Executive Summary

- Recent upward pressure on Japanese government bond yields has sparked dire warnings about the sustainability of Japanese debt and its impact on global equity markets *(the end of the mother of carry trades)*
- The memory of August last year, with a sharp correction on stock markets following a rise in BoJ rates (with the Nikkei losing 15% in one day and still not having recovered its highs), keeps investor tension high
- In this paper, we analyse the main characteristics of Japanese debt with the help of data and graphs, comparing it with two other highly indebted countries, the United States (which we recently wrote about to our clients) and Italy. The comparison helps keep key factors in perspective
- **What is interesting about our analysis is that all three countries are at risk of crisis if they do not address either growth or fiscal spending (or a mix of both). Yet due to three different characteristics, each country has time to intervene and correct their accounts and balances**

The issue of tariffs seems to have diminished its impact on the market, as the Trump administration's stance appears much more conciliatory than announced during 'liberation day' in early April (*TACO* effect?). The market is discounting an average tariff on American imports of between 10% and 15%, and seems able to live with these figures. The impact on earnings in 2025 and 2026 is now incorporated, with growth no longer at 13% (for 2025) but closer to 7%.

The risks for the stock market have therefore shifted to the bond market, i.e. to yields (upward); tariffs will initially support inflation. Most DM countries are adopting (for different reasons) expansionary fiscal plans and monetary, albeit in a context of growth (i.e. procyclical fiscal policy and no longer countercyclical as in the past); this worries the 'bond vigilantes' and curves are steepening. We recently wrote a piece on US debt, and in this paper we focus on Japanese debt. In fact, a (now long) series of surprises on inflation indicators has led to a sharp rise in long-term JGB yields, due to fears that the Bank of Japan will not be able to counter them. In fact, rates in Japan are still at 0.5% and the amount of debt makes it difficult to apply restrictive monetary policies. The Bloomberg Table (1) shows that the BoJ is the only central bank expected to raise rates in the next 12 months, albeit by a negligible amount (28 bps).

Country	Policy Rate	Efctv	Basis	Meeting	Implied Policy 3M	6M	1Y	2Y	3Y Curve	Total Change 1Y
Americas										
United States	4.38	4.330	-4.5	06/18	4.30	4.02	3.56	3.30	3.49	-82
Canada	2.75	2.750	0.0	06/04	2.56	2.36	2.34	2.53	2.57	-41
Mexico	8.50	8.767	26.7	06/26	8.00	7.52	7.29	7.40	7.74	-121
Chile	5.00	5.000	0.0	06/17	4.66	4.45	4.17	4.38	4.78	-83
Brazil	14.75	14.650	-10.0	06/18	14.87	14.83	13.82	12.64	13.66	-93
EMEA										
Eurozone	2.25	2.161	-8.9	06/05	1.91	1.76	1.67	1.90	2.18	-58
United Kingdom	4.25	4.211	-3.9	06/19	4.13	3.93	3.68	3.66	3.78	-57
Switzerland	0.25	0.250	0.0	06/19	-0.12	-0.29	-0.36	-0.19	0.11	-61
Norway	4.50	4.640	14.0	06/19	4.34	4.11	3.60	3.46	3.44	-90
Sweden	2.25	2.262	1.2	06/18	2.05	1.85	1.83	2.04	2.26	-42
Denmark	1.85	1.989	13.9		1.51	1.39	1.31	1.61	1.92	-54
Czech Republic	3.50	3.160	-34.0	06/25	3.28	3.03	3.46	3.01	3.41	-4
Poland	5.25	5.210	-4.0	06/04	4.75	4.45	4.21	3.57	3.75	-104
Asia/Pacific										
Australia	3.85	3.840	-1.0	07/08	3.44	3.13	2.98	3.08	3.38	-87
New Zealand	3.25	3.250	0.0	07/09	3.09	2.96	3.02	3.35	3.64	-23
Japan	0.50	0.476	-2.4	06/17	0.55	0.66	0.78	0.96	1.00	28
China	1.40	1.750	35.0		1.26	1.20	1.10	1.07	1.14	-30

Table 1: consensus estimates for monetary policy in key countries

As can be seen from Chart 1, inflation has exceeded the BoJ's target (2%) since 2019, and the BoJ has done little to normalise monetary policy. In the first phase of rising inflation, the authorities took an opportunistic stance, which pushed the JPY to weaken against the dollar (by 35%, as per the normalised index) and the Nikkei to recover to 1990s levels.

