Japan Event Flash

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Risk of Yen Appreciation Decreased Under the Takaichi Administration

Against the backdrop of divergent monetary policy between Japan and the U.S. (the Fed cutting rates while the BOJ raises them), the dollar-yen exchange rate is currently trending weaker at around the low 150 yen level, contrary to the market consensus expecting further yen appreciation and dollar depreciation (Exhibit 1). Although the yield spread between Japanese and U.S. 5-year bonds is narrowing due to the divergence in monetary policy direction, the dollar-yen rate has moved in the opposite direction and risen. Following the formation of the Takaichi administration in October and the subsequent sharp yen depreciation, domestic and international financial institutions have successively revised their dollar-yen forecasts toward a weaker yen and stronger dollar. Has the risk of yen appreciation truly diminished under the Takaichi administration? We will examine the outlook for the dollar-yen exchange rate.

The author had also anticipated a gradual decline in USD/JPY (yen appreciation/dollar depreciation) due to the divergence in monetary policy direction between Japan and the US. However, following the inauguration formation of the Takaichi administration in October, this forecast was revised to expect USD/JPY to continue trading within a range centred around the low 150 yen level. Unless the risk scenario materializes where the U.S. falls into recession and the Fed significantly cuts rates, a sharp plunge in the dollar-yen rate is likely to be avoided. The dollar-yen rate should remain resilient for the following reasons.

(1) The high probability that a “loose monetary policy + expansionary fiscal policy” will be implemented under the Takaichi administration

The USD/JPY market had already priced in the prospect of the Bank of Japan raising rates to around 1.5% while the Fed would cut rates to around 3%, leading to reduced sensitivity to the US-Japan interest rate differential. Against this backdrop, the recent rise in USD/JPY appears driven by growing awareness of the possibility that the Bank of Japan may be unable to raise rates as much as anticipated, and that the Fed may be unable to cut rates as much as expected. Given Prime Minister Takaichi's previous opposition to BOJ rate hikes, the likelihood of the BOJ pursuing aggressive rate hikes has diminished. Recently, senior Fed officials have also softened their tone regarding rate cuts after December due to inflation concerns, increasing the possibility that the Fed may not cut rates as much as anticipated.

Furthermore, expectations are growing that the Takaichi administration will pursue expansionary fiscal policy. During the House of Representatives Budget Committee on November 7th, Prime Minister Takaichi stated that she is considering revising the approach to achieving a primary balance (PB) surplus, moving away from the single-year target and instead focusing on confirming balance over a multi-year period. Moreover, reports indicate a succession of appointments of reflationists or proponents of active fiscal policy to private-sector seats on the Council for Economic and Fiscal Policy. Prime Minister Takaichi likely aims for a significant expansion of near-term economic measures. Under the Takaichi administration, the likelihood of implementing “accommodative monetary policy + expansionary fiscal policy” is high, suggesting yen depreciation pressure is likely to persist.

(2) Japanese Households Increasing Investment in Overseas Assets

Since 2024, Japanese households have been actively increasing their investment in overseas assets, driven by the introduction of the new NISA (a system allowing tax-free capital gains on stocks and other assets for individual investors) (Exhibit 2). Japanese household investment in investment trusts (primarily invested in overseas securities) and overseas securities reached ¥11.6 trillion in 2024, more than triple the ¥3.2 trillion in 2023 and exceeding it by over ¥8 trillion. As inflation becomes entrenched in Japan, households are likely to actively increase investments in overseas assets to avoid erosion of asset value. Consequently, downward pressure on the yen is expected to persist.

(3) Japan's digital deficit is widening

The digital balance consists of three categories: the “telecommunications, computer, and information services” (including cloud services), the “professional and management consulting services” (including online advertising), and the “royalties and similar payments” (including video and music streaming). In recent years, against a backdrop of increasing dependence on overseas big tech companies, it has resulted in a massive deficit. Japan's digital deficit (the excess amount paid by Japanese companies and individuals for overseas IT services) has been expanding, rising from approximately ¥2 trillion in 2014 to about ¥6 trillion in 2024 (Exhibit 3). While domestic digital services lack competitiveness and fail to generate sufficient revenue overseas, dependence on foreign big tech companies is expected to grow even further. If Japanese companies further leverage AI developed primarily by US firms, Japan's digital deficit will widen. This increased payment to overseas Big Tech companies (selling yen to buy dollars) is expected to maintain downward pressure on the yen.

