OMNIGENCE
ASSET MANAGEMENT

The Japan Anchor Lifts:

Monetary Normalizations, Capital Repatriation, and the Repricing of Global Fixed Income

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EXECUTIVE SUMMARY:

For three decades, Japan functioned as the world's monetary anchor, suppressing global long-term interest rates by exporting vast quantities of cheap capital. Japanese institutions, operating in an environment of zero or negative domestic yields, became the largest foreign holders of sovereign debt in the United States, Europe, and beyond. That era ended in January 2026. The Bank of Japan's policy rate now stands at 0.75%, its highest level since 1995, and the 40-year Japanese government bond yield has breached 4% for the first time in over thirty years.

The implications extend far beyond Tokyo. Japan holds approximately USD 1.2 trillion in U.S. Treasury securities, making it the single largest foreign creditor of the American government. Japanese investors collectively hold USD 12 trillion in foreign assets. As domestic yields rise, the incentive structure that drove this capital outward is reversing. Life insurers are retreating from foreign markets to manage unrealized losses that reached an estimated USD 60 billion for the four largest firms alone. The world's largest pension fund, GPIF, faces growing pressure to increase its allocation to now-attractive domestic bonds. The yen carry trade, estimated at between USD 1 trillion and USD 4 trillion in direct exposure, confronts a structurally narrowing interest rate differential.

This paper examines the mechanics and timeline of Japan's monetary normalization, the institutional capital flows at risk of reversal, the transmission channels through which Japanese repatriation affects global bond markets, and the investment implications for portfolios positioned for a world in which the anchor has been lifted.

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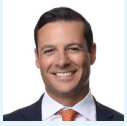

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THREE DECADES OF THE JAPAN ANCHOR:

Japan's role as the world's low-rate anchor was not an accident of circumstance but the direct consequence of a policy regime born from crisis. Following the collapse of its asset price bubble in 1990, the Bank of Japan progressively reduced its policy rate to zero by 1999. When deflation persisted, unconventional measures followed: quantitative easing from 2001, negative interest rates from 2016, and yield curve control (YCC) from the same year, which explicitly targeted a 10-year Japanese government bond yield of zero percent.

The domestic consequences were straightforward. Japanese savers, pensioners, and institutional investors found themselves in a yield desert. The rational response was to seek returns abroad. Over two decades, Japanese institutions accumulated approximately USD 12 trillion in foreign assets, with portfolio investments and other investments comprising USD 7.4 trillion. Japan's foreign investment income reached USD 240 billion annually, exceeding its trade surplus and fundamentally reshaping the country's balance of payments from an export-driven surplus to an income-driven one.

The global consequences were equally profound. Japanese capital acted as a structural buyer of sovereign debt worldwide, compressing yields and flattening term premia in markets from Washington to Frankfurt to Canberra. The Bank for International Settlements has repeatedly warned that yen-funded positions are deeply embedded in global leverage. Japanese investors became the single largest foreign holder of U.S. Treasuries, holding approximately USD 1.2 trillion as of October 2025, representing 15.2% of all foreign-held U.S. government debt. Japan also became a major holder of European sovereign bonds, providing a steady bid that European governments came to rely upon for financing.

This was not a temporary arrangement. It was a structural feature of global capital markets for a generation. Its unwinding, even if gradual, represents a tectonic shift in the supply and demand dynamics for sovereign debt in every major developed economy.

THE JANUARY REBELLION:

The theoretical end of Japan's low-rate era arrived incrementally, with the BoJ exiting negative rates in March 2024, abandoning YCC, and raising policy rates in stages through 2024 and 2025. But the market's acknowledgement of the shift arrived all at once in January 2026, in what commentators have described as a bond market rebellion.

On January 20, 2026, the yield on the 40-year Japanese government bond surged to 4.24%, the first time a Japanese sovereign maturity breached the 4% threshold in over three decades. The 30-year JGB yield hit 3.92%, also a record since that tenor was introduced in 1999. The 10-year yield, which had been anchored near zero under YCC just three years earlier, climbed above 2% for the first time since 1999.

