

Daiwa's View

JGB yield outlook update: Expectation of three rate hikes per year raises long-term yield forecast by 20bp

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Shun Otani

81-3-5555-8764
shun.otani@daiwa.co.jp



Kengo Shiroyama

81-3-5555-8755
kengo.shiroyama@daiwa.co.jp



Daiwa Securities Co. Ltd.

JGB yield outlook update

Daiwa Securities FICC Research Department updated its JGB yield outlooks for FY26. Specifically, primarily due to rising inflation, the policy rate forecast has been changed from two rate hikes per year to three. In conjunction with the change in the terminal rate assumption—the end point for rate hikes—from 1.50% to 1.75%, we have raised the year-end and fiscal year-end forecast for the 10-year yield from 2.60% to 2.80%. In this report, by reviewing the market environment in May, we will examine the changes from early May to the present and analyze the impact of the upward revision in inflation and policy rate forecasts on long-term yields and the yield curve. Furthermore, we will also consider the risks of a postponed rate hike and discuss investment strategy.

Chart 1: FY26 JGB Yield Outlook as of 1 Jun

(%)	Apr-Jun		Jul-Sep		Oct-Dec		Jan-Mar	
	Range	Term-end	Range	Term-end	Range	Term-end	Range	Term-end
Policy rate		1.00		1.00		1.25		1.50
2yr	1.25 ~ 1.65	1.45	1.40 ~ 1.80	1.60	1.70 ~ 2.10	1.90	1.75 ~ 2.15	1.95
5yr	1.70 ~ 2.20	1.95	1.85 ~ 2.35	2.10	2.05 ~ 2.55	2.30	2.10 ~ 2.60	2.35
10yr	2.30 ~ 2.90	2.60	2.30 ~ 2.90	2.60	2.50 ~ 3.10	2.80	2.50 ~ 3.10	2.80
20yr	3.20 ~ 3.80	3.50	3.20 ~ 3.80	3.50	3.40 ~ 4.00	3.70	3.40 ~ 4.00	3.70
30yr	3.50 ~ 4.10	3.80	3.50 ~ 4.10	3.80	3.70 ~ 4.30	4.00	3.70 ~ 4.30	4.00

Source: Compiled by Daiwa.

Chart 2 (Ref): FY26 JGB Yield Outlook as of 7 May

(%)	Apr-Jun		Jul-Sep		Oct-Dec		Jan-Mar	
	Range	Term-end	Range	Term-end	Range	Term-end	Range	Term-end
Policy rate		1.00		1.00		1.25		1.25
2yr	1.25 ~ 1.65	1.45	1.30 ~ 1.70	1.50	1.40 ~ 1.80	1.60	1.50 ~ 1.90	1.70
5yr	1.70 ~ 2.20	1.95	1.75 ~ 2.25	2.00	1.80 ~ 2.30	2.05	1.85 ~ 2.35	2.10
10yr	2.30 ~ 2.90	2.60	2.30 ~ 2.90	2.60	2.30 ~ 2.90	2.60	2.30 ~ 2.90	2.60
20yr	3.20 ~ 3.80	3.50	3.20 ~ 3.80	3.50	3.20 ~ 3.80	3.50	3.20 ~ 3.80	3.50
30yr	3.50 ~ 4.10	3.80	3.50 ~ 4.10	3.80	3.50 ~ 4.10	3.80	3.50 ~ 4.10	3.80

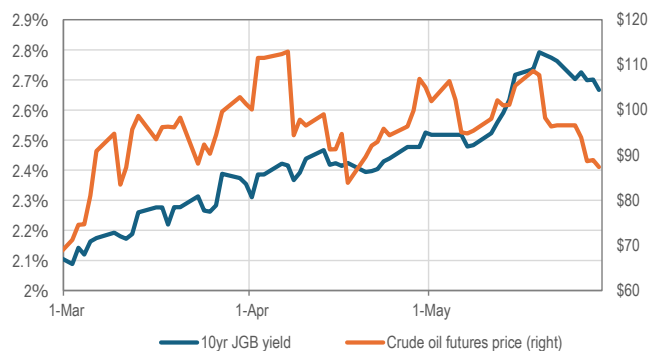
Source: Compiled by Daiwa.

