# Japan Q&A: are the narratives of US pressure and the BoJ being behind the curve true?

- **Is the narrative that coordinated Japan-US FX intervention has left Japan indebted to the US, forcing it to proceed with rate hikes in response to US Treasury Secretary Scott Bessent's demands, true?**
- **Is the narrative that pressure from the Takaichi administration has delayed BoJ rate hikes, leaving it "behind the curve" and driving up long-term yields, true?**

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***Question 1:*** *Is the narrative that coordinated Japan-US FX intervention has left Japan indebted to the US, forcing it to proceed with rate hikes in response to US Treasury Secretary Scott Bessent's demands, true?*

**Our view:**

The idea that long-term yields would decline as the BoJ proceeds with rate hikes is unlikely to materialise unless the economy deteriorates significantly. If the BoJ continues to raise rates, long-term yields would face upward pressure even if the yield curve flattens. The fact that long-term yields have continued to rise alongside BoJ rate hikes demonstrates this.

Higher Japanese government bond yields make JGBs more attractive, putting selling pressure on US Treasuries, which is not a desirable scenario for US Treasury Secretary Scott Bessent. The narrative that Bessent has strongly demanded BoJ rate hikes does not rest on sound macroeconomic logic, and its credibility is questionable. As reflected in his statement that "a strong JPY reflecting Japan's solid economic fundamentals is desirable", it is reasonable to assume that Bessent understands that a strong currency is brought about by a strong economy, including expanding investment, rather than aggressive central bank rate hikes. If rates were raised to the point of weakening the economy, concerns over Japan's economic outlook would accelerate JPY depreciation.

If the aim is to halt the rise in US long-term yields, a decline in long-term JGB yields should be desirable. Given reports that Prime Minister Sanae Takaichi asked BoJ Governor Kazuo Ueda to purchase JGBs, the possibility that Bessent also asked Japan to contain the rise in long-term yields through JGB purchases should be considered.

If foreign government interference demanding BoJ rate hikes did occur, the independence of the BoJ's monetary policy would have been compromised. If future rate hikes were also perceived in this way, they would not help reverse JPY depreciation. Instead, compromised independence would risk becoming another factor driving JPY weakness. This is also because it would increase the opposite risk: if Japan's domestic demand were weak, rate cuts could be demanded to reduce the trade deficit, and the BoJ might be unable to resist such demands.

Although a strong USD helps lower import costs, excessive USD strength would hinder the US objective of expanding domestic manufacturing capacity. The logic is the same as that behind the relocation of many Japanese manufacturing facilities overseas due to excessive JPY appreciation. Coordinated Japan-US FX intervention therefore also benefits the US, and it would be simplistic to conclude that Japan has become indebted to the US.

JPY depreciation also reflects differences in the strength of investment. The US has made a major shift towards public–private collaboration and industrial policy, while Japan has lagged behind. It is inevitable that capital flows into the US, where investment and growth are strong, strengthening its currency. Japan needs to expand investment for the JPY to shift towards appreciation.

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***Question 2:*** *Is the narrative that pressure from the Takaichi administration has delayed BoJ rate hikes, leaving it "behind the curve" and driving up long-term yields, true?*

**Our view:**
The rise in long-term yields is not unique to Japan but is a common global development, including in the US. Looking at movements in the spread between 10Y government bond yields and policy rates since last July's Upper House election, when the process leading to the Ishiba administration's resignation and the emergence of the Takaichi administration began, Japan's steepening has been considerably milder than that in the US and the UK.

If the BoJ were actually "behind the curve" in responding to inflation, the bond market should be pricing in sharp rate hikes measured in percentage points to address inflation, but this is not happening. The market is pricing in one 25bp rate hike by the end of the year, followed by gradual rate hikes thereafter, suggesting that it is not concerned about the BoJ being "behind the curve".

If these expectations reflect the view that government pressure prevents substantial rate hikes, inflation forecasts for 2027 should be extremely high. Instead, they are around 2%, making the macroeconomic logic of the "behind the curve" narrative inconsistent.

