Daiwa Securities

# Daiwa's View

## Examining 10yr JGB yield level under policy interest rate exceeding 2.5% scenario

- 10yr JGB yield approaching 3% as government bond yields rise around the world
- Market aware of possible policy interest rate exceeding 2%
- Visualizing 10yr JGB yield level if policy interest rate climbs to 2.5%
- Rise to mid-3% range possible, but could settle at around 3% if concerns subside

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### 10yr JGB yield on track to reach 3% amid rising global yields

On 18 August (Tokyo market), JGB yields continued to rise in line with the global trend of rising yields. As of the close on that day (3:00 PM), the 10-year JGB yield stood at 2.935% (simple yield), up 1.5bp from the previous day to move closer to the key 3% level. Despite some concerns, the 5-year JGB auction produced solid results. However, weakness in the super-long sector, as evidenced by a 6bp rise in the simple yield on the on-the-run 30-year JGB, spilled over into the 10-year sector.

Rising JGB yields are viewed as the result of various factors, including global factors such as rising long-term yields in the US and Europe, monetary policy factors, including the increased probability of a rate hike in September, and fiscal factors, which have been a long-standing theme in the JGB market. Nikkei QUICK's August survey of 123 bond market participants asked, "What factors are you monitoring that could cause yields to rise over the near term? (select up to two)." 67% of participants cited concerns about fiscal expansion, 40% cited concerns about delays normalizing monetary policy (worries that BOJ is falling behind the curve), and 33% that expressed worries about inflation.

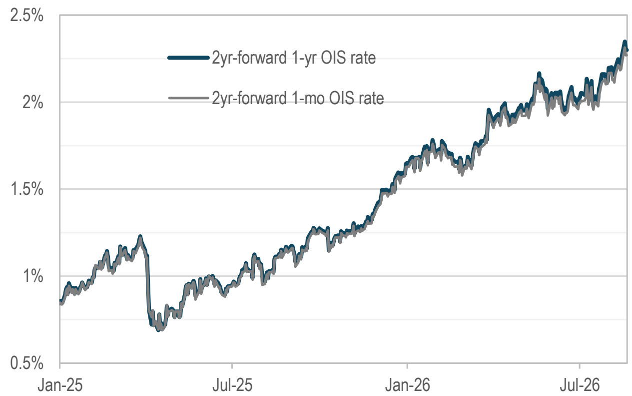
### Market mindful of terminal possibly exceeding 2%

The survey also covered forecasts for the BOJ's terminal rate. Here, the average rate was 1.76% and the mode was 1.50%. Meanwhile, the 2-year forward 1-year OIS rate, which many market participants use as a benchmark for terminal rates, has risen above 2%. Indeed, as of 18 August, it had climbed to 2.30%. The 2-year forward 1-month OIS rate also stands at 2.27%, indicating that the market is aware of the risk that the policy interest rate could top 2%, at the very least. The background likely entails concerns about a widening output gap due to proactive fiscal policy[1], in addition to the "behind the curve" concerns mentioned above.

Even though we continue to assume a terminal rate of 1.75%, the aim of this report is to examine the 10-year JGB yield level under a risk scenario in which the policy interest rate is raised to 2.50%. The results indicated that, barring any changes in the various assumptions, the 10-year JGB yield could rise to the mid-3% range. Meanwhile, if the uncertainties regarding fiscal and monetary policy currently priced into the yield curve subsides and the term premium narrows, the 10-year JGB yield could remain at around 3% even if the policy interest rate rises to 2.50%.

[1] Shun Otani (17 Aug 2026).*Daiwa's View: Proactive fiscal policy and reassessment of terminal rate ~ Upside risk from perspective of Taylor rule*.