Table 1: JGB Yield Curve Shift

Tenor	Dec 2022	Dec 2024	Dec 2025	Jan 2026 Peak
2-Year	~0.0%	~0.60%	~0.70%	~0.85%
10-Year	~0.25%	~1.05%	~1.20%	~2.18%
30-Year	~1.50%	~2.30%	~2.75%	~3.92%
40-Year	~1.70%	~2.60%	~3.10%	~4.24%

Sources: Bank of Japan; Bloomberg. Figures are approximate and reflect intraday peaks where noted.

The catalyst was the collision of two forces: the BoJ's tightening cycle and Prime Minister Sanae Takaichi's aggressive fiscal expansion. Takaichi, who took office in October 2025, announced a record JPY 122.3 trillion (USD 783 billion) budget for fiscal year 2026 on top of a JPY 21.3 trillion (USD 135 billion) stimulus package, funded by additional government bond issuance. The combination of rising rates and rising supply shattered investor confidence in the sustainability of Japan's fiscal trajectory.

The rebellion signalled that the term premium, the extra compensation investors demand for holding long-term debt, had returned to Japan with force. For decades, the BoJ's presence as a buyer of last resort had suppressed this premium to historically unprecedented levels. With the central bank now reducing its monthly JGB purchases as part of quantitative tightening, the market was left to price risk without a backstop.

U.S. Treasury Secretary Scott Bessent, speaking at the World Economic Forum in Davos in January 2026, acknowledged that the fiscal shift unfolding in Tokyo was the primary source of pressure on global markets, dismissing other explanations for the synchronized rise in sovereign yields.

WHO HOLDS WHAT: MAPPING THE USD 12 TRILLION

Understanding the global impact of Japan's monetary normalization requires mapping the institutional capital stack that accumulated foreign assets during the zero-rate era. The key holders fall into five categories, each with distinct incentives, constraints, and repatriation timelines.

Government Pension Investment Fund (GPIF): The GPIF is the world's largest pension fund, with approximately JPY 277 trillion (USD 1.87 trillion) in assets under management as of September 2025. Its target allocation is divided equally: 25% domestic equities, 25% international equities, 25% domestic bonds, and 25% international bonds, with allowable deviations of 6 to 8 percentage points per asset class.

At the end of its fiscal third quarter, approximately half of GPIF's investments were in bonds, with close to half of those holdings in foreign bonds, representing investments totalling JPY 72.8 trillion (approximately USD 470 billion). Bloomberg reported in January 2026 that speculation was growing around a potential GPIF portfolio shift toward now-attractive domestic JGBs, which would entail reducing its foreign bond allocation, notably U.S. Treasuries. As a trend-setter for other Japanese institutional investors, any GPIF rebalancing would have outsized signalling effects.

GPIF had already begun reducing its U.S. Treasury weighting, cutting it from 47% of foreign debt holdings to 35% in the fiscal year ending March 2025, a record reduction. While some of this was achieved by increasing European sovereign allocations rather than outright Treasury sales, the direction of travel is clear.

Life Insurance Companies: Japan's life insurers are among the most consequential holders of both domestic and foreign bonds, and they are currently experiencing acute balance sheet stress. Four of the country's largest life insurers, Nippon Life, Dai-ichi Life, Meiji Yasuda, and Sumitomo Life, reported combined unrealized losses on domestic bond holdings of approximately JPY 8.5 trillion (USD 60 billion) for the fiscal year ending March 2025, roughly four times the total a year earlier.

This stress is forcing a strategic retreat from foreign markets. Life insurers are liquidating holdings in U.S. and European debt to cover domestic obligations and pivot toward the now-attractive yields available at home. Japanese insurance companies have hedged only 46% of their foreign asset exposure, well below the 63% peak in 2020 and the 54% fifteen-year average, leaving them exposed to yen appreciation.