In Honebuto, the government stated that "to achieve a 'strong economy', it is extremely important that appropriate monetary policy is conducted to help achieve 'stable inflation'", imposing a dual mandate of "strong economic growth" and "stable inflation" on the BoJ. However, domestic demand cannot yet be described as sufficiently strong. An acceleration in the pace of rate hikes driven by external factors, disregarding fundamentals, would further depress economic growth.

The deviation of the call rate from its estimated macro fair value, calculated using net domestic fund demand – the combined funding demand of the corporate and government sectors (the corporate savings rate + the fiscal balance) – the output gap and the 10Y US Treasury yield, exceeds 1.25 standard errors. This is a level last seen under Governors Yasushi Mieno and Masaaki Shirakawa, who were known for monetary restraint. Estimates based on the fundamentals emphasised by the government suggest that the BoJ is not "behind the curve" but, conversely, "ahead of the curve (raising rates prematurely)". Inflation forecasts can also be said to be stable precisely because the BoJ is "ahead of the curve".

The rise in long-term yields reflects expectations for the "strong economic growth" sought by the Takaichi administration. It should be viewed as a move towards normalisation, with long-term yields converging towards the recent nominal GDP growth trend of around 3%, rather than as a reflection of fiscal concerns.

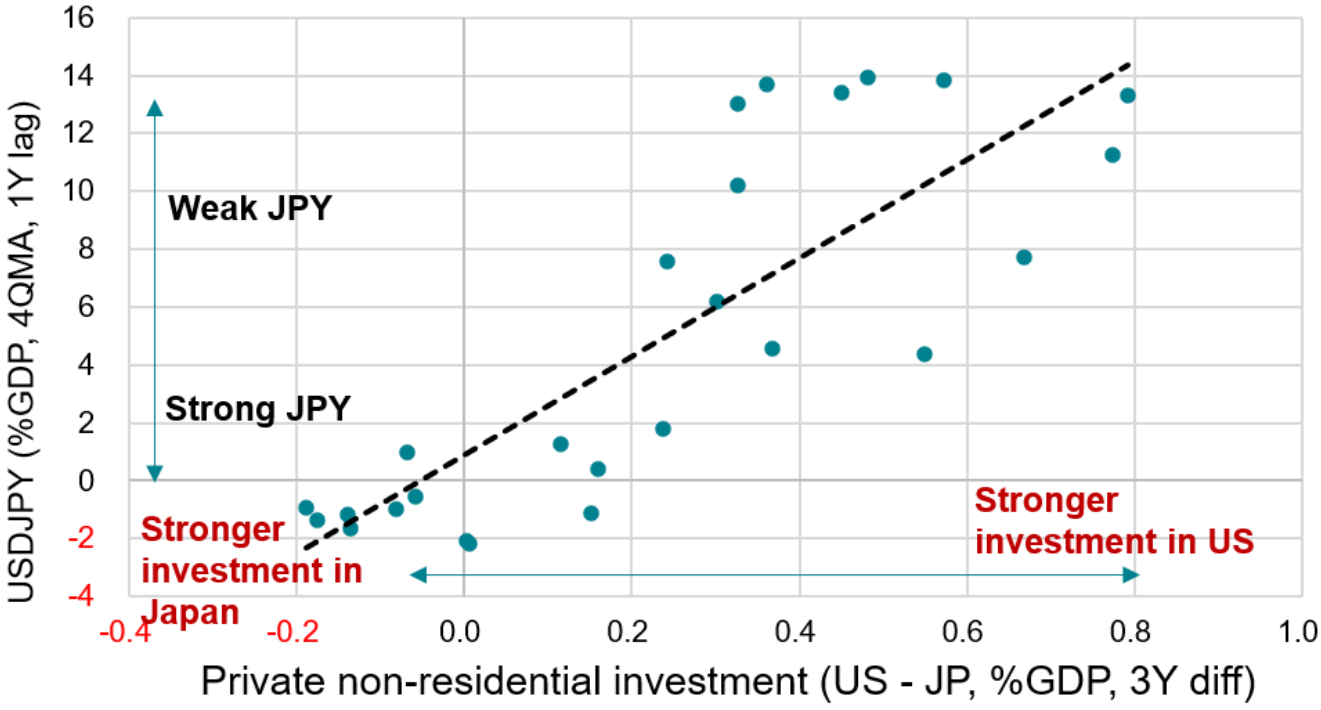
Moreover, the rise in long-term yields has broadly tracked the increase in the terminal rate priced in for BoJ rate hikes, indicating that it is not being driven by an expansion in the term premium due to fiscal concerns. The term premium remains around its level before the introduction of large-scale monetary easing in 2013. The term premium suppressed by Abenomics is merely returning to its previous level.

