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ECONOMIC RESEARCH – JUNE 2025

INVESTMENT INSIGHT JAPAN

- ✓ 10-year yields stall at 1.5%
- ✓ Yen likely to strengthen against the dollar
- ✓ The Nikkei's rebound is now likely to run out of steam

REDUCED OUTLOOK FOR JAPANESE ASSETS

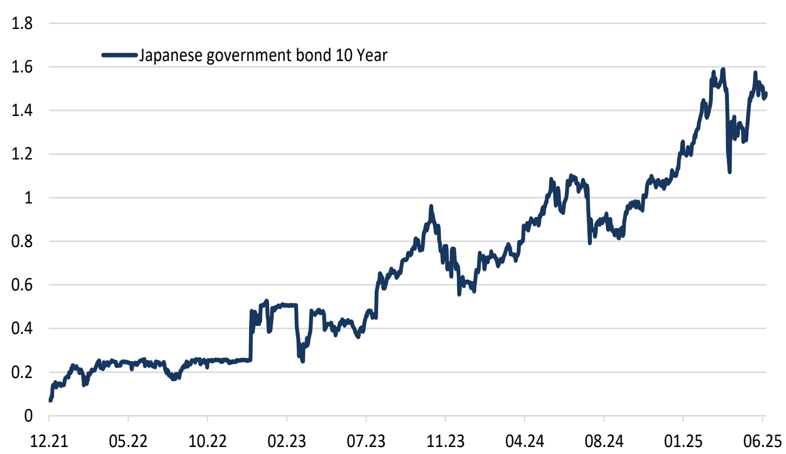
Japanese bond yields stabilize

Japanese government bond yields are stabilizing after a significant upward trend that saw them approach 1.6% in March 2025. This movement was initiated by the Bank of Japan's (BoJ) decision in March 2024 to end its yield curve control policy, allowing long-term yields to be determined more freely by market forces.

Bank of Japan's cautious stance on policy normalization

Despite recent key rate hikes to 0.50%, the BoJ is now exercising heightened caution. Influenced by international economic slowdown risks from U.S. tariff policies, the central bank is prioritizing stability over a rapid return to its inflation target. A further rate increase is unlikely in the coming quarters, as the BoJ is caught between the need to support a fragile economic recovery and counter persistent inflationary pressures. The weakness of the yen also presents a concern, as it makes imports more expensive and fuels inflation. The central bank is navigating a delicate transition, aiming to consolidate the return of inflation to its 2% target in a sustainable manner.

Ten-year government bond yields



Sources : Bloomberg, BBGI Group

Yield curve outlook and attractiveness for investors

The Japanese yield curve is positive, but is expected to flatten as the BoJ holds rates and long-term yields face downward pressure from global economic uncertainties. This limits prospects for capital gains on yen bonds. The perceived lack of safety compared to other sovereign debt makes Japanese bonds unattractive for most foreign investors.

Yen strength driven by narrowing yield spreads

The yen's recent appreciation against the U.S. dollar is driven by the narrowing interest rate differential between the two countries. The ten-year yield differential recently fell below the 300 bps threshold, a trend expected to continue as the U.S. economy slows. This is eroding the attractiveness of "carry trade" positions, increasing demand for the yen and supporting its appreciation.

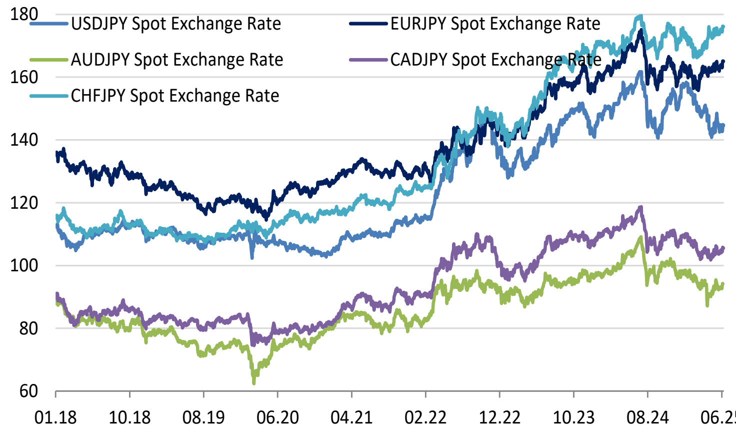
Securitized real estate remains vulnerable to rate volatility

The Japanese securitized real estate sector is highly sensitive to interest rate fluctuations. While physical property prices have shown some resilience, securitized real estate indices have performed less robustly. The recent upward movement in long-term yields has had a negative impact, preventing a sustained recovery. The outlook for this segment remains mixed and is linked to the trajectory of interest rates.

Nikkei's rebound faces significant headwinds

The Nikkei index's recent rebound faces a challenging environment. We believe the current economic climate is not conducive to sustained corporate profit growth, especially for exporters. They are facing a dual challenge from rising global trade tensions and the appreciating yen, which will likely weigh on earnings and market sentiment. While the index has recovered, prospects for significant further growth appear limited.

Yen performance against major currencies



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