MIZUHO | Innovating today. Transforming tomorrow.

Forex Medium-Term Outlook

November 29, 2024

Overview of Outlook

USD/JPY fluctuated significantly in November. At one point, it rose sharply to the mid-156 range, but by the end of the month, it had fallen below 150 with the unwinding of JPY short positions in anticipation of the U.S.-Japan interest-rate differential narrowing. I have been arguing in this report that JPY depreciation since the end of September has been led by speculative JPY selling, and that its sustainability is doubtful, as real-demand-led JPY selling lacks momentum. The appreciation of JPY toward the end of November in anticipation of the next moves by the Japanese and U.S. central banks seems to confirm that my view was correct. JPY could continue to strengthen during early-mid December amid the continued rollback of speculative JPY selling, but one must be wary of an end to the Fed's interest interest-rate cuts becoming a point of contention at some point during the current forecasting period. Market expectations regarding Scott Bessent, the next Secretary of the Treasury, are keeping U.S. interest rates from rising. However, there is no denying that the second Trump administration's policy mix will be inflation-inducing, and going by what happened during the first Trump administration, it is unclear to what extent the wishes of the Treasury Secretary himself will be respected. Now that the Trump administration, with its inflation-inducing policies, has been added to the already strong U.S. real economic performance, my basic outlook is that the end of Fed rate cuts will become a major issue from mid-2025 onward, and JPY weakness driven by the U.S.-Japan interest-rate differential could become somewhat protracted. Regarding the JPY supply and demand environment, which I always look at in this report, the main focus will be on whether or not household JPY selling can be maintained at the same pace as in 2024. Any slowdown in household JPY selling would slow down JPY depreciation by contributing to an improvement in JPY supply and demand.

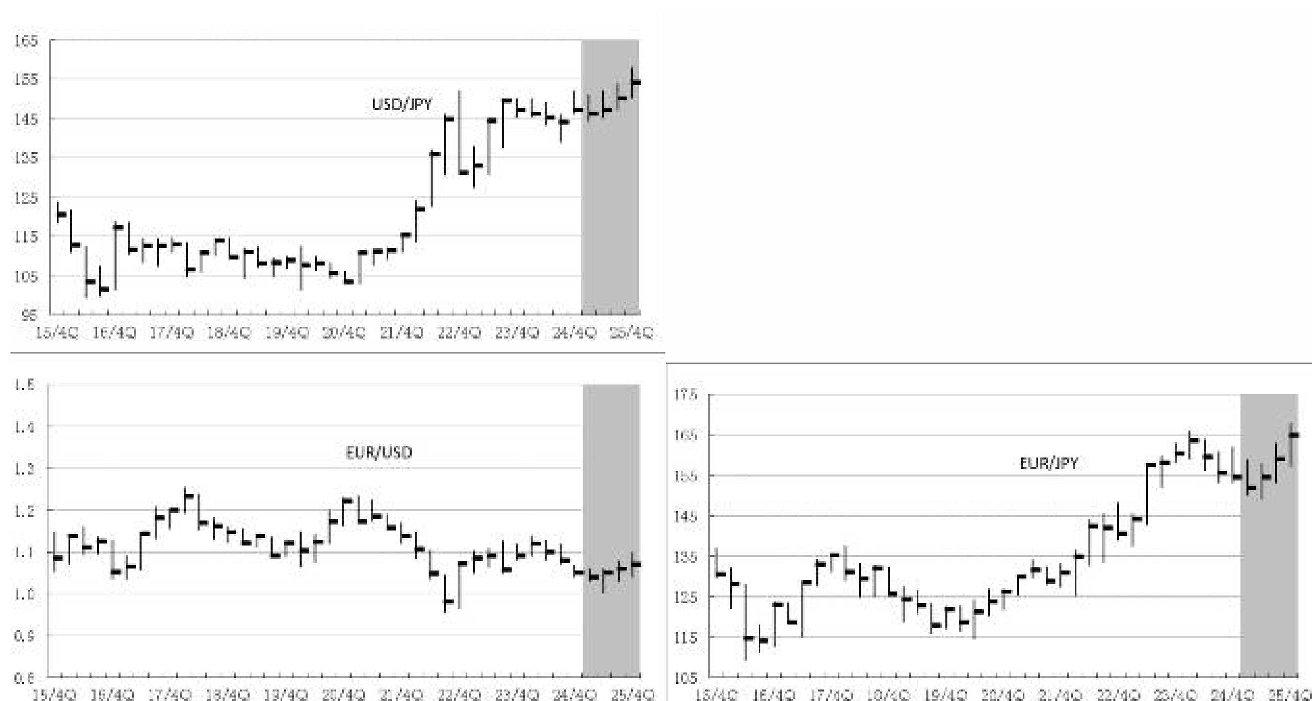
EUR renewed its year-to-date low in November. The headwinds against EUR are only getting stronger. The region's economic and financial conditions, led by Germany, remain lackluster. The collapse of the German coalition government, an increase in geopolitical risks, and the expectation of additional tariffs under the second Trump administration have added to this, causing the economic outlook for companies in the region to deteriorate to unprecedented levels. A rate cut at the ECB's December Governing Council meeting is almost certain, but it seems increasingly likely that there will be a big difference in the number of rate cuts by the Fed and the ECB over the course of the current forecasting period. Although the euro area job market seems tight at present, job and wage growth are expected to slow down from 2025 onward, and rate cuts will be sequentially implemented. It is safe to assume that the sharp drop in EUR/USD in November was the result of factoring in such a future. Toward the end of November, EUR recovered some of its value with the unwinding of speculative EUR short positions, but I do not expect much change in the underlying market sentiment as the Europe-U.S. interest-rate gap continues to widen in line with the economic gap between the two economies, making it easier to sell EUR. In last month's issue of this report, I predicted that EUR/USD would fall below 1.05 over the next year, but now that this has already happened, the focus will shift to whether or not it will fall below parity.

Summary Table of Forecasts

	2024 Jan-Nov (Actual)	Dec	2025 Jan-Mar	Apr-Jun	Ju-Sep	Oct-Dec
USD/JPY	139.58 ～ 161.96 (150.58)	146 ～ 152 (147)	144 ～ 151 (146)	145 ～ 152 (147)	147 ～ 154 (150)	150 ～ 158 (154)
EUR/USD	1.0332 ～ 1.1214 (1.0562)	1.04 ～ 1.07 (1.05)	1.03 ～ 1.06 (1.04)	1.00 ～ 1.06 (1.05)	1.03 ～ 1.08 (1.06)	1.04 ～ 1.10 (1.07)
EUR/JPY	154.94 ～ 175.42 (159.04)	153 ～ 162 (154)	150 ～ 159 (152)	149 ～ 158 (154)	153 ～ 163 (159)	157 ～ 168 (165)

(Notes) 1. Actual results released around 10am TKY time on 29 NOVEMBER 2024. 2. Source by Bloomberg
3. Forecasts in parentheses are quarter-end levels.

Exchange Rate Trends & Forecasts



USD/JPY Outlook - Weakening Real-Demand-Led JPY Selling vs. Strengthening Speculative JPY Selling

Current Status and Future Outlook for Second Trump Administration - Possible Impact on Japan

Criticism of Weak JPY and Japanese Trade Surplus to Continue During Second Trump Administration

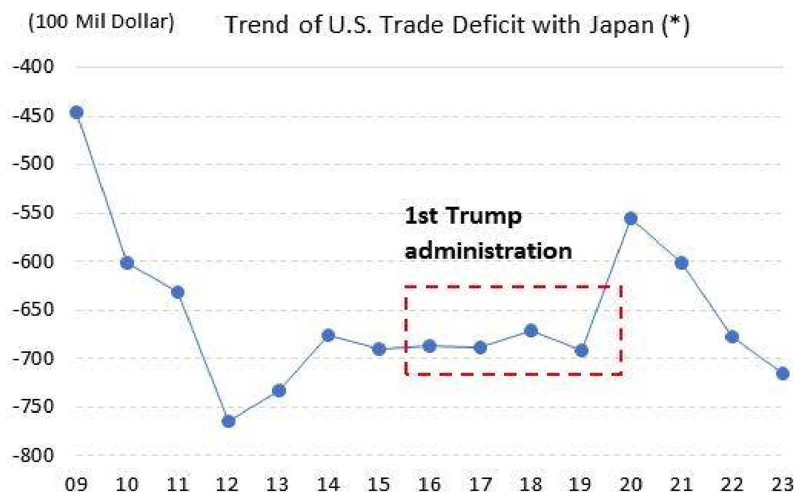
The impact of Donald Trump's reelection on the Japanese economy is being discussed from various angles, but the most worrying issue in practical terms is the deterioration of bilateral trade relations. No matter how much Trump may dislike it, JPY (and other currency) weakness as the flip side of USD strength is difficult to correct as long as U.S. prices and interest rates remain strong. Given that Trump himself is encouraging strong prices and interest rates in the U.S., there seems no way out of the situation. On November 22, Trump nominated investor Scott Bessent as his next Treasury secretary, which calmed down the reflationary Trump trade, and U.S. interest rates fell significantly. However, it was often seen during Trump's first term that his words and actions did not match those of his Treasury secretary, and it is difficult to say anything for sure this time until after the second administration has been inaugurated.

Essentially, JPY weakness and Japan's trade surplus with the U.S. will remain during the upcoming four years of the second Trump administration, and Trump is bound to cite these as circumstantial evidence of an unfair trade relationship between Japan and the U.S. and vent his dissatisfaction with Japan. Unhappy with the continued depreciation of JPY, Trump's solution will likely be to impose additional tariffs on Japan.

