Japanese Economy Returning to "A World with Interest Rates"

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Long-Term Interest Rates Nearing 3%

Japan's long-term interest rates, which generally refers to the yield on 10-year government bonds, are showing signs of approaching the 3% mark. Looking at the secondary market yield on newly issued 10-year government bonds (hereinafter referred to as the 10-year bond yield), which is used as a leading indicator in Japan's economic trends index, long-term interest rates in Japan have remained below 3% for nearly 30 years, ever since falling below 3% at the end of August 1996 *(Chart 1)*. In this month's article, let us examine the trend in long-term interest rates over the past 30 years, comparing it to various economic data.

Policy Rate Spread Remains in 2-Percentage Point Range

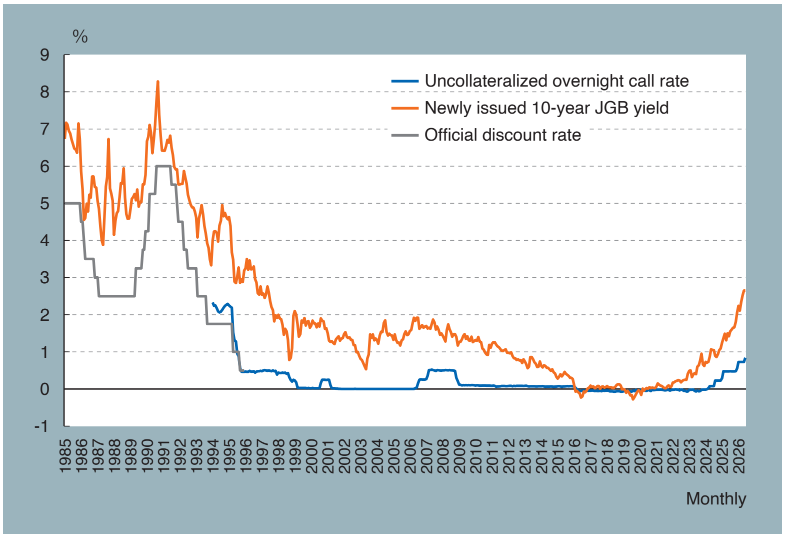
The primary factor impacting long-term interest rates is the Bank of Japan's (BOJ) monetary policy. This is because long-term interest rates are considered to reflect market expectations regarding the BOJ's future policy rates. Since the BOJ's policy interest rate changed from the traditional discount rate to the unsecured overnight call rate in the mid-1990s, *Chart 1* shows both data.

Thirty years ago, the BOJ was in the process of cutting the policy interest rate in response to the burst of the bubble economy. In 1991, the official discount rate which stood at 6% was quickly reduced, falling to 1.75% by the fall of 1993. Materials on the reduction of the official discount rate released by the BOJ at the time note that "the new official discount rate is at a sufficiently low level, even in light of the current economic situation", but the official discount rate was cut twice in 1995 to 0.5%. The unsecured overnight call rate, which had taken over the role of the policy interest rate, also fell to around 0.5 % by the fall of 1995.

The spread between long-term interest rates and the policy rate stood at 2.5 percentage points by the end of August 1996. During the period when the so-called unconventional monetary policy was being implemented, particularly in the latter half of the 2010s, the spread narrowed to almost zero at times, but this can be regarded as an exceptional circumstance. In contrast, the policy interest rate stands at 1% at the time of writing this article. Considering the outlook of the policy interest rate, it is only a matter of time before long-term interest rates reach the 3% range. Furthermore, with many market participants anticipating the BOJ raising the policy interest rate further, the spread between long-term interest rates and the policy interest rate is likely to further widen.

CHART 1

Trends in Japan's policy rate & long-term interest rate



Source: Bank of Japan; Cabinet Office "Indexes of Business Conditions"

Relationship with GDP Growth Rate Boosted Fiscal Management, But ...

