

Daiwa's View

FICC Research Dept.

Surging super-long JGB yields: Really due to just fiscal concerns?

- Recent super-long JGB yield surge has shifted from JGB-led to OIS-led
- This curious shift may reflect changing confidence in monetary policy
- Timely, appropriate additional rate hikes could increase confidence in monetary policy; JGB yield curve may twist/flatten if concerns about falling behind curve subside

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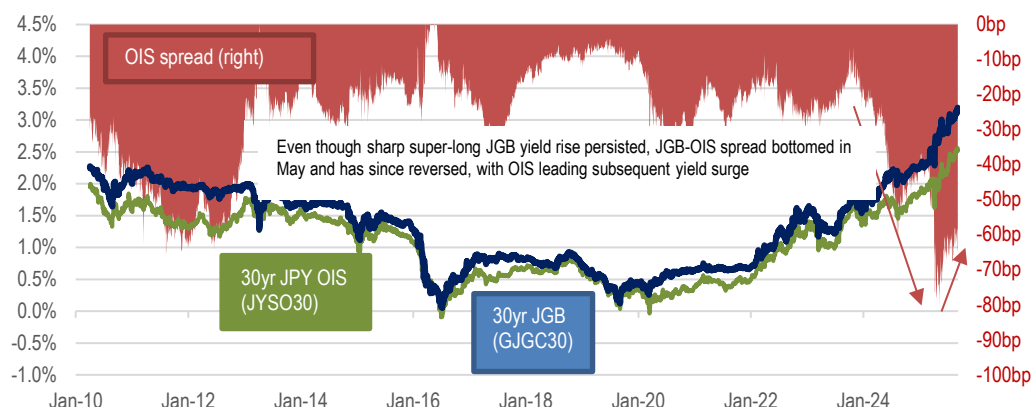


The fiscal deterioration in advanced economies since the pandemic, as well as the rise of populism unable to curb that deterioration, are key themes on the market right now. Furthermore, their significance is unlikely to diminish anytime soon. That said, such discussions are based on long-term perspectives and it is difficult to determine how closely they should be tied to the assessment of the current situation. In a recent speech, BOJ Deputy Governor Ryozi Himino said that economic changes do not suddenly appear in their fundamental form, but rather they often manifest first as **curious** movements in isolated, specific “weak points.”

In that sense, the shift in the rise of super-long JGB yields since July, from being led by JGBs to being led by OIS, strikes us as a “curious movement.” If JGBs are leading the way, linking the recent trend to fiscal concerns is natural. However, if JGB yields are rising due to higher OIS rates, dismissing this solely as “fiscal concerns” is superficial and could obscure the true essence of the situation.

JGB-driven → OIS-driven JGB yield rise

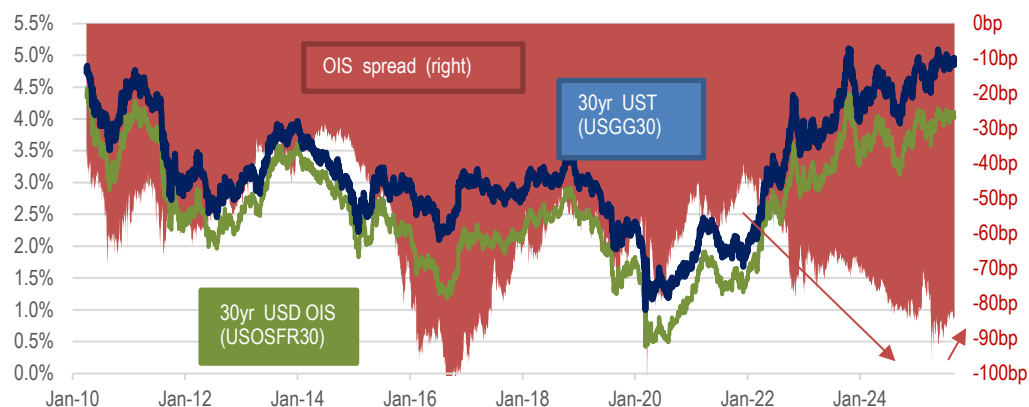
Let's take a look at the data. As the 30-year JGB yield rose, the OIS spread widened sharply from -10bp in November 2023 to -81bp in May 2025. However, this trend reversed after bottoming out in May and is currently holding steady at a high level around -60bp. Meanwhile, the 30-year JGB yield (compound) has risen 37bp over four months, from 2.8% on 7 May to 3.17% on 4 September. The fact that JGB yields have surged despite stable OIS spreads indicates that the recent yield rise has been OIS-driven.

