



# GLOBAL MARKETS UPDATE

## BoJ normalisation points to higher JGB yields & stronger yen

- **We think the Bank of Japan's continued steps towards policy normalisation are consistent with somewhat higher JGB yields and a significant rebound in the yen over the coming quarters.**
- To recap, [the BoJ](#) made another tweak to its Yield Curve Control (YCC) policy on Tuesday. At face value, downgrading the 1% ceiling on the yield of 10-year JGBs enforced since July from a "strict cap" to an "upper bound reference" may look underwhelming – at least in comparison to expectations of a more substantial shift. **But the effect is to allow JGB yields across the curve to move more freely and, most likely, a bit higher. In our view, the decision marks another step on the path towards the final abandonment of the long-standing YCC policy and the BoJ returning interest rates to positive territory.**
- In response to this week's decision, JGB yields have risen across the curve, despite the sharp fall in yields in the US and most other major markets. The 10-year JGB yield now stands at ~0.92%, about 5bp higher than at the start of the week, while the 10-year OIS rate (which is not directly bound by the YCC constraints) has already risen to ~1.10%. (See [Chart 1.](#)) Likewise, the 30-year JGB yield is nearing 2%, which arguably also suggests further upside for the 10-year yield, even if there does not appear to a "kink" in the curve around the 10-year point, as there was earlier in the year. (See [Chart 2.](#))
- At the same time, money markets already appear to discount ~60bp of rate hikes from the BoJ over the next couple of years. (See [Chart 3.](#)) While we think policymakers will leave negative interest rates behind early next year, we expect only a symbolic hike to 0.1%. That leaves some room for disappointment on that front. **But it is likely that market participants will continue to discount some chance of higher policy rates in most scenarios. With policymakers having already made clear that the current -0.1% policy rate is the effective lower bound, the risks around future policy rates are clearly skewed to the upside.** And there are signs that the [longer-term outlook](#) for [wages and inflation](#) in Japan is finally starting to shift higher.
- What's more, we continue to think that long-term yields in the rest of the world will drop back as the Fed and other central banks bring their tightening cycles to an end and shift towards easing next year. To the extent that the surge in yields globally has been a key factor driving JGB yields higher, lower yields elsewhere over the coming quarters would put a lid on the rise in JGB yields. **On balance, we think JGB yields are unlikely to rise much further over the next couple of years. We have revised up our forecast for the 10-year JGB yield to 1% for end-23 and end-24, from 0.75% previously.**
- The other key aspect of the BoJ's policy announcement is the impact on the yen, which has weakened significantly over the past two years as the divergence between tighter monetary policy in other advanced economies and the BoJ's accommodative stance has widened. We think that trend is now finally coming to an end, as the BoJ continues to normalize policy even as other central banks start to shift towards easing.
- The yen dropped nearly 2% against the dollar in the immediate aftermath of Tuesday's policy meeting, but renewed intervention threats and falling US interest rate expectations in the wake of some softer US data and a relatively [dovish FOMC meeting](#) have since allowed the yen to claw back some ground. **Officials plainly hope to avoid actual intervention. But while their continued jawboning has helped contain the USD/JPY rate in the 150-152 zone, they may soon have to back up words with concrete action.**
- However, even in the absence of intervention, there may now be some light at the end of the tunnel. Between the BoJ's and the FOMC's policy announcements, expected interest rates have shifted in favour of Japan this week, even if that has not been fully reflected in a stronger yen. (See [Chart 4.](#)) We think that expected interest rate differentials will continue to shift in favour of Japan as the US economy slows and the FOMC moves towards easing next year – which ought to put upward pressure on the yen.
- What's more, the bigger picture is that the yen looks extremely weak not just against the dollar, but also on a real trade weighted basis. (See [Chart 5.](#)) It is far below our [estimates of "fair value"](#). And investors' short positioning against the yen continues to look stretched. (See [Chart 6.](#))
- **The upshot is that there is plenty of scope for the yen to rebound, and we continue to think that a sustained turnaround is drawing closer. Our end-2023 and end-2024 forecasts for the USD/JPY rate stand at 145 and 130, respectively, compared to ~150 currently.**



Chart 1: 10-year JGB Yield & OIS Rate (%)