In a clear departure from Abenomics, which implemented large-scale monetary easing, the Takaichi administration appears to accept gradual rate hikes accompanying an expansion in investment. The votes against the rate hike by Policy Board members Toichiro Asada and Ayano Sato at the September Monetary Policy Meeting can be interpreted as strategic, preserving room for the BoJ to slow the pace of rate hikes in line with the pace of investment expansion – from roughly once a quarter back to roughly once every six months.

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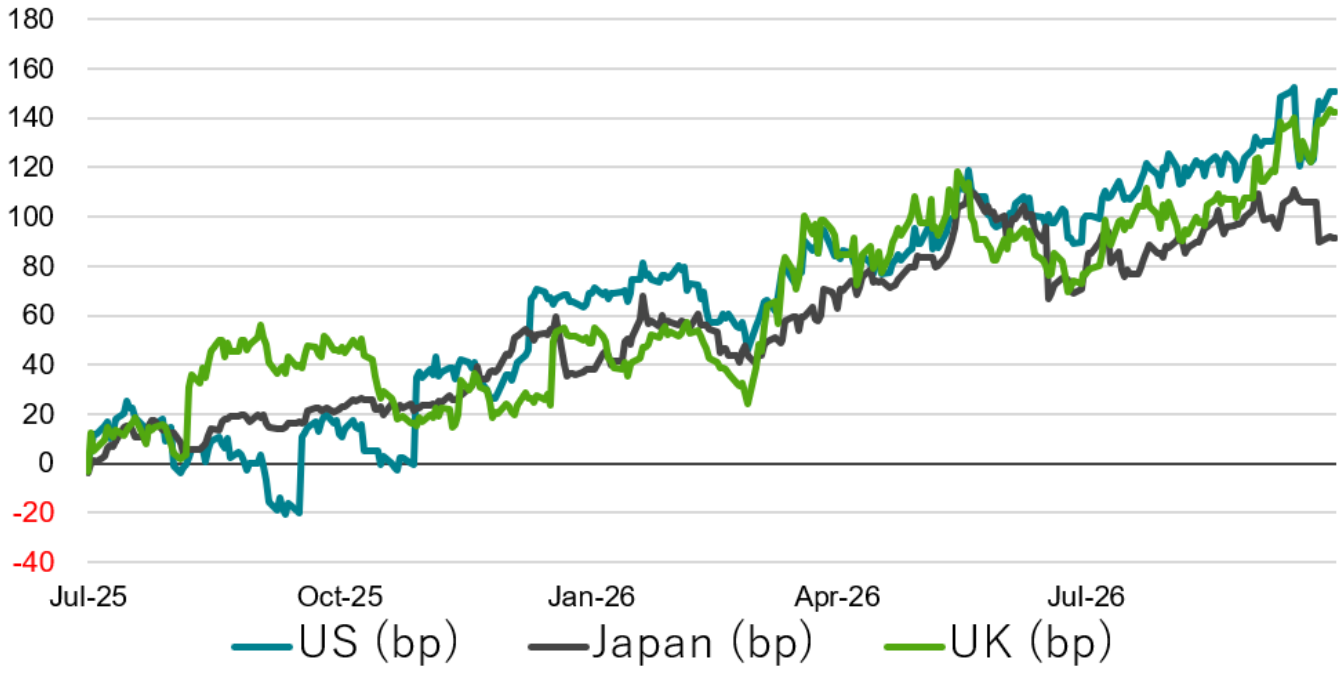
**Fig 1. Effects on USD/JPY from capex cycle**




