

Daiwa's View

Will a sub-3% long-term yield take hold? – Fiscal policy and inflation expectations

- BOJ Governor Ueda cited fiscal factors as a driver of higher long-term yields
- IMF's *GFSR* pointed to deteriorating liquidity in the JGB market
- We expect the 10-year JGB yield to remain range-bound around 3%, reflecting fiscal risks and persistently high inflation expectations

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Will a sub-3% long-term yield take hold? – Fiscal policy and inflation expectations

The 10-year JGB yield temporarily fell below 3% on 13 October. Whether a sub-3% yield will take hold is likely to become a major focus for the JGB market. BOJ Governor Kazuo Ueda cited market perceptions of fiscal policy as a factor behind the rise in long-term yields, while the IMF, in its *Global Financial Stability Report*, also warned of the risk of sharp yield increases in sovereign bond markets. In addition, household inflation expectations remain elevated. Although the Takaichi administration has distanced itself from reflationary policies, there has been no major change in its proactive fiscal policy stance. In light of these considerations, we believe that, from the perspectives of both fiscal policy and inflation expectations, the 10-year JGB yield is unlikely to settle below 3% and enter a downtrend. Instead, we expect it to remain range-bound around 3% for the time being.

Drivers of higher long-term yields: Governor Ueda's Diet testimony and Fed Chair Warsh's assessment

Appearing before the House of Representatives Budget Committee on 13 October, BOJ Governor Ueda responded to a question from Takayuki Ochiai, a lawmaker from the Centrist Reform Alliance, and cited four factors behind the rise in long-term yields, while noting that these reflected the views of market participants: (1) inflationary pressure stemming from developments in the Middle East; (2) market views on large-scale AI-related corporate bond issuance; (3) market perceptions of fiscal policies in various countries; and (4) the continued release of favorable economic data, particularly in the US.

Meanwhile, when asked by Axios's Neil Irwin about the rise in long-term bond yields at the press conference following the September FOMC meeting, Fed Chair Kevin Warsh cited three factors: (1) economic strength; (2) competition for capital; and (3) geopolitics.

"Competition for capital" can be understood as encompassing not only private-sector demand for funds, including corporate bond issuance associated with increased AI investment demand, but also increased government bond issuance resulting from fiscal expansion. However, Chair Warsh avoided directly referring to "fiscal factors," which many market participants regard as one of the drivers of higher long-term yields.

By contrast, Governor Ueda explicitly cited "market perceptions of fiscal policies in various countries" as one of the factors behind higher long-term yields, albeit as the view of market participants. Although he did not directly refer to Japan's fiscal policy, it is noteworthy that he indicated that the recent rise in long-term yields is related not only to the economic and inflation outlook but also to the market's assessment of government bond supply and fiscal management. Whereas Chair Warsh used the broad expression "competition for capital," Governor Ueda's use of the term "fiscal policy" suggests that the BOJ also recognizes the bond market's current focus on fiscal factors.

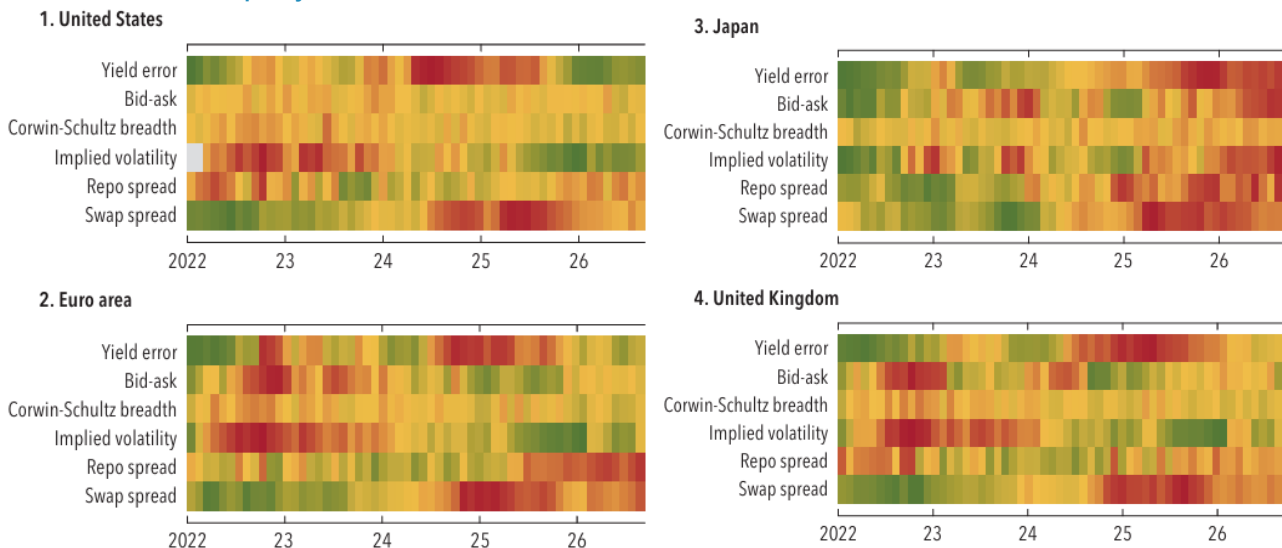
IMF Global Financial Stability Report

On 13 October, the IMF released [the full Global Financial Stability Report \(GFSR\)](#), published every April and October. In the report, the IMF identified three risks that could tighten financial conditions and trigger market turmoil: (1) an AI-driven market correction; (2) a sharp rise in sovereign bond yields; and (3) cyber threats.

