

FX Viewpoint Flash

Currencies
Global

JPY: Takaichi-san wins the LDP election

- ◆ Elected new LDP president, Sanae Takaichi, is set to become Japan's next PM
- ◆ The JPY has weakened as markets digest the policy impact of a Takaichi victory...
- ◆ ...but we still see room for a JPY recovery; USD-JPY is likely to fall modestly with a narrowing yield differential

Japan's ruling Liberal Democratic Party (LDP) selected Sanae Takaichi, 64, as its new leader on 4 October (Saturday). She is thus likely to become Japan's next prime minister (PM) at the head of a coalition government in a parliamentary vote in mid-October.

The JPY opened weaker today (Monday 6 October), with USD-JPY increasing c1.5% to 149.7 (*Bloomberg*, 6 October at 09:00 am HKT). Heading into this LDP leadership contest, we believed **it would be unlikely any Japanese leader would follow policies to weaken the JPY**, as the economic reality is that a weaker JPY will further exacerbate cost of living issues. This line of reasoning still resonates with us when Takaichi noted in her victory speech that it is important to control (cost-push) inflation.

Japan's likely new PM has expressed dovish views on monetary policy. However, **our economists think that the Bank of Japan (BoJ) is likely to raise its policy rate to 0.75% at its 30 October meeting**. Markets are now pricing in a c20% chance of a BoJ hike in October, and a c50% chance of this happening in December (*Bloomberg*, 6 October). USD-JPY is likely to be sensitive to the potential for an indecisive Bank of Japan (BoJ) and pro-easing voices coming back into the frame but could decline amid a dovish pivot of the Federal Reserve (Fed).

The JPY is also most likely to be sensitive to Takaichi's shaping of the FY26 budget in the coming months. **Takaichi has in the past supported expansionary monetary and fiscal policies**, being an advocate of the reflationary policies of former Prime Minister Shinzo Abe. Depending on coalition discussions, her election therefore likely portends looser fiscal policy, though it is not clear whether she will agree to opposition demands for a lower sales tax (beyond groceries). Instead, she has advocated cash handouts and tax rebates to lower income households (*Bloomberg*, 5 October). The coming days will be important to gauge her policies and from other potential members in her likely cabinet.

However, **a near-term factor that could help suppress USD-JPY comes down to the ongoing US federal government shutdown**. The USD has tended to drift slightly lower during previous shutdowns. Other offsetting factors that should put a lid on USD-JPY include **the risk of FX intervention** if USD-JPY rises above the 150 big figure. In addition, narrowing yield differentials between the US and Japan, as well as a rising domestic equity market, among others, could eventually reduce net portfolio outflows from Japan.

Our base case is that **USD-JPY can still fall modestly with a narrowing yield differential**. But given the domestic policy uncertainty, the balance of risk is tilting to a slower convergence.

If elected PM, Takaichi would become Japan's first female leader

The JPY weakened when digesting the policy impact of a Takaichi victory

Pro-BoJ easing voices coming back into the frame could weigh on the JPY

There could be heightened JPY sensitivity to Takaichi's shaping of the FY26 budget

But there are limits to how high USD-JPY could go

We still see room for a JPY recovery

Disclosure appendix

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