Japan's Financial Services Agency accelerated a scheduled review of major life insurers' balance sheets in January 2026, seeking details on unrealized securities losses, responses taken, and future investment plans. Separately, the Japanese Institute of Certified Public Accountants has proposed easing impairment accounting rules for life insurers' JGB holdings, a regulatory signal of systemic concern. Mid-size insurers have already stopped buying 30- and 40-year JGBs and are rotating toward shorter-duration instruments.

Megabanks: Japan's three megabanks, Mitsubishi UFJ Financial Group, Sumitomo Mitsui Financial Group, and Mizuho Financial Group, are in a comparatively stronger position. Their unrealized JGB losses in September 2025 accounts were small relative to profit forecasts (less than 9% for MUFG and Mizuho), and unrealized equity gains well offset potential bond losses. The megabanks benefit from rising rates through improved net interest margins on their lending books, making them net beneficiaries of normalizations in the near term.

The Yen Carry Trade: The yen carry trade, in which investors borrow in low-yielding yen and invest in higher-yielding foreign assets, represents the most opaque and potentially volatile component of the capital stack. Estimates of its size vary enormously depending on what is included:

Table 2: Yen Carry Trade Size Estimates

Measure	Estimated Size	Source
Japanese banks' foreign lending (narrow)	~USD 1 trillion	BIS (March 2024)
Yen forwards held by hedge funds/PTCs	JPY 35T (~USD 230B)	BCA Research (Oct 2025)
Yen-funded carry positions (broad)	~USD 4 trillion	BIS (Dec 2025)
Total FX forwards/swaps/currency swaps	JPY 2,281 trillion	BCA Research (Oct 2025)
Government balance sheet (extreme)	~USD 20 trillion	Deutsche Bank

Sources: BIS Quarterly Review; BCA Research; Deutsche Bank; Seeking Alpha. Estimates are not directly comparable owing to differing methodologies and definitions.

The August 2024 episode provided a preview of the risks. A 15-basis-point BoJ rate hike triggered a 12% yen appreciation in 48 hours, sent the VIX to 65, and erased approximately USD 2.5 trillion in global equity market capitalization in three trading days. BCA Research has argued that rising Japanese interest rates alone will not trigger the unwind; rather, falling prices of assets funded by yen borrowing will catalyze the reversal, as occurred in 2008, 2015, and 2020.

Retail Investors (Mrs. Watanabe): Japanese retail investors, colloquially known as Mrs. Watanabe, hold an estimated USD 400 billion in foreign securities purchased via carry strategies. This cohort is price-sensitive and tends to amplify institutional flows during periods of yen volatility, creating self-reinforcing dynamics in which retail selling strengthens the yen, triggering further selling.

REPATRIATION MECHANICS: HOW FAST CAN CAPITAL COME HOME?

The critical question for global bond markets is not whether Japanese capital will begin flowing home, but how quickly. The answer depends on institutional stickiness, regulatory constraints, and the evolution of the yield differential between JGBs and foreign sovereign debt.

The TIC Data: Slowing but Not Reversing: U.S. Treasury International Capital (TIC) data show that Japanese institutions continued purchasing U.S. Treasuries through October 2025, but at a markedly slower pace. Cumulative purchases for 2025 totalled approximately USD 45 billion year-to-date, compared with USD 180 billion for the full year 2024. The slowing pace suggests caution, but actual net selling has not yet begun. Consensus estimates suggest net selling could commence in the

second quarter of 2026 at the earliest, after the Japanese fiscal year begins on April 1, with meaningful sustained outflows potentially not materializing until late 2026 or 2027.

Institutional Friction: Several factors work against rapid repatriation. Japanese institutional investors tend to move slowly, constrained by internal governance, regulatory requirements, and the sheer size of their portfolios. JGB market liquidity, while improving, remains relatively low and volatile compared with U.S. Treasuries, which would limit the pace at which large institutions can redeploy capital domestically. New solvency rules taking effect in March 2026 add another layer of complexity, requiring insurers to account for mass lapse risks in their economic solvency ratios.

