

FX & Rates Focus

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Market implications of Japan LDP election results

USDJPY movements are not purely a reflection of JPY dynamics, but also a broader function of USD, UST yields and carry trade dynamics. Given the uncertainties, USDJPY may still trade with a bid tone in the interim unless USD falls in a significant way or if the BoJ signals a rate hike earlier. Elsewhere, MoF rhetoric is also a key consideration, with regards to the volatility and level of USDJPY.

JPY OIS pared back rate hike expectation. Our base-case is for a 25bp hike before year-end, and another 25bp hike in H1-2026, which will then bring BoJ Target rate to 1.00%. The JGB curve steepened as a response. Long-end bond/swap spreads went deeper into negative, reflecting the risk premium required by investors.

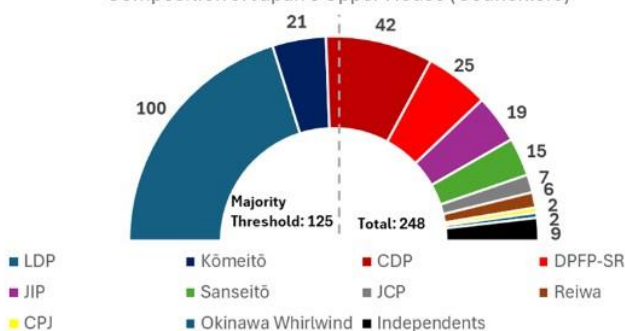
LDP leader awaits parliamentary confirmation

Sanae Takaichi was elected as the leader at the LDP election on 4 Oct, in a run-off vote after none of the 5 candidates won a majority in the first round. The second-round run-off between the top 2 candidates then saw Takaichi came out top with 185 votes (149 from LDP members in the Diet and 36 prefectural votes) while Shinjiro Koizumi garnered 156 votes (145 from LDP members in the Diet and 11 from the prefectures).

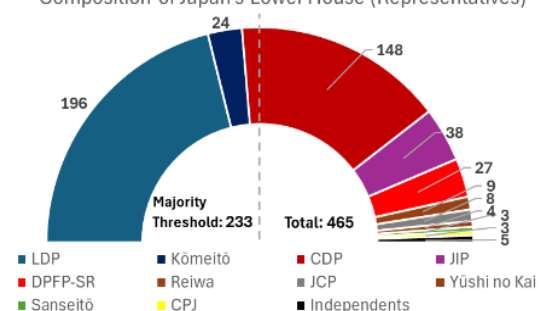
She is expected to be appointed the next PM after the vote in parliament, scheduled on 15 Oct. But it may not be as assured like in the past as the LDP-led coalition no longer commands a majority in either house and will likely require support from the smaller opposition parties.

Both lower and upper houses of the parliament will vote on its choice of PM and a simple majority rule is sufficient. However, in the event, the 2 chambers disagree on the candidate, then the lower house's choice prevails, as seen in 2008 when the lower house (LDP-led) chose Taro Aso while the upper house supported Ichiro Ozawa.

Composition of Japan's Upper House (Councillors)



Composition of Japan's Lower House (Representatives)



Source: The House of Councillors*, The House of Representatives^

Note: Last updated as of *5 Oct 2025 and ^18 Sep 2025 respectively

Frances Cheung, CFA

FX and Rates Strategy

FrancesCheung@ocbc.com

Christopher Wong

FX and Rates Strategy

ChristopherWong@ocbc.com

With assistance from

Wan Tze Yuen

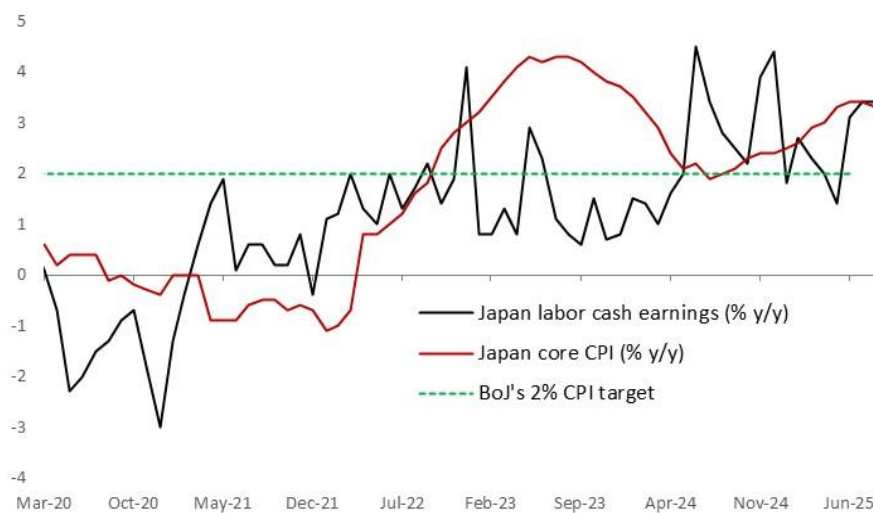
JPY may still trade on the back foot

PM-to-be Takaichi was vocal against BoJ hiking rates last year, and on winning the race over the weekend, she made it clear that the government will take the lead in setting fiscal and monetary policy, and that her priority is to reflate demand and the broader economy.

