Japan Economic & Financial Weekly

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We expect the 10-year JGB yield to tread water just below 3% in September, although it may test that level at times. The 10-year yield touched 2.90% in intraday trading on July 9 but fell sharply the next day after Finance Minister Satsuki Katayama suggested the Government Pension Investment Fund (GPIF) might increase its investments in domestic assets. It subsequently rebounded, rising as high as 2.945% on August 18. More recently, it has been range-bound in the area around 2.85% - 2.90% as upward momentum in the 10-year UST yield and crude oil prices has stalled.

The main themes in September are likely to be: (1) the Bank of Japan's Monetary Policy Meeting and the subsequent path for the policy rate and (2) the outlook for the FY27 budget and JGB issuance plan reflecting the Takaichi cabinet's slogan of "responsible and proactive fiscal policy." Naturally, developments in the Middle East or new indications regarding Federal Reserve Chair Kevin Warsh's “next move" would also influence the market.

We expect the BoJ will raise the policy rate to 1.25% at the September 17-18 MPM(see “BoJ watch” section below for details). With the market assuming an 80%-plus probability of a rate hike, that would be in line with expectations. The market's focus will be on the subsequent pace of tightening. Market expectations for the terminal rate may rise further if Governor Kazuo Ueda signals a need to accelerate the pace of rate hikes. Even if concerns over the Bank falling behind the curve fade, the expected endpoint of this tightening cycle (the risk-free rate) would move higher, potentially lifting the entire yield curve in a bear flattening move. Conversely, we expect to see some dip-buying if the governor's remarks on the pace of rate hikes are moderate in tone and he says that it will “depend entirely on economic activity, prices and financial conditions, as well as the likelihood of the outlook materializing and associated risks.” This represents our base case. We think raising the policy rate to 1.25% while also adopting a more hawkish stance would have too great an impact on the broader JGB market.

With respect to fiscal policy, the deadline for ministries and agencies to submit theirFY27 budget requests is August 31, and figures -- including the total amount requested -- are likely to become available in the first part of the week of August31, possibly after Finance Minister Katayama returns from an overseas trip. The total will almost certainly exceed the JPY122 trillion requested for FY26, with Kyodo News reporting it is expected to top JPY130 trillion. The Cabinet Office's Economic and Fiscal Projections for Medium- to Long-Term Analysis, released on July 30, projected general account expenditures of JPY138.1 trillion in FY27 (Table1). Although this is merely a mechanical estimate based on an effective increase in government spending of JPY10 trillion each year, it provides one benchmark for assessing total budget requests. Concerns over increased JGB issuance are likely to emerge if the total substantially exceeds JPY140 trillion, although there is a possibility of the Ministry of Finance subsequently walking that back during its review. If the total remains in the JPY130-140 trillion range, it would likely be regarded as being within the range of expectations, limiting any shock to themarket.1However, it will be some time before we have a clear picture of the overall budget and JGB issuance plan, given that 1) item-only requests with unspecified amounts will be incorporated during the budget formulation process heading into December, 2) it remains unclear how the consumption tax cut for food items will be funded, and 3) an increase in defence spending appears likely. Given the persistent risk premium associated with concerns over fiscal expansion, we think the downside for the 10-year JGB yield will be limited even if total budget requests are in line with expectations. For reference, Table 2 summarizes budget requests from individual ministries and agencies based on recent media reports.

September forecast range (intraday basis):

Source: https://www.mufgresearch.com/rates/japan-economic-financial-weekly-31-august-2026/