactive public finance are driving a sharp rise in long-term interest rates is mistaken. Although the amount of new government bond issuance under the FY27 government budget is expected to increase from around JPY30trn in FY26, it would likely be around JPY40trn, similar to the level in FY25. At that time, the long-term interest rate was around 1.5%. The true causes should therefore be factors that have changed substantially since then. These are the global trend and the BoJ's rate hikes. Globally, the era in which long-term investment was restrained by neoliberal cost-cutting has given way to an era in which long-term investment is expanding amid competition over public-private strategic investment, industrial policy and AI investment. This has led to a substantial increase in demand for long-term funding. In addition, the BoJ's front-loaded stance on rate hikes has caused the market's expectation of the eventual level of the policy rate to rise sharply from around 1% to above 2%.

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Question 2: *Against this backdrop, the BoJ appears increasingly likely to accelerate its rate hikes, which it has previously decided at intervals of around six months. The reason is intensifying inflationary pressure. At a press conference, BoJ Policy Board Member Hajime Takata said of the rate hikes implemented roughly every six months since March 2024 that "consecutive rate hikes are also possible as a general proposition". BoJ Governor Kazuo Ueda has also indicated that the Bank would consider raising rates at its next Monetary Policy Meeting on 17 and 18 September. What is your view of the possibility that the BoJ may accelerate the pace of its rate hikes?*

Our view: The sharp rise in long-term interest rates is underpinned by the mistaken perception that delays in the BoJ's rate hikes are creating concerns that the economy and inflation would overheat. Based on this mistaken perception, many argue that BoJ rate hikes would eliminate overheating concerns and lower long-term interest rates. However, both the BoJ and the market forecast real GDP growth in the 0% range and inflation in the 2% range, indicating no overheating whatsoever. In fact, long-term interest rates have continued to rise as the BoJ has adopted an increasingly front-loaded stance on rate hikes. Unless a BoJ rate hike leads to expectations of an economic downturn, the likelihood that it would lower

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long-term interest rates is extremely small. Neither the government nor the BoJ should be seeking to weaken the economy.

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Question 3: *Some have pointed to the influence of US "external pressure", reflecting the US desire for the BoJ to act to reverse JPY depreciation, as one factor behind the apparent acceleration of BoJ rate hikes. US Treasury Secretary Scott Bessent said that he believed "the Japanese government and the BoJ would take measures that would lead to JPY appreciation", expressing expectations for action by the Japanese authorities. The US has been concerned about the risk that JPY depreciation and rising interest rates in Japan could push up US interest rates. The Japanese and US governments conducted coordinated JPY-buying intervention at the end of July. What is your view of Treasury Secretary Bessent calling on the BoJ to take action?*

Our view: US Treasury Secretary Scott Bessent appears to be concerned about the sharp rise in US long-term interest rates. He is reportedly concerned that JPY depreciation would heighten inflation concerns in Japan, leading to a sharp rise in Japanese long-term interest rates that could spill over to the US. However, JPY depreciation is not caused by delays in the BoJ's rate hikes, but by Japan lagging behind Europe and the US in expanding investment. The currency of a country with strong investment is bought as expectations of higher interest rates emerge, while the currency of a country with weak investment is sold. The government is therefore seeking to halt JPY depreciation by expanding investment through public-private strategic investment and industrial policy. If this mistaken perception causes the BoJ to accelerate its rate hikes and derails investment momentum, there is a risk that, contrary to the intended effect, even stronger depreciation pressure would be placed on the JPY. It is a serious problem that, despite repeated assertions that "the government should not intervene in monetary policy", hardly any voices are calling for the BoJ's independence to be protected when the US Treasury Secretary makes a similar demand of the Bank. If economic policy is distorted by external pressure based on a mistaken perception, the sound development of the national economy would be impeded.

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Question 4: *During the "Honebuto shock" in June, interest rates surged amid speculation that the BoJ's independence and fiscal consolidation could be threatened, based on the wording of the Basic Policy on Economic and Fiscal Management and Reform, known as Honebuto, forcing the government to move quickly to calm the situation. Does the BoJ's independence mean that it should be independent only from the Japanese government?*

Our view: I believe the "Honebuto shock" in June was a market narrative created by parts of the media and was not based on fact. This is because the government had repeatedly made clear since the inauguration of the Takaichi administration last year that it was asking the BoJ to pursue a dual mandate of "achieving both strong economic growth and stable inflation". Nevertheless, there should not have been many market participants so unsophisticated as to be "shocked" by this. This is a policy choice within the duty to coordinate with the government stipulated by the Bank of Japan Act. It seeks to shift from an ECB-style framework, under which price stability is the sole mandate, to an FRB-style framework, under which both price stability and maximum employment are mandates, and therefore does not constitute an erosion of independence. In Honebuto, the government states that, "under the achievement of the 2% price stability target, economic growth exceeding 1% in real terms and 3% in nominal terms would be firmly established as soon as possible and subsequently raised further". In contrast, if the BoJ were effectively forced to raise rates because of intervention by a foreign government, it would have to be regarded as a serious erosion of the BoJ's independence. Distrust of a BoJ that had lost its independence could paradoxically create further JPY depreciation pressure by undermining confidence in the currency. It is necessary to recognise once again that central bank independence is itself a fundamental pillar supporting the strength of a currency.

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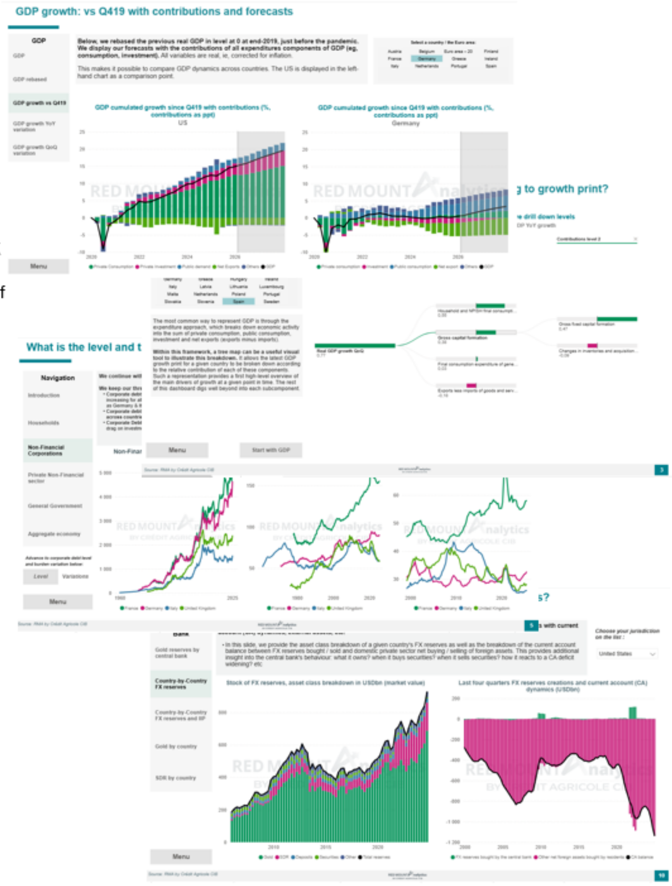

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