She is a strong advocate of Abenomics and Abe's 3 arrows were 1) government spending to boost demand and consumption; 2) structural reforms and 3) aggressive monetary policy involving low interest rates, leading to weaker JPY. There are concerns that her appointment could delay BoJ policy normalisation, and that BoJ may again hold rates steady at the 30 Oct BoJ meeting.

The concern maybe valid but at the same time, the macro-economic conditions today vs. the macro conditions during former PM Abe's era are different. During those days, Japan was fighting deflation but today, inflation is already running above 2% target for more than several months. A gradual pace of BoJ normalisation is still plausible given that rate remains relatively low and the conditions - wage growth, broadening services inflation and upbeat economic activities - remain appropriate for policy normalisation.

Price, wage pressures remain



Source: Bloomberg, OCBC Research

But going forward, we need to monitor how her proposed policies will be executed and if they will be toned down or if BoJ policy bias may be affected. A pushback against her proposed policies may help to moderate the pace of the upmove or even see the pair turn lower. Elsewhere, it is also worth keeping a look out on cabinet reshuffling, budget and trade policy. In particular, she earlier indicated that she wanted to review the US trade deal especially the \$550 billion Japanese investment fund.

Not just the JPY but also the USD

USDJPY movements are not purely a reflection of JPY dynamics, but also a broader function of USD, UST yields and carry trade dynamics. Factors such as the pace of Fed easing, Fedspeaks, US data surprises, and the length of US government shutdown can feed into UST yields, USD and by extension, influence USDJPY behaviour.

Still positive correlation between USDJPY and DXY

USDJPY-DXY Correlation (30D rolling)



Source: Bloomberg, OCBC Research

US government shutdown, triggered by repeated impasses over budget appropriations and debt ceiling debates, injects another layer of uncertainty into the near-term outlook for USD and USDJPY. Broadly speaking, past episodes of shutdown have coincided with safe-haven demand and a dip in USD but not all government shutdowns are the same. Some shutdowns are longer like the last one in 2018 over 2019 while other shutdowns were shorter – like 3 days in early 2018. The duration of the shutdown and the impact on asset classes can also vary. The last shutdown in 2018 crossing over to 2019 (during Trump presidency 1.0) was one of the longest (over 30days) in modern history. And during that period, USDJPY was down 1.5% and DXY was down over 1%.

US shutdown also has implications on USD, UST yields

Past incidents of US Government Shutdown	Days	2Y UST yield (bps)			USDJPY (%)			DXY (%)		
		Ts-3 days*	During	Td+3 days*	Ts-3 days*	During	Td+3 days*	Ts-3 days*	During	Td+3 days*
Dec 2018	35	-0.50	-3.26	-9.82	-1.16%	-1.50%	-0.47%	-0.15%	-1.20%	-0.47%
Jan 2018	3	5.05	-0.39	1.15	0.29%	0.14%	-1.36%	0.20%	-0.19%	-1.12%
Sep 2013	16	-2.34	-0.21	-1.97	-0.16%	0.54%	-0.59%	-0.14%	0.23%	-0.96%
Dec 1995	21	-0.90	-20.80	6.70	0.27%	3.93%	-0.56%	-0.35%	0.20%	-0.18%
Nov 1995	5	-0.10	-7.90	6.70	-0.64%	1.29%	-1.27%	0.06%	-0.08%	-0.27%
Average		0.24	-6.51	0.55	-0.28%	0.88%	-0.85%	-0.08%	-0.21%	-0.60%