30yr JGB Yield, 30yr OIS Rate, OIS Spread

Source: Bloomberg; compiled by Daiwa.

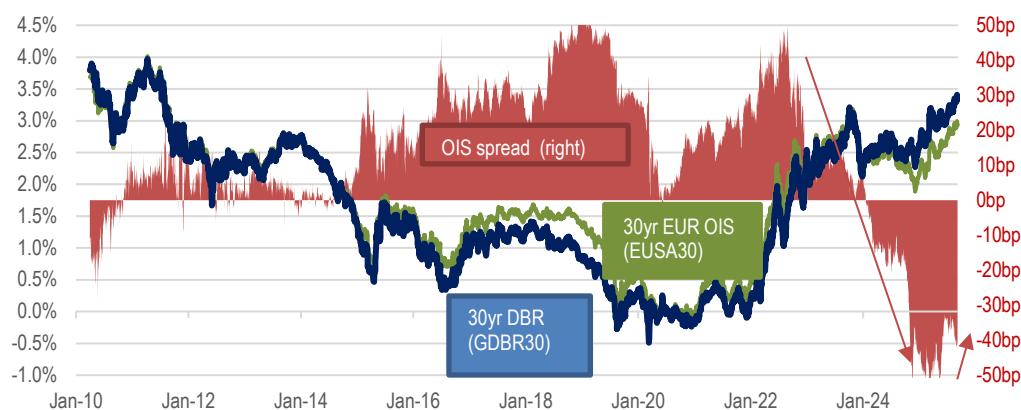
A similar phenomenon has been observed for super-long government bond yields in Europe and the US. From April to June of this year, as well as the subsequent period, while super-long JGB yields rose, the OIS spread stabilized despite some fluctuations, halting its deterioration trend. Of course, it could simply be that the OIS spread has deteriorated sufficiently from a historical perspective, causing that trend progression to halt. In any event, it seems strange to simply dismiss the super-long JGB yield rise since July factor—shift to being driven by OIS rates—as “fiscal concerns,” as was the case until May of this year.

30yr UST Yield, 30yr OIS Rate, OIS Spread



Source: Bloomberg; compiled by Daiwa.

30yr DBR Yield, 30yr OIS Rate, OIS Spread



Source: Bloomberg; compiled by Daiwa.

Confidence in monetary policy shifting?

What could be the actual cause? A past *Bank of Japan Review*, published immediately after the BOJ ended its zero interest rate policy and quantitative easing that followed the domestic financial crisis of the late 1990s, is thought to have served the role of broadly reminding society of the return to “normal” for monetary policy operations. When re-reading this review “Yield Term Structure and Monetary Policy” (our translation) (April 2006, Shigenori Shirazuka), we felt the need to consider the possibility that shifting confidence in central bank monetary policy may also influence a portion of the current bear steepening for super-long JGB yields, driven by OIS rates.

Within that *Bank of Japan Review*, the long-term forward rate is broken down into market expectations regarding the three components of equilibrium real interest rate, equilibrium inflation rate, and term premium. Discussions are then focused on how the yield term structure responds to monetary policy.

In the case of a change in monetary policy (hike in interest rates), (1) basic pattern suggests that the long-term forward rate curve is constant, while the spot rate curve bear-flattens. As for cases where confidence in monetary policy changes, there are cases in which the forward rate curve shifts upward in parallel and there are cases in which it twists.

In the cases of (2) parallel shift and (3) twist, there is the assumption that some change has occurred in market participants' perception of the steady state. In particular, it is important to note that while a "(2) parallel shift" is more likely to occur when confidence in monetary policy declines and the term premium on inflation expectations (inflation risk premium) rises, a "(3) twist" is more likely to occur when confidence increases and the inflation risk premium falls.