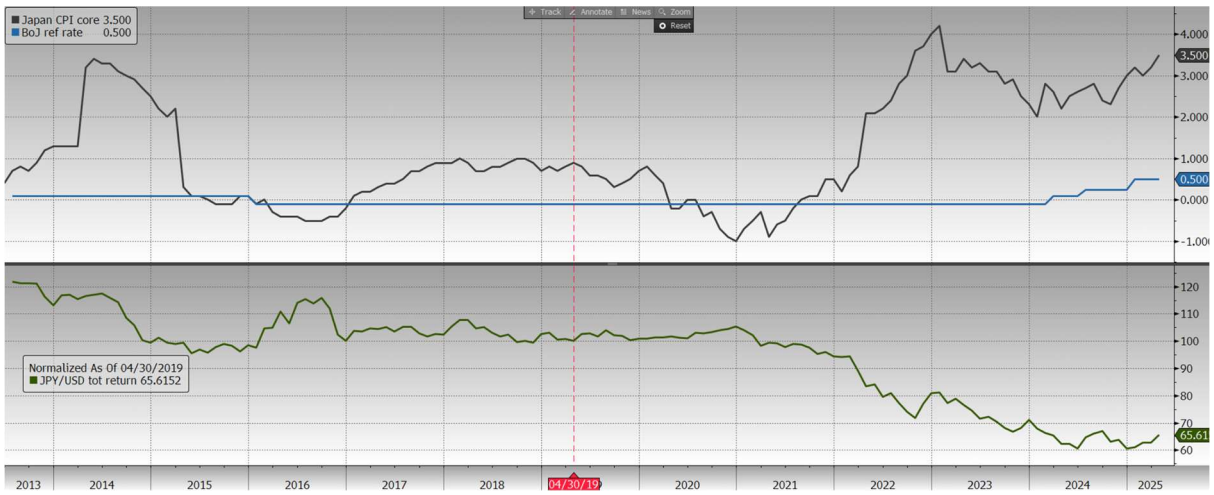

Chart 1: Japan core CPI, BoJ interest rate, and JPY performance vs USD (below, green line)

Chart 2 shows what is frightening about yields: it is not so much the level reached as the rapid steepening of the curve, with the 30-year yield 220 bps higher than the 2-year yield. The BoJ is doing very little to counteract the rise in inflation, and therefore long-term expectations are increasing. With inflation at 3.5% YoY, real yields remain deeply negative, even after a 28 bps rate hike!

Chart 2: Japan 2y and 30y yields, and 30y – 2y spread (green line, below)

In the second Table, which we have compiled by combining many sources, we report the characteristics that we consider relevant for analysing long-term debt sustainability. We then analyse the most relevant characteristics in blocks. In orange, we highlight what stands out as a defence element for the three countries. In summary: Japan has a very long debt maturity and primarily domestic holders, in addition to the fact that more than half of the debt is held by the Central Bank. In the 'Real net Debt/GDP' column, we have calculated the amount of debt that must actually be repaid by the government, since the central bank transfers the proceeds to the treasury (and could potentially wipe out the debt with the stroke of a pen, absorbing the loss). We can therefore see how 254% debt becomes a more presentable 119%.

