The bond strike: Is the U.S. turning the tables on Japan?

- Japan's bond yields jumped to multi-decade highs, sparking recession fears.
- Foreign selling, possibly by U.S. investors, may be a key trigger.
- The move risks yen stability and weakens Japan's trade leverage.

Japan's long-term bond yields spike, raising recession fears

Japanese government bond (JGB) yields have surged unexpectedly, with the 40-year JGB yield breaching 3.5%—the highest since before the 2008 crisis. The 30-year yield has exceeded 3.0% (a 25-year high), and the 10-year has crossed 1.5%, signaling stress in Japan's long-stable debt market. While known factors such as quantitative tapering (QT), persistent inflation (3.6% y-y in Mar-25), and fiscal constraints are at play, these have been long-anticipated. The magnitude and speed of the move suggest a new catalyst—possibly a shift in foreign investor behavior or a geopolitical trigger—especially ahead of elections in July and amid a sharp yen depreciation.

Retaliatory selling? A strategic signal from the U.S.

In Apr-25, U.S. 30-year Treasury yields spiked past 5%, initially blamed on Chinese selling. But data later revealed Japanese investors as the primary sellers. At the time, Japan hinted it might leverage its massive U.S. Treasury holdings (USD1.1tr, highest globally) in trade talks with the U.S. Now, it appears the tables may have turned. Some analysts suspect U.S. institutions are offloading Japanese bonds in response—a strategic "countermove" to weaken Japan's yield curve and reduce Tokyo's bargaining power ahead of further trade negotiations. While speculative, the timing aligns with U.S. trade de-escalation and mounting friction with Japan over yen policy.

Japan's bond market: Domestic-led but still vulnerable

Japan's government debt equals 263% of GDP—the highest globally—but is largely domestically held. As of Jan-2025, the BoJ holds 46.3% of JGBs, followed by domestic banks and insurers. Foreign holdings remain low at 11.9%, yet even a moderate pullback from overseas funds can trigger sharp repricing due to thin liquidity and BoJ's QT. In contrast, over 70% of U.S. Treasuries are held by foreign investors, with Japan (USD1.13tr), the UK, and China among the top holders. While Japan's domestic investor base has long been seen as a stabilizing force, it now leaves the market exposed if institutional demand softens amid rising rates and fiscal stress.

Macro risks intensify: Carry trade, recession, and fiscal strain

Higher JGB yields threaten to unwind the yen carry trade—where investors borrow cheaply in yen to invest in higher-yielding assets like U.S. Treasuries. This could trigger volatility across currencies, equities, and bonds. Rising yields also worsen Japan's fiscal position, where interest payments already account for over 25% of the national budget. With growth still fragile and the BoJ moving cautiously on policy normalization, the risk of a policy misstep triggering a recession is rising. A prolonged yield surge could also dent Japanese equity markets, especially if higher borrowing costs depress corporate investment and consumer confidence.

Yen pressure, equity risks, and diplomatic leverage

Japan will auction 40-year JGBs on 28-May-25, amid BoJ plans to cut monthly bond purchases by ¥400b per quarter. With foreign demand uncertain, this adds pressure on domestic investors to absorb more supply—at a higher yield. The weakening yen complicates matters further, threatening import inflation and worsening trade balances. At the global level, Japan's ability to exert leverage in U.S. trade talks may erode if financial stress mounts.

