

## FX Watch

# Q&A on JPY – domestic risks skewed to a weaker yen

## Q&A on JPY

In this note, we answer frequently asked questions on JPY we encountered last week. We think the domestic political development can put renewed pressure on JPY though US economy and trade policies pose risks against our view.

### Is the LDP-Komeito breakup positive or negative for JPY?

Negative beyond initial position unwinding, as it increases political uncertainty, which could delay hikes by the Bank of Japan (BoJ), while the risk of a bigger budget remains.

### What are FX implications in each PM election scenario?

In most plausible scenarios, the risk is a fragile government, dovish bias on monetary policy, and bigger budget, which would give little reason to buy JPY immediately, so the risk appears biased toward a weaker yen.

### What level would trigger MOF FX intervention?

A breach of 155 could trigger intervention, judging from recent intervention episodes. However, the lack of political leadership could increase the bar for intervention in the near-term.

### How may President Trump's planned visit affect USD/JPY?

We do not know what will be discussed. However, any discussions to accelerate the implementation of the investment deal and any commitment by the Japanese government could be positive for USD/JPY while we see limited risk of the US-side warning against the yen weakness.

### What could strengthen JPY?

We currently see relatively limited risk of JPY strength from domestic factors. Instead, US economy and US trade policies remain the biggest source of potential JPY strength.

### What is BofA's JPY strategy?

We favor being short JPY, barring major external shocks, and see key G10/JPY pairs as interesting – USD/JPY EUR/JPY, and AUD/JPY.

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G10 FX Strategy  
Global

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LDP: Liberal Democratic Party

PM: Prime minister

MOF: Ministry of Finance

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## Is the LDP-Komeito breakup positive or negative for JPY?

The news of Komeito's withdrawal from the coalition prompted buying of JGB (Japanese government bond) futures and JPY in overseas markets on Friday, but the rise for both was more muted than the decline in Nikkei 225 futures. We think expectations for a renewed escalation of the US-China trade conflict were also a major factor behind the yen's rally and the decline in yields.

Two opposing market views have formed about the impact of Komeito's coalition exit on FX and rates. The first is that the unwinding of the Takaichi trade and "risk-off" will result in a stronger JPY and twist-flattening of the JGB curve. The second is that increased political uncertainty will result in continued yen weakness and twist-steepening. Considering the implications for politics and fiscal/monetary policy, we believe the latter appears more convincing.

**Politics:** Uncertainty has risen and would remain elevated.

**Fiscal policy:** A supplementary budget will likely take longer to pass, but we doubt that Komeito's exit will lead to greater fiscal discipline. If the LDP (Liberal Democratic Party) remains in power, it will be with Takaichi as PM (prime minister). In the event of a new government centering on current opposition parties, DPFP (Democratic Party For the People) leader Yuichiro Tamaki looks to be a leading candidate for PM, according to media reports. Tamaki and Takaichi share a belief in accommodative fiscal and monetary policy. The need for any future government to incorporate the demands of multiple parties could also tend to swell the budget.

**Monetary policy:** The spike in political uncertainty makes the BoJ even less likely to hike in October, given the potential criticism it risks facing for any unforeseen consequences from a unilateral decision to raise interest rates. With political instability now more likely to persist over the medium term, we think investors will focus on the risk of the BoJ pushing back its rate-hiking cycle.

Once the partial unwinding of the Takaichi trade concludes, we expect a return to yen weakness, though external risks can prevent such a move.

## What are FX implications in each PM election scenario?

A 12 October Nikkei article outlined three potential outcomes from political parties' competition to secure a majority vote for their prime ministerial candidate in the diet session which the article says may begin in around 10 days (Exhibit 1).

- LDP rules as single party, Takaichi elected PM
- LDP forms new coalition, Takaichi elected PM
- CDP (Constitutional Democratic Party) / JIP (Japan Innovation Party, or Ishin) / DPFP form coalition, Tamaki elected PM

See [Japan Macro Watch: Rockier road for the LDP 13 October 2025](#) for a detailed discussion about the prime ministerial election. We see the following two points as key for FX.

1. Takaichi and Tamaki, the two leading candidates for PM, are both known to advocate loose fiscal/monetary policy.
2. All the above scenarios would result in a government led by a minority party, which could only be able to form a minority coalition, and policy disagreements among coalition members may easily emerge. We expect political uncertainty to remain high with risk of an early snap election. A weak government may also be difficult to call for BoJ hikes even if a coalition party is a proponent of monetary policy tightening.