	Avg Cost of Debt	Current 10 year yield	Average debt maturity	Debt/GDP	Debt Held by CB /GDP	Primary deficit	"Real" net Debt / GDP	Debt Domestically held/GDP	Interest Payments /GDP	Interest Payments/ Gov. Revenue	Avg. Gov. Revenues /GDP (%)	Avg Real Growth last 10 yrs	Avg Nom Growth last 10 yrs
Japan	2.00%	1.53%	9.5	254%	53%	-2.5%	119%	>90%	~1.2%	8.50%	32%	0.7%	1.50%
US	3.20%	4.52%	5.9	124%	17%	-3.3%	103%	~65%	~3%	11%	30%	2.1%	4.50%
Italy	3.50%	3.52%	7.6	137%	25%	-0.4%	103%	~75%	~3.7%	13%	47%	0.5%	2.50%

Table 2: key economic indicators of debt and growth dynamics, Novum calculations. Sources: MoF Japan, Italian Treasury, US Treasury, Visual Capitalist, Trading Economics, IMF Fiscal Monitor, Japan cabinet Office, Bloomberg

After the rate rise of recent weeks, the fiscal authorities seem to be addressing the problem of rising yields with a slightly more proactive attitude. It appears (according to unofficial reports) that the Treasury is discussing reducing issuance on the long end of the curve to halt an upward movement that has brought 30-year. **This was enough, for the moment, to halt the sell-off. Japan's long average maturity gives the government leeway to manage refinancing risk by adjusting issuance strategy.** In recent decades, the Treasury has taken advantage of very low interest rates to issue long-term bonds, ensuring a very low interest cost/GDP ratio of 1.2% (about one-third of that of the United States and Italy), despite its enormous debt.

On the other hand, Japan (like Italy) must address the problem of growth.

	Interest Payments /GDP	Interest Payments/ Gov.	Avg. Gov. Revenues /GDP (%)	Avg Real Growth last 10	Avg Nom Growth last 10 yrs
Japan	**~1.2%**	**8.50%**	**32%**	**0.7%**	**1.50%**
US	~3%	11%	30%	**2.1%**	**4.50%**
Italy	~3.7%	13%	47%	0.5%	2.50%

Table 3: Focus on interest payments and growth

As can be seen from Table 3, the differences are enormous: only the United States has the ability to 'inflate its debt away', as Bessent recently stated, after the failed attempt to reduce public spending with DOGE. The Italian problem is clear: an enormous tax burden that limits structural growth, both real and nominal. Japan, on the other hand, has a low tax burden, similar to the US, but clearly has other factors on the supply side that limit real growth. And we know that without growth, the debt problem becomes much more difficult to solve.

In graph 3, we also see how the cost of debt has started to rise, so it will no longer be possible to rely on it in the coming years.

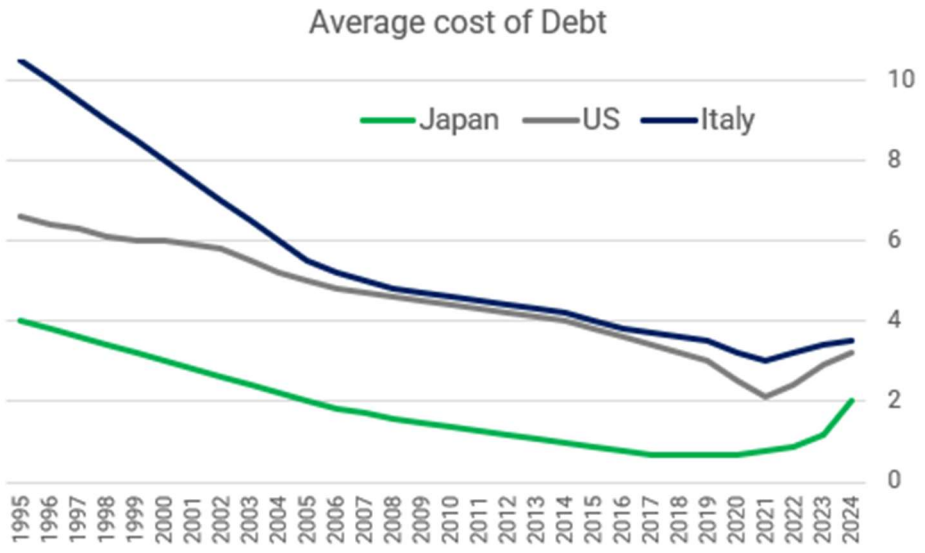

Chart 3: Average cost of debt

The fourth Chart shows that interest expenses are still very low for Japan, both in relation to GDP and government revenue. The trend for the United States and Italy is more alarming and must be addressed before the market puts pressure on politicians.