There were, indeed, occasions during his recent election campaign when he criticized JPY weakness. For example, in April of this year, Trump attracted attention when he posted on social media that JPY, which was the lowest against USD in about 34 years, was "a total disaster for the United States." He added, "(USD strength) sounds good to stupid people, but it is a disaster for our manufacturers and others. They are actually unable to compete and will be forced to either lose lots of business, or build plants, or whatever, in the "smart" Countries," criticizing President Joe Biden for "let(ting) it go." He further said during a media interview in July, "We have a big currency problem because the depth of the currency now in terms of strong dollar/weak yen, weak yuan, is massive," and "(USD strength is) a tremendous burden on our companies that try and sell tractors and other things to other places outside of this country." Essentially, Trump is convinced that JPY weakness is the flip side of USD strength, and that U.S. manufacturers are being let down by this situation.

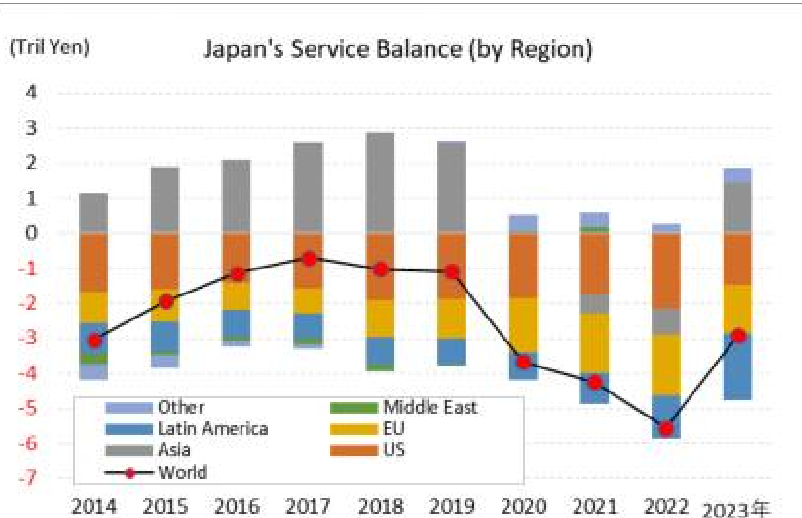
Mutual Sale of Automobiles vs. Digital Services

Trump's value system, coupled with his political strategies, is unlikely to change anytime soon. If so, he will probably repeat statements similar to the above going forward. However, Trump's criticism of JPY weakness is based on at least two points of misunderstanding. First, the U.S. trade deficit with Japan has not expanded in proportion with JPY's fall to its weakest in 34 years. It is true that the U.S. trade deficit with Japan expanded over the three years starting 2020, but this expansion (approximately USD70 billion) was roughly the same as during the first Trump administration (see figure). The reason Japanese cars sell in the U.S., and U.S. cars do not sell in Japan is not because of the exchange rate, but owing to the difference in quality between the two.I am deliberately taking up the goods and services trade balance here because of Japan's services deficit led by its digital deficit with the U.S., which has become a hot topic in Japan in recent years. Looking at Japan's services deficit by region (see figure), a large part of it is owing to trade with the U.S., Europe, and Central and South America. Payments to Central and South America are expanding because of the well-developed reinsurance market in that region, with most of the deficit expansion being due to payments toward insurance and pension services.



(Source) Macrobond; total of goods and services

On the other hand, digital services are a major contributor to Japan's services deficit with the U.S. and Europe. As explained in previous issues of this report, the headquarters of U.S. IT giants, represented by GAFAM (Google, Apple, Facebook, Amazon, Microsoft), are located in the EU, especially Ireland. In other words, much of Japan's services deficit recorded with Europe and the U.S. is ultimately owing to U.S.-based companies. Trump is ignoring the fact that the U.S. may be losing to Japan in the trade of goods (although trade is not really a game in which you win or lose), but is winning handily in the trade of services. In fact, JPY weakness has bloated the amount Japan pays the U.S. toward platform services, contributing further to the expansion of its services deficit (a surplus from the U.S. perspective). This is the second point that Trump misunderstands (or perhaps he understands it but chooses not to acknowledge it).



(Source) Bank of Japan

Japan's services deficit with the U.S. is basically owing to the quality of services provided by GAFAM, and there is no room for Japan to complain about this being unfair (except with regard to tax avoidance by these companies). Japan's trade deficit in recent years has also been expanding due to large foreign consulting firms with headquarters in major European and U.S. cities, but Japan has not complained about this being unfair either. In other words, to summarize the goods and services balance between Japan and the U.S., the U.S. is being sold cars from Japan, while Japan is being sold platform services by U.S. companies. The perception that the U.S. is being forced to accept an unfair one-sided trade is false, and if we expand our view to include the trade in services, Japan is the one that faces the larger upside risk from the expanding deficit. U.S. complaints are, therefore, fundamentally unfounded.

Japan's Investments in the U.S. are Worthy of Pride

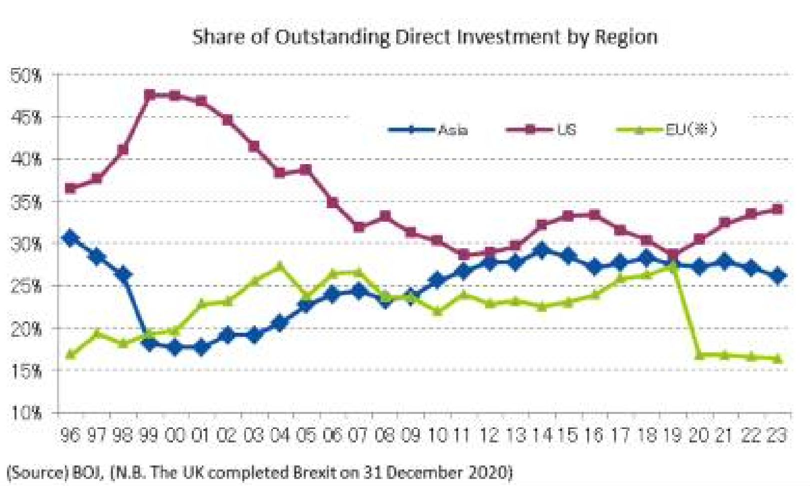
Having said all that, it seems unlikely that Trump will accept the aforementioned reasonable arguments. Trump can criticize JPY weakness as much as he wants, but JPY cannot appreciate against USD to his satisfaction given the large U.S.-Japan interest-rate differential (partly his doing) and the overall weakness of Japan's foreign-currency supply and demand structure. While the reality is that Japan is helpless to correct JPY weakness, Trump may choose to further punish the country with additional tariffs due to its large trade surplus with the U.S. Trump may alternatively give Japan the option of increasing its investments in the U.S. if it does not want to face additional tariffs. However, as I have argued many times in the past, Japan is one of the key contributors to the U.S. job market and is known, especially, for its large foreign direct investment (FDI) in the U.S. automobile industry. In the manufacturing industry, Japan has a history of being the largest contributor. Even looking at data from the U.S. Department of Commerce (see figure on the right), there is no room for debate about the magnitude of Japanese companies' contribution to the U.S. economy.

Share of Various Countries in Terms of No. of Workers Employed and Amount of Compensation by Their Companies in the US (2021)

	No. of workers	Compensation
UK	15.4%	13.3%
Japan	12.6%	12.4%
Germany	11.6%	11.5%
Canada	10.9%	10.6%
France	9.3%	8.1%
China	1.5%	1.2%
Italy	1.3%	1.0%
S.Korea	1.1%	1.3%

(Source) U.S. Department of Commerce

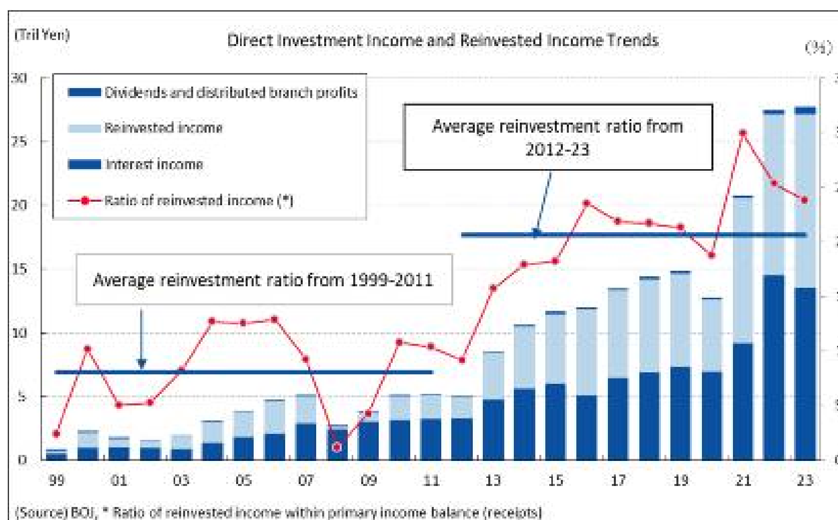
Former Prime Minister Shinzo Abe had once directly brought this point up with Trump. One hopes that the current Japanese government and ruling party will make similar efforts going forward. As of now, the U.S. still boasts the largest share in terms of outstanding balance of FDI from Japanese companies (at 34%). Asia (26.1% as of 2023) has not been able to catch up despite fierce pursuit since the late 1990s (see figure). Asia's share has, in fact, been declining in recent years due to the relocation of bases from China to other regions, and this trend is likely to continue in the future. In this regard, Japanese companies seem to be under pressure to redistribute their bases among three poles, namely the U.S., Europe, and the Global South, and even without Trump's appeal, the U.S., which already has the required infrastructure and is more predictable (than the other two poles), may be an easier choice for investment. Japanese companies can be proud of the fact that they have returned the foreign currency historically earned from trade with the U.S. through direct investment in the U.S., and this may continue to be the case in the future.