We therefore see little reason to buy JPY immediately in any of the above scenarios, and think the risks are skewed toward a weaker yen.

### Exhibit 1: Scenarios for parties' voting behavior in PM election (from Nikkei)

Takaichi or Tamaki the viable candidates

Party	Number of seats	Scenario		
		LDP alone PM Takaichi	LDP + other party(ies) PM Takaichi	CDP+DPFP+Ishin PM Tamaki
LDP	196	Takaichi	Takaichi	Takaichi
Komei	24	Abstention	Abstention	Abstention
CDP	148	More than one party to abstain	JIP or DPFP to vote for Takaichi	Tamaki
JIP	35		Tamaki	
DPFP	27		Tamaki	
Other	35			
Total	465			

Source: BofA Global Research, Nikkei

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## What level would trigger MOF FX intervention?

As the example of July 2024 made clear, the Japanese government strategically maintains some uncertainty about FX interventions, making it difficult to predict their level. We use multiple data points to triangulate. Exhibit 2 compares current market conditions as of Friday's close vs market conditions during USD/JPY-selling interventions since 2022. Below, we give a rundown of current market conditions.

**Levels:** The first three past interventions in our sample took place shortly after USD/JPY exceeded key levels, in ¥5 increments. Each intervention was at the recent high. USD/JPY is now at ¥151, ¥2 lower than the recent high of ¥153 and well below ¥155.

**Volatility:** Before past interventions, USD/JPY was on average about 8% above its two-month low (versus +3.2% now), and had risen by an average of 1.9% over the past two weeks (versus +1.1%) and 4.2% over the past month (+2.5%) at the preceding business day's close. The one-month implied volatility for USD/JPY averaged 11.6, versus 10.2 at present. Volatility still looks too low to trigger an intervention.

**Intraday vol:** In three out of the four past interventions, USD/JPY rallied around 1.1-1.3% before suspected interventions.

**Other markets:** There is no consistent pattern in other market conditions around past interventions, but Japanese stocks and short-term interest rates were often higher. It shows authorities can decide to intervene regardless of Japanese stock market performance, while pressure on the BoJ could at a margin encourage authorities to intervene.

### Picture at 155 and 160

Exhibit 2 also shows the results of a move from current levels to ¥155/\$ or ¥160/\$. A move to 155 would be of a similar size to those that triggered past interventions; a move to 160 would be larger on almost all yardsticks. Ignoring political conditions, we think the government could opt to intervene at closer to 155 than 160.

### Political turmoil could preclude intervention even at 155

However, Komeito's decision to dissolve its coalition with the LDP ramps up political turmoil and clouds visibility on when a new government could be formed. The Ishiba cabinet will remain in power until the new administration takes over, but it will likely struggle to make proactive policy decisions and cabinet members may in any case be devoting most of their time to internal party politics.

The lack of political leadership will make it difficult for MOF (Ministry of Finance) to intervene in a way that could materially affect FX rates. A weaker yen acts as a warning



about fiscal risk and political instability as well. We would therefore bear in mind the risk that MOF could forego an intervention even at ¥155/\$.

## Exhibit 2: Indicators at the time of USD/JPY-selling interventions (see Note) since 2022 vs current conditions

Current conditions suggest intervention not immediate

Date of 1st intervention	USD/JPY's intraday high on the day of intervention**	Intraday % rally in USD/JPY on the day of intervention	USD/JPY at close on previous business day	% deviation from 2m high	% deviation from 2m low	2w % change	1m % change	1m implied vol	NKY 2w % change	30yr JGB 2w change (bp)	1y x 1y OIS 2w change (bp)
9/22/2022	145.90	1.28	144.1	-0.4	9.5	0.2	4.8	12.8	-0.4	0.7	1.2
10/21/2022	151.95	1.20	150.2	0.0	10.0	3.5	4.5	14.1	-1.1	16.5	6.0
4/29/2024	160.17	1.16	158.3	0.0	7.7	3.3	4.6	11.0	-4.0	1.7	2.2
7/11/2024	161.76	0.04	161.7	0.0	4.4	0.5	3.0	8.5	5.5	-1.8	1.3
Average	154.9	0.9	153.6	-0.1	7.9	1.9	4.2	11.6	0.0	4.3	2.7
10/10/2025			151.2	-1.2	3.2	1.1	2.5	10.2	6.0	3.1	-2.9
Scenario 1: USD/JPY at 155			155.0	0	5.8	3.7	5.1				
Scenario 2: USD/JPY at 160			160.0	0	9.2	7.0	8.5				

Source: BofA Global Research, Bloomberg

\*We treat interventions within five trading days as part of the same series of interventions

% deviation and % change is vs at close of previous business day of each intervention

\*\*Based on Bloomberg data

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## How may President Trump's visit affect USD/JPY?

