

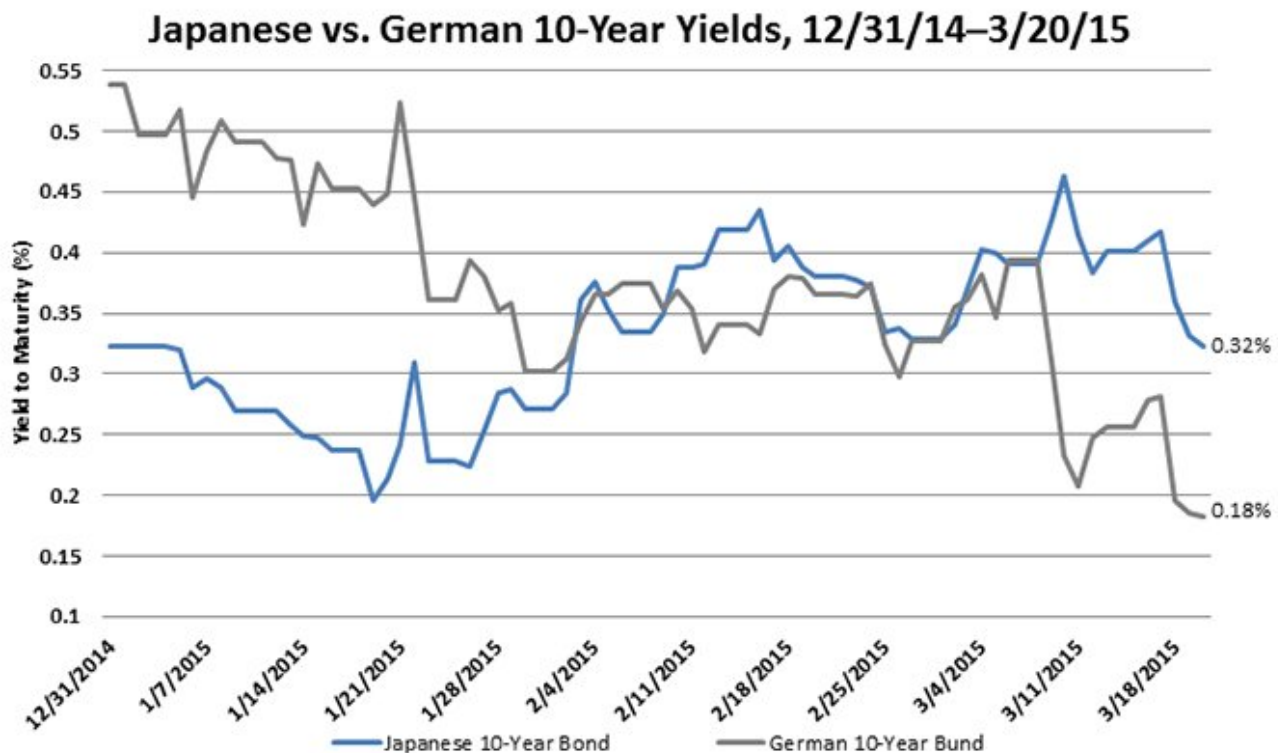
Japanese 10 Year Rates Double in 2015, Rise Above German Bunds

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In an [earlier blog post](#), WisdomTree's research team asked, "Is the euro the new yen?" While the focus of that piece was on the relationship between each country's equity and currency markets, another interesting development is occurring in the Japanese and German bond markets. Since reaching historic lows in mid-January, Japanese government bond (JGB) yields had doubled over the last several weeks before retracing.¹ In the process, they have eclipsed German 10-year bund yields for the first time in over 20 years. While we believe this recent development has several interesting implications, the most relevant one for investors focuses on what could be driving this trend. Quite simply, bond purchases by the Bank of Japan (BOJ) are currently the single most important determinant of Japanese bond yields. Should the BOJ decrease its preference for JGBs as the primary tool for affecting monetary policy in the coming months, bond yields may continue to rise. **Rising vs. Falling** While here we primarily focus on the Japanese side of the equation, changes in European policy have also had a significant impact on the markets. While yields have drifted higher in Japan, they have fallen in precipitously Germany. In our view, one of the primary reasons why the European Central Bank (ECB) is choosing to go down the path of quantitative easing is to hopefully avoid the "lost decades" that Japan has experienced since the 1990s: weak growth, deflation, wage stagnation and a mounting debt burden. However, while Japan has arguably had the most aggressive central bank over the last few years, it is also purchasing assets other than bonds. A perceived shift in preference and a meaningful uptick in inflation will likely be the primary contributors to a rise in JGB yields. **Japan Overtakes Europe**



Source: Bloomberg, as of 3/20/15. Past performance is not indicative of future results.

For definitions of terms in the chart, please visit our [glossary](#). As illustrated in the chart above, on February 3 the yield on the 10-year Japanese government bond was higher than the yield on the German 10-year bund for the first time in 20 years. The date stands out as it coincided with the announcement of tepid results for a 10-year JGB auction.² Auctions have been a preferred means of access for the BOJ, given that they allow it to put large amounts of money to work with minimal secondary market impact. In a few subsequent auctions, investors (including the BOJ) generally demanded a higher interest rate to buy JGBs. While auction demand has recently stabilized, a key takeaway may be that JGB volatility may be poised to rise. With yields still at very low levels and some critics wondering about the future sustainability of bond purchases, an attractively skewed trade could include a short position in JGBs along with a short position in the Japanese yen. ¹Source: Bloomberg, as of 3/20/15. ²Source: Bloomberg, 2/3/15.

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