(Source) BOJ, (N.B. The UK completed Brexit on 31 December 2020)

Actual Benefits of Japan's Nominal Trade Surplus Enjoyed by Other Nations

Further, as I have repeatedly argued in past issues of this report, profits from FDI by Japanese companies are increasing year by year, but close to half of these profits are reinvested in the overseas location rather than being repatriated to Japan (see figure).Statistically, the increase in direct investment income is reflected as an expansion of Japan's primary income surplus, which increases its current account surplus, but this has little real impact on the Japanese economy given that the proportion of reinvested income is also increasing year by year. I have long discussed this situation as a "nominally surplus nation" problem, where there is a statistical current-account surplus but not on a cash-flow basis, and this has now also become common

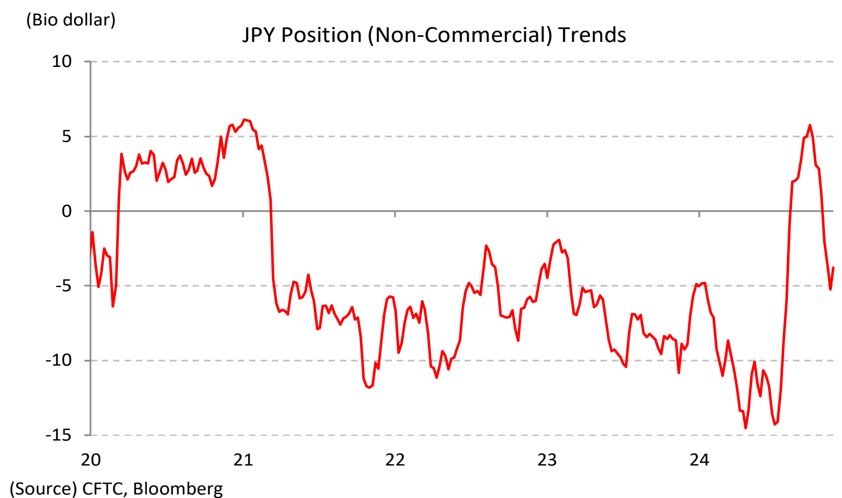


(Source) BOJ, * Ratio of reinvested income within primary income balance (receipts)

knowledge in the Japanese economic media, and policymakers are questioned about it very frequently.
Japanese authorities should actively present these points to the Trump administration. No matter how one looks at it, it is the country that receives the investment (the U.S., in this case) that practically benefits from the "nominal surplus" earned by the country that makes the investment (Japan, in this case). It is the countries that have received investment from Japanese companies, such as the U.S., that have enjoyed the benefits of job creation and, of course, wage increases too. Meanwhile, Japan, despite its current account surplus, is suffering imported inflation due to its weak currency.
The U.S. Treasury Department's report on The Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States, which is often discussed in the forex markets, sets the size of a country's current account surplus as the criterion for determining whether the country is a currency manipulator, not taking the "nominal surplus" issue into consideration. An objective analysis of Japan's current account balance situation would leave one confused by the U.S. criticism that Japan is devaluing its currency in its insatiable hunger for a trade surplus. One of the things that will be expected of the Ishiba administration is to make the second Trump administration understand, primarily through balance of payments statistics, that Japan's current account surplus is worthy of praise rather than criticism from the U.S.

JPY and JPY Supply and Demand - Weakening Real-Demand-Led JPY Selling vs. Strengthening Speculative JPY Selling

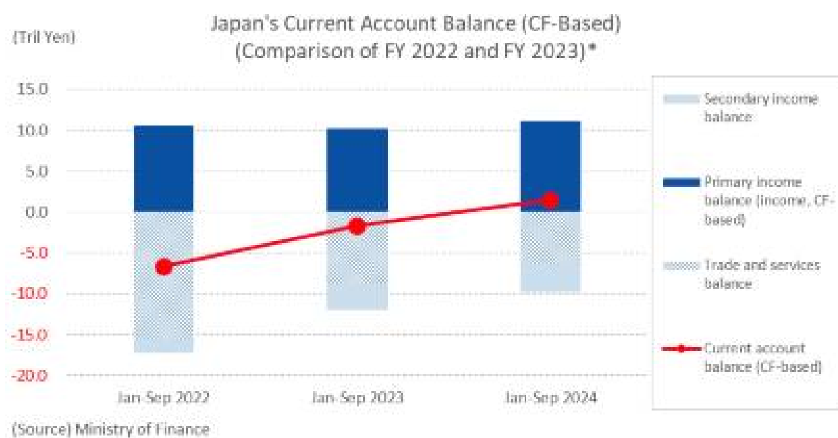
Trump Trade Triggers Speculative JPY Selling
While some corrections were also mixed in, the financial markets in November were primarily characterized by "Trump trade," i.e., trade that had factored in expansionary fiscal and monetary policies and an upswing in the outlook for U.S. prices and interest rates. As part of this trend, USD/JPY has settled in the 150 range, but some are beginning to predict a return to the 160 range. How must we interpret this situation? The recent JPY depreciation is due to an increased likelihood of a no-landing (i.e., recession avoidance) scenario for the U.S. economy since September, which has made the Fed more hawkish in its stance and forced the U.S.-Japan interest-rate gap to widen again. My understanding is that speculative trading in response to interest rate trends is likely to determine the direction of USD/JPY, but its level will be determined by supply and demand. It is difficult to explain JPY's depreciation from around 110 to the dollar in March 2022 to 160 to the dollar in July 2024 based solely on the widening U.S.-Japan interest-rate differential.
One must also take into account the dramatic changes in the JPY supply-demand climate, such as Japan's cash-flow-based current account balance going into deficit, and the sudden emergence of the household sector as a new seller of JPY with the launch of the new NISA scheme. Even though JPY supply and demand is clearly on the mend (details below), there is also a resurgence in JPY carry trade betting on a no-landing scenario in the U.S. IMM currency futures trading data, which reflects speculative trading trends, reveals that speculative JPY short positions have once again surged to levels not seen since the end of July this year (see figure). This is evidence that speculative predictions of another widening of the U.S.-Japan interest-rate differential are beginning to pick up steam. At the time of writing this report, speculative JPY shorting is still on the rise.



(Source) CFTC, Bloomberg

JPY Supply and Demand is Improving
In contrast to speculative JPY selling, real-demand-led JPY selling has not increased. This can be seen from the balance of payments statistics. As reported previously, Japan has posted exceptionally large surpluses since the beginning of 2024.In fact, the JPY supply-demand balance as seen from the balance of payments is clearly improving contrary to the unrelenting trend of JPY depreciation since the summer. During 2022-23, despite posting nominal current account surpluses, Japan could not be assured of stable CF-based current account surpluses, i.e., surplus after excluding the flow of the primary income balance not converted back into JPY, and my hypothesis was that this was the underlying cause of JPY depreciation. The above is the gist of the commonly discussed theory of structural JPY depreciation.

However, comparing the CF-based current account balance for the January-September period for the three years since 2022, we see a deficit of approximately -JPY6.7 trillion in 2022 and -JPY1.7 trillion in 2023, but a surplus of approximately +JPY1.5 trillion this year (see figure). As the figure shows, the biggest driver behind this trend is the contraction of Japan's trade and services deficits. Specifically, this is owing to (1) a decline in the trade deficit as resource prices stabilize, and (2) a yoy expansion of the travel surplus. Looking at the cumulative results for January through September for each of the above, the travel surplus has nearly doubled from +JPY2.418 trillion in 2023 to +JPY4.3542 trillion this year, and the trade deficit has shrunk from -JPY5.454 trillion to -JPY3.8123 trillion. Against the backdrop of these developments, the trade and services deficits have improved by over +JPY2 trillion, from -JPY8.6337 trillion to -JPY6.4434 trillion.

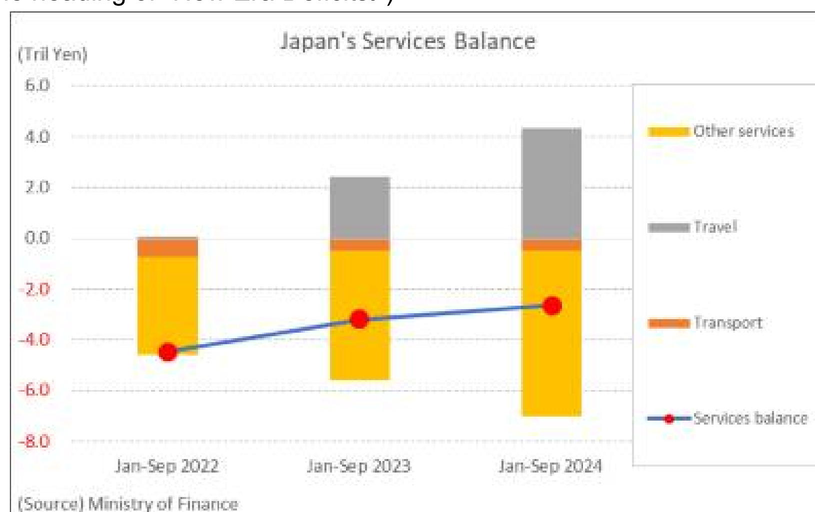


There is, further, a third driver of this trend in the form of (3) a slight expansion in the CF-based primary income surplus. For the January-September 2023 period, for instance, primary income posted a statistical surplus of +JPY26.4022 trillion and a CF-based surplus of approximately +JPY10 trillion, as per my calculations. By contrast, the statistical surplus was +JPY32.1904 trillion, and the CF-based surplus was approximately +JPY11.2 trillion for the January-September period this year. The JPY conversion rate (i.e., primary income surplus converted to JPY ÷ the total primary income surplus) is slightly lower than last year, but given that the nominal primary income surplus has improved by over JPY6 trillion yoy (perhaps due to JPY weakness), the CF-based primary income surplus, and therefore the CF-based current account balance, have also improved. At any rate, it would be safe to say that the momentum of real-demand-led JPY selling has been slowing down in recent years as judged from the current account balance.

The Digital Deficit has Grown by 1.7x in Two Years

While it has not yet become an obvious problem thanks to the rapid expansion of the travel surplus, the other services deficit, led by the digital deficit, is expanding toward its largest ever. (N.B., For details, please see previous issues of this report, where I discuss this issue under the heading of "New Era Deficits.")

