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Daiwa Securities

Daiwa's View

Sharp JGB yield rise: Rate hike expectations rising, yield curve steepening

- Implications of simultaneous rising rate hike expectations, yield curve steepening
- Rising yields reducing fiscal capacity
- Updating BOJ's estimates for natural rate of interest and our estimates

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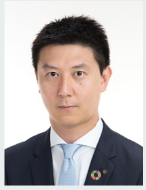


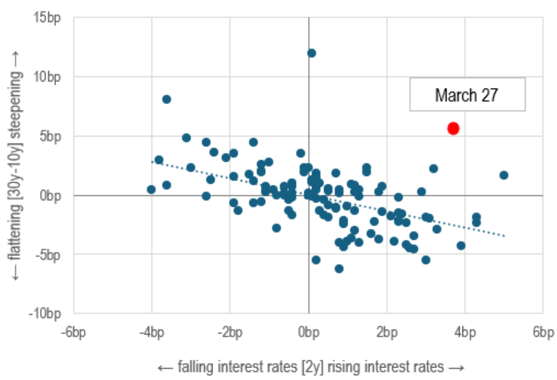
Sharp JGB yield rise: Concurrent rise in rate hike expectations, yield curve steepening

Expectations for a rate hike rose following the BOJ's upward revision of the output gap announced on 26 March. This caused JGB yields to rise significantly on 27 March, with gains of 10bp for the 10-year JGB yield and 18bp for the 30-year JGB yield (simple yield basis). Chart 1 is a scatter plot of the daily changes (bp) for the 2-year JGB yield and the 30yr-10yr spread on the JGB yield curve since last October. Here, a generally negative correlation was observed. During periods when interest rate hike expectations rise (≈ 2-year JGB yield rise), super-long JGBs tend to flatten due to concerns about falling "behind the curve." Meanwhile, on 27 March, the JGB yield curve continued to steepen despite rising expectations of interest rate hikes, suggesting that the market is entering a new phase.

As Professor Olivier Blanchard reiterated at the Council on Economic and Fiscal Policy on 26 March, future fiscal conditions will depend heavily on the relationship between r (interest rate) and g (growth rate). In a world where interest rates exceed growth rates (r-g > 0), achieving a primary surplus is a necessary condition for fiscal sustainability.

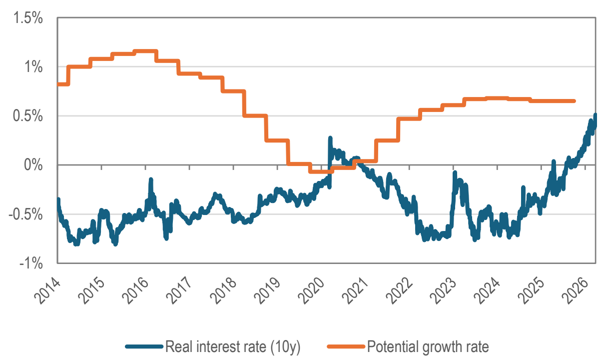
In the Updates on the Output Gap and Potential Growth Rate,[1] released by the BOJ on 26 March, the output gap, which had previously been considered negative, was revised to positive following a reassessment of capital utilization, while the potential growth rate (g) remained at 0.65%. Meanwhile, as market inflation expectations (BEI) remained flat in the high 1% range, nominal yield rose. Then, on 27 March, the 10-year real yield (r) exceeded 0.50%. The fact that the point at which r-g > 0 is fast approaching is another factor contributing to growing fiscal concerns.

Chart 1: Daily Changes for 2yr JGB Yield and 30yr-10yr JGB Yield Spread



Source: Bloomberg; compiled by Daiwa.

Chart 2: Real Yield (10yr) and BOJ's Potential Growth Estimate



Source: BOJ, Bloomberg; compiled by Daiwa.

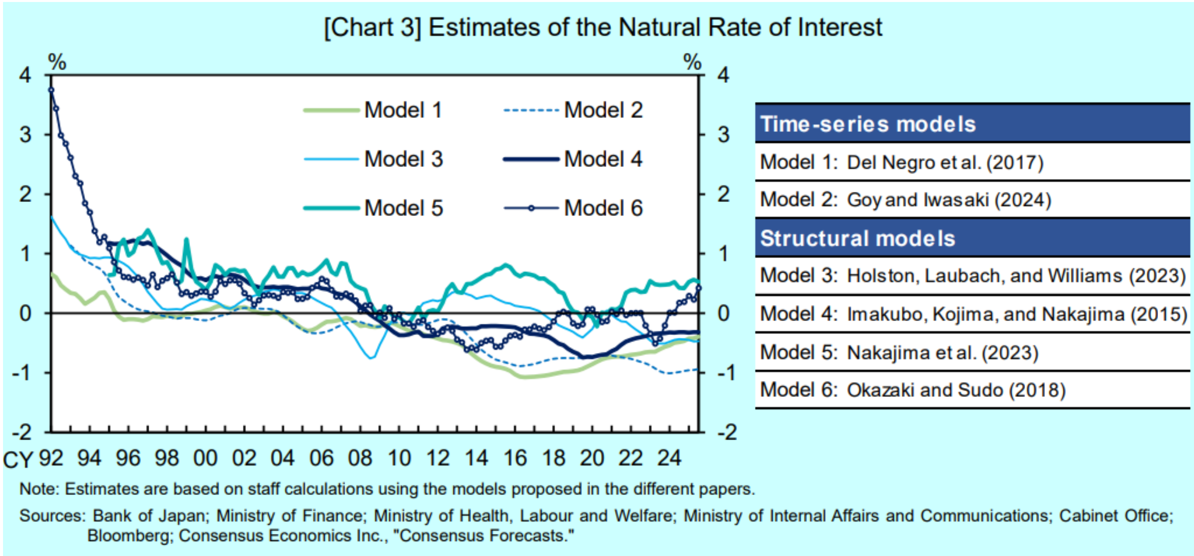
[1] 27 Mar 2026. Daiwa's View: Price assessment timeline indicated by BOJ output gap revisions. (Tani, Yamamoto)

Updating natural rate of interest estimates

On 27 March, a BOJ Review titled [Developments in the Natural Rate of Interest and the Assessment of the Degree of Monetary Accommodation] was released. As for the natural rate of interest, the BOJ has published estimates of Japan's natural rate of interest based on six representative models since the BOJ workshop held in December 2023 as part of their broad-perspective review. However, the data had not been updated and the estimated figures were only up to 1Q 2023. This review uses the latest data, which reflects revisions to the output gap and potential growth rate. The estimates have been updated through 3Q 2025.

As a result, the latest values in the estimates (for 3Q 2025) range from a high of 0.53% (Nakajima et al., 2023) to a low of -0.935% (Goy and Iwasaki, 2024). The simple average of the six models came to -0.194%. The previous estimates (as of 1Q 2023) were a high of 0.509%, a low of -0.99%, and an average of -0.211%. As such, when comparing these two points in time, the increase appears to be modest.

Chart 3: Natural Rate of Interest Estimate



Source: Reprinted from BOJ "Developments in the Natural Rate of Interest and the Assessment of the Degree of Monetary Accommodation".

The natural rate of interest estimate is recalculated using the latest data with past figures updated accordingly. When we examine the overall trend of this estimate using the average of the six models (Chart 4), we can see that the natural rate of interest, which had been declining since the 1990s, bottomed out in the latter half of the 2010s and then began to rise gradually in the 2020s. The average value has risen by approximately 20bp over the past two years.

In a report published last December[2], we conducted our own estimates for three of the six models mentioned above using information available at the time and presented our results. Even when comparing our estimates with the BOJ's latest estimates, the trend of a gradual upward trajectory remains consistent[3]. As pointed out by our Chief Economist Kenji Yamamoto, there has been no change in the view that the natural rate of interest is on a gradual upward trend. That said, that pace is equivalent to only a 20bp rise over a period of two years, which is less than the recent 25bp rate hikes. As such, rather than serving as a basis for deciding on rate hikes at each meeting, estimates of the natural rate of interest can be viewed as supporting the need for continued rate hikes.

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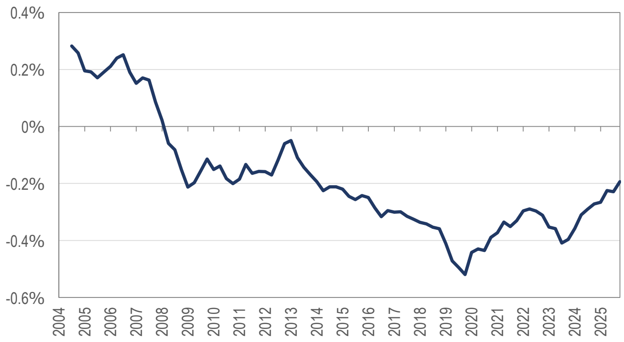
[2] 3 Dec 2025.*Daiwa's View: Latest estimates for the natural rate of interest.*

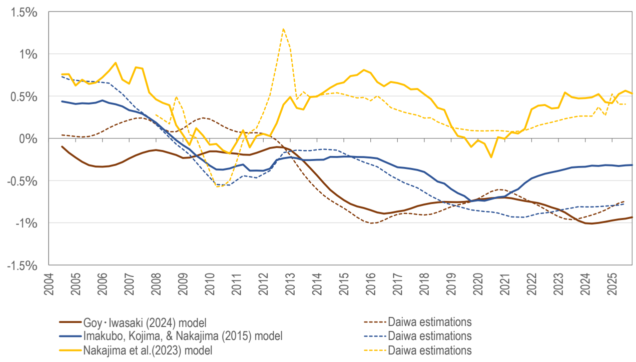
[3] Regarding the Goy-Iwasaki (2024) model, which the market had been watching as a rate hike target, while our estimates point to a gradual increase, the BOJ's estimates are largely flat. On this point, the paper on the Goy–Iwasaki (2024) model has not yet been published. So, we substituted it with Hatayama and Iwasaki (2024) report "Estimating the Natural Yield Curve in Japan Using a VAR with Common Trends." Differences in the surveys used were also pointed out.

Chart 4: Estimated Natural Rate of Interest (avg of six models)



Source: BOJ; compiled by Daiwa.

Chart 5: Latest BOJ Estimates and Daiwa Estimates as of Dec 2025



Source: BOJ, Daiwa; compiled by Daiwa.

Summary

Based on the 26 March output gap revision and the update for the natural rate of interest estimate on 27 March, the BOJ is now expected to proceed steadily with interest rate hikes. Also, energy shocks stemming from the deteriorating geopolitical environment are also heightening concerns about inflation and serving as a catalyst for interest rate hikes even amid rising uncertainty. Meanwhile, the fact that nominal yields have risen to a certain extent and that fiscal capacity, as measured by the difference between yields and the growth rate, is shrinking is destabilizing the JGB yield curve, particularly in the supe-long zone. Another cause for concern is that the administration of Prime Minister Sanae Takaichi is attempting to address the energy shock through fiscal measures such as subsidies. Of course, we cannot draw conclusions based solely on price movements for just 27 March. However, given that the nominal yield rise resulting from rate hikes involves a trade-off (mitigating future inflation risks, but reducing fiscal flexibility), we need to pay even more attention to the latter factor.

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