FX Pulse

FICC Research Dept.

Takaichi or Koizumi?

- Time to trade on speculation over next LDP president

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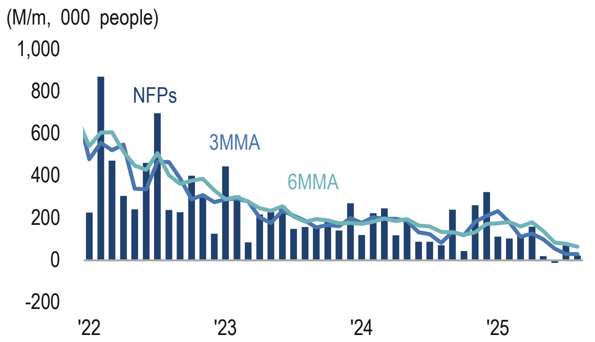
US jobs data within expectations

The US jobs data for August, released on 5 September, showed that non-farm payrolls (NFP) increased by 22,000 m/m, falling below the forecast of +75,000 (Chart 1). The previous two-month data was also revised downwards by a total of 21,000, but this was not as much as the prior revision (–258,000 in total). The figures for June were also revised downwards, falling into negative territory (+14,000 to –13,000), posting the first decline since December 2020. The 3-month moving average, which represents employment momentum, stood at just +29,000, and the 6-month moving average has also decelerated significantly to +61,000.

Private sector employment rose by 38,000, with the 3-month moving average at +29,000, its slowest pace of growth since May 2020. Private education and health services, while slowing to +46,000 (from +79,000 in Jul), remained the largest driver of growth, and other sectors continued to show a downtrend (Chart 2). The unemployment rate was 4.3%, in line with market expectations, but up from 4.2% for the previous month. Including the third decimal place, the unemployment rate was 4.324% (4.248% in Jul), its highest level since October 2021. Furthermore, the U-6 rate, the broadest measure of unemployment which includes discouraged workers, also rose to 8.1%, its highest level since October 2021.

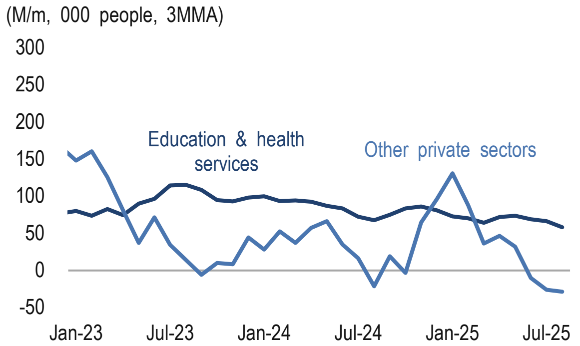
Based on trends in the Quarterly Census of Employment and Wages (QCEW), the preliminary benchmark revisions to be released on the 9th are highly likely to result in significant downward revisions to the NFP series, similar to last year (Chart 3 on the next page). In his speech at end-August, Fed Governor Christopher Waller showed projections that the benchmark revisions would lower employment by about 60,000 on a monthly average basis, or 720,000 annually. Given this, he argued for a 25bp rate cut in September. Therefore, the key regarding the extent of the rate cut in September will be whether the downward revisions to employment data are significantly greater than Waller's projections.

Chart 1: Change in No. of US Non-farm Payrolls (NFPs)



Source: US Department of Labor; compiled by Daiwa.

Chart 2: Change in No. of US Education & Health Services and Other Private Sector Employment



Source: US Department of Labor; compiled by Daiwa.

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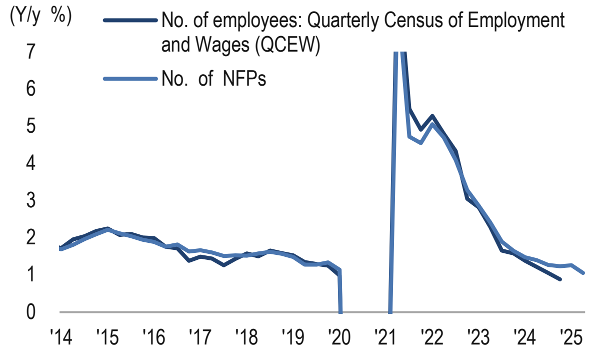
Chart 3: US Employment Growth Rate (establishment survey and QCEW data)



Source: US Department of Labor; compiled by Daiwa.