A comparison of the January-September period other services deficit for 2023 and 2024 shows an expansion from -JPY5.1152 trillion in 2023 to -JPY6.5208 trillion this year (see figure). Incidentally, the figure for 2022 was -JPY3.8128 trillion, indicating that this deficit has grown by 1.7x in two years. If we focus on the digital-related deficit within the other services balance (New Era Deficits), there is a steady trend of expansion from about -JPY3.5091 trillion in 2022, to -JPY4.2126 trillion in 2023, and -JPY5.1639 trillion this year. As this also amounts to a 1.7x growth in two years, it can be surmised that the New Era Deficit is being driven by deficits in the digital sector. The important thing to note is that the remarkable expansion in the travel surplus reflects a special factor, namely the weak travel figures for 2023 due to border control measures that were in place until March 2023, but the digital-related deficit is growing along a more natural trajectory. In contemplating the future of Japan's balance of payments, we should be concerned about the expansion of the digital-related deficit even as the travel surplus shows signs of plateauing due to labor shortages. It seems inevitable that the services deficit will begin to expand if these trends continue. This in itself is a structural factor encouraging JPY depreciation.



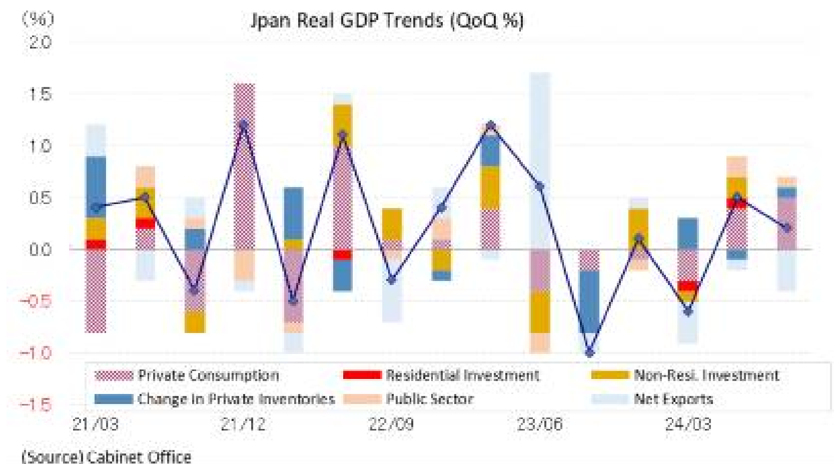
Speculative Trading Could Increase Volatility

Figures since the beginning of 2024 give the strong impression of a decline in real-demand-led JPY selling, which is caused by vulnerabilities in Japan's current account structure. The current situation, therefore, can be summed up as a decrease in real-demand-led JPY selling alongside an increase in speculative JPY selling. However, a weak-JPY trend not supported by real demand is also quite unreliable, as was obvious in the chaos during early August, when the trend was disrupted as confidence in the U.S. economy took a hit. Even if JPY continues, for some time, to weaken compared with levels seen in the past over two years, the trend itself lacks stability in the absence of a real-demand

tailwind. Meanwhile, the tailwind of speculation could cause significant volatility in the trend. This increase in volatility is bound to be confirmed after the inauguration of the second Trump administration. As already obvious in the case of currencies such as CAD and MXN, it could become the norm for the forex markets to be shaken by a single social-media post by the president. Speculative positions are bound to react sensitively to such factors.
In light of the recent weakening of JPY, some are hastily predicting a 160- or 165 level going forward, but my basic understanding is that a considerable amount of speculative JPY selling will be necessary to make up for the lack of real-demand-led JPY selling for USD/JPY to reach those levels. The outlook for USD/JPY must be formulated based on a careful consideration of the various drivers of JPY depreciation and the differences between them.

The Japanese Economy Now and Going Forward - GDP Results a Godsend for BOJ Rate Hike in December?

A Godsend for a December Rate Hike
At the time of writing this report, a BOJ interest-rate hike at the year's final Monetary Policy Meeting (MPM) in December is steadily being factored in. Given the size of speculative JPY short positions currently being accumulated, it is difficult not to be a little anxious about the possibility of market turmoil similar to that in early August. However, given the motivation to avoid chronic JPY weakness, small rate hikes on an intermittent basis may be unavoidable for the time being.
Japan's 2024 July-September quarter real GDP growth rate (first preliminary report), which was released by the Cabinet Office on November 15, may be a useful reference when contemplating the BOJ's next move. The real GDP growth rate was +0.9% yoy, annualized (+0.2% qoq), exceeding the market prediction of +0.7% yoy, annualized. The main driver of growth was personal spending, which had increased by +0.9% qoq, the highest growth rate in nine quarters since April-June 2022, and it contributed as much as +5.5 pp to the overall growth rate (see figure). The government's fixed-amount tax cut exceeding JPY3 trillion is said to be behind this increase in personal spending, but it seems likely that the dissipation of temporary factors that were suppressing personal spending may also be at play; for instance, automobile sales rebounded compared with 1Q, when they were depressed as a result of the test fraud scandal, thereby boosting spending. In other words, if we assume that temporary factors boosted personal spending, there is no guarantee that the current momentum will continue.

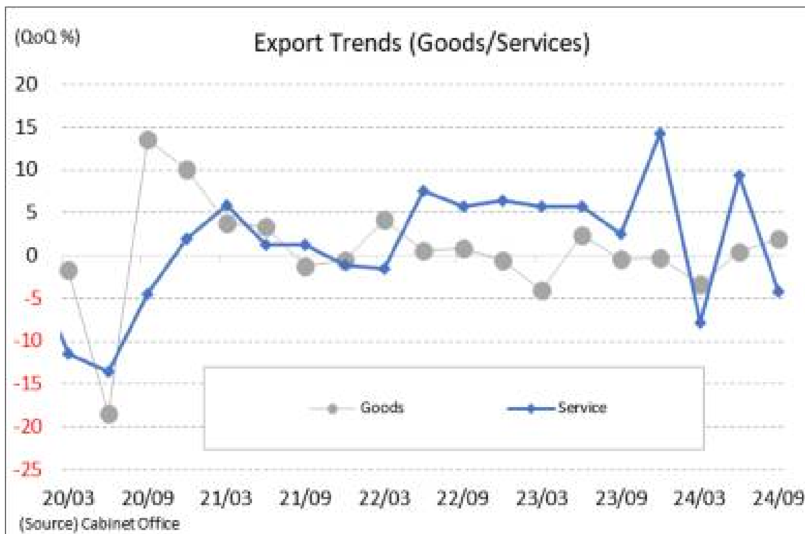


(Source) Cabinet Office

Meanwhile, capital investment, which is also a pillar of private demand alongside personal spending, decreased by -0.2% qoq, posting its first decrease in two quarters. However, there is no need to be overly concerned in this regard, as the previous quarter saw a large growth (+0.9% qoq) and also given that some factories were shut down due to typhoons. (The seasonally adjusted Maehara series shows a growth rate of +5.4% yoy, and the average of the three quarters since the beginning of the year also shows a strong growth rate of +5.0%). As reported on a daily basis, corporate earnings have remained strong, at least for the recent quarter. Although personal spending remains strong and capital investment has not slowed significantly, the growth rate remains lackluster because of significant negative contribution from net exports (details below).
The above GDP performance cannot be overlooked from the perspective of anticipating the BOJ's next move. Even though the growth rate itself did not come as a big surprise, the figures are sufficient for the BOJ to claim "robust" domestic demand. In other words, the recently released GDP growth data may serve as a good excuse for the BOJ to implement a rate hike at its December 18-19 MPM. The markets have already factored in a 50% chance of a rate hike at the time of writing. Of course, a look at the details shows that domestic demand was supported only by personal spending this time, and final demand excluding private inventory changes and government spending (each of which contributed +0.1 pp) barely grew, at +0.1% qoq. Naturally, then, some will question the legitimacy of an interest rate hike. However, since JPY weakness has already heightened the upside risk of inflation, there is an incentive to raise interest rates using the same logic as in July. If the BOJ does not want to openly attribute its rate hike to forex trends, the recent personal spending figures could be a godsend.

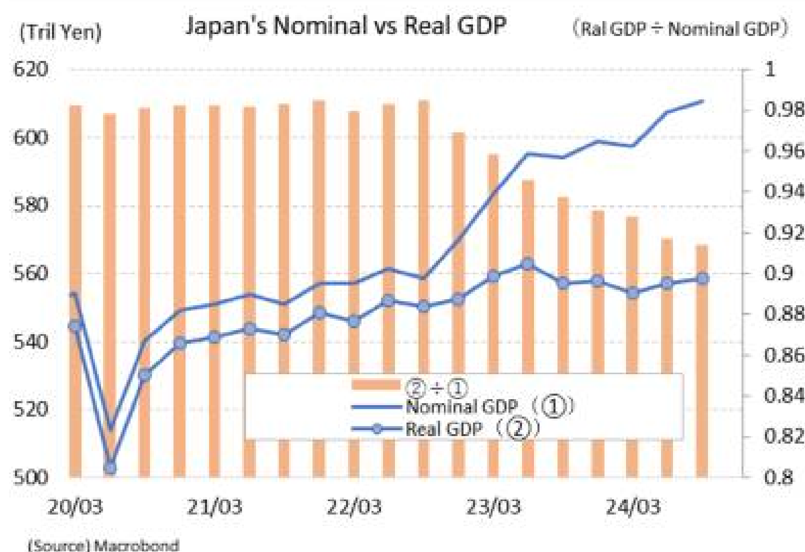
Beginning of the End of Growth in Tourist Spending?