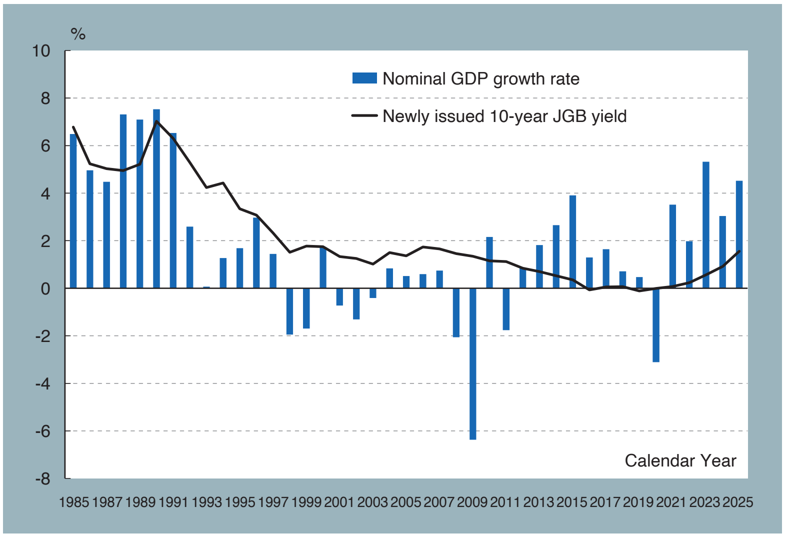
Long-term interest rates have been closely watched also for their relationship with nominal GDP growth. This is because high growth rates indicate strong demand, which in turn leads to a rise in long-term interest rates through higher demand for funds. In addition, they are also closely watched from the perspective of fiscal sustainability. Japan's national tax revenue for fiscal 2025, which was released on July 3, reached a record high partly due to the high nominal GDP growth rate. If long-term interest rates remain low compared to the nominal GDP growth rate, the government can benefit from increased tax revenue while keeping interest payments low.

Looking at *Chart 2*, which compares the annual average of the end-of-month secondary market yields on newly issued long-term government bonds (10-year) with the nominal GDP growth rate, it can be confirmed that since 2013, with the exception of 2020 during the coronavirus pandemic, Japan has continued to manage its public finances against a favorable backdrop where the nominal GDP growth rate has exceeded long-term interest rates.

On the other hand, looking at the year-on-year growth rate of nominal GDP on a quarterly basis, it has slowed to 3.6% in the January to March quarter of 2026. Moreover, the year-on-year growth of real GDP was only 0.4% with much of it attributed to rising prices. There is also a need to monitor the possibility of market participants becoming reluctant to purchase government bonds in anticipation of future risks to fiscal management, leading to a rise in long-term interest rates.

CHART 2

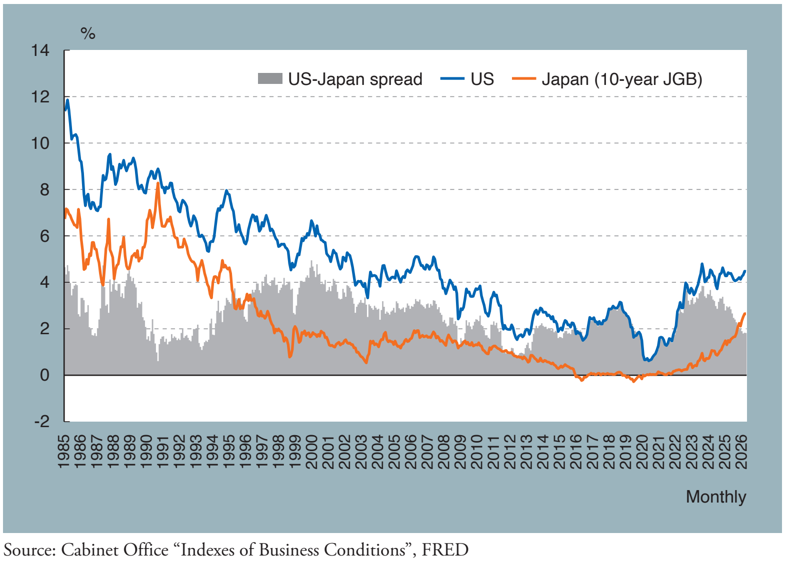
Trends in nominal GDP growth rate & long-term interest rate



