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Analysis of today
Assessment of tomorrow

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The Bank of Japan and the end of the era of cheap financing

The Bank of Japan's (BoJ) decision to raise its key short-term interest rate from 0.5% to 0.75% may seem modest compared to levels in the US or Europe.

In the Japanese context, however, it marks a turning point. This is the highest interest rate in Japan in the past thirty years.

The decision was unanimous, indicating that the central bank no longer sees inflation as a temporary disturbance but as a condition requiring a permanent change in monetary policy.

Most media will describe this as another step towards "normalisation" after decades of ultra-loose policies. That is true, but it is not the most important aspect.

The essence of this decision lies not in the 0.75% rate itself, but in the new combination of circumstances in Japan. The central bank is attempting to tighten monetary conditions gradually, while the political leadership signals higher public spending and a more ambitious fiscal policy.

In this environment, markets estimate that the rise in interest rates will not necessarily strengthen the currency, as the effect of monetary tightening is partly offset by expectations of increased government borrowing.

Japan's yen carry trade and its global impact

To understand the broader significance of this decision, one must consider Japan's role in the global financial system.

For more than two decades, Japan has been a source of extremely cheap yen funding. Low interest rates, a stable institutional framework, and a large government bond market have allowed investors to borrow in yen and invest those funds in higher-yielding assets elsewhere.

This mechanism, known as the carry trade (a strategy of borrowing in a low-interest currency to invest in higher-yielding instruments), has become a key part of global capital flows.

> The Bank of Japan's influence extends beyond its national role and directly shapes the dynamics of global financial markets

Any movement in Japanese interest rates therefore has an impact that extends far beyond the domestic market.

The Bank of Japan's decisions affect not only domestic borrowing costs but also investor behaviour worldwide. When a currency long used as a source of cheap financing begins to offer higher interest rates, strategies based on small differences in returns become riskier.

During periods of market volatility, this prompts rapid closing of positions and a return of capital to the yen, amplifying sudden price movements.

Thus, the Bank of Japan's influence extends beyond its national role and directly shapes the dynamics of global financial markets.

The political stakes behind the BoJ's rate move

Why is the BoJ tightening policy now? The basic reasoning is that inflation no longer appears to be a brief, imported episode but a sustained domestic trend.

According to the AP, inflation in November was about 3%, above the BoJ's 2% target, while Reuters and the FT note that the bank is seeking inflation sustainability supported by wage growth.

Hence the political significance of what seems a technical decision: the BoJ, which for decades defended growth with near-zero interest rates, now publicly signals its

readiness to shift to a regime where price stability is maintained through more expensive financing.

The market reaction shows this is not a routine decision. After the interest rate increase, the yen weakened to around 156.8 to the dollar instead of strengthening.

This suggests investors are currently focusing more on fiscal signals and political expectations than on the monetary move itself.

> As government bond yields increase, the cost of government borrowing rises and fiscal flexibility diminishes

At the same time, the yield on ten-year Japanese government bonds exceeded 2%, the highest level since 1999. For the domestic market, this marks a significant change, as it directly affects government borrowing costs and the balance sheets of banks, insurance companies, and pension funds.

The key issue is not just inflation but the relationship between monetary and fiscal policy in Japan. Public finances are large in scale and sensitive to rising yields.

As government bond yields increase, the cost of government borrowing rises and fiscal flexibility diminishes. Markets may doubt the consistent implementation of monetary tightening if political leaders simultaneously signal their readiness for increased public spending.

Under such conditions, the Bank of Japan's ability to continue raising interest rates depends on whether rising yields can be managed without destabilising the domestic bond market.

The end of permanently cheap yen?

For European readers, the most important question is not “Is 0.75% high?” but what this means for the global alignment of interest rates and capital flows in 2026.

If Japan continues to raise rates, the yield gap between Japanese, US, and European bonds will gradually narrow. This changes the behaviour of institutional investors.

Japanese capital, which has sought returns abroad for years, now finds a better alternative at home. In practice, this may mean less “automatic” demand for foreign bonds, different approaches to hedging currency risk, and greater sensitivity of global markets to political developments in Tokyo.

None of this is dramatic in a single day, but cumulatively it is significant.

> The consequences will become clearer through movements in the bond market

It is a mistake to reduce this decision to the simple headline that Japan has raised interest rates. It is an attempt to change the monetary regime in a system that, for decades, was based on the assumption of permanently cheap money.

Such changes are rarely smooth. It is already evident that the rise in interest rates has not led to a strengthening of the yen, indicating the market's doubts about the overall direction of economic policy.

In the coming months, the consequences will become clearer through movements in the bond market and through the adjustment of investors who have used the Japanese yen for years as a stable source of financing.

When the last safe zone of cheap financing closes

The Bank of Japan will, by all accounts, continue with the gradual tightening of

monetary policy, but in an environment where a return to the long-term regime of extremely low interest rates is increasingly difficult to justify.

When the yen ceases to support easy borrowing, the global financial system becomes stricter on debt, less tolerant of fiscal irresponsibility, and more sensitive to political decisions

The crucial question is no longer the inflation rate in a single quarter, but whether price growth is maintained at a stable level and is accompanied by permanent wage increases, rather than one-off shocks or temporary measures. Only in that case can the central bank claim to have left the deflationary regime.

At the same time, the growth of yields on government bonds increases pressure on public finances and makes fiscal decisions more politically sensitive.

In such circumstances, the Bank of Japan's further actions will depend equally on monetary indicators as well as on the government's ability to control public spending, as this relationship will determine the extent to which monetary tightening can proceed without destabilising the domestic bond market.

From a European perspective, this decision comes at a time when monetary policies around the world are once again diverging in pace, but not in direction. Almost all major central banks are moving towards more expensive money and a stricter attitude towards risk.

Japan has been an exception to this trend for years. Its exit from the ultra-loose policy regime means that the last major "safe zone" of cheap financing is closing.

When the yen also ceases to support easy borrowing, the global financial system becomes stricter on debt, less tolerant of fiscal irresponsibility, and more sensitive to political decisions.

That is why this is not just news about Japan. It is a signal of a change in the conditions under which the global economy will operate in the coming period.