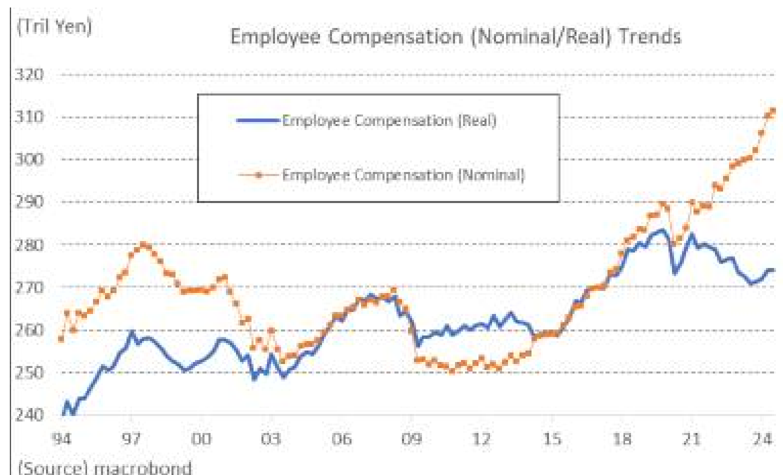
In contrast with personal spending, external demand was noticeably weak this time. I particular, "domestic direct purchases by non-resident households," which indicates spending by tourists coming to Japan, decreased by -13.3% qoq, posting the first negative growth in eight quarters since April-June 2022.This was also the first double-digit decline since April-June 2020 (which recorded -81.0% qoq), soon after borders were closed globally in response to the pandemic. Of course, there were factors that dampened travel demand, such as the sharp appreciation of JPY and the landfall of several typhoons during the July-September period, but was that really all? I have long been concerned about the plateauing of tourist spending due to labor shortages and other factors, and I cannot helping wondering if the recent negative growth is the beginning of the end. With the decline in tourist spending weighing down service exports, overall exports grew only slightly at +0.4% qoq (see figure). Meanwhile, imports as a whole grew by +2.1% qoq, so net exports ended up contributing -0.4 pp to GDP growth.



The Widening Gap Between Nominal and Real GDP

As mentioned above, the big question here is how the BOJ will interpret the recent results. The results mark the second consecutive quarter of positive real GDP growth, and there is no denying that they are strong. However, it is also true that the pain of inflation resulting from the past two years of JPY weakness is beginning to sink in, particularly affecting the household sector. As the figure shows, the gap between real and nominal GDP is steadily widening as the size of real GDP relative to nominal GDP steadily shrinks. Leaving aside the recent quarter's results, which were boosted by the fixed-amount tax cut, the fact is that Japanese disposable incomes have declined as a result of the inflation tax, and personal spending has not grown as one would wish in recent years. JPY weakness has also increased the demand for tourism-related spending, thereby pushing up prices of goods and services that appeal to the spending and investment appetite of foreign tourists, crowding out the spending and investment appetites of local residents to some extent. Japan is in the midst of importing inflation through JPY weakness, and since there is no guarantee of an increase in nominal wages commensurate with that inflation, real GDP is not growing as expected. This is quite evident, for instance, from employee compensation, which is growing in nominal terms but decreasing in real terms (see figure). As the temporary boost to personal spending from the flat-amount tax cut is not expected to continue into the October-December quarter, it is possible personal spending will decline.





A Rate Hike may be the Only Solution

Of course, none of this is to say that the BOJ must implement a rate hike. It is unreasonable to insist that the BOJ raise interest rates based on a single "snapshot" of strong personal spending in the July-September quarter GDP results. If the BOJ does implement a rate hike, however, it makes more sense to explain it, as in July, as being in view of an increase in inflation risk due to unexpected JPY weakness, the likelihood of which is undoubtedly increasing. If personal spending

weakens in the upcoming quarters, it will likely be due to imported inflation via JPY weakness, and interest rate hikes will have to be considered as a solution one way or the other. Of course, at the time of writing, many economic indicators that could influence the BOJ's decisions are yet to be released, such as the November employment statistics, so it is not possible to give a definite preview of the Bank's next move. It does, however, seem quite likely that interest rates will be raised in December without waiting for the January Outlook for Economic Activity and Prices (Outlook Report).

U.S. Monetary Policy and Economy Now and Going Forward - Trump 2.0 is Inflation 2.0

Over 40% Chance of Status Quo at December 17-18 FOMC Meeting

As expected by the market, the federal funds (FF) target range was lowered by 25bp to 4.50-4.75% at the November 6-7 FOMC meeting. This was the second consecutive meeting to implement a rate cut. According to the minutes of the meeting, which were published in late November, "Many participants observed that uncertainties concerning the level of the neutral rate of interest complicated the assessment of the degree of restrictiveness of monetary policy and, in their view, made it appropriate to reduce policy restraint gradually." While it is likely that the Fed will continue cutting interest rates for some time to come, there is also the impression is that the number of rate cuts will be limited. In his press conference after the meeting, Fed Chair Jerome Powell said, "We're (...) not declaring victory, obviously, but we feel like the story is very consistent with inflation continuing to come down on a bumpy path over the next couple of years and settling around 2 percent," hinting at the possibility of further rate cuts, but it is also true that since October, a series of strong U.S. economic indicators have raised doubts about the justification for rate cuts. The FOMC meeting minutes also, therefore, seem to be tinged with caution regarding sequential rate cuts.

Regarding the shocking weakness of the U.S. October job data, released in early November, Powell noted that it "would have been somewhat higher were it not for the effects of labor strikes and hurricanes," and while the unemployment rate is rising, it is still low, indicating that it is not possible to be complacent about a labor market slowdown. Powell also suggested that core inflation may take some time to cool off due to factors such as housing lease renewals taking time to catch up to the market. In response to this communication from the Fed, at the time of writing, the markets have priced in an over 40% chance of the status quo being maintained at the December 17-18 FOMC meeting. In short, there is growing speculation that FF rate cuts, which began in September, will be temporarily suspended after two consecutive cuts, which is a scenario that will prop up USD/JPY.

The Big Question is What Will Happen from January Onward

The November rate cut had been considered a certainty to begin with, and the possibility of the Fed skipping a rate cut in December had also begun to be factored in even before the November meeting. The big question is what will happen from January 2025 onward, with the Trump administration set to take up the reins again. As indicated by the markets already factoring in expansionary fiscal and monetary policies in what is called "Trump trade," there are growing expectations that prices and interest rates in the U.S. will rise. At his press conference, Powell clearly stated, "in the near term, the election will have no effects on our policy decisions." The new administration will be inaugurated in January 2025, and it will take several months from then for any economic/financial impact of policies to emerge. The markets, for their part, are also unlikely to have assumed that the elections would impact policy decisions in the near term, so one assumes that their recent trading patterns price in developments predicted to happen significantly in the future. Powell too acknowledged this point, but considering that U.S. interest rates have risen compared with the previous year, the current situation seems to indicate that the economy is on the mend even as monetary policy is being corrected toward greater accommodation.

I have formulated my forex outlook assuming the end point of the Fed's interest rate cuts to become a point of contention from mid-2025 onward, but some people are already starting to talk about it. A growing number of analysts are talking about a return to the 160 range, based on an awareness that the interest rate cut phase may be shorter than expected. In this regard, given that speculators have recently been accumulating significant JPY short positions, I view a reversal (i.e., JPY buyback) as being more likely in the short term. In the medium to long term, however, I too think it reasonable to expect a resumption of JPY depreciation assuming a no-landing scenario for the U.S. economy.

The Conundrum of Trump 2.0 Being = Inflation 2.0

Many of the policies expected to be implemented under the upcoming Trump administration are inflation-inducing by nature (see chart on next page). Although U.S. interest rates have fallen due to Treasury Secretary designate Bessent's emphasis on fiscal discipline, as of the present time, there is no reason to believe this will be sustainable. Going by his past performance, Trump seems likely to repeat his incoherent working style of implementing policies that stimulate inflation expectations while expressing a preference for low interest rates and USD weakness in terms of monetary/currency policy. The combination of expansionary fiscal policies, which increase total demand, trade policies that raise import prices, and immigration policies that tighten labor supply means that general prices in the U.S. are likely to heat up under the second Trump administration. The first three months or so of the new administration will be a test of whether this preconception at the time of his election, that Trump 2.0 = Inflation 2.0, can be overturned. In this context, market participants will also be checking to see how consistently Bessent's proposed 3-3-3 policy can be implemented. 3-3-3 stands for (1) reducing the fiscal deficit to 3% of GDP by 2028, (2) raising GDP growth to +3%, and (3) increasing crude oil production by 3 million barrels per day.

In the end, the fate of U.S. currency and monetary policies will only be decided ex post facto in response to the above fiscal policies. Even if Trump wants low interest rates and a weak USD, whether the real economy will allow it is a different matter.

What most market participants already seem to have forgotten is that it was the Trump administration that sowed the seeds of inflation by implementing expansionary fiscal policies, symbolized by large amounts of cash handouts, during the pandemic. Of course, the Biden administration continued with those policies, so, in the end, both the Republican and Democratic parties are equally guilty when it comes to the present high rate of inflation, but Trump's image is, without a doubt, associated with high inflation growth since his first administration. For the time being, the Fed will continue to justify continuing with interest rate cuts, but whether that is in line with the situation on the ground will be entirely up to Trump's behavior. In that sense, the Fed's communication, including the dot plot and whether there will be a rate cut in December, is less worth watching than during normal times.