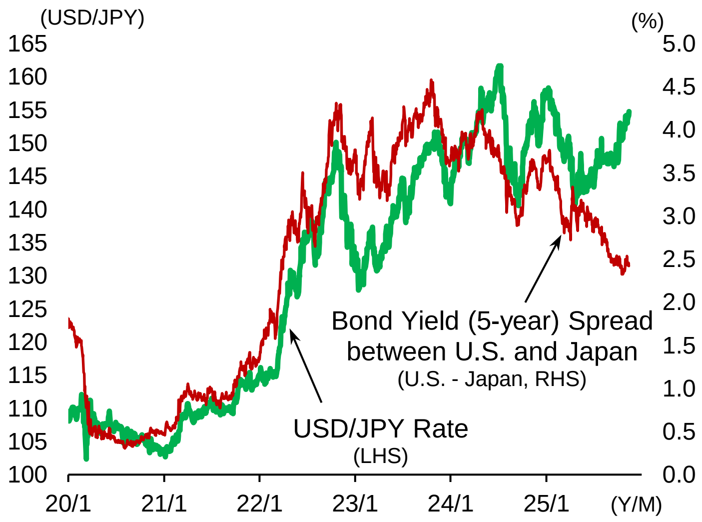
(4) The appeal of yen carry trades is relatively high

Against the backdrop of diverging monetary policy directions between Japan and the US (with the Fed cutting rates while the BOJ raises them), the US-Japan interest rate differential is gradually narrowing. Consequently, the appeal of yen carry trades (borrowing low-interest yen to invest in high-interest dollars and profit from the spread) has peaked. The carry risk ratio (3-month interest rate differential / implied volatility), which indicates the attractiveness of yen carry trades, has declined from around 0.7 in February 2024 to 0.39 as of November 7, 2025 (Exhibit 4). However, viewed within the range observed since 2000, the current carry risk ratio still remains at a relatively high level. While the U.S. economy shows resilience, concerns about renewed inflation suggest the Fed has limited room for further rate cuts (with rate cuts ending in December 2025). Meanwhile, under the Takaichi administration, which favours accommodative monetary policy, the Bank of Japan's room for rate hikes is also limited. Therefore, the carry risk ratio is expected to remain relatively high as long as implied volatility stays low (Exhibit 5). In other words, the appeal of yen carry trades is likely to remain substantial. Although the author assumes the Bank of Japan will raise rates to 1%, the fact remains that Japan still has the second-lowest interest rates after Switzerland when viewed relatively. Looking at the dollar-yen risk reversal (the spread between implied volatility of yen puts and yen calls), the strengthening view of a weaker yen under the Takaichi administration suggests yen carry trades will likely continue to a considerable extent (Exhibit 6). Such yen carry trades are considered a supportive factor for the dollar-yen rate.

While these factors suggest persistent downward pressure on the yen, concerns over potential currency intervention have intensified following Finance Minister Katayama's remarks cautioning against yen weakness Therefore, we do not anticipate USD/JPY rising to 160 yen. We expect USD/JPY to continue trading in a range centred around the low 150 yen level.

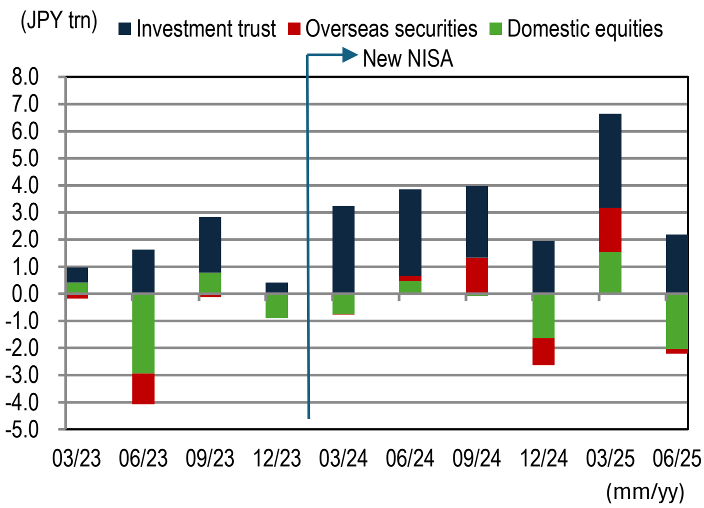
Following the upward revision to the USD/JPY outlook, corporate earnings, particularly in the manufacturing sector, are likely to be revised upward going forward. According to the Tankan survey (September 2025), large manufacturing firms' assumed exchange rate for FY2025 is 145.61 yen (145.89 yen for the first half, 145.33 yen for the second half), reflecting a significantly stronger yen and weaker dollar assumption than current levels. For the second half of FY2025, we also want to focus on stocks benefiting from a weaker yen.

Exhibit 1: USD/JPY and the Japan-U.S. Rate Spread



Source: Bloomberg, MUFG: Trust Bank

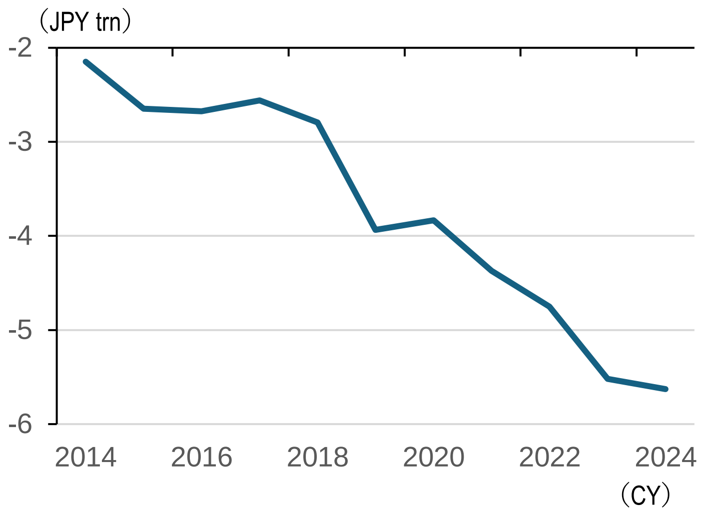
Exhibit 2: Japanese Household Investments