Regarding the second risk in particular, the IMF pointed out that term premiums, which are contributing to higher long-term yields across countries, are at the upper end of their historical ranges amid concerns over fiscal deficits and elevated government debt. The IMF also expressed concern that such increases in government bond yields could weigh on asset prices, including AI-related equities, through higher discount rates, while potentially eroding the value of government bonds used as collateral in derivatives and other financial transactions.

With regard to Japan, a comparison of multiple liquidity metrics within each market's own historical range since 2022 shows that, while liquidity conditions have tended to improve in the US, the euro area, and the UK, Japan's liquidity metrics, including yield curve fitting errors, bid-ask spreads, and implied volatility, have deteriorated. The IMF noted that liquidity conditions in the JGB market may have deteriorated, against the backdrop of factors including increased yield volatility associated with monetary policy normalization following the end of yield curve control.

Chart 1: Bond Market Liquidity Metrics



Source: Reprinted from IMF GFSR (Oct 2026).

Note: For each market metric, green indicates favorable liquidity and red unfavorable liquidity relative to its own historical range since 2022.

The IMF's analysis is not an absolute comparison across countries. Rather, it positions current conditions in each market within that market's range over the past four years. The deterioration in Japan's liquidity metrics therefore does not signify that the JGB market is performing better or worse than US and European markets. Nevertheless, while interest rate hikes and monetary policy normalization began earlier in the US and Europe, Japan's normalization process remains underway. With the effects of large-scale monetary easing still present in the market, declining liquidity in the JGB market could increase volatility in long-term yields.

Market participants' perceptions and inflation expectations

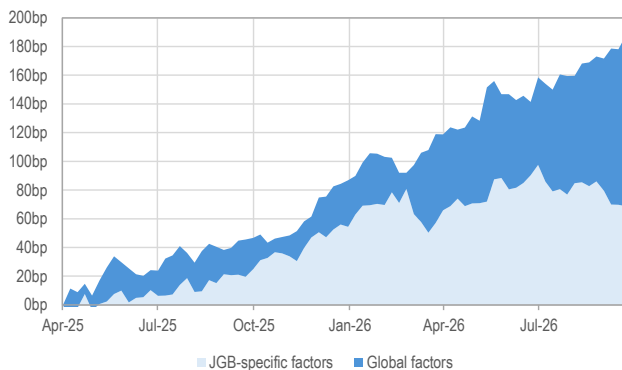
In our 1 October report¹, we constructed a common global trend through principal component analysis of long-term yields in the US, Japan, Germany, and the UK. Assuming a constant contribution from the common global trend, we then decomposed movements in Japan's long-term yield into global and JGB-specific factors. The results showed that, while JGB-specific factors accounted for a large part of the rise in Japan's long-term yield in 2025, the contribution

¹ Shun Otani (1 Oct 2026). [Daiwa's View: Key driver of the rise in JGB yields shifts from fiscal concerns to global factors.](#)

from global factors has increased, particularly since March 2026. In terms of market movements, the rise in overseas yields has been particularly notable, and it is undeniable that this has had some impact on the level of JGB yields.

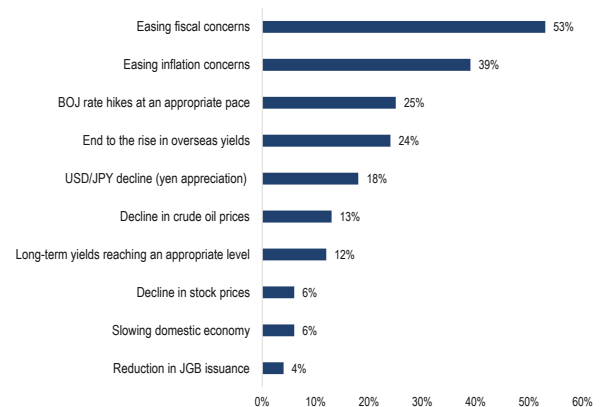
Meanwhile, the QUICK Monthly Survey (Bonds) for September 2026, released by QUICK on 5 October, included a question asking respondents to select two “factors that could halt the rise in Japan’s long-term yields.” “Easing fiscal concerns” was selected by 53% of respondents, while “an end to the rise in overseas yields” was selected by 24%, ranking only fourth overall. Thus, even when overseas yields have risen notably, Japanese investors appear to regard the easing of fiscal concerns as a necessary condition for lower yields.