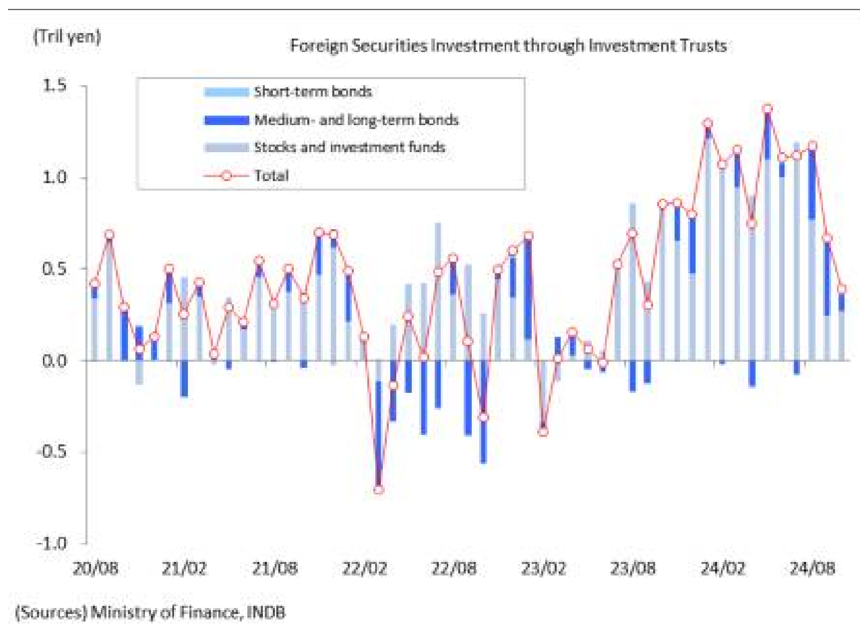
Policies of Next Trump Administration vs. Potential USD Rates

	Direction	Specific Policy	Prices	U.S. Interest Rates	USD
Fiscal Policies	Accommodative	Lowering corporate taxes, semi-permanent extension of Trump tax cuts, etc.	Increase	Increase	**USD strength**
Monetary Policies	Accommodative (→Tight)	Trump himself wants USD weakness and lower interest rates, but policies are inflation-inducing	Increase	Decrease (→increase)	**USD strength**
Trade Policies	Tight	Flat tariffs (60% on China, 10-20% on other countries)	Increase	Suggesting increase	**USD strength**
Other Policies	Restrictions on immigration	Trump has promised "largest deportation" in U.S. history	Increase	Increase	**USD strength**
	Renewal of energy policy	End of excessive climate change measures	Decrease	Decrease	**USD weakness**
	Debt ceiling measures	"Triple-red" could end protracted turmoil	?	Probably decrease?	**USD weakness?**

(Source) Compiled by author based on various media reports

Risks to My Main Scenario – Has Household JPY Selling Peaked?

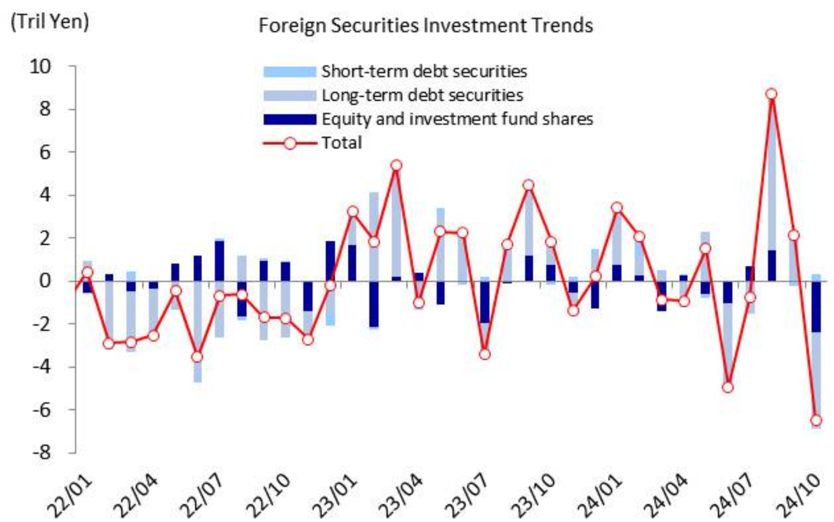
Household JPY Selling at Lowest Level in 13 Months



Household JPY selling, which is thought to have been driving JPY depreciation since the beginning of the year, is starting to show signs of change that cannot be overlooked when formulating the medium- to long-term outlook for JPY. According to the International Transactions in Securities (based on reports from designated major investors) released by the Ministry of Finance on November 11, foreign securities investments via investment trust management companies (hereinafter "investment trusts") had increased by +JPY393 billion, the smallest net purchase in 13 months since September last year. Looking at it by product, equity and investment fund shares had increased by +JPY271.7 billion, long-term debt securities had increased by +JPY86.3 billion, and short-term debt securities had increased by +JPY35 billion, all of which posted net purchases, but by extremely small amounts relative to what we have seen since the launch of the new NISA scheme. The reason is not altogether clear, but with expectations of a Trump victory leading the markets in October, a triple upswing in U.S. interest rates, USD, and stock prices was increasingly evident despite dramatically weak job data and other fundamentals for September. Under these circumstances, there is a strong view that the move to sell off U.S. Treasuries (cut losses), including by investment trusts (i.e., households), dominated in the markets. Looking only at long-term debt securities, a historically large net purchase of around JPY 400 billion was posted for August and September, when there was talk of the Fed starting a rate cut phase. The explanation that the move by investors to cut their losses predominated is certainly convincing, and perhaps we should appreciate the fact that a net purchase (rather than a net sale) was still maintained.

Largest Net Sale in Foreign Securities Investment as a Whole

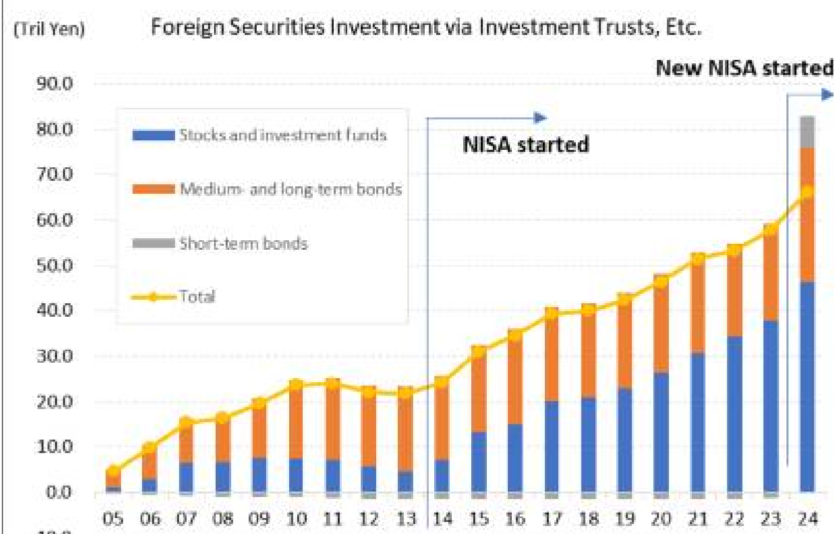
The net sale of foreign debt securities was also a theme throughout October. The October foreign securities investment as a whole posted its largest net sale ever recorded, at -JPY6.4987 trillion. As the figure shows, the biggest contribution to this net sale came from long-term debt securities, at -JPY4.4881 trillion. However, this should be evaluated as a set with the largest net purchase ever recorded, at +JPY7.337 trillion, posted in August. The aforementioned explanation that investors bought in August and cut their losses in September is quite convincing. Meanwhile, inward securities investment for October posted a net purchase of +JPY6.5934 trillion, resulting in a net inflow of +JPY13.921 trillion (JPY6.4987 trillion +JPY 6.5934 trillion) for inward and foreign securities investment combined. This figure is also the largest ever to be posted. Note that there was a sharp rise in USD/JPY in the forex market, with the currency pair eventually settling at the 150 level. Since the volume of inward and foreign securities investment with currency hedges is also relatively large, it is difficult to find a stable relationship between the net capital inflow and the market price. In the case of inward securities investment, in particular, since most of it is currently in the form of equity and investment fund shares, it is reasonable to assume that this portion represents a currency-hedged flow.



(Source) Ministry of Finance, INDB, Mizuho Bank

Has Household JPY Selling Peaked?

Foreign securities investment trends by investment trusts have also been attracting attention as much of the household JPY selling associated with the launch of the New NISA scheme is not currency-hedged, and it is suspected that this is the main driver of large-scale outright JPY selling. In fact, there is strong suspicion that this flow contributed to JPY depreciation during 1H of 2024.The cumulative net purchase by investment trusts for the first 10 months of the year reached as much as +JPY10.1045 trillion though showing signs of stalling in September and October. While it is difficult to predict the pace of net purchase growth for the remaining two months of the year, the fact is that investment trusts have already sold more than twice the amount of JPY they had sold for the whole of 2023 (+JPY4.5 trillion), making it difficult not to link this with JPY weakness. Precisely for this reason, it is important to pay attention to whether household JPY selling will continue to shrink.



(Source) INDB; Cumulative total starting from 2005.
The figure for 2024 is up to September.

Since November, speculative JPY selling in response to interest rate differentials has increased, and given that the New York Dow Jones Industrial Average and other stock indexes are continuing to renew all-time highs, the household sector's desire to invest in foreign-currency-denominated assets will probably recover, but there is a possibility that households will give precedence to decisions that may seem wise in the short term, such as selling while prices are high, especially with the experience of August burned into their memories (as investors, Japanese households are known to be highly risk-averse).If that happens, one must consider the risk that investment trust trading trends may turn from net buying to net selling again. In itself, that would engender a change in the tide that contributes to curbing JPY depreciation, which would be positive for the Japanese economy in the short term. On the other hand, some may view this as a stumbling block in the way of Japan becoming a leading asset management center. At any rate, the issue of whether or not the unprecedented pace of household JPY selling continues to falter will significantly impact the sustainability of JPY depreciation. I think the household sector recognizes expectations of JPY depreciation going forward as a fairly persistent market phenomenon, so my prediction is that it will continue to invest in foreign-currency-denominated assets at a steady pace, but the risk of this not being the case must also be kept in mind.

EUR Outlook –EUR Dragged Down by ECB's Continued Rate Cuts

Euro Area Monetary Policy Now and Going Forward - Growing Contrast Between Euro Area and the U.S.

Situation Conducive to December Interest Rate Cut?