President Trump is scheduled to visit Japan between 27-29 October, though this could be postponed if a new administration has yet to take over. Assuming a new government is in place, we look below at the potential impact on USD/JPY from a US-Japan summit. At this point nothing is known about the content or potential outcome of discussions, but we see the following two concerns for USD/JPY.

First, any discussions to accelerate the implementation of the US-Japan investment deal could cause the FX market to focus on prospects for Japan to accelerate investment in the US.

Second, compared with the US-EU agreement, Japan has not quantifiably committed to increasing military spending or strengthening its defense capabilities. If the talks suggest that Japan will ramp up its spending or result in an actual agreement, the potential worsening in Japan's government finances and prospects for an increase in imports of US military equipment could support USD/JPY.

We previously saw limited risk that the Trump administration would warn Japan about allowing JPY to weaken, and the tariff and investment deals further supported our view (see [Liquid Insight: Market implications of US-Japan investment agreement 24 September 2025](#)).

While it is hard to forecast the implications of President Trump's visit, we believe the risk is tilted to a higher USD/JPY.

## What could strengthen JPY?

We see relatively limited risk of JPY strength from domestic factors as we have mentioned above. Instead, a slowdown in the US labor market, the ongoing US government shutdown, and US trade policies are currently the biggest sources of potential JPY strength. Renewed escalation in the US-China trade conflict may dominate the price action in the FX market in the very near-term.

Our US economists recently upgraded their growth forecasts and note wealth effects could support spending and eventually prop-up the labor market (see: [US Economic Weekly: A deepening conundrum 03 October 2025](#)). This base case would be supportive of USD/JPY.



## What is BofA's JPY strategy?

We favor selling JPY, barring external shocks, and see the following currency pairs as interesting.

**USD/JPY:** Last week we closed our long USD/JPY call spread recommendation ahead of the approaching expiry, but we remain constructive on USD/JPY for 4Q25 (see: [FX Alpha: Close USD/JPY call spread 08 October 2025](#)). Japanese companies' investment in the US, the US-Japan investment deal, and the gradual pass through of tariffs by Japanese exporters could boost USD/JPY (see: [FX Viewpoint: USD/JPY – contrarian long for 4Q25 06 October 2025](#)).

We see the risk of MOF intervening, but as noted we think the obstacles are greater than usual. USD weakened versus JPY and European currencies on Friday following President Trump's announcement of higher China tariffs, but there are still three weeks until they take effect on 1 November.

A full-scale move to liquidate market risk positions could also be more bullish for USD than JPY. The hurdle for the US to introduce policies that slow the US economy enough to require the Fed to accelerate rate cuts appears high too. We would not expect a sustained slide in USD/JPY, and would buy on dips particularly below 150.

**AUD/JPY:** The pair fell the most of the G10 pairs on Friday. However, for the same reasons as USD/JPY, the decline in AUD/JPY caused by escalating US-China tensions could be temporary. Political turmoil in Japan is also exacerbating the risk of yen depreciation. AUD could outperform as USD and JPY depreciate as we remain constructive on AUD (see: [World at a Glance: Autumn Disquiet 24 September 2025](#)). If MOF intervenes by selling USD/JPY, the sell-off in USD could also limit any decline in AUD/JPY especially if gold rallies.

**EUR/JPY:** We have recommended being long EUR/JPY amid investors' move to reduce USD exposure and structural outflows from Japan (see: [Liquid Insight: Case for a higher EUR/JPY 22 April 2025](#)). France's political turmoil may weigh on EUR in the near term. However, we expect more FX impact from political risk in Japan. France is a core eurozone country, but only part of a larger whole. This is also the fourth change in France's PM in the past two years. Komeito's coalition exit may be the prelude to longer-term political turmoil in Japan. If MOF intervenes by selling USD/JPY, the downward pressure on EUR/JPY should be limited if USD weakens and EUR/USD rallies.



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