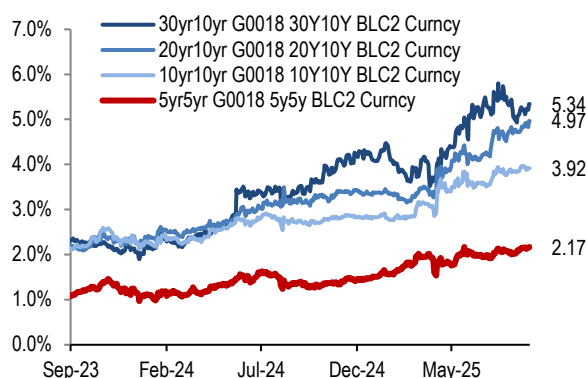
Term Structure Responses and Steady State: Monetary Policy Implications (rate-hiking case)

Reactions of long-term forward rates	Reactions of spot rates	Perception of steady state	Implication on monetary policy
(1) Basic pattern	Bear flattening	No change	Stable
(2) Parallel shift	Parallel or bear steepening	<ul style="list-style-type: none"> • Rise in equilibrium real interest rate • Rise in equilibrium inflation expectations, etc. 	Signals diminished confidence in monetary policy in case of rise in equilibrium inflation expectations attributable to term premium (inflation risk premium)
(3) Twist	Bear or twisted flattening	<ul style="list-style-type: none"> • Decline in equilibrium real interest rate • Decline in equilibrium inflation expectations, etc. 	Signals heightened confidence in monetary policy in case of decline in equilibrium inflation expectations attributable to term premium (inflation risk premium)

Source: Bank of Japan Review "Yield Term Structure and Monetary Policy" (our translation) (Apr 2006, Shigenori Shirazuka); compiled by Daiwa.

As such, the recent sharp rise in forward rates (feels out of step with shifts in perceptions of real economy, such as equilibrium real interest rates) on the JGB market may signal a decline in market confidence in monetary policy (inflation control), similar to the case of a parallel shift. If that is the case, dismissing the sharp rise in super-long JGB yields on the market solely as a matter of fiscal concerns would be short-sighted.

JGB Forward Yields



Source: Bloomberg; compiled by Daiwa.

Possible twist/flattening due to additional rate hikes

Finally, we would like to touch on implications for future government bond yields in Japan and the US. First, in the case of the US, if the Trump administration's intervention in the Fed's operations is deemed a serious [violation of central bank independence](#), long-term forward rates could cause a steepening of the yield curve as it reflects an expansion of the inflation risk premium. That should be relatively simple.

Meanwhile, in the case of Japan as well, should market participants' concerns about falling behind the curve increase further in the future, there would be concerns that the rise in super-long

forward rates could persist. At the same time, if the BOJ succeeds in dispelling the increasingly mentioned concerns about falling behind the curve, by implementing timely and appropriate interest rate hikes, a twisting trend (3) may emerge. In any event, as we can infer from the fact that rising yields are OIS-driven, this is not a problem that can be resolved by MOF's current approach of simply reducing its JGB issuance in response to the structural decline in demand for super-long JGBs.

As a reference, it is our understanding that [BOJ Deputy Governor Himino's recent speech](#) was not as dovish as some market participants perceived it to be. This could provide an "opportunity" for the market to autonomously form and adjust its own views on the timing of rate hikes. Indeed, we believe the sharp rise for the 30-year JGB yield to around 3.3%, driven by the market's interpretation of Himino's speech as dovish, was excessive. Following that speech, [Prime Minister Shigeru Ishiba and BOJ Governor Kazuo Ueda held a meeting](#). This meeting confirmed a heightened tone of caution regarding financial market trends, including forex trends. Considering that Trump's signing of an executive order (US/Japan tariff agreement) on 4 September further reduced downside risks for the Japanese economy, the likelihood of an additional rate hike within this year, even as early as October, has by no means diminished. Comments on the market regarding concerns about falling behind the curve following Himino's speech may have slightly exaggerated the actual situation.

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