Review of May

Looking back at the JGB market in May, crude oil prices rose sharply through the middle of the month amid heightened uncertainty over the situation in the Middle East, leading to stronger inflationary pressures. Coupled with higher overseas yields, JGB yields rose substantially, particularly in the long-term and superlong sectors, with the 10-year yield at one point reaching its highest level in roughly 30 years. From late May, yields turned lower as crude oil prices declined, but they did not fully reverse the gains seen in the first half of the month. On a monthly basis, the yield curve bear-steepened out to the 10-year sector.

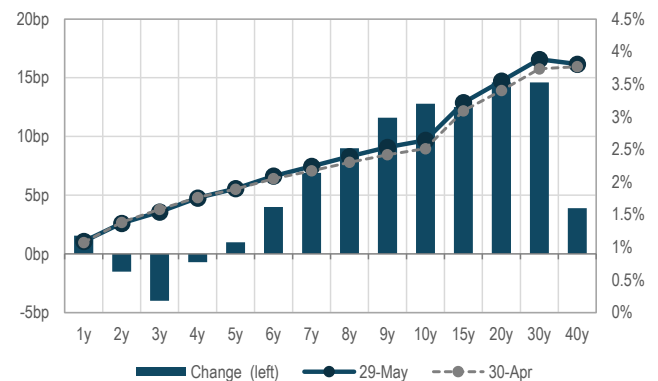
On 14 May, media reported that the government was considering compiling a supplementary budget¹. Although the final size was limited to around Y3tn, this came as a surprise to the market, as Prime Minister Sanae Takaichi had previously expressed a negative stance on the need for a supplementary budget. In addition, while the impact of higher crude oil prices has not yet fully appeared in consumer prices, the April Corporate Goods Price Index released on 15 May significantly exceeded market expectations, confirming that some of the cost increases associated with higher import prices are being passed on to prices at the upstream stage. Despite these two factors—expectations for fiscal expansion and upward pressure on prices—the market did not price in an acceleration in the pace of rate hikes. As a result, concerns that the BOJ may fall behind the curve appear to have intensified.

Chart 3: 10yr JGB Yield, Crude Oil Futures Price (WTI)



Source: Bloomberg; compiled by Daiwa.

Chart 4: Change in JGB Yield Curve (30 Apr - 29 May)



Source: Bloomberg; compiled by Daiwa.

Outlook update: Change in the policy rate path

The main factor behind the revision to our JGB yield outlook is the change in our economists' outlook for inflation in Japan and the policy rate path. Our Senior Economist Kento Minami expects core CPI to temporarily rise to the upper 3% range y/y in 2H FY26, based on the view that price pass-through from upstream (corporate goods prices) to downstream (consumer prices) is accelerating. Accordingly, reflecting the need to return the policy rate to the neutral level at an earlier stage, we have revised our view regarding the BOJ's rate-hike path, from the previously assumed pace of two hikes per year as of May, to three hikes per year. In other words, we anticipate a rate hike in June, followed by additional rate hikes this autumn and in 2H FY26, with the policy rate reaching 1.50% by end-March 2027. We have also raised our terminal rate forecast by 25bp, to 1.75%, from the previous 1.50%.

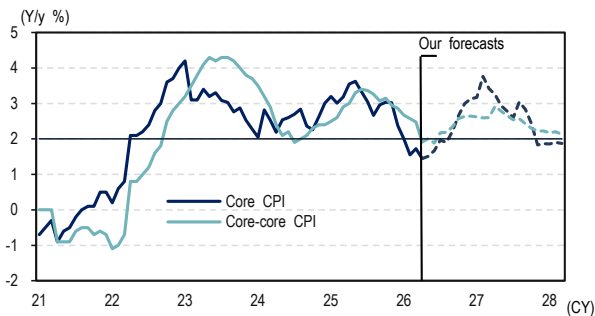
Long-term yield outlook, and picture of yield curve going forward

We have not changed our baseline scenario that the fair value of a long-term equilibrium level for the long-term yields is around 2.5–2.7%, calculated by adding the 2% price stability target to the currently estimated potential growth rate of around 0.50–0.70%. Furthermore, based on the historical relationship between the long-term yield, the policy rate, and US yields (Chart 6: 10-year

¹ Koji Hamada (15 May 2026). [Economic Commentary \(supplementary budget\): Considering early supplementary budget scale and funding.](#)

yield matrix²), and assuming the current US yield level of 4.50%, the 10-year JGB yield would be estimated at 2.65%, provided the terminal rate remained at 1.75%.

