

MACRO RESEARCH INSIGHT

CROSS-ASSET ANALYSIS

JAPAN ASSETS

August 2026



THE RISE OF THE YEN THREATENS THE NIKKEI – Part 3

- ✓ Sharp steepening of the yield curve
- ✓ Conditions finally in place for a yen appreciation
- ✓ Mixed outlook for Japanese stocks

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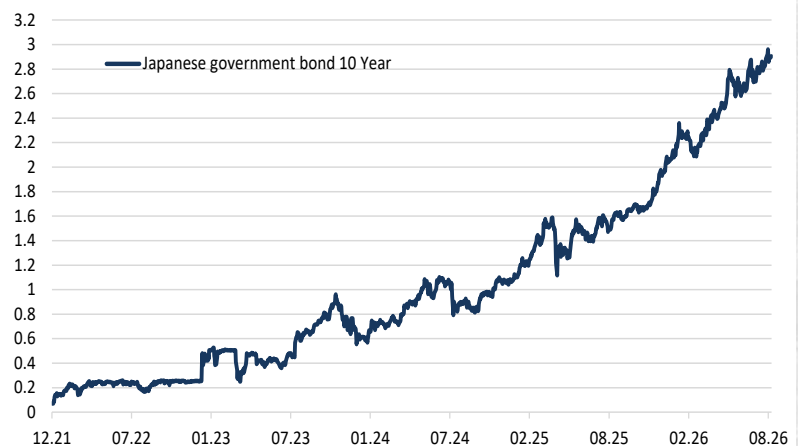
Yield Curve Steepens as 10-Year Yields Break 2.9%

A marked steepening at the long end of the Japanese government bond yield curve pushed 10-year yields above 2.9% in August 2026. This upward shift was accelerated by persistent Q2 inflation, yen volatility, and the Bank of Japan's planned reduction in monthly debt purchases. The gradual withdrawal of the central bank as the primary public debt buyer has unanchored market volatility and raised long-term borrowing costs. Institutional buyers are demanding higher term premiums to absorb sovereign issuances amid ongoing fiscal support. Consequently, 10-year yields are projected to stabilize between 3.0% and 3.5% by the end of 2026.

Institutional Portfolio Shifts Mark the End of Cheap Capital

Local banks and insurers are reallocating portfolios away from medium-term maturities to wait for higher entry yields as short-term policy rates head toward 1.5%. Balance sheet normalization and rate hikes are creating an environment of less negative real yields, which is essential to curbing capital flight. This structural shift in domestic capital allocation signals the definitive end of Japan's era of zero-cost borrowing. Rising sovereign yields are beginning to feed directly into broader corporate financing costs. This tighter credit environment will force corporate borrowers to adjust to higher long-term funding expenses.

Yield on 10-year government bonds



Sources : Bloomberg, BBGI Group

Domestic Bond Yields Trigger Capital Repatriation to Japan

Japanese pension funds and life insurers are initiating a fundamental portfolio reallocation toward domestic bonds, drawn by rising sovereign yields. With 10-year yields targeting 3.5% and policy rates rising, narrowing yield spreads against U.S. and European debt make unhedged domestic assets attractive. This steady repatriation of institutional capital complements joint central bank actions to halt the yen's structural decline. Financial giants are finally securing viable domestic returns without taking on foreign currency exposure. This realignment creates a structural bid for domestic paper, reducing systemic selling of the national currency.

Household Retail Outflows into Foreign Assets Peak

Retail investor enthusiasm for foreign investments via tax-exempt NISA accounts is leveling off due to rising currency conversion costs and global market volatility. Scheduled household capital flows into foreign index funds are slowing, limiting systematic arbitrage in favor of the dollar and euro. This deceleration in retail capital flight removes a key structural pressure point that previously accelerated currency depreciation. Reduced retail selling of the domestic currency narrows the structural balance-of-payments deficit. Together with institutional inflows, this shift establishes favorable conditions for a sustained currency appreciation.

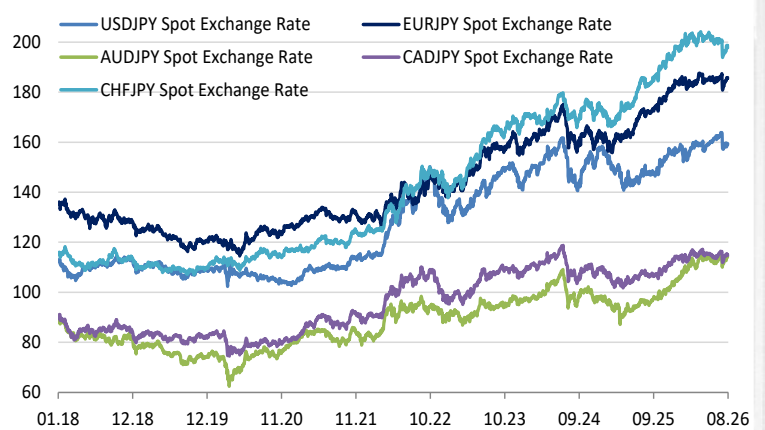
Equities Consolidate 10% to 15% Below Record Highs

The Nikkei 225 entered a clear consolidation phase after peaking over 75,000 points, stabilizing 10% to 15% below its record high. Coordinated foreign exchange interventions and prospective BoJ monetary tightening are raising the likelihood of a stronger currency, which threatens export sector profit margins. This shift strips away the primary foreign exchange tailwind that previously drove major automotive and tech shares. Consequently, analysts are issuing downward revisions to full-year earnings guidance for major exporters. Broad equity markets are losing their primary performance engine as foreign exchange tailwinds reverse.

Underweight Equities Recommended

Rising sovereign yields and borrowing costs are beginning to spill over into the real economy, weighing on corporate capital expenditure and SME operating margins. Domestic-focused businesses face margin compression as rising financial expenses and input costs make it difficult to pass on price increases without hurting sales volume. Due to these compounding trade-offs, financial advisors recommend underweighting Japanese equities relative to benchmark indices. Investors are shifting toward high selectivity, favoring defensive balance sheets over large cyclical sectors. Until corporate earnings adapt to a stronger currency and higher interest rates, equity upside remains constrained.

Yen's performance against major currencies



Sources : Bloomberg, BBGI Group

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