Schroders' global unconstrained fixed income fund manager James Ringer has characterized Japanese capital returning home as a risk that needs constant monitoring, while noting that JGB volatility remains relatively high and liquidity relatively low, conditions that would need to improve before any large repatriation flows materialize.

Scenario Analysis

Table 3: Repatriation Scenarios

Scenario	Probability	Flow Impact	UST Yield Effect
Gradual rotation	~55%	USD 2-4B/month selling	+5-10bps over 12 months
Moderate repatriation	~30%	USD 4-8B/month selling	+15-25bps over 12 months
Accelerated unwind	~15%	USD 50B+ in Q1 alone	+30-40bps compressed

Source: Omnigence analysis based on TMS Capital Research, Goldman Sachs cross-market analysis, and historical TIC flow data. Probabilities are illustrative.

The tail scenario, while carrying only an estimated 15% probability, would represent the largest quarterly foreign selling of U.S. Treasuries since 2022. It assumes the BoJ hikes by 50 basis points cumulatively by mid-2026, the 10-year JGB yield reaches 2.50%, and USD/JPY breaks below 150. Under this scenario, the combination of Japanese outflows, continued Chinese Treasury reduction (approximately USD 25 billion per year), and ECB quantitative tightening could produce a structural foreign demand deficit for U.S. Treasuries.

GLOBAL TRANSMISSION CHANNELS:

Japan's capital repatriation does not occur in isolation. It transmits through multiple channels simultaneously, amplifying the impact on global fixed income markets.

Direct Yield Pressure: Goldman Sachs' cross-market analysis suggests that every 10 basis points of JGB yield shock propagates approximately 2 to 3 basis points of pressure onto U.S. yields and other global sovereign markets. The January 2026 JGB sell-off, which saw 30-year yields rise approximately 30 basis points in a single session, was accompanied by a nearly 6-basis-point increase in the U.S. 10-year Treasury yield and pressure on the 30-year Treasury toward pre-2008 highs above 4.90%.

Carry Trade Reversal: The unwinding of yen-funded carry positions forces a reverse flow: investors who borrowed in cheap yen to fund investments in higher-yielding assets must liquidate those foreign positions to repay their yen liabilities as borrowing costs rise. This creates synchronized selling of U.S. Treasuries, European bonds, and emerging market debt precisely when risk appetite is fragile. The August 2024 episode demonstrated that this mechanism can produce outsized market dislocations, with correlations across asset classes spiking as carry positions are unwound simultaneously.

The Fiscal Doom Loop: Japan itself faces a fiscal doom loop that could accelerate the repricing. With gross government debt at approximately 235% of GDP, the highest in the developed world, even modest rate increases have outsized fiscal consequences. Each 25 basis point increase in the BoJ's policy rate adds an estimated JPY 10 trillion annually to government debt service costs. This arithmetic creates a perverse dynamic: the more the BoJ normalizes rates to address inflation, the more it strains the fiscal position, which in turn drives further bond selling, pushing yields higher, and increasing debt service costs further.

Prime Minister Takaichi's fiscal expansion compounds this loop. Her record budget and proposed food tax suspension are being funded by additional JGB issuance at precisely the moment when the BoJ is stepping back as a buyer. The resulting supply-demand imbalance is the fundamental driver of the January rebellion.

Emerging Market Contagion: The transmission extends beyond developed markets. As yen carry trade unwinding accelerates, foreign investors holding emerging market debt may liquidate to raise funds for repatriation or to meet margin calls. India has already experienced this dynamic, with the Nifty 50 declining sharply amid foreign institutional investor selling and rupee weakness. The pattern is likely to repeat across emerging markets with significant foreign portfolio investment, particularly those with current account deficits and limited foreign exchange reserves.

THE BOJ'S DILEMMA:

Governor Kazuo Ueda faces conflicting mandates that make the path forward extraordinarily narrow. Inflation has exceeded the BoJ's 2% target for four consecutive years, a structural break from decades of below-target readings. Wage growth, supported by the spring Shunto negotiations that delivered 5.25% increases in 2025, is embedding inflation expectations in a way that Japan has not experienced since the early 1990s. The IMF has explicitly urged the BoJ to continue raising interest rates, stating that it is appropriately withdrawing monetary accommodation.