Chart 5: CPI Forecasts by Senior Economist Minami



Source: Ministry of Internal Affairs and Communications; compiled by Daiwa.
 Notes (1) Forecasts are based on assumptions of average USD/JPY rate of Y158 in FY26 and Y156 in FY27, and average WTI crude oil price of \$85/bbl in FY26 and \$76/bbl in FY27.
 (2) Figures include effects of the government's subsidies for electricity and gas bills scheduled to be implemented in summer of 2026. However, they do not include effects of the consumption tax cut currently under consideration by the government.

Chart 6: Matrix of 10yr JGB Yield (%)

		10yr US yield					
		3.00	3.50	4.00	4.25	4.50	5.00
Japan: Policy rate	0.75	1.29 (0.78-1.79)	1.5 (0.99-2)	1.71 (1.2-2.21)	1.81 (1.31-2.32)	1.92 (1.41-2.42)	2.13 (1.62-2.63)
	1.00	1.47 (0.97-1.97)	1.68 (1.18-2.18)	1.89 (1.39-2.39)	2 (1.49-2.5)	2.1 (1.6-2.6)	2.31 (1.81-2.81)
	1.25	1.65 (1.15-2.16)	1.86 (1.36-2.37)	2.07 (1.57-2.58)	2.18 (1.68-2.68)	2.28 (1.78-2.79)	2.5 (1.99-3)
	1.50	1.84 (1.33-2.34)	2.05 (1.54-2.55)	2.26 (1.75-2.76)	2.36 (1.86-2.87)	2.47 (1.96-2.97)	2.68 (2.18-3.18)
	1.75	2.02 (1.52-2.52)	2.23 (1.73-2.74)	2.44 (1.94-2.95)	2.55 (2.04-3.05)	2.65 (2.15-3.16)	2.86 (2.36-3.37)
	2.00	2.21 (1.7-2.71)	2.42 (1.91-2.92)	2.63 (2.12-3.13)	2.73 (2.23-3.23)	2.84 (2.33-3.34)	3.05 (2.54-3.55)

Source: Compiled by Daiwa.
 Note: The range indicates the 80% confidence interval, based on data from 1990 to 2025.

However, the perceived rise in consumer prices, which is likely to become more pronounced from the summer onwards, and BOJ rate hikes implemented at a faster pace than currently priced in by the market are expected to exert some upward pressure on long-term yields. For this reason, we have revised our forecast for the 10-year yield from Oct–Dec onwards to 2.80%, using the highest level in May as a point of reference. Furthermore, given the historical range of fluctuations in long-term yields, we anticipate that the 10-year yield could temporarily exceed 3%. With respect to the entire yield curve, we expect the short- to medium-term sectors to flatten in line with rate-hike pricing and actual rate hikes, and anticipate a parallel shift in the superlong sector beyond 10 years. The 10-year/30-year spread did not change significantly during the rise in yields in May. This can be attributed to the fact that, while concerns over fiscal policy and inflation are putting pressure on the long end of the yield curve, the continuous reduction in the scale of issuance of superlong JGBs is tightening supply/demand conditions. Assuming that this balance between fiscal/inflation concerns and supply/demand factors continues, we expect superlong JGB yields to rise in line with the 10-year yield, with the 30-year yield trading around 4%.

Risk scenario involving a postponed rate hike, and the yield curve

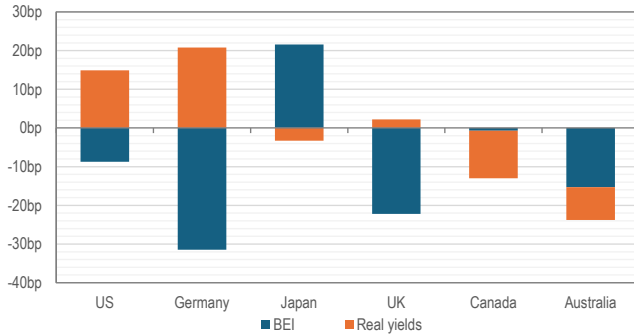
Our outlook is based on the assumption that the BOJ will respond appropriately to rising inflationary pressure through rate hikes, and we do not anticipate a situation in which concerns about the BOJ falling behind the curve materialize, with, for example, rate hikes of more than 50bp or rate hikes into restrictive territory exceeding the neutral rate level, which we anticipate will be around 1.50–2.00%. The market is pricing in more than a 70% probability of a June rate hike, but some are skeptical about a hike, given the consistency of the government's economic measures and the administration's stance.