**Chart 1: Market-Based Benchmarks for Terminal Rate**




*Source: Bloomberg; compiled by Daiwa.*

## Analysis using 10-year JGB yield matrix

Our strategist Kazuya Sato created a matrix based on the results of a regression analysis of 10-year JGB yield levels from 1990 to the present[2], using the policy interest rate and the 10-year UST yield. This matrix has been frequently mentioned in this series of reports when measuring benchmarks for the 10-year JGB yield[3]. If Japan's policy interest rate is 1.75% and the 10-year UST yield is 4.75%, then the fair value of the 10-year JGB yield would be 2.76%. Meanwhile, if the policy interest rate is raised to 2.0%, the 10-year JGB yield would land at 2.94%, which is roughly in line with the current level. Also, if the policy interest rate is raised to 2.50%, the 10-year JGB yield would rise to 3.31%.

**Chart 2: 10yr JGB Yield Matrix (regression analysis using the policy rate and UST yields)**

| (%) | | US: 10yr yield | | | | |
|---|---|---|---|---|---|---|
| | | **4.00** | **4.25** | **4.50** | **4.75** | **5.00** |
| Japan: Policy rate | **1.50** | 2.26 (1.75~2.76) | 2.36 (1.86~2.87) | 2.47 (1.96~2.97) | 2.57 (2.07~3.08) | 2.68 (2.18~3.18) |
| | **1.75** | 2.44 (1.94~2.95) | 2.55 (2.04~3.05) | 2.65 (2.15~3.16) | 2.76 (2.25~3.26) | 2.86 (2.36~3.37) |
| | **2.00** | 2.63 (2.12~3.13) | 2.73 (2.23~3.23) | 2.84 (2.33~3.34) | 2.94 (2.44~3.45) | 3.05 (2.54~3.55) |
| | **2.25** | 2.81 (2.31~3.31) | 2.92 (2.41~3.42) | 3.02 (2.52~3.52) | 3.13 (2.62~3.63) | 3.23 (2.73~3.73) |
| | **2.50** | 2.99 (2.49~3.5) | 3.1 (2.6~3.6) | 3.2 (2.7~3.71) | 3.31 (2.81~3.81) | 3.41 (2.91~3.92) |

*Source: Bloomberg; compiled by Daiwa.*
*Notes: 1) The range represents an 80% confidence interval.*
*2) The data period is Jan 1990 to Nov 2025.*
*3) The explained variable is the 10yr JGB yield, and the explanatory variables are the BOJ policy rate and the 10yr UST yield.*

Since this model is based on estimates using a long-term data set spanning 35 years from 1990 onward, the period of high interest rates in the early 1990s is also included in the analysis. Furthermore, it offers the advantage of grasping a stable view of the relationship between the 10-year yields, policy interest rates, and UST yields. This makes the results easy to understand intuitively. Meanwhile, this model assumes that the relationships between the variables are linear. The regression analysis assumes that the coefficient of the policy interest rate is 0.74 and, regardless of the JGB yield level, a 100bp increase in the policy interest rate would lift the 10-year JGB yield by 74bp. However, in reality, if policy interest rate hikes continue, approaching the

[2] Kazuya Sato (23 Jan 2025). *Daiwa Memorandum: 10-year JGB yield with policy interest rate at 0.5%.*
[3] 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%.*

terminal rate level, there would be a strong likelihood of pressure on the yield curve to flatten. As such, it is important to note that the relationship between the policy interest rate and the 10-year JGB yield may differ from past average trends.

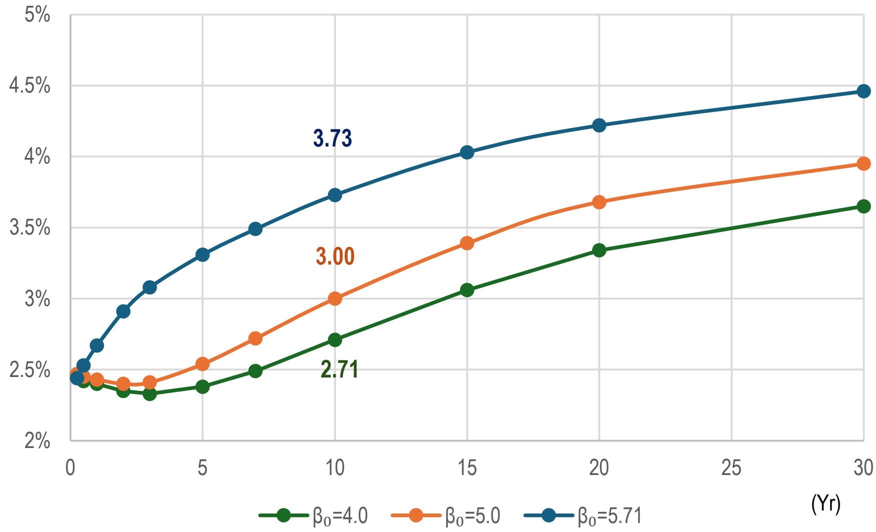
## Image of yield curve based on Nelson-Siegel model