Source: Cabinet Office "National Accounts", "Indexes of Business Conditions"

CHART 3

Trends in US & Japan long-term interest rates



Source: Cabinet Office "Indexes of Business Conditions", FRED

Narrowing Spread with US 10-Year Treasury Yield

The spread between long-term interest rates in Japan and the United States is also closely watched for its potential impact on the yen-dollar exchange rate. *Chart 3* compares the Interest Rates: Long-Term Government Bond Yields: 10-Year: Main (Including Benchmark) for the US, obtained from the FRED database of the St. Louis Federal Reserve with the secondary market yield on newly issued 10-year long-term government bonds. Looking at the bar chart which subtracts 10-year Japanese government bonds from the yield on 10-year US Treasury bonds, it is clear that the spread between Japan and the US, which had been widening from around 2021, has narrowed over the past year. Since the 1990s, the yen-dollar exchange rate tended to strengthen during the contraction phase of the US-Japan spread, but most recently the yen has instead been weakening. Has there been a change in the relationship between the US-Japan spread and the yen-dollar exchange rate? Is it simply a matter of the absolute level of the spread, or is it a structural change?

NOTE: This article was based on information available as of July 28, 2026.

Article translated from the original Japanese by Mio Kawashima

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Calendar year, Quarter and Month	Real GDP		Nominal GDP		IIP rate of increase over previous year/term (month) (%)	CPI (All terms, less fresh food) rate of increase over previous year/the same term (month) of the previous year (%)
	Amount (trillion yen)	Rate of increase over previous year/term (%)	Amount (trillion yen)	Rate of increase over previous year/term (%)		
2018	580.9	0.8	569.2	0.7	0.6	0.9
2019	579.1	-0.3	571.8	0.5	-2.6	0.6
2020	554.3	-4.3	554.1	-3.1	-10.4	-0.2
2021	574.2	3.6	573.7	3.5	5.4	-0.2
2022	581.3	1.2	584.5	1.9	-0.1	2.3
2023	586.5	0.9	616.7	5.5	-1.3	3.1
2024	586.9	0.1	636.9	3.3	-2.6	2.5
2025	593.7	1.2	666.4	4.6	-0.3	3.1
2025/3rd Qtr.	592.3	-0.4	668.8	0.3	-1.1	2.9
4thQtr.	593.8	0.2	675.0	0.9	0.3	2.7
2026/1st Qtr.	596.6	0.5	679.8	0.7	2.5	1.7
2nd Qtr.	598.3	0.3	687.7	1.2	0.2	1.5
Nov.	—	—	—	—	-2.0	3.0
Dec	—	—	—	—	0.6	2.4
2026/Jan.	—	—	—	—	4.3	1.9
Feb.	—	—	—	—	-2.0	1.5
March	—	—	—	—	-0.4	1.7
April	—	—	—	—	0.5	1.4
May	—	—	—	—	0.1	1.4
June	—	—	—	—	1.9	1.6
Sources	"SNA (National Accounts of Japan)", Cabinet Office				"Indices of Industrial Production", Ministry of Economy, Trade and Industry	"Consumer Price Index", Statistics Bureau, Ministry of Internal Affairs and Communications