*Note: sample data after 2020*

*Source: Cabinet Office, Bloomberg, Credit Agricole CIB*

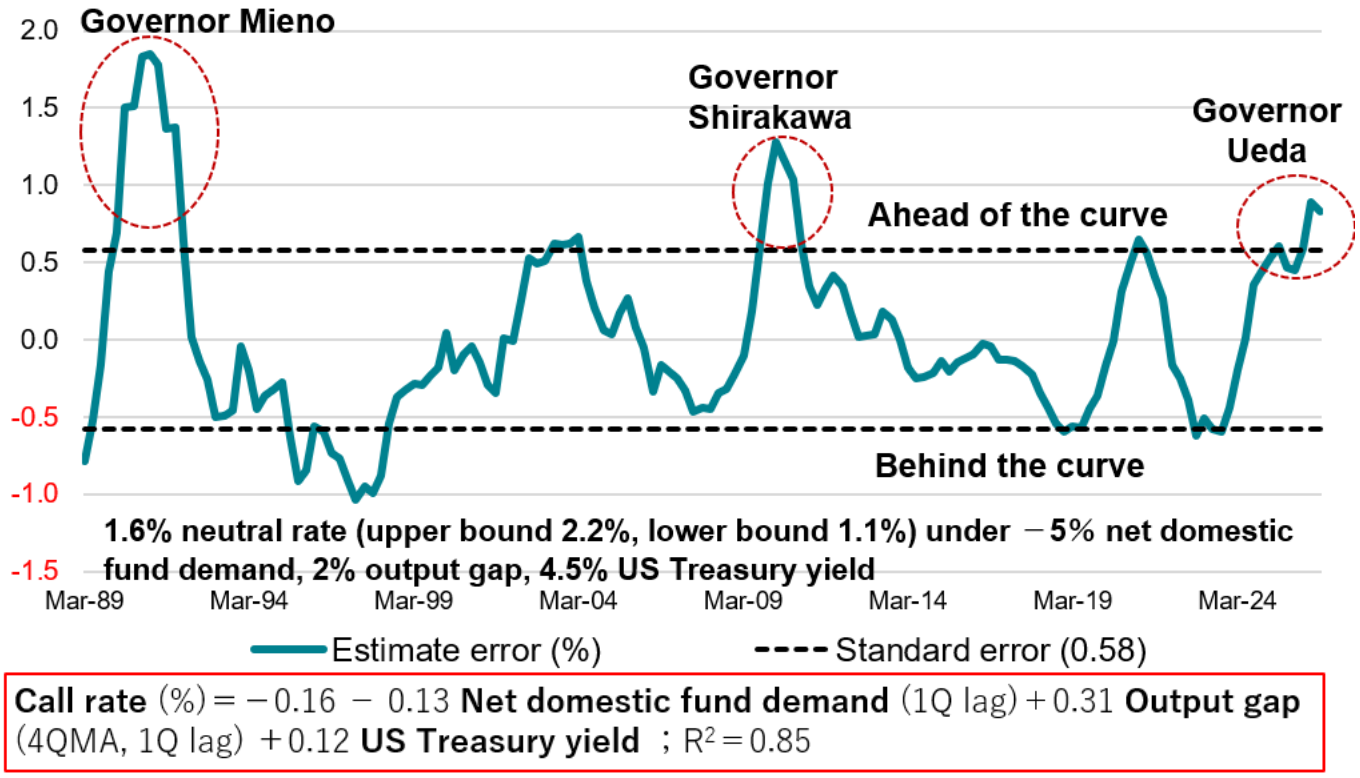
**Fig 2. Spread between 10Y government bond yield and CB policy rate (Jun 2025 = 0)**