Yet the BoJ must balance this imperative against several countervailing forces. Yen weakness, driven by the wide interest rate differential with other major economies, raises import costs for households and businesses. The BoJ's real policy rate remains the most negative in the world, suggesting that further normalization is warranted. Board member Hajime Takata proposed raising rates to 1% at the January 2026 meeting, though his motion was defeated.

Table 4: BoJ Rate Path Expectations

Forecast	Terminal Rate	Timeline
State Street (base case)	1.25%	One hike 2026, one 2027
State Street (yen stress)	1.50%	Two hikes 2026 if yen >160
EFG International	1.25-1.75%	End 2026 to end 2027
Oxford Economics	1.00%	One hike per year 2025-2026
IMF projection	~1.25%	Gradual hikes, neutral by 2027

Sources: State Street Global Advisors; EFG International; Oxford Economics; IMF Article IV (February 2026).

The political dimension adds further complexity. Takaichi, who won a snap election in February 2026, has historically opposed rate hikes, though she has softened her stance since taking office. The tension between her expansionary fiscal agenda and the BoJ's tightening cycle mirrors the fiscal-monetary collision that drove the January bond market rebellion. The IMF, in its February 2026 assessment, explicitly warned against loosening fiscal policy and called for the BoJ's continued independence and credibility.

WHAT THIS MEANS FOR GLOBAL RATES:

The lifting of the Japan anchor has implications that extend well beyond the JGB market. For a generation, Japanese capital provided a structural bid for sovereign debt worldwide, compressing yields and enabling governments to borrow at rates that would not have been sustainable on domestic demand alone. The reversal of this dynamic arrives at the worst possible time for the world's largest debtor nations.

The United States faces the most direct exposure. Japan's USD 1.2 trillion Treasury holding represents a critical pillar of U.S. debt financing. Even a gradual reduction in Japanese purchases, let alone net selling, would need to be absorbed by other buyers at a time when the federal deficit runs at approximately USD 2 trillion annually, China continues to reduce its Treasury holdings, and the Federal Reserve is engaged in quantitative tightening. The prospective loss of Japanese demand arrives precisely as the supply of Treasury issuance is at historic highs.

European sovereign markets face a similar, if less acute, dynamic. Japanese institutions are major holders of French, German, Italian, and UK government bonds. Any broad repatriation would withdraw demand from markets already contending with elevated issuance to fund defense spending increases and fiscal deficits. The knock-on effects include higher mortgage rates, increased corporate borrowing costs, and tighter financial conditions without any central bank action.

The structural conclusion is that the era of artificially suppressed global yields, in which central bank intervention and Japanese capital exports combined to maintain a low-rate environment, is giving way to a regime of market-determined pricing in which term premia, credit risk, and supply-demand dynamics reassert themselves. This is not a cyclical shift. It is a structural one, and it has implications for every asset class priced off the risk-free rate.

CONCLUSION:

The Bank of Japan's monetary normalizations is not a domestic policy adjustment. It is a systemic global event that alters funding costs, liquidity dynamics, and cross-border capital flows. The three-decade period during which Japanese capital suppressed global yields is ending, and the transition will be neither smooth nor painless.

The most probable outcome is a gradual repatriation of Japanese capital over a multi-year period, punctuated by episodes of acute volatility when institutional flows accelerate or carry trade positions unwind abruptly. The January 2026 bond rebellion was the first such episode. It will not be the last.

For institutional investors, the message is clear. Portfolios constructed on the assumption that sovereign yields would remain anchored by Japanese and central bank demand face a structural repricing risk. Duration exposure in fixed income carries embedded downside that has not been fully recognized. And asset classes that derive their valuations from discounted cash flow models benchmarked to risk-free rates must contend with a risk-free rate that is no longer artificially suppressed.

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