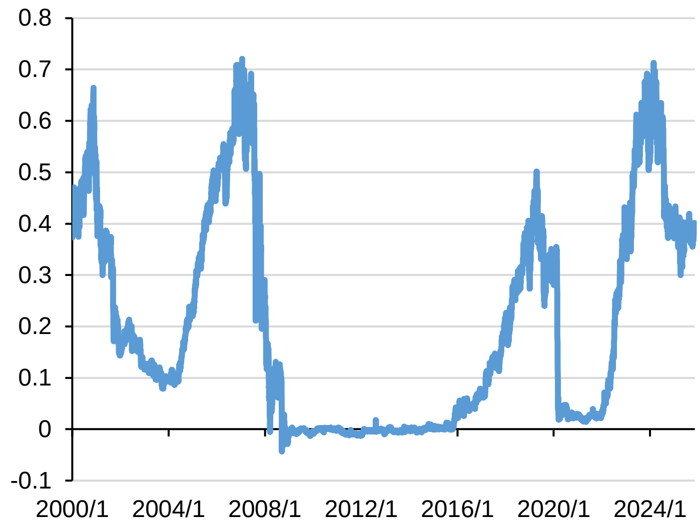
Source: BOJ, MUFG: Trust Bank

Exhibit 4: USD/JPY Carry Risk Ratio

Exhibit 3: Japan's Digital Deficit



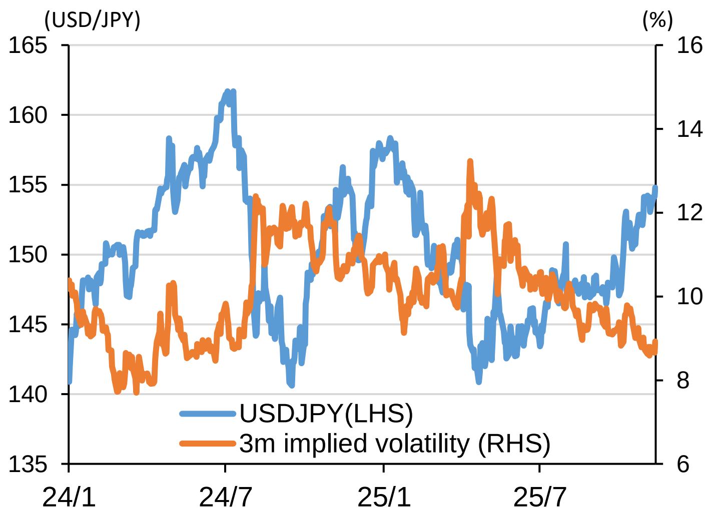
Source: BOJ, MUFG: Trust Bank



Source: Bloomberg, MUFG: Trust Bank

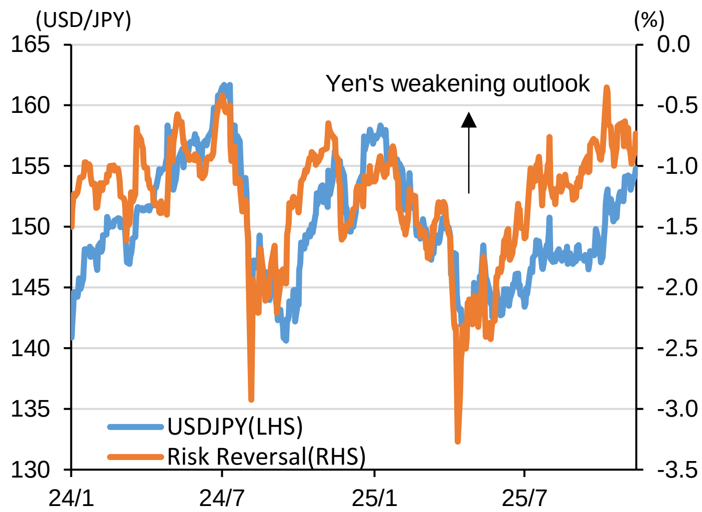
Note: Carry Risk Ratio = 3-Month Rate Spread / Implied Volatility

Exhibit 5: USD/JPY and 3-month implied volatility



Source: Bloomberg, MUFG: Trust Bank

Exhibit 6: USD/JPY and Risk Reversal (3-month)



Source: Bloomberg, MUFG: Trust Bank

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