*Source: Bloomberg, Credit Agricole CIB*

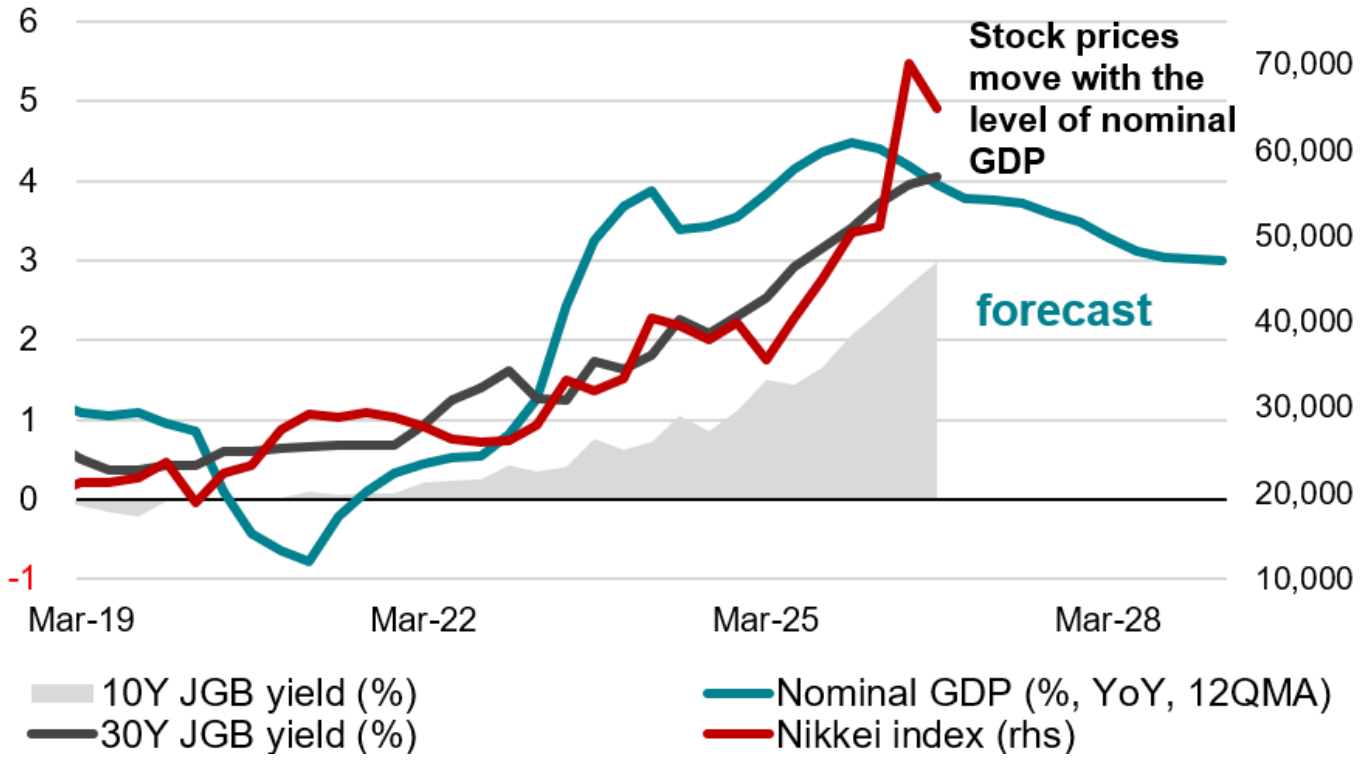
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**Fig 3. Estimate error of ON call rate macro fair value**




