Arculus
FUNDS MANAGEMENT

Japan at the Turn

The outlook for inflation, growth, unemployment and interest rates · 22 July 2026

> *Japan has not escaped its debt problem; it has changed the currency in which that problem is paid. The adjustment is running through the exchange rate and the price level, not through the bond market. That is a slower crisis, and a more insidious one.*

1.25%	4.25–4.50%	158–168	55%
POLICY RATE · Q4 2026	30Y JGB · Q4 2026	USD/JPY · Q4 2026	BASE CASE PROBABILITY

THE CALL

Japan is roughly eighteen months into the most consequential regime change of any developed economy since the financial crisis. The Bank of Japan abandoned yield curve control in March 2024, raised the policy rate to 1.00% on 16 June 2026 — the highest since September 1995 — and is running a balance sheet reduction that cuts JGB holdings by roughly a third by 2030.

Simultaneously, the Takaichi government's Basic Policy of 21 July removed "fiscal consolidation" from official policy and replaced the primary balance target with a multi-year debt-to-GDP objective. **Monetary policy is tightening into a fiscal expansion, and the yen is the release valve.**

Our central case is not a crisis. It is something more awkward for portfolio construction: a persistent, grinding repricing of Japanese duration and the yen, punctuated by episodes of disorder around fiscal events.

HEADLINE CALLS

	Policy rate	10y JGB	30y JGB	USD/JPY
Q4 2026	1.25%	3.10–3.30%	4.25–4.50%	158–168
Mid-2027	1.50%	3.40%	4.60%	155–165

Terminal policy rate this cycle 1.75–2.00%. Fair value for an unsupported 30-year JGB 4.75–5.75%. Source: Arculus Funds Management.

FORECAST SUMMARY

	Current	Q4 2026	Mid-2027	End-2027
Policy rate	1.00%	1.25%	1.50%	1.75%
Core CPI (y/y)	1.4%	2.2–2.5%	2.0%	1.8–2.0%
Real GDP (y/y)	0.4%	0.7%	0.9%	1.0%
Unemployment	2.5%	2.5%	2.6%	2.6%
10y JGB	2.90%	3.10–3.30%	3.40%	3.50%
30y JGB	4.00%	4.25–4.50%	4.60%	4.75%
USD/JPY	~162	158–168	155–165	152–162

Ranges reflect genuine uncertainty rather than forecast precision. Source: Arculus Funds Management.

HOUSE VIEW IN BRIEF

INFLATION

2.2–2.5%

CORE CPI BY Q4 2026

Energy subsidies hold measured core CPI some 50–70bp below its underlying rate. Corporate expectations have anchored above target. Underlying inflation is at, not below, target.

WAGES

5.01%

SHUNTO 2026 SETTLEMENT

A third consecutive year above 5%, across 5,368 unions, with real wages +1.4%. The deflationary wage-setting norm has broken.

THE STALE FX ASSUMPTION

152.57 vs 162

PLANNING RATE VS SPOT

Firms are planning FY2026/27 six per cent from the traded rate. That is not a forecasting error — it is a pipeline of cost pass-through that has not yet reached the shelf.

GROWTH

0.7%

CALENDAR 2026

Q1 was strong on the headline but poor in composition: business investment revised to −0.7%, and capex plans of +11.5% sit against recurring profits at −6.7% — investment through margin compression.

UNEMPLOYMENT

2.5%

CLOSE TO UNINFORMATIVE

Japan clears through hours, participation and wages, not the jobless rate. Watch the vacancy ratio (1.17, falling) and the Tankan employment DI (−37). 2.5–2.7% through 2027.

RATES

1.75–2.00%

TERMINAL THIS CYCLE

Hold on 31 July, 1.25% in October, 1.50% by mid-2027. The more important call is the curve: continued bear steepening driven by term premium and supply, not policy expectations.

163.19

USD/JPY · 22 JULY · 40-YEAR LOW

The yen. Intervention controls the pace of depreciation, not the level. The MoF spent a record ¥11.73trn across April–May and USD/JPY was back through the intervention level inside six weeks. That is not a market trading the rate differential; it is one trading the credibility of the policy mix.

WHERE WE DIFFER: THE SHADOW-YIELD QUESTION

A strand of commentary argues that unsupported Japanese long-end yields would be in double digits. We think that is directionally right about the yen and substantially wrong about the bond. The premise has been overtaken by events: yield curve control ended in March 2024, the Bank is in QT, and the 30-year has already repriced from under 1% in 2021 to 4.00%.

The stock effect is real — the Bank still holds roughly half the market, concentrated long, which we put at 100–200bp on the 30-year — but its unwinding is scheduled, publicised and gradual, which is precisely the condition under which markets do not gap. The ECB analogy does not transfer: Italy and Spain issue in a currency they cannot create, so default probability gaps; Japan cannot be forced into nominal default. **In a foreign-currency-equivalent regime, the bond breaks. In a local-currency regime with a printing press, the currency breaks. Japan is the second case.**

4.75–5.75%

Our estimate of fair value for an unsupported 30-year JGB, offered for adjudication rather than as a settled house number. That is a serious number. It is not ten per cent.

SCENARIOS TO END-2027

Base — grinding normalisation — 55%

BoJ 1.25% October, 1.50% by mid-2027. Core CPI 2.0–2.5%, growth 0.7–1.0%. Fiscal delivery lags announcement.

MARKET EXPRESSION 10y 3.10–3.30%, 30y 4.25–4.50%, USD/JPY 158–168. Continued bear steepening.

Honebuto-shokku — 20%

Food tax cut plus an uncapped FY2027 request round. Fiscal risk premium repricing, no growth offset.

MARKET EXPRESSION 30y through 4.75%, 2s30s beyond 350bp, USD/JPY through 170. Unscheduled BoJ operations.

Hawkish reaction-function reset — 15%

BoJ accelerates to consecutive moves, explicitly citing the currency. Terminal repriced to 2.25%+.

MARKET EXPRESSION Front end sells off, curve bull flattens from the long end, USD/JPY 145–150. Global carry unwind.

Stagflationary energy shock — 10%

Hormuz re-closure or Gulf escalation. Headline above 3%, BoJ caught between mandate and growth.

MARKET EXPRESSION Curve twists, yen weakens on terms of trade, equity de-rating. Worst outcome for Japanese assets.

Probabilities are Arculus Funds Management estimates and are subjective.

What this means for Australian fixed income portfolios

- **AUD/JPY into the ACGB long end.** Our standing house view is that Australian long-end steepening is driven by the unwind of the yen carry trade through AUD/JPY, not by domestic inflation expectations. A domestic 30-year at 4.00%, heading to 4.25–4.50%, competes directly for the balance sheets of Japanese lifers and trust banks. The trigger to monitor is AUD/JPY, not Australian breakevens.
- **Carry unwind risk.** The hawkish-reset scenario transmits most violently. AUD is a primary carry destination and would bear a disproportionate share of an August-2024-style adjustment; books carrying credit beta and duration together should be sized with that correlation in mind.
- **Positioning.** Underweight ultra-long duration in both markets; prefer the front end and belly; hold curve steepeners as the cleanest structural expression; treat a sharp yen appreciation as a de-risking signal for credit, not a benign one. Floating rate exposure remains the defensive allocation in a term-premium-driven selloff.

The full paper — **Japan at the Turn**, 22 July 2026 — is available to clients of Arculus Funds Management.

Full analysis of the inflation mechanics, the fiscal regime change, the shadow-yield debate and scenario construction.