Calendar year, Quarter and Month	Foreign Trade Statistics									
	Exports amount (trillion yen)	Exports rate of increase over previous year/ the same term (month) of the previous year (%)	Imports amount (trillion yen)	Imports rate of increase over previous year/ the same term (month) of the previous year (%)	Exports amount to US (trillion yen)	Exports to US rate of increase over previous year/ the same term (month) of the previous year (%)	Imports amount from US (trillion yen)	Imports from US rate of increase over previous year/ the same term (month) of the previous year (%)	Exports amount to EU (trillion yen)	Exports to EU rate of increase over previous year/ the same term (month) of the previous year (%)
2018	81.5	4.1	82.7	9.7	15.5	2.4	9.0	11.4	7.7	7.8
2019	76.9	-5.6	78.6	-5.0	15.3	-1.4	8.6	-4.2	7.4	-3.0
2020	68.4	-11.1	68.0	-13.5	12.6	-17.3	7.5	-13.7	6.3	-15.1
2021	83.1	21.5	84.9	24.8	14.8	17.6	8.9	19.6	7.7	21.4
2022	98.2	18.2	118.5	39.6	18.3	23.1	11.8	31.9	9.4	22.0
2023	100.9	2.7	110.4	-6.8	20.3	11.0	11.6	-1.7	10.4	10.9
2024	107.1	6.2	112.7	2.1	21.3	5.1	12.7	9.8	10.0	-3.9
2025	110.4	3.1	113.3	0.5	20.4	-4.3	12.9	1.8	10.1	1.3
2025/3rd Qtr.	27.2	0.3	27.9	-3.1	4.7	-12.8	3.3	5.7	2.5	2.1
4thQtr.	29.9	4.9	29.7	2.6	5.4	-2.5	3.4	12.6	2.8	9.8
2026/1st Qtr.	29.7	10.5	30.2	5.8	5.2	-3.1	3.4	9.9	2.8	19.1
2nd Qtr.	30.9	17.0	31.5	15.9	5.6	11.5	4.2	34.4	2.9	20.6
Nov.	9.7	6.1	9.4	1.4	1.8	8.8	1.1	7.3	0.9	19.5
Dec	10.4	5.1	10.3	5.4	1.8	-11.1	1.1	9.3	1.0	2.5
2026/Jan.	9.2	16.8	10.4	-2.6	1.5	-5.1	1.1	3.2	0.8	29.6
Feb.	9.6	4.0	9.5	10.3	1.8	-8.0	1.1	8.5	0.9	14.0
March	11.0	11.5	10.4	11.0	1.9	3.4	1.2	18.1	1.0	16.1
April	10.5	14.8	10.2	9.9	1.9	9.5	1.2	24.3	1.1	27.0
May	9.5	16.8	9.9	12.5	1.7	12.3	1.3	26.1	0.9	14.0
June	10.9	19.3	11.3	25.4	1.9	12.9	1.6	52.7	1.0	20.2
Sources	"Trade Statistics of Japan", Ministry of Finance									

Calendar year, Quarter and Month	Cash salary amount rate of increase over previous year/the same term (month) of the previous year (%)	Active job openings-to-applicants ratio (time(s))	Unemployment rate (%)	M2 rate of increase over previous year/ the same term (month) of the previous year (%)	Balance of payments		Yen/$ rate (averaged during the term)
					Trade balance (trillion yen)	Current balance (trillion yen)	
2018	1.4	1.61	2.4	2.9	1.1	19.5	110.4
2019	-0.4	1.60	2.4	2.4	0.2	19.3	109.0
2020	-1.2	1.18	2.8	6.5	2.8	16.0	106.8
2021	0.3	1.13	2.8	6.4	1.8	21.5	109.8
2022	2.0	1.28	2.6	3.3	-15.5	11.4	131.4
2023	1.2	1.31	2.6	2.5	-6.6	22.5	140.5
2024	2.8	1.25	2.5	1.7	-2.7	29.3	151.5
2025	2.3	1.22	2.5	1.2	-0.6	32.2	149.6
2025/3rd Qtr.	2.4	1.21	2.5	1.3	0.2	10.7	147.5
4thQtr.	2.2	1.19	2.6	1.7	0.7	7.3	154.1
2026/1st Qtr.	3.0	1.19	2.7	1.8	0.5	9.6	156.9
2nd Qtr.	3.4	1.18	2.5	2.3	0.3	7.8	159.4
Nov.	1.7	1.19	2.6	1.7	0.6	3.7	155.1
Dec	2.4	1.20	2.6	1.7	0.1	0.9	155.9
2026/Jan.	2.5	1.18	2.7	1.6	-0.6	0.9	156.8
Feb.	3.4	1.19	2.6	1.7	0.3	3.9	155.2
March	3.1	1.18	2.7	2.0	0.8	4.8	158.6
April	3.6	1.18	2.5	2.3	0.4	3.9	159.3
May	3.3	1.17	2.5	2.4	0.0	4.0	158.3
June	3.4	1.18	2.5	2.2	-0.1	-0.1	160.7
Sources	"Monthly Labour Survey", Ministry of Health, Labour and Welfare	"Employment Referrals for General Workers", Ministry of Health, Labour and Welfare	"Labour Force Survey", Statistics Bureau, Ministry of Internal Affairs and Communications	"Money Stock", Bank of Japan	"Balance of Payments", Ministry of Finance		Bank of Japan

