BearBull
Global Investments Group

Bearbull Global Investments Group Limited
Al Fattan Currency House – Tower 1 – Unit 702
Dubai International Financial Centre (DIFC) - Dubai - UAE
www.bearbull.ae +971 4 2722719

ECONOMIC RESEARCH – MARCH 2025

INVESTMENT INSIGHT JAPAN

- ✓ 10-year yields approach 1.5%
- ✓ Yen-friendly yield differential
- ✓ Nikkei likely to consolidate

YIELD DIFFERENTIAL IN FAVOR OF THE YEN

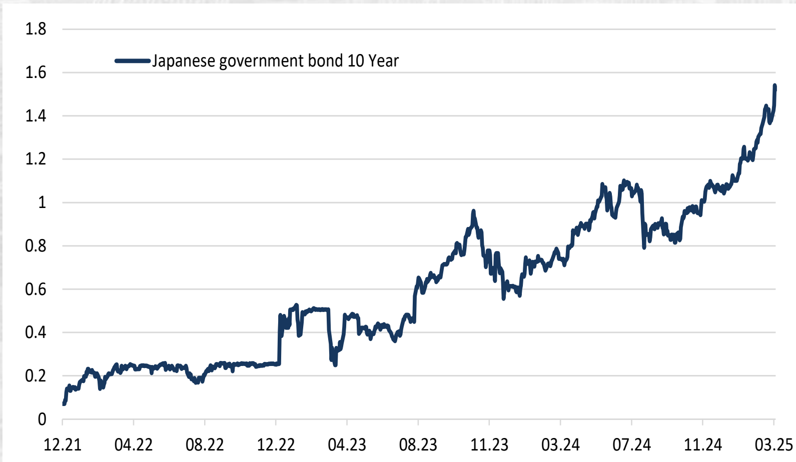
Rising Japanese 10-year yields

Japanese government bond yields are continuing their upward trajectory, recently reaching levels not observed in over two decades. The gradual increase from -0.25% in 2019 accelerated significantly after the Bank of Japan's (BoJ) initial policy shift in January 2024. This trend has pushed 10-year yields from 0.8% at the end of September 2024 to a peak of 1.46% in February 2025, a level last seen in 2009.

Diverging yield curve dynamics

Japan's current yield curve stands in stark contrast to those of Europe and the United States. While the Japanese government yield curve is positive, with short-term key rates at 0.5% and 10-year rates at 1.46%, many Western curves have shown a tendency to invert. The recent rise in Japanese long-term yields, fueled by resurgent inflation and the prospect of further BoJ rate hikes, appears to be a legitimate and necessary adjustment within the current domestic context. This divergence suggests that the expected downward movement in bond yields in other G7 countries may not be mirrored in Japan.

Ten-year government bond yields



Sources : Bloomberg, BBGI Group

Outlook for fixed-income investments

The Japanese yield curve is expected to gradually flatten as the BoJ continues its normalization process, pushing key rates higher towards the 1% mark. However, with inflation remaining above the 2% target, the long end of the curve is also likely to adjust upward. This outlook suggests limited prospects for capital gains on yen-denominated bond investments in the medium term. Consequently, these bonds remain unattractive for most foreign investors who can find more appealing international alternatives, although domestic investors may still see a value proposition.

Favorable Yen-yield differential

The yield differential between US 10-year Treasuries and Japanese government bonds has historically been a critical factor for the yen's valuation. During 2023 and 2024, spreads ranging from 300 to 400 basis points contributed to significant yen depreciation. However, the recent narrowing of this spread to below 300 bps has made the outlook more favorable for the yen. We anticipate that US yields will decline more rapidly than Japanese yields, which could narrow the spread further to 250 or 225 bps, potentially causing the yen to appreciate toward the 140 level in Q2 2025, as was the case in Q3 2024.

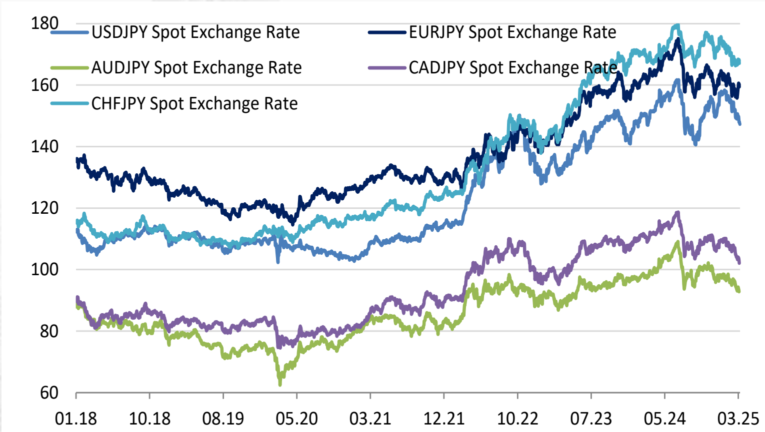
The Nikkei's consolidation phase

Following a period of stabilization between 38,000 and 40,000 points, the short-term outlook for the Nikkei stock market appears to be unfavorable. The recent surge in inflation to 4% and the resulting expectation of further BoJ rate hikes are negative factors for market performance. Additionally, the anticipated strengthening of the yen poses a specific risk for Japanese exporters and the yen-denominated earnings of listed companies, creating headwinds for the market.

Risk of a market correction

The prevailing economic context suggests a high probability of a correction in the Japanese stock market. The Nikkei's key support level of 38,000 points may soon be tested, with a significant risk of a correction down to 34,000 points. Given these headwinds, the Japanese market is viewed as a prime candidate for profit-taking by investors, which is likely to contribute to a period of consolidation in the coming months.

Yen performance against major currencies



Sources : Bloomberg, BBGI Group