Chart 2: Decomposition of Factors Behind Changes in 10yr JGB Yield (cumulative since Apr 2025)



Source: Bloomberg; compiled by Daiwa.
 Note: Reprinted from the 1 Oct report.

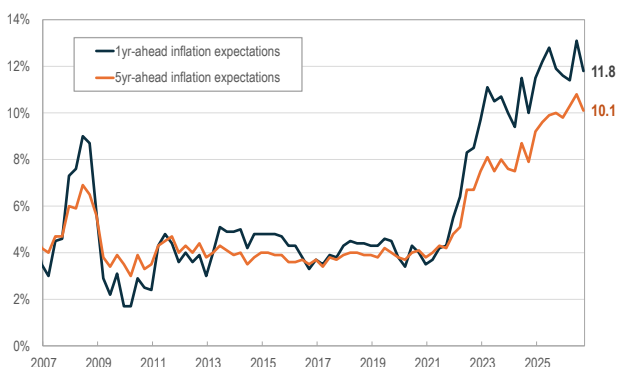
Chart 3: Factors That Could Halt the Rise in Japan’s Long-term Yields (QUICK Monthly Survey)



Source: QUICK; compiled by Daiwa.

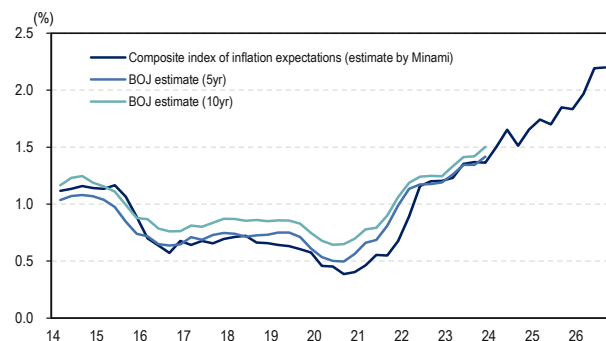
In our 13 October report², we identified the stabilization of long-term inflation expectations as one factor that could cause the 10-year JGB yield to fall below 3%. The BOJ’s Opinion Survey on the General Public’s Views and Behavior, released at 1:30 p.m. on the same day, showed that household inflation expectations had declined from the June survey for both the short term (one year ahead) and the long term (five years ahead), but remained elevated. Our Senior Economist Kento Minami estimated a composite index of inflation expectations using inflation expectations among households, firms, and economists, and pointed out that the index remains above 2%.

Chart 4: Household Inflation Expectations (avg)



Source: BOJ; compiled by Daiwa.

Chart 5: Composite Index of Inflation Expectations by Senior Economist Minami



Source: Reprinted from the 13 Oct 2026 report by Senior Economist Minami.

² Shun Otani (13 Oct 2026). [Daiwa’s View: Possibility of the 10-year JGB yield falling below 3%: A move away from deflation and shifts in inflation expectations.](#)

Long-term yield outlook: Below 3% or range-bound?

On the evening of 13 October, Bloomberg reported, citing people familiar with the matter, that the BOJ was likely to forgo a rate hike at its meeting this month, while not ruling out a rate hike in December. Given that current inflation and inflation expectations remain elevated, the BOJ appears to intend to avoid the shock of rate hikes at consecutive meetings while reinforcing market expectations that it could continue raising rates on a broadly quarterly basis.

With regard to inflation expectations among the various economic agents, a change in trend can be observed, as their upward momentum appears to be moderating. Nevertheless, the market and the authorities appear to share the view that inflation expectations remain elevated. This assessment is also consistent with Governor Ueda's view that the "phase has changed," in the sense that the underlying inflation rate is approaching 2% and the risk of inflation overshooting the 2% price stability target is increasing.

Regarding the fiscal factor cited by many market participants as a condition for lower long-term yields, the government has distanced itself from reflationary policies, but there has been no major change in its policy of promoting government investment. On 8 October, Prime Minister Takaichi stated that "this is not a phase in which so-called reflationary policies are necessary," while on 13 October she stated in the Diet that "now is precisely the time to move swiftly to implement responsible, proactive fiscal policy."

In the JGB market on 13 October, the flattening trend seen ahead of the long weekend continued, while a decline in US yields during Tokyo trading hours also provided support. The yield on the on-the-run 10-year JGB (No. 384) briefly fell below 3% before closing at 3.00% (both on a simple-yield basis). Nevertheless, inflation expectations among the various economic agents remain elevated, and no major change has been observed in the government's policy of expanding government investment. Given that market interest in fiscal management and government bond supply-demand conditions also remains high, we expect Japan's long-term yield to remain range-bound around 3% for the time being, rather than settling below 3% and entering a downtrend.

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