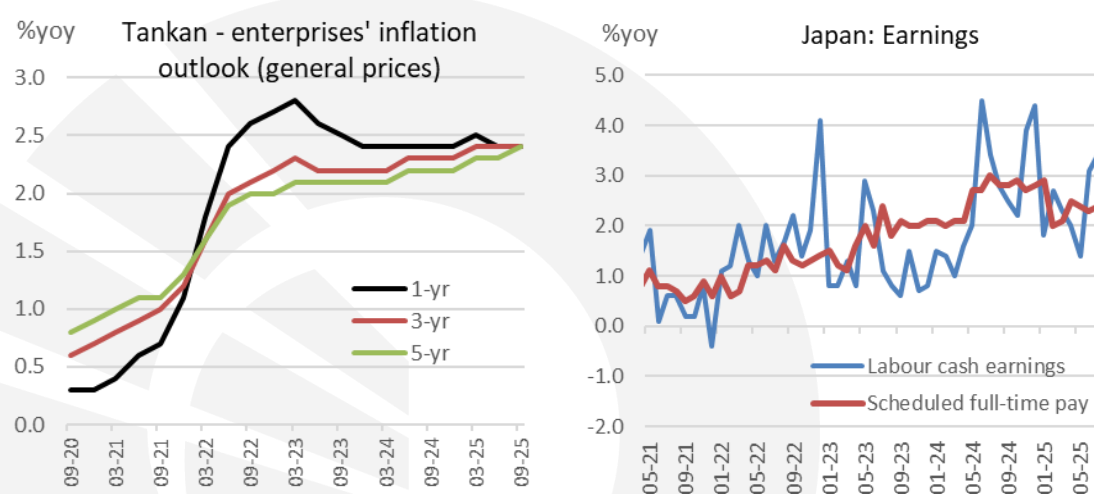
*Ts represents the start date of government shutdown, Td represents the end date of government shutdown. Source: Bloomberg, OCBC Research

BoJ policy rate outlook

Market pared back BoJ rate hike expectation after weekend's LDP election. JPY OIS pricing fell to 11bps of hike by year end earlier on Monday morning and was last at 13bps; these compared to as much as 21bps priced last week. Our base-case has been for a 25bp hike before year-end, with the October meeting presenting a window of opportunity for the BoJ to deliver this expected hike.

BoJ has maintained the stance that "if its outlook for economic activity and prices will be realised, the Bank, in accordance with improvement in economic activity and prices, will continue to raise the policy interest rate and adjust the degree of monetary accommodation". In the Summary of Opinions for the September Monetary Policy Meeting, BoJ said "judging solely from the perspective of Japan's economic conditions, it may be time to consider raising the policy interest rate again". What had hindered a rate hike, as we read, were the high uncertainties on trade policy, the outlook of US monetary policy, and a rate hike not being in the price; "a policy interest rate hike at this point, which would come as a surprise to the market, should be avoided".

On balance, continued policy normalisation remains on the agenda, but with the risk that the next rate hike will be further delayed. Our base-case has been for a 25bp hike before year-end. Thereafter, we have pencilled in another 25bp hike in H1-2026 which will bring BoJ Target rate to 1.00%. Real interest rates are low compared to major economies, while BoJ opined the impact of previous hikes "on Japan's economy as a whole has been extremely limited". On the data, September Tokyo CPI printed softer than expected, at 2.5% across headline, core and core core readings. There are slew of data releases to watch before October meeting, including August labour cash earnings, September PPI and CPI. Prospect remains for sustained wage growth with pass-through onto prices.



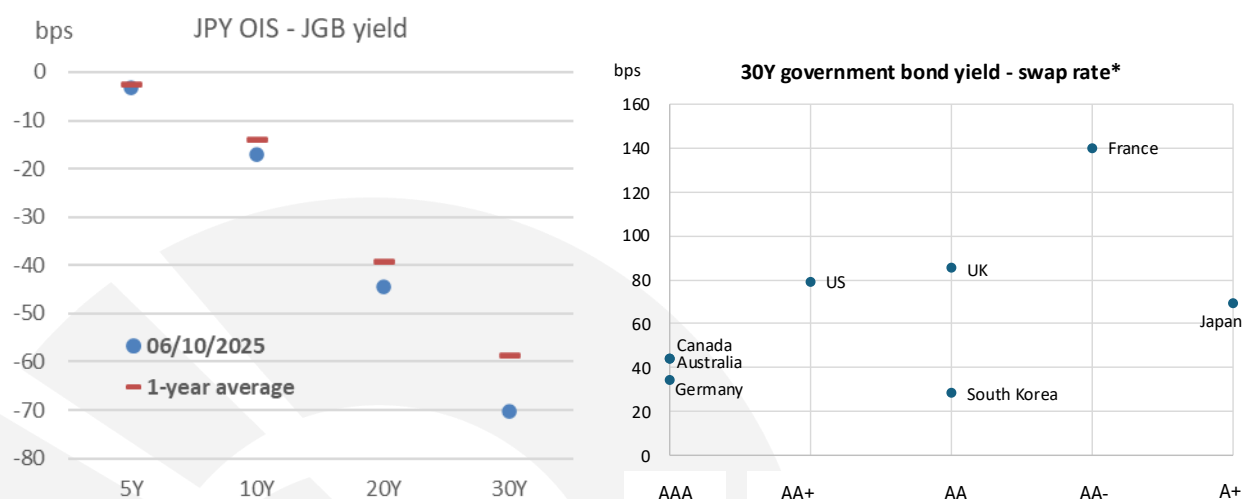
Source: Bloomberg, OCBC Research

JGB curve steepened

Perceived lower chance of a hike before year end, together with Takaichi's stimulus stance, is exerting a steepening pressure on the JGB curve as initial market reaction. While long-end bond/swap spreads may start to look supportive of bonds, fiscal uncertainty is still likely to keep the risk premium on the high side.