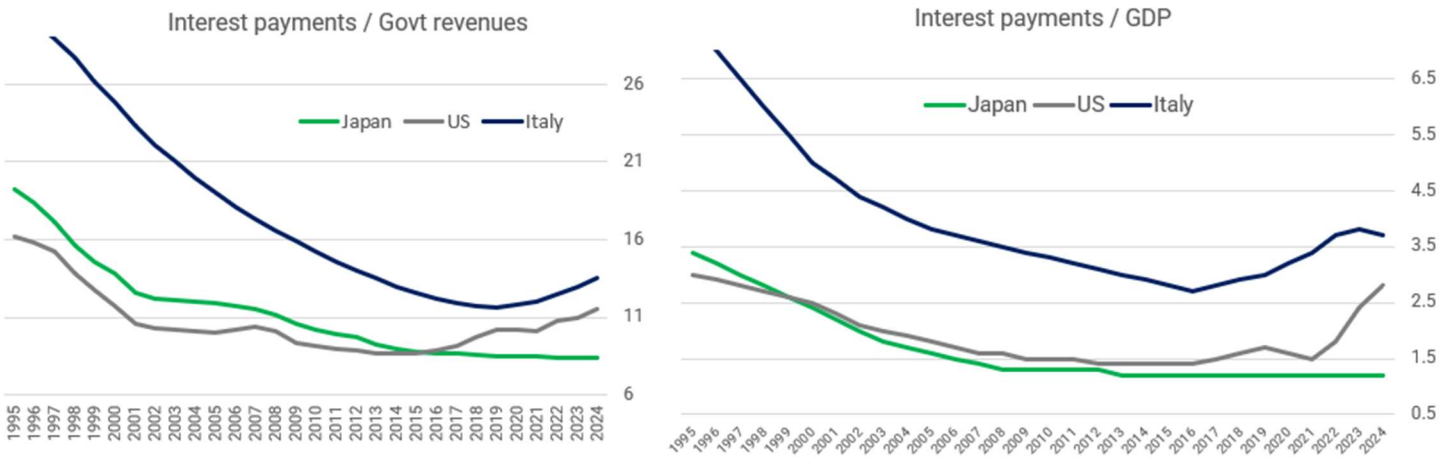

Chart 4: Interest payments over revenues and GDP

The last Table (4) shows how Italy is saved by the actions of the Central Bank after Draghi's QE began to accumulate debt, and thanks to fiscal virtuosity. For years, Italy has been one of the very few developed countries with a primary deficit close to zero. Of course, with a tax burden of 47%, it is impossible to generate growth.

	Debt/GDP	Debt Held by CB /GDP	Primary deficit	"Real" net Debt /
Japan	**254%**	**53%**	**-2.5%**	**119%**
US	124%	17%	-3.3%	103%
Italy	137%	25%	**-0.4%**	103%

Table 4: Focus on debt levels and deficits

Conclusion:

The volatility in Japanese yields has reignited concerns over debt sustainability, yet our analysis suggests these fears may be overstated—at least for now. Japan's unique debt structure, with a long average maturity, low interest burden, and domestically concentrated ownership (particularly via the BoJ), offers insulation against shocks.

However, the real vulnerability lies elsewhere: in persistently weak growth. Without structural reforms or a sustained acceleration in nominal GDP, even Japan's favourable debt mechanics could eventually come under pressure.

As investors, we must look beyond headline debt ratios and assess the composition, cost, and holders of sovereign liabilities. In an environment where many developed economies are drifting toward procyclical fiscal policy and structurally higher rates, Japan remains a complex but navigable case.

We will continue to monitor the evolution of Japan's yield curve, inflation dynamics, and issuance strategy.