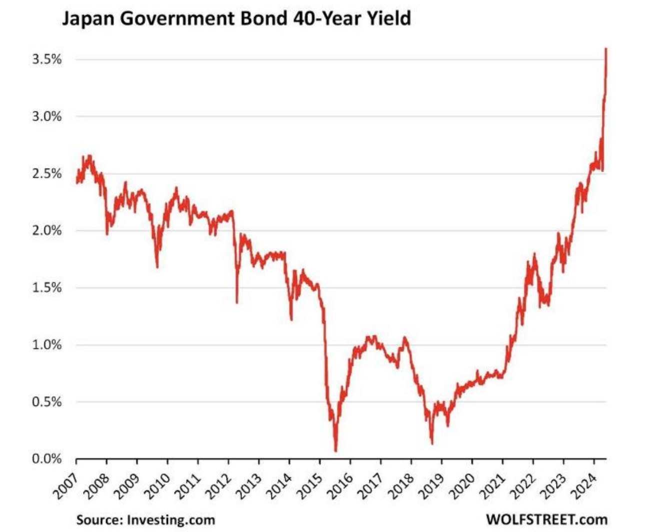
Analyst

Suwat Sinsadok, CFA, FRM, ERP
suwat.s@globlex.co.th,
+662 687 7026

Siriluck Pinthusoonthorn
Siriluck@globlex.co.th,
+662 672 5806

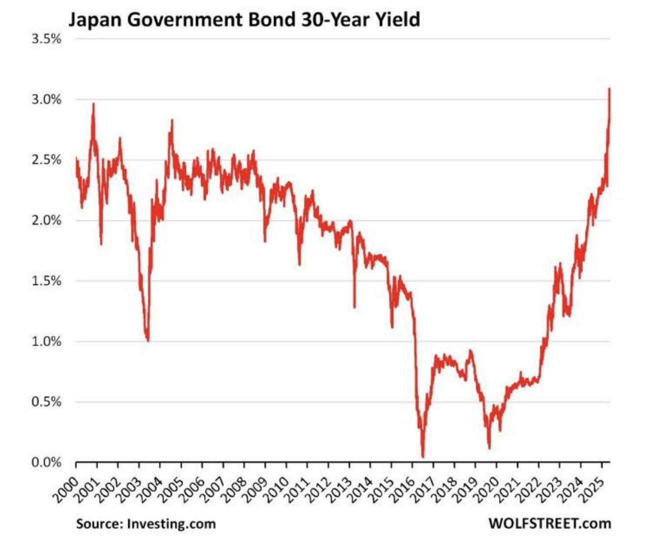
Assistant Analyst
Peerayu Sirivorawong

Exhibit 1: Japan Government Bond 40-Year yield



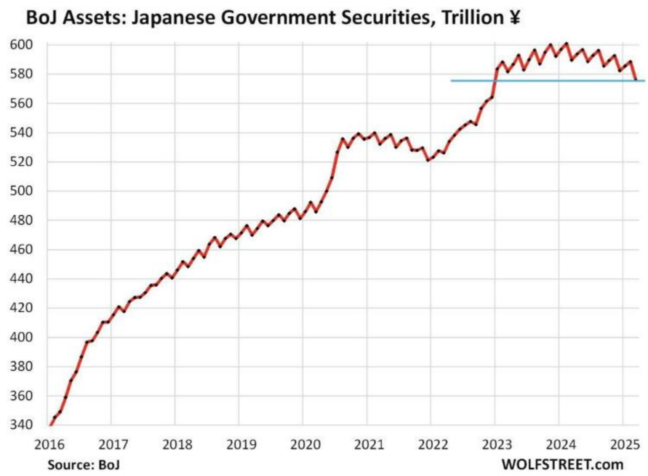
Sources: Wolfstreet.com

Exhibit 2: Japan Government Bond 30-Year yield



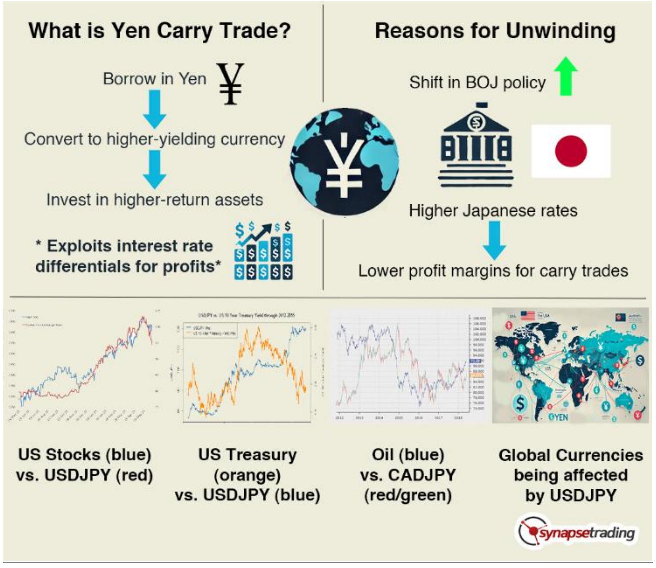
Sources: Wolfstreet.com

Exhibit 3: BoJ's Assets



Sources: Wolfstreet.com

Exhibit 4: The Yen carry trade



Sources: synapsetradding

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Suwat Sinsadok, Register No. 020799, Globlex Securities Public Company Limited

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Stock ratings are based on absolute upside or downside, which we define as (target price* - current price) / current price.

BUY: Expected return of 10% or more over the next 12 months.
HOLD: Expected return between -10% and 10% over the next 12 months.
REDUCE: Expected return of -10% or worse over the next 12 months.

Unless otherwise specified, these recommendations are set with a 12-month horizon. Thus, it is possible that future price volatility may cause temporary mismatch between upside/downside for a stock based on market price and the formal recommendation.
* In most cases, the target price will equal the analyst's assessment of the current fair value of the stock. However, if the analyst doesn't think the market will reassess the stock over the specified time horizon due to a lack of events or catalysts, then the target price may differ from fair value. In most cases, therefore, our recommendation is an assessment of the mismatch between current market price and our assessment of current fair value.

Sector Recommendations

Overweight: The industry is expected to outperform the relevant primary market index over the next 12 months.
Neutral: The industry is expected to perform in line with the relevant primary market index over the next 12 months.
Underweight: The industry is expected to underperform the relevant primary market index over the next 12 months.

Country (Strategy) Recommendations

Overweight: Over the next 12 months, the analyst expects the market to score positively on two or more of the criteria used to determine market recommendations: index returns relative to the regional benchmark, index sharpe ratio relative to the regional benchmark and index returns relative to the market cost of equity.

Neutral: Over the next 12 months, the analyst expects the market to score positively on one of the criteria used to determine market recommendations: index returns relative to the regional benchmark, index sharpe ratio relative to the regional benchmark and index returns relative to the market cost of equity.

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