30Y bond/swap spread (JPY OIS – JGB yield) fell to -70bps this morning, compared to one-year average of -59bps. Bond/swap spreads are more negative further out the curve, reflecting the risk premium that investors required for fiscal concerns. LDP Leader Takaichi has mentioned she would ensure her active fiscal policy is “responsible”, but fiscal uncertainty may keep the risk premium on the high side. That said, 30Y bond/swap spread at -70bps may start to look supportive of the bond domestically, potentially meaning the initial reaction is done. Immediate support for 30Y JGB is at the recent high of 3.28%. For foreign investors, pick-up at long-end JGBs is still not particularly attractive; on bond/swap spread, it was lower at -80bps for 30Y USTs versus -70bps for 30Y JGBs while USTs are on a higher credit rating; asset swap pick-up was last at around SOFR+58bps at 30Y JGB. Nevertheless, the pick-up has improved over the past months and long-end JGBs are viable alternatives for portfolio diversification. This might explain the small spillover onto UST market in terms of the steepening move.

Comparing bond/swap spreads



Source: Bloomberg, OCBC Research

*3 Oct close, except for Japan which incorporated 6 Oct reaction

USDJPY Technical Outlook

USDJPY gapped higher in the open this morning. Pair was last at 150.10 levels. Daily momentum showed tentative signs of turning mild bullish while RSI rose. Golden cross appears to be in the making, where 50 DMA cuts 200 DMA to the upside. Risks skewed to the upside in the interim.

Resistance at 150.90 levels (Jul high), 151.70 (61.8% fibo retracement of 2025 high to low) and 152.50 levels. Support at 148.30 (200 DMA), 147.80 (21, 50 DMAs) and 146.50 (100 DMA).

Given the uncertainties, USDJPY may still trade with a bid tone in the interim unless USD falls in a significant way or if the BoJ signals a rate hike earlier. Elsewhere, MoF rhetoric is also a key consideration, with regards to the volatility and level of USDJPY. To some extent, 150 may have been an unspoken *line in the sand* for topside resistance, but this may have been shifted out. In previous episodes when USDJPY's move was rapid and/or the level was around 150, there were Finance Ministry officials voicing concerns. For example, in early Aug-2025, when USDJPY breached 150, Finance Minister Kato said that *the Japanese government is deeply concerned about movements in the FX market, including those driven by speculation*. But this time round, we have yet to hear such rhetoric, yet – which may suggest that the threshold could be shifted higher, though the magnitude of the move is also a key consideration. We would continue to watch out for any verbal intervention should USDJPY move become disorderly as that may help to put an interim cap on the pair.

USDJPY (Daily chart): Upticks



JPY Currency (Japanese Yen Spot) Candle Chart Daily 07OCT2022-06OCT2025

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Source: Bloomberg, OCBC Research

Macro Research

Selena Ling
Head of Research & Strategy
lingssselena@ocbc.com

Herbert Wong
Hong Kong & Taiwan Economist
herberhtwong@ocbc.com

Jonathan Ng
ASEAN Economist
jonathanng4@ocbc.com

Tommy Xie Dongming
Head of Asia Macro Research
xied@ocbc.com

Lavanya Venkateswaran
Senior ASEAN Economist
lavanyavenkateswaran@ocbc.com

Ong Shu Yi
ESG Analyst
shuyiong1@ocbc.com

Keung Ching (Cindy)
Hong Kong & Macau Economist
cindyckeung@ocbc.com

Ahmad A Enver
ASEAN Economist
ahmad.enver@ocbc.com

FX/Rates Strategy

Frances Cheung, CFA
Head of FX & Rates Strategy
francescheung@ocbc.com

Christopher Wong
FX Strategist
christopherwong@ocbc.com

Credit Research

Andrew Wong
Head of Credit Research
wongvkam@ocbc.com

Ezien Hoo, CFA
Credit Research Analyst
ezienhoo@ocbc.com

Wong Hong Wei, CFA
Credit Research Analyst
wonghongwei@ocbc.com

Chin Meng Tee, CFA
Credit Research Analyst
mengteechin@ocbc.com

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