*Source: BoJ, Cabinet Office, Bloomberg, Credit Agricole CIB*

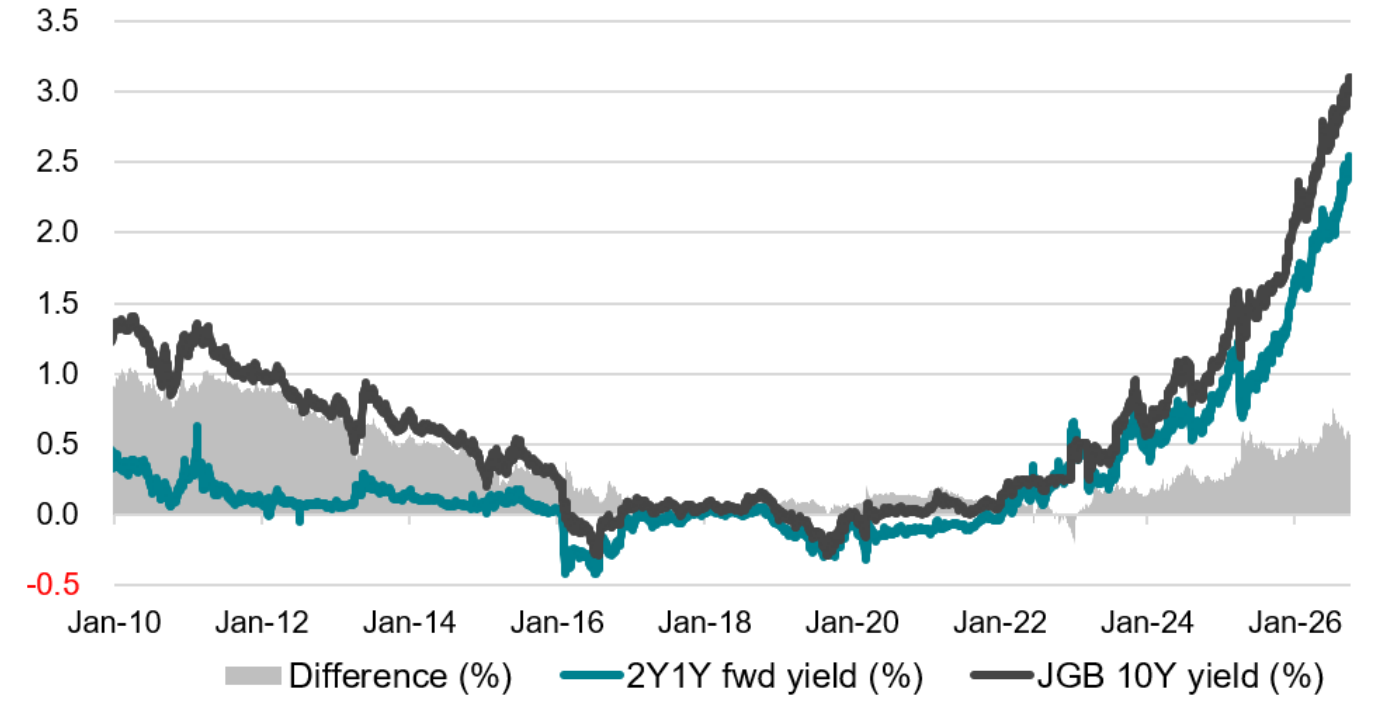
**Fig 4. Nominal GDP and JGB yield**




*Source: Cabinet Office, Bloomberg, Credit Agricole CIB*

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**Fig 5. Market implication on BoJ terminal rate and JGB 10Y yield**




*Source: Bloomberg, Credit Agricole CIB*

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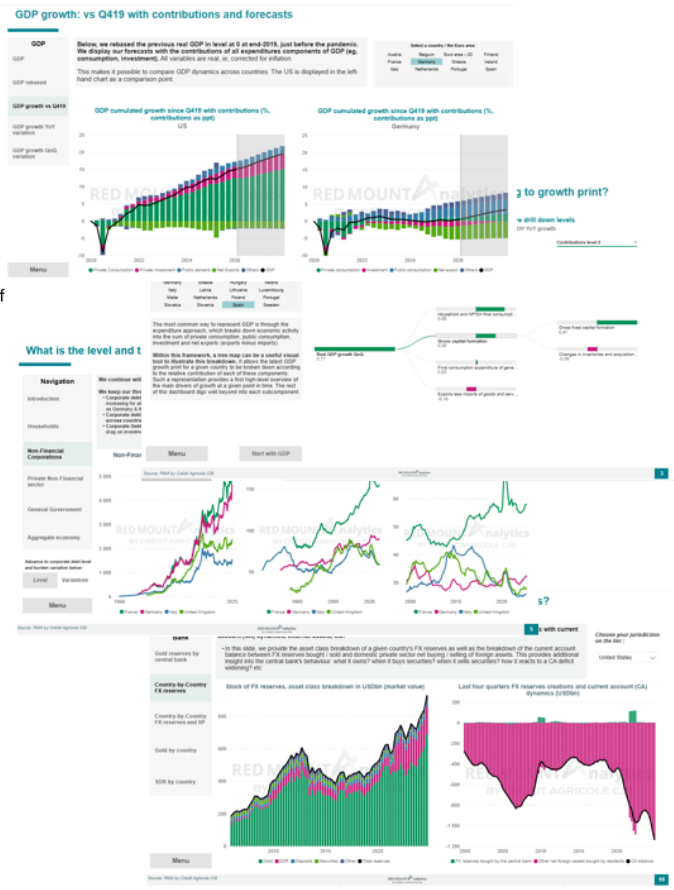
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