

Rising on Borrowed Tides: How Global Flows Shape Japan's Reflation

EBC Financial Group highlights how foreign inflows and yen-funded carry trades are sustaining Japan's rally, while policy risks could reverse momentum.

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/EINPresswire.com/ -- Japan's equity rally is frequently described as evidence of reflation, but the drivers tell a different story. According to [EBC Financial Group \(EBC\)](#), foreign investors have been the main force behind the surge in Japanese equities, while domestic institutions and households have been net sellers. At the same time, the yen carry trade remains a core source of global liquidity, channelling cheap Japanese funding into higher-yielding assets worldwide.



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Reflation in focus: Yen-funded carry flows are inflating global markets, with tech emerging as the biggest bubble risk.

David Barrett, CEO of EBC Financial Group (UK) Ltd, noted that the carry trade remains central to Japan's market dynamic. As he noted in The Japan Times, "Everybody's written about the carry trade, but they've not really written about the carry trade. It's broader, more complex and more convoluted than it's been sold."

Foreign vs Domestic Flows

Foreign investors have injected more than ¥3.5 trillion (US\$23 billion) into Japanese equities this year, driving the Nikkei and Topix to record highs. Domestic investors, however, have pulled money out—selling equities and reallocating into overseas assets. Household investors in particular remain cautious, with surveys showing limited conviction in the sustainability of the rally.

David Barrett noted that this divergence illustrates Japan's reliance on external demand: "The current rally looks less like homegrown reflation and more like foreign-funded optimism. Without

renewed participation from domestic institutions, the risk is that Japan's markets remain vulnerable to sudden changes in global sentiment."

Carry Trade Dynamics

The yen remains central to global liquidity. With the Bank of Japan (BoJ) holding its policy rate at 0.50% and the U.S. Federal Reserve above 5%, the yield gap continues to incentivise yen-funded trades. The dollar-yen pair has been defending the ¥146–148 range after rebounding from its August lows, underlining the persistence of funding pressure on the yen.

EBC analysts noted that the yen's weakness isn't just a currency story - it's the transmission channel for liquidity into global equities, tech, and emerging markets - traders need to watch not only BOJ policy but also U.S. tariff risks, which could shift yield expectations and spark volatility.

Fragile Foundations

The sustainability of both Japan's reflation rally and the global carry trade rests on uncertain ground. Much depends on global rather than domestic conviction. Japanese institutions have increased capital outflows into U.S. Treasuries and European bonds, rather than doubling down on local equities. At the same time, global investors are positioning for a turn in yen strategy, anticipating policy divergence that could eventually strengthen the currency.

Analysts at EBC say that this leaves both the equity rally and the carry trade exposed. A surprise tightening from the Bank of Japan, or a U.S. policy shift that narrows rate differentials, could reverse flows sharply, forcing an unwind of carry positions and weighing on risk assets globally.

David Barrett added:

"Japan's reflation rally is being driven primarily by foreign inflows and supported by yen-funded liquidity. Until domestic investors re-engage, the foundation remains fragile. Any shift in policy or sentiment could reverse flows quickly, with consequences extending beyond Japan's borders."

Trader Implications

EBC analysts underscore that the key variables to monitor are central bank policy and currency dynamics. Any shift in the Bank of Japan's stance—particularly around yield curve control or policy rates—would have immediate consequences for the carry trade. U.S. developments matter just as much: Federal Reserve guidance and tariff-related policy shifts could alter yield differentials and global risk appetite.

In FX markets, EBC analysts suggest that the USD/JPY pair remains a critical barometer; moves around the ¥146–148 range may test the Bank of Japan's tolerance for weakness and increase the risk of intervention. Together, these factors will determine whether Japan's foreign-funded

reflation can be sustained or whether it proves to be another liquidity-driven upswing vulnerable to reversal.

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