No ECB Governing Council meetings were held in November. However, the Account of the October 16-17 meeting were released on November 14 and will serve as important material for predicting the outcome of the December 12 meeting, so I would like to provide an overview of the current situation at the time of writing this report based on the Account. A 25bp rate cut was decided in the natural course of things at the October meeting, and ECB President Christine Lagarde stressed on the weakness of the regional economy in her press conference. The Account also reveals concerns about the regional economy, for example, noting about the latest readings of soft data typified by the PMI, that they "signalled a weaker near-term outlook than had been foreseen in the September projections." It further mentions a downward revision from September projections in the ECB's monthly Survey of Monetary Analysts (SMA). As the chart shows, recent SMA projections increasingly foresee the euro area Harmonized Index of Consumer Prices (HICP) falling stably below +2% on a core basis during 2025. A situation conducive to emphasizing a rate cut as the next move by the ECB was developing.

ECB Survey of Monetary Analysts (SMA) Projections for Forseable Future

	Real GDP			HICP（Core）		
Projection period	Jul	Sep	Oct	Jul	Sep	Oct
Jul 2024	2.8	2.8	2.8	3.0	2.2	1.9
Oct 2024	2.7	2.7	2.7	2.6	2.3	2.1
Jan 2025	2.6	2.5	2.4	2.5	2.1	2.0
Apr 2025	2.4	2.3	2.2	2.2	2.0	1.9
Jul 2025	2.2	2.1	2.1	2.1	1.8	1.9
Oct 2025	2.1	2.1	2.0	2.1	1.9	1.8
Jan 2026	2.0	2.0	2.0	2.0	1.9	1.8

(Source) ECB

Inflation Not Seen to be "Undershooting"

However, the weakening of the regional economy has suddenly become a point of contention since the summer, and it seems possible that it may have been over-hyped as a justification for rate cuts, especially by short-term investors. The Account of the Governing Council meeting continued to state that "Labour cost dynamics would also continue to be a key concern for domestic inflation, and wage pressures needed to be carefully monitored." Although the sharp nominal wage growth trend has clearly peaked, wage growth "was expected to remain (...) volatile for the rest of the year, given the significant role of one-off payments and the staggered nature of wage adjustments." It is true that the negotiated wages and service prices in the HICP have maintained high growth (details below), and that is why the Account noted that "more readings would be needed for a clearer picture" in order for the Governing Council to arrive at a decision. It additionally mentioned that "key data (...) would only arrive in the first half of 2025."
Regarding the outlook for inflation overall, taking into account movements in nominal wages, it is also stated, "A large, persistent undershooting of the 2% inflation target (...) remained unlikely. This was mainly because structural inflationary trends such as geopolitical fragmentation and climate change were likely to lead to more frequent adverse supply shocks." The Account repeatedly stressed that there was no need to consider "a scenario of undershooting" at the present time. In sum, there is no sense that vigilance against inflation expectations will be lifted anytime soon.

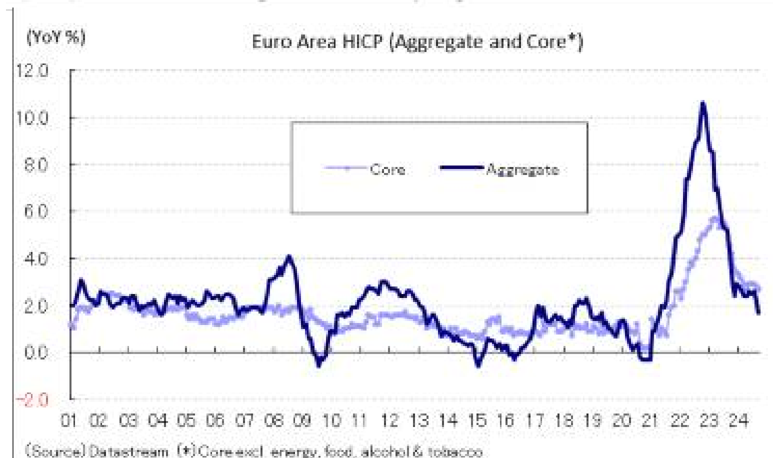
Policy Interest Rate Trajectory

In my Mizuho Market Topics edition previewing the October 17 Governing Council meeting, given that the interval between the October and December meetings was longer than usual, with the U.S. presidential election falling in between, I had surmised that the ECB might have to pay a large price for not cutting interest rates in October by having to implement a -50bp rate cut in December. Based on this, I had predicted that the Lagarde administration, with its dislike for discontinuous policy operation, might implement a preventive -25bp rate cut in October. The Account confirms that this was indeed the case. "A few members initially expressed a view that they would have preferred to accrue more information and to wait until December, when a comprehensive assessment of the medium-term outlook for inflation was available. However, these members could see the precautionary risk management case for cutting now, and thus expressed their readiness to support the proposal." A unanimous decision was, therefore, made to implement a -25bp cut. Going by the discussions at the October Governing Council meeting, a rate cut at the December 12 meeting, the final meeting of the year, does not seem certain. However, given that existing concerns about the regional economy have not been completely dispelled, and the start of the second Trump administration also looms on the horizon, a third consecutive rate cut may be the expected course of action.

Euro Area Economy and EUR Now and Going Forward - Paying No Attention to Soaring Wages

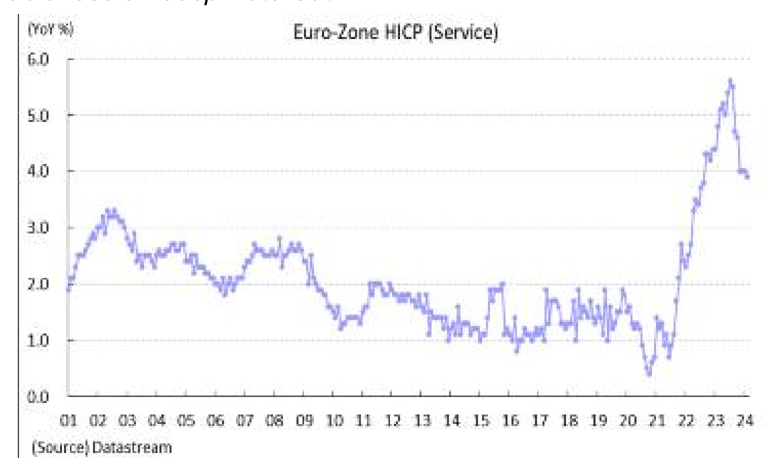
Negotiated Wage Growth at All-Time High

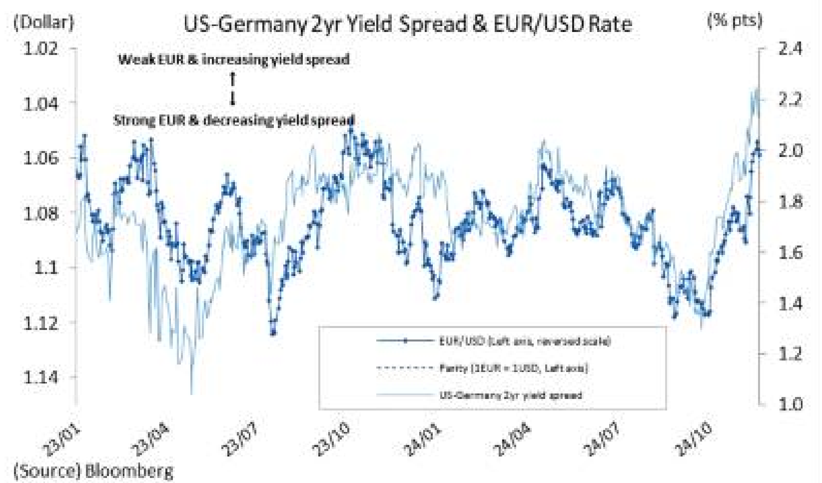
The strength of basic economic indicators must be estimated based on the discussions at the most recent meeting as described above. On November 20, the euro area's negotiated wage growth for the July-September period, an important indicator for predicting the ECB's next move, was released, and I would like to take a look at it here. Negotiated wages grew by +5.4% yoy, accelerating from +3.5% yoy for the previous quarter and recording the largest growth since statistics began. One day earlier (on November 19), Germany's central bank, the Deutsche Bundesbank, had announced that German negotiated wages for the July-September quarter had posted +8.8% yoy growth, nearly three times the previous quarter's +3.1% and the strongest since the summer of 1993.The figure for the euro area as a whole was boosted largely by Germany's strong growth. The Bundesbank stated that the results were mainly owing to strong wage growth in the retail, wholesale, and foreign trade sectors, pointing out the attempt by workers to weather the weak economy by demanding higher wages. The bank also stated, however, that it "expects the forthcoming wage negotiations to result in distinctly lower agreements." going forward, which is consistent with the ECB's perception of the market in the entire region.



Economic Slowdown From 2025 Onward and Reasonableness of -50bp Rate Cut

In fact, as the above chart shows, the wages advertised in job postings, which are a leading indicator, do not suggest an increase in negotiated wages in Germany or the euro area going forward. The ECB has repeatedly explained that the reason why negotiated wages rose more than advertised wages had suggested during the July-September period this year was because of lump-sum payments from companies aimed at restoring past purchasing power. The policy view of the ECB and the Deutsche Bundesbank is that negotiated wages will cool off and converge to the level of advertised wages, and the financial markets have also factored this in, which is why the interest rate cut at the Governing Council on December 12 is considered a given. However, I have my doubts regarding the expected -50bp rate cut rather than -25bp.Considering the strength of negotiated wage growth and service prices (visualized in the chart, top right), the ECB will find it difficult to implement a -50bp rate cut even if negotiated wage growth is expected to fall going forward. Further, even though the 5-year, 5-year forward inflation swap, which the ECB traditionally pays attention to, is on the decline, it has not yet fallen below 2%.It is a delicate situation as to whether a significant rate cut is necessary because the anchor for inflation expectations has been removed (see chart, bottom).However, the ECB may decide to act now based on the perspective that it would be too late to act after the anchor is gone.





