

FX Viewpoint Flash

Currencies
Global

JPY: Takaichi wins an overwhelming supermajority

- ◆ Weakened opposition now holds less sway over fiscal policy in Japan
- ◆ FX intervention warnings could buy time to strengthen credibility and ease political and fiscal risks
- ◆ USD-JPY is likely to remain choppy and elevated in 1H26, before moderating more sustainably in 2H26

Following Japan's Prime Minister Sanae Takaichi's surge in approval ratings, **the Liberal Democratic Party (LDP) has secured a historic 316 out of 465 seats in the Lower House by itself, granting a two-thirds supermajority.** This outcome enables the LDP to override decisions made by the opposition-controlled Upper House. Given the large victory, in our economists' view, **Takaichi now faces less pressure to accommodate her junior coalition partner or the opposition** when it comes to the proposed consumption tax cut on food or other fiscal measures.

For the JPY, Prime Minister Takaichi's strong mandate presents both opportunities and challenges. While some market participants anticipate that this mandate could reinforce the Prime Minister's "reflationary" policy stance, others suggest that reduced political compromise may result in greater fiscal discipline. At present, **there remains uncertainty regarding potential changes to fiscal spending, funding strategies, monetary policy, and foreign policy** following the election.

With USD-JPY trading near the intervention zone of 158-162 during April-July 2024, the immediate focus for the FX market is **whether Japan's Ministry of Finance (MoF) will engage in verbal intervention** as assertively as it did in January, and **whether the prospect of coordinated intervention with US authorities will be highlighted** once again.

While FX intervention does not resolve underlying concerns about Japan's fiscal sustainability, it could prompt some market participants to temporarily close short JPY positions to mitigate volatility. **Such intervention can also provide time for the government to implement measures**, such as tax adjustments to Nippon individual savings accounts (favouring domestic assets), regulatory measures or incentives for pension funds and insurers to increase FX hedging or shift towards domestic assets, and potential rate hikes by the Bank of Japan (BoJ), and more disciplined fiscal policy.

A sustained recovery in the JPY is likely to require a more proactive BoJ, clear evidence of fiscal discipline, and supportive capital flow measures. However, **the JPY could still strengthen if external factors deteriorate**, such as a sharp decline in US real yields, increased US fiscal risks, or a severe global economic shock prompting major central banks to cut rates. Overall, we expect **USD-JPY to remain choppy but elevated over the near term, before moderating in a more sustained way in 2H26.**

Our economists continue to **forecast a single 25bp rate hike by the BoJ in July**, though the risk of earlier or additional hikes is increasing, given ongoing JPY weakness and the likelihood of continued fiscal expansion under the new administration.

The LDP's supermajority enables it to override Upper House decisions

Takaichi's strong mandate brings both opportunities and risks for the JPY

FX markets are watching for potential MoF and US-Japan intervention signals

FX intervention offers only temporary relief from fiscal sustainability concerns

A lasting JPY recovery requires proactive BoJ action and fiscal discipline

The BoJ is likely to raise rates in July, with further hikes increasingly possible

Disclosure appendix

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