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Abstract

Despite the rise in public debt, Japanese Government Bond (JGB) yields have remained low and stable, supported by steady inflows from household and corporate sectors, high domestic ownership of JGBs, and safe-haven flows in light of ongoing European debt crisis. Nonetheless, the market capacity to absorb new government debt will likely decline over time as the population ages, posing risks for the JGB market. This paper examines the key risks of the JGB market, including a decline of private sector savings and potential spillovers from global financial distress, which could push up the government bond yields. A sharp rise in interest rate could pose challenges on public debt dynamics and financial stability in Japan. In that regard, more ambitious fiscal reforms to reduce public debt will help limit these risks.

The views presented here represent solely from the authors and should not be interpreted as the policy views by the International Monetary Fund.

Keywords: Fiscal sustainability ▪ sovereign risk ▪ government yields ▪ financial distress

JEL: E44, E60, E62