In the first place, the reason the ECB has refrained from issuing decisive information on rate cuts is because of a lingering risk that sustained higher-than-expected wage growth could lead to aggressive pricing behavior by companies. I will retain my prediction of a 25bp rate cut. However, this is only in connection with market predictions of a 50bp rate cut at the December meeting. I do not disagree that rate cuts will continue throughout the first half of 2025.At present, financial markets are pricing in rate cuts worth just under -120bp over the four meetings through April. Assuming the above to be the most dovish scenario, the policy interest rate could be on a trajectory to receive a -75bp to -100bp cut (assuming -25bp at each meeting by April, or skipping just one meeting) if things go smoothly. In November, EUR/USD temporarily fell below 1.05 as the contrast between the Fed's rate cuts, which are nearing their end, and the ECB's rate cuts, with no end in sight, began to sink in. This movement itself is as I have expected in this report (see figure).

German Politics Now and Going Forward - Sudden Collapse of Coalition Government and What Followed

German Political Collapse Backstage of Japanese-American Politics

Following the Japanese snap general election of the House of Representatives at the end of October and the recent presidential election in the U.S., the Japanese and U.S. political scenes are on the verge of major change. However, little attention has been paid to the extreme turmoil in Germany's political situation behind the scenes. As previously reported, the Olaf Scholz administration, which was formed in 2021, suddenly collapsed in early November. Having come barely a few hours after the U.S. presidential election (on November 6), the story got buried in the global news, but it is worth noting that, in addition to the country's economy, which is said to have entered a long-term stagnation phase, its political situation is also on the verge of extreme turmoil. Rather, it may be because of the stagnant economy, and the country's politicians' inability to find solutions out of the current situation, that its politics has been thrown in turmoil. It is truly a situation of "poverty makes the mind dull." The trigger for the recent collapse was a conflict within the administration over the budget proposal for next year (details below).

Let me begin by summarizing the current state of German politics. The Christian Democratic Union (CDU) led by former Chancellor Angela Merkel was defeated in the September 2021 general election. This marked the end of Merkel's reign of 16 years, the longest ever in German politics, and the beginning of what has been called the "After-Merkel" era. A coalition government comprising the center-left Social Democratic Party of Germany (SPD) led by Chancellor Olaf Scholz, the pro-environment Alliance 90/The Greens party, and the libertarian Free Democratic Party (FDP) took the place of the CDU. However, as feared from the start, this coalition government, which is a perfect example of "same bed, different dreams," was inconsistent in all its policy decisions, and its approval rating has continued to deteriorate amid intermittent differences of opinion. The coalition was saddled with a structure in which the SPD and The Greens advocated for expansionary fiscal policies in order to strengthen social security and address climate change, while the FDP advocated strict austerity (details below). Moreover, the FDP, which advocates a realistic energy policy, takes a tolerant view of the use of nuclear power, while The Greens strongly advocate the penetration of renewable energy. This makes the FDP-Greens coalition literally like "oil and water." Meanwhile, the FDP takes a stricter stance on immigration, which is a constant point of contention in German society, while the SPD and The Greens take a more tolerant attitude here. For the past three years, the above three parties have managed to keep their coalition intact by finding partial common ground with each other.

Snap General Election to be Held in February 2025

However, as the German economic slump, caused mainly by the worsening energy situation, begins to be taken seriously, an irreparable crack has finally begun to appear in the coalition. The deciding factor was, as expected, the difference between the SPD, which advocates expansionary finance, and the FDP, which advocates austerity. As generally known, the German constitution has a budget-balancing provision (known as the "debt brake"), which limits the size of the government's budget deficit per year to no more than 0.35% of its GDP. However, this provision is not a time-honored tradition; it was only introduced by the Merkel administration in 2009.

With the real economy already weak, and anticipating that the protectionist policies of the second Trump administration would become a drag on the German economy, Scholz invoked the emergency clause to avoid the debt brake and advocated propping up the economy through expansionary fiscal policy. Given the current state and outlook for the German economy, this was a reasonable decision. However, FDP leader and Finance Minister Christian Lindner refused to go along. The ever-existent gap between the SPD and FDP could not be bridged even in the midst of a German economic downturn. Despite the worsening energy situation due to the outbreak of the Russia-Ukraine war, Germany went on to completely phase out nuclear power, leading to the current economic downturn. It appears that this attitude of "self-destruction through the prioritization of ideals over reality" is a common feature of all politics. Given

the current state of Germany, which is mocked as “the return of the ‘sick man’ of Europe,” one could justify some government support, but the FDP refused to compromise on austerity. As a result, German politics are heading for chaos, and the FDP may have difficulty being elected to power again in the next election.
Scholz dismissed Lindner as finance minister, stating at a press conference on November 6, “We can no longer build trust,” and “he is acting irresponsibly,” leading to the collapse of the coalition government. Going forward, Scholz will seek the cooperation of other opposition parties and consult with the parliament (Bundestag) on his intended policies, such as support for the automotive industry and measures to reduce the energy burden on the corporate sector. He has indicated his intention to hold a vote of confidence in the chancellor in the Bundestag on December 16, 2024. Scholz had originally scheduled the vote of confidence for January 15, 2025, but was pressured by calls for an earlier vote, mainly from the largest opposition party, the CDU, and its sister party, the Christian Social Union (CSU).
If the no-confidence motion passes, President Frank-Walter Steinmeier will decide whether to dissolve parliament within 21 days, and a general election will be held within 60 days of the dissolution. As of the present time, the snap election seems likely to take place in February 2025. This is more than six months earlier than the previously scheduled date sometime in September 2025.

Merz May be Next Chancellor, but Coalition Structure Still Undecided

As the no-confidence vote in the chancellor has not yet been passed, it is too early to give a preview of the general election. However, going by recent trends, it seems likely that the CDU/CSU will regain power, and that CDU leader Friedrich Merz will become the next chancellor. Incidentally, Merz is said to have been on very bad terms with and broken off ties with former Chancellor Merkel. Whether or not there is any intention to reject Merkel’s policies, the current CDU administration under Merz has expressed opposition to any energy policy that avoids certain energy sources. In other words, it is willing to restart nuclear power plants.
However, it may be difficult for the CDU/CSU to gain a majority on their own, so there will be no change in the situation when it comes to the need for stitching together a precarious coalition. There is a strong view that the FDP may not be able to win any seats, due in part to the negative image it has gained from the recent political turmoil. The easiest option would be to form a coalition with the far-right Alternative for Germany (AfD) party, which is right behind the CDU/CSU in terms of support ratings, but the CDU/CSU are adamantly opposed to this. With the German economy in dire straits, German politics is in greater need of stability than ever before, but a coalition with the AfD is almost unthinkable. If so, it is expected that, in addition to the grand coalition between the CDU and SPD, other parties such as The Greens will join. Of course, the SPD and The Greens may refuse to join the coalition, fearing a slowdown in their momentum if they become overshadowed by the CDU. The Greens have low support ratings due to the criticism that their excessive environmental protectionism is threatening people’s livelihoods through changes to the automobile industry and energy policy, and it is doubtful how much fighting power they will have as a coalition partner (frankly, the German people have brought this on themselves with their excessive idealism).
In the midst of this, a coalition between the CDU and the far-left Sahra Wagenknecht Alliance (BSW), which was founded just last year, is rapidly gaining attention. In the state elections held in September in three former East German states, the far-right and far-left parties AfD and BSW both made great strides, but the CDU are in coalition talks with the BSW to prevent the AfD from participating in state governments. However, the pro-Russia stance of the BSW, which rejects aid to Ukraine, is incompatible with the CDU/CSU. It has also been pointed out that the CDU’s party rules prohibit it from forming a coalition with the far-left. Given how difficult it is to achieve a compromise between the two parties following state elections, it is difficult to take for granted that they will form a coalition in national politics.
Of course, it is too early to provide a detailed preview of a potential general election even before the vote of no-confidence in Chancellor Sholz has taken place or a date for the general election has been announced. However, as symbolized by Volkswagen’s closure of its factory in Germany, both domestic and foreign companies are currently avoiding Germany as their base of operations. There are many possible coalitions that could be formed following the upcoming general election, and nothing can be said for certain at this point. However, there is little doubt that the German economy is in need of a stable energy policy under a stable government more than it has been ever before. Going forward, a variety of compromises will be absolutely necessary, including in energy policy (the use of nuclear power), fiscal policy (revising the debt brake), environmental policy (revisions to industrial policy emphasizing EVs), and many other areas. As a result, it can be said that the times call for a certain degree of compromise in the composition of the coalition government as well.

Daisuke Karakama
Chief Market Economist
Global Markets Sales & Trading Department
Mizuho Bank, Ltd.
Tel: +81-3-3242-7065
daisuke.karakama@mizuho-bk.co.jp

These materials and the content of any related presentation are confidential and proprietary and may not be passed on to any third party and are provided for informational purposes only. Assumptions have been made in the preparation of these materials and any such presentation and Mizuho Bank, Ltd. ("**Mizuho**") does not guarantee completeness or accuracy of, and no reliance should be placed on, the contents of these materials or such presentation. Nothing in these materials or any related presentation constitutes an offer to buy or sell or trade and the terms of any transaction which may be finally agreed will be contained in the legal documentation for any such transaction, with such transaction being priced at market rates at the relevant time (the rates herein or in any related presentation being purely illustrative). (As a general rule you will not have a right to terminate early any transaction entered into – if you wish to do so, losses may be incurred by you.) These materials and any related presentation should not be considered an assertion by Mizuho of suitability for you of any transaction, scheme or product herein or therein. Mizuho has no duty to advise you on such suitability, nor to update these materials or contents of any related presentation. You must determine in your own judgment the potential risks involved in the transactions outlined herein or in any related presentation (taking professional financial, legal and tax and other advice) and whether or not you will enter into any transaction that may arise from these materials or related presentation. Nothing herein or in any related presentation should be construed as providing any projection, prediction or guarantee of performance or any financial, legal, tax, accounting or other advice. Mizuho shall have no liability for any losses you may incur as a result of relying on the information herein or in any related presentation. "MHBK provides this information for free. Please request for cancellation of subscription if you do not want to receive free-of-charge information from MHBK."