Chart 4: Terminal Rate Priced in by US Interest Rate Market

Source: Bloomberg; compiled by Daiwa.
Note: Minimum values over the next two years in interest rate futures market.

As mentioned in last week's report, movements towards lower interest rates and a weaker dollar will depend on (1) whether expectations for three or more rate cuts (75 bp) this year—including discussions of a 50bp cut in September—increase in the market and (2) to what extent the market prices in the possibility of the terminal rate falling significantly below 3%. In light of the August jobs data, the market is now pricing in a 50bp cut in September to some extent, with a total cut of 69bp expected by year-end. The market is kind of sensing a level below 3% for the terminal rate, but it has not yet moved to fully price it in (Chart 4). The 10-year US yield has fallen below 4.1% and appears to be breaking out of the range it has been in for the past six months (excluding the chaotic period after the US "Liberation Day" on 2 Apr), but the Dollar Index (DXY) continues to trade within its range.

Time to trade on speculation over next LDP president

On 2 September, the Liberal Democratic Party (LDP) held a review committee meeting about the Upper House election in which the ruling coalition failed to secure a majority. The committee's findings were reported at the Joint Plenary Meeting of LDP Members of Both Houses of the Diet ("Joint Plenary Meeting") held on the same day. At the Joint Plenary Meeting, Secretary-General Hiroshi Moriyama, who chaired the review committee, announced his intention to resign as Secretary-General, stating he would leave his fate in the hands of Prime Minister Shigeru Ishiba. Shunichi Suzuki (General Council Chairman), Itsunori Onodera (Policy Research Council Chairman), and Seiji Kihara (Election Strategy Committee Chairman) also tendered their resignations to PM Ishiba after the Joint Plenary Meeting.

The next key political event was to be the confirmation of requests to implement an "extraordinary party leadership election" at the Joint Plenary Meeting" slated for the 8th. However, with the 7 September announcement of PM Ishiba's intention to resign, the focus will now shift to the timing of the leadership election and who will become the next LDP president. As happened when the market reacted to the news that Secretary-General Moriyama had indicated his intention to resign, the market at the start of the week is likely to see selling pressure on the yen and upward pressure on yields, mainly in the superlong sector, due to concerns about fiscal expansion.

On the 7th, PM Ishiba held an emergency press conference at the prime minister's office and announced that he would resign as President of the LDP. He explained that one issue had been settled with US President Trump's signing of an executive order that includes reductions in automobile tariffs. However, he can be said to have abandoned his bid to stay in office once it became inevitable that the leadership election—effectively a recommendation for him to step down—would be moved up.

By the end of this week, the LDP is expected to decide on the schedule and format for the leadership election accompanying the prime minister's resignation. If it opts for "full-scale" voting, which includes a vote by party members and takes more time, the new leader is expected to be chosen in early October. With PM Ishiba stating that he will not run, attention is turning to potential candidates, such as former Minister for Economic Security Sanae Takaichi and Minister of Agriculture, Forestry and Fisheries Shinjiro Koizumi, who were top contenders in the previous leadership election in September 2024.

Given that Ms. Takaichi came in first in the initial round of the 2024 leadership election before being defeated by Ishiba in the run-off, it is natural that she would be seen as a strong contender if she declares her candidacy. Since she has emphasized the continuation of "Abenomics," her presidency would likely be closely associated with expansionary fiscal policy and a retreat from the path of interest rate normalization, potentially being seen as a factor for yen depreciation.

With prolonged inflation having become a political issue, she might be cautious about curbing the path towards monetary normalization in a way that fuels yen weakness. However, if she were to make remarks such as “I think it would be stupid to raise interest rates now,” as she did during the last leadership race, it could trigger a resumption of the yen carry trade (in the current context, an unwinding of yen long positions).

Meanwhile, the media reported that on the night before PM Ishiba announced his resignation, LDP Vice President Yoshihide Suga and Agriculture Minister