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Letter from Tokyo (Last of a Series)

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“Rice supplies in Japan still low, with prices almost doubled since a year ago.” – Headline, Asia News Network.

Always attuned to market conditions on the ground, we heard from friends in Tokyo last week that, incredibly, grocery stores were out of rice. The impact of hot, wet weather and dealers hoarding product has sent rice prices soaring and supplies dwindling. A five-kilogram bag now costs ¥4,000, or about $28. In the US, a container twice as large goes for $10.99 at Stop & Shop. The Japanese government promised to release stockpiles of rice shortly to ease shortages.

Rice is not Japan’s only pain point these days. The yen depreciated 50% against the USD over the past four years in concert with the Fed’s rate hike to fight inflation. This costs the Japanese consumer more for imported food and energy, though supports tourism revenues. Recently this has reversed, with the USD depreciating by approximately 10% over the past four months. As tariff pressures build, the BOJ is more likely to pursue rate hikes to battle future inflation.

Elevated rates have created other challenges. Banks and other financial institutions are working to decrease the duration of their JPY-denominated bond holdings through swaps and hedging. This has not been the case with foreign fixed income portfolios. Rate hikes created significant unrealized losses on balance sheets related to those holdings. BoJ’s *Financial System Report* (April 2025 edition) estimates financial institutions hold ¥300 trillion in bonds (US$2 trillion); one-quarter are non-JPY.

Long-duration positions also prove a challenge for some institutional investors positioning portfolios for more private credit allocation. The benefits – hedge against higher rates, consistent income stream, premium yield for lower risk assets, and less correlation – are clearly recognized. Japanese investors have long experience in bank loans so understand private credit better than most. The bank selling bonds at a loss in part is making room for more direct lending exposure.

Another hurdle is currency hedging. The cost for Japanese investors of hedging JPY/USD risk is in the 4-4.25% range. For investment grade bonds, the medium-digit yields make that cost prohibitive. But with middle market yields at 10% or more, investors can absorb the hedging cost and still make a reasonable return.

Tariff-related concerns understandably have some investors taking a wait-and-see approach to continuing (or starting) to allocate to US private credit. But the longer-term trend is unmistakably towards more direct lending commitments.

From rice shortages to higher rates, markets in Japan are heating up. But as the sun rises on a new era of private credit, one thing is clear: the long game there has just begun. The question for Japanese investors is no longer whether to allocate to private credit — but how soon, and how much.