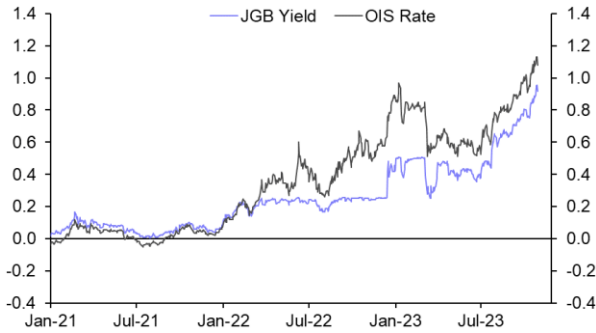


Chart 2: 10-year JGB Yield

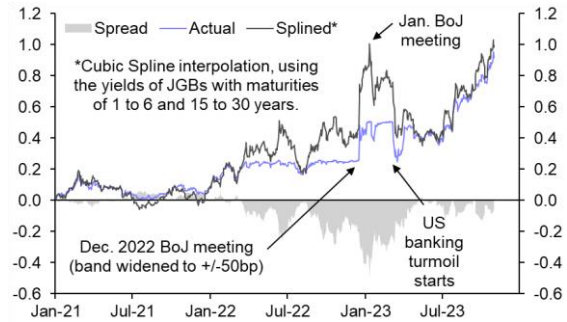


Chart 3: Japan Policy Rate (%)

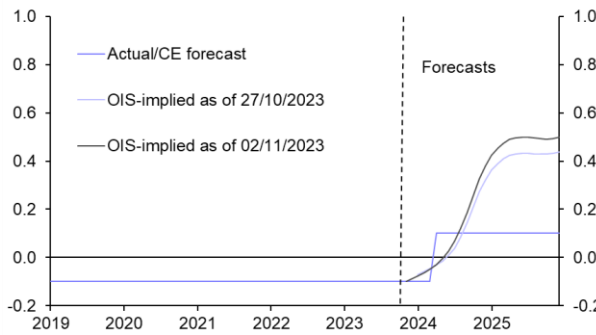


Chart 4: USD/JPY & US Less Japan 5-year OIS Rate Gap

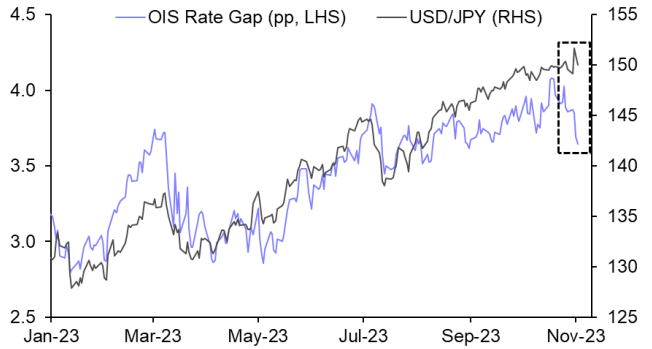


Chart 5: Japan Real Effective Exchange Rate & Terms Of Trade (Jan. 1980 = 100)

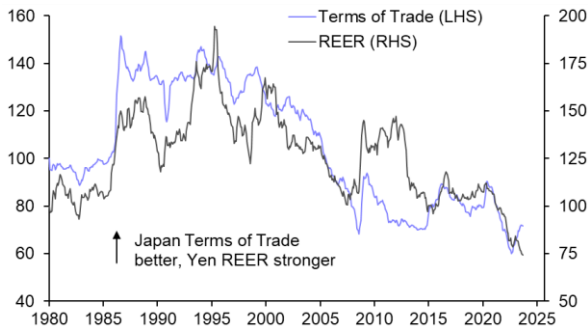
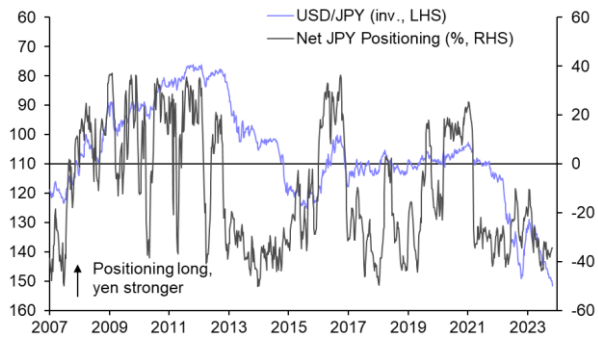


Chart 6: USD/JPY & CFTC Net USD/JPY Positioning (% Of Total Open Interest)



Sources: Refinitiv, Capital Economics



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