Calendar year, Quarter and Month	Foreign Trade Statistics									
	Imports amount from EU (trillion yen)	Imports from EU rate of increase over previous year/ the same term (month) of the previous year (%)	Exports amount to Asia (excluding China) (trillion yen)	Exports to Asia (excluding China) rate of increase over previous year/ the same term (month) of the previous year (%)	Imports amount from Asia (excluding China) (trillion yen)	Imports from Asia (excluding China) rate of increase over previous year/ the same term (month) of the previous year (%)	Exports amount to China (trillion yen)	Exports to China rate of increase over previous year/ the same term (month) of the previous year (%)	Imports amount from China (trillion yen)	Imports from China rate of increase over previous year/ the same term (month) of the previous year (%)
2018	8.8	10.6	28.8	2.9	20.0	7.8	15.9	6.8	19.2	4.0
2019	8.8	0.3	26.6	-7.6	19.0	-5.3	14.7	-7.6	18.5	-3.9
2020	7.8	-12.1	24.1	-9.4	17.2	-9.4	15.1	2.7	17.5	-5.1
2021	9.5	21.8	30.2	25.0	20.7	20.6	18.0	19.2	20.4	16.4
2022	11.4	21.1	36.4	20.6	28.6	37.8	19.0	5.7	24.8	21.9
2023	11.4	-0.2	34.7	-4.6	27.6	-3.4	17.8	-6.5	24.4	-1.7
2024	12.0	4.7	38.0	9.4	28.6	3.7	18.9	6.2	25.3	3.6
2025	12.8	6.6	41.1	8.2	29.1	1.6	18.8	-0.4	26.7	5.5
2025/3rd Qtr.	3.2	-1.3	10.3	4.9	7.2	-3.3	4.7	0.5	6.5	2.5
4thQtr.	3.3	6.0	11.0	8.6	7.6	3.3	5.1	1.8	7.3	5.6
2026/1st Qtr.	3.3	6.1	11.5	15.4	8.0	7.6	4.9	11.5	7.3	12.6
2nd Qtr.	3.3	3.3	11.8	20.5	8.8	30.2	5.3	17.0	7.6	18.7
Nov.	1.0	6.6	3.6	7.9	2.4	4.3	1.6	-2.5	2.4	2.4
Dec	1.2	21.6	3.9	12.5	2.6	5.4	1.8	5.5	2.5	14.7
2026/Jan.	1.0	-1.1	3.7	23.3	2.7	-1.2	1.5	32.0	2.6	0.6
Feb.	1.1	3.1	3.7	8.9	2.4	7.0	1.4	-11.0	2.3	35.5
March	1.2	16.7	4.2	15.0	2.9	17.9	2.0	17.7	2.3	8.9
April	1.0	3.9	4.0	16.3	2.9	30.1	1.8	15.5	2.6	15.0
May	1.1	4.7	3.6	20.2	2.7	29.6	1.7	17.9	2.4	13.7
June	1.1	1.7	4.2	24.9	3.2	30.7	1.8	17.6	2.6	27.9
Sources	"Trade Statistics of Japan", Ministry of Finance									