

Journal of Economic Issues >

Volume 48, 2014 - [Issue 2](#)

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Understanding the Low Yields of the Long-Term Japanese Sovereign Debt

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Pages 331-340 | Published online: 07 Dec 2014

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🔗 <https://doi.org/10.2753/JEI0021-3624480206>



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Abstract

During the past two decades, chronic fiscal deficits have led to elevated and rising ratios of government debt to nominal GDP in Japan. Nevertheless, long-term Japanese government bonds' (JGBs) nominal yields initially declined, and have since stayed remarkably low and stable. This is contrary to the received wisdom which holds that higher government deficits and indebtedness will exert upward pressures on nominal yields. This paper examines the relationship between JGBs' nominal yields and short-term interest rates, as well as other factors, such as low inflation, persistent deflationary pressures, and tepid growth. We also argue that Japan has monetary sovereignty, which gives the Japanese government the ability to service its debt, and enables the Bank of Japan (BOJ) to keep JGBs' nominal yields low by ensuring that short-term interest rates are low, and by using various other tools of monetary policy. The

argument that short-term interest rates and monetary policy are the primarily drivers of long-term interest rates follows John Maynard Keynes's (1930) insights.

Keywords:

Japanese government bonds

long-term interest rates

monetary sovereignty

nominal bond yields

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