Currency and Bonds Market View:

Yen and JGB Market Outlook after the Lower House Election

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The results of the House of Representatives election held on October 27 revealed that the ruling coalition (Liberal Democratic Party and junior coalition ally Komeito) failed to secure a simple majority of seats. On October 28, the foreign exchange market has seen the yen depreciate to around the high 153 yen per dollar level, while yen interest rates have risen, particularly for ultra-long-term maturities.

Regarding the prospects for the yen and Japanese government bond markets following the election results, our broad outlook is as follows:

- In terms of the exchange rate impact, we expect short-term pressure for the yen to depreciate. Since the ruling coalition failed to achieve a majority, the Liberal Democratic Party (LDP) will need to collaborate with opposition parties to pass the supplementary budget for fiscal year 2024 and the budget for fiscal year 2025. The LDP is most likely to seek support from the Democratic Party for the People and the Japan Innovation Party, both of which advocate for expansionary fiscal policies such as tax cuts. It is therefore possible that any upcoming economic measures could incorporate some of the opposition's voices, leading to a more expansionary policy stance. As a result, expectations of expansionary fiscal policy could put further pressure on the yen to depreciate.

- While political negotiations toward the budget formulation may exert pressure for a weaker yen, we believe the longer-term risk for the yen could be towards the upside. From the perspective of monetary policy, we expect the Bank of Japan (BOJ) to maintain its current approach of raising interest rates in response to persistent yen depreciation and the related inflationary pressures. Although there may be some speculation that political instability might limit the BOJ's ability to raise interest rates, we fundamentally believe the BOJ will continue on the path towards normalizing monetary policy. If the yen weakens significantly following the election results, we expect the BOJ to move towards additional rate hikes. Moreover, considering that major overseas central banks, including the Federal Reserve, will continue to lower interest rates, we can expect some narrowing of the interest rate differential, making it more likely for the yen to appreciate.

- In the Japanese government bond market, the expected emphasis on expansionary fiscal policy is likely to generate upward pressure on yields for longer-dated bonds, leading to an initial steepening of the yield curve. However, given the BOJ's unchanged stance on implementing rate hikes, we can expect to see a gradual increase in yields in all maturities along the curve as a general trend.

*This commentary is based on personal views of the author and does not necessarily represent Nomura Asset Management house view.