In this series of reports, our executive strategist Eiichiro Tani has analyzed the JGB yield curve using the Nelson-Siegel model[4]. This is a classic model for explaining yield curves that have been in use since the 1980s. It represents the yield curve at a given point in time using the four parameters of long-term component $\beta_0$, short-term component $\beta_1$, medium-term component $\beta2$, and the speed of convergence to the long-term level $\tau$. This model is known for its ability to grasp complex curve changes while being easy to understand intuitively.

When the Nelson–Siegel model is applied to zero-coupon JGB yields as of the close on 18 August, $\beta_0$, which represents the equilibrium interest rate at the super-long end of the yield curve, is estimated at 5.71%, while $\beta_0 + \beta_1$, which represents the yield level as maturity approaches zero, is estimated at 1.11%. In order to have an image of the 10-year JGB yield level in the event that the policy interest rate is raised to 2.5%, let's assume $\beta_0 + \beta_1$ equals 2.50% and reconstruct the yield curve with all other parameters held constant. That produces a 10-year JGB yield of 3.73% and a 30-year JGB yield of 4.46%.

Meanwhile, the figure of 5.71% for the super-long equilibrium level seems quite high, even when compared to Japan's potential growth rate. Applying the Nelson-Siegel model to the US and German yield curves as of the end of July, we calculate $\beta_0$, which is 5.81% and 4.16%, respectively. $\beta_0$ tends to be calculated on the high side when the super-long zone of the yield curve steepens. We assume that Japan's current yield curve is reflecting (pricing in) concerns about fiscal policy and the BOJ "falling behind the curve." Assuming that Japan's $\beta_0$ declines from 5.71% to either 4.00%, roughly the same level as Germany's, or 5.00%, roughly midway between the US and German levels, the resulting yield curves imply 10-year JGB yields of 2.71% and 3.00%, respectively.

**Chart 3: Nelson-Siegel Model-implied JGB Yield Curves at a 2.5% Policy Rate**




*Source: Bloomberg; compiled by Daiwa.*

[4] Eiichiro Tani (6 Jan 2026). *Daiwa's View: JGB yield curve changes implied by Nelson-Siegel's τ*.

### Image of 10yr JGB yield if policy interest rate reaches 2.50%

Based on the results of the analysis provided above, if Japan's policy interest rate is raised to 2.50% and, barring any significant changes for the other assumptions, we cannot rule out that the 10-year JGB yield could rise to the mid-3% range. Meanwhile, the current JGB yield curve could be steepening due to the pricing in of uncertainties surrounding fiscal policy and the conduct of monetary policy (in the form of term premiums). As a result, the Nelson-Siegel model estimates $\beta_0$ to be at a high level, comparable to that of the US. If these concerns subside and the risk premium priced into the super-long zone declines, the 10-year JGB yield could remain at just under 3% (close to current level) even if the policy interest rate is raised to 2.50%.

The government's "Basic Policy on Economic and Fiscal Management and Reform" formulated this summer includes raising the real growth rate to around 1% at an early stage, while maintaining price stability and achieving nominal growth of around 3%. In light of the Domar condition, which evaluates fiscal sustainability based on the relationship between the nominal economic growth rate ($g$) and interest rates ($r$), a 10-year JGB yield of 3% is a critical threshold at which the relative magnitudes of $g$ and $r$ may reverse. With a 10-year JGB yield of 3% in sight, questions are once again being raised about whether consistent fiscal management is possible.

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