We would like to consider a scenario in which the June rate hike was postponed. Decomposing the change in long-term yields in major countries in May into BEI (inflation expectations) and real yields shows that real yields were the main driver in the US and Europe. In Japan, however, real yields remained almost unchanged, with inflation expectations being the primary driver. When we break down Japanese and US long-term yields into the risk-neutral yield and term premium using the New York Fed's ACM model and Daiwa JGB Term Premium calculated using a similar methodology, we see that, while the estimation of term premium depends on the data period and must be interpreted with caution, the risk-neutral yield is the main driver in the US, whereas the term premium accounts for the majority in Japan. The rise in US yields reflects the changes in the market pricing of rate hikes (= rising nominal yields), as well as, in part, a growth story involving

² Shun Otani and Kazuya Sato (5 Dec 2025). [Daiwa's View: Market must be prepared for a rise above 2% / Long-term yield would reach the lower half of 2% range given a terminal rate of 1.5%.](#)

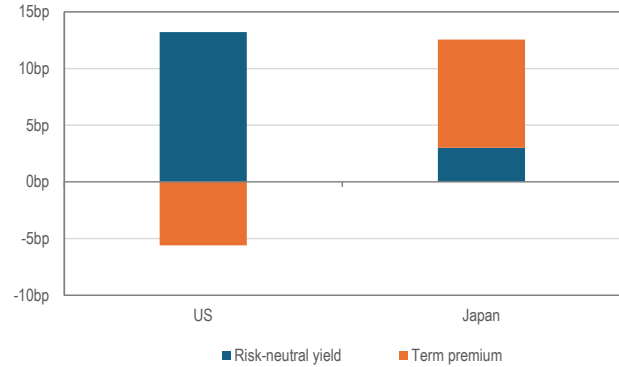
an increase in r-star (the natural rate of interest) due to productivity improvements from AI. In Japan, on the other hand, concerns about inflation are the predominant cause of the rise in the risk premium.

Chart 7: Factor Decomposition of Long-term Yields in Major Countries (30 Apr- 29 May)



Source: Bloomberg; compiled by Daiwa.

Chart 8: Factors Behind Changes in Long-term Yields in Japan and US (30 Apr - 29 May)



Source: Bloomberg; compiled by Daiwa.

Under these circumstances, if the BOJ were to skip a rate hike that the market expected, there are concerns that it would have a serious impact on expectation formation regarding the yield curve. In our baseline scenario, we believe that the 10-year yield in the mid- to high-2% range offers investment value. However, if a rate hike were skipped, we would not be able to rule out the possibility that the emergence of concerns about the BOJ falling behind the curve could cause 3% to become a mere transit point for the long-term yield. There is also a risk of a steepening of the superlong end of the yield curve, where supply/demand conditions are currently balanced. Even if a rate hike were implemented in June, yields would be shaped by the interaction between actual inflation data from summer onwards and rate-hike expectations. In his speech on 27 May, BOJ Governor Kazuo Ueda described the current situation with the Japanese economy as being a test of the inflation regime during the fifth oil price shock. It could also be seen as a test of the central bank's actions by the market.

Investment strategy

In early May, based on the assumption of rising yields, we recommended a 5-year/10-year flattening position, although the timing needed to be considered carefully, because we expected the yield curve out to 10 years to come under flattening pressure in line with developments with rate hikes. However, since mid-May, the rise in yields has been led by the 10-year sector, causing the 5-year/10-year spread to widen, resulting in this position moving in the opposite direction. Our view that this position is attractive remains unchanged provided that rate hikes proceed in line with our outlook. However, considering the stronger-than-expected price pass-through and inflation concerns, we believe that the entry point has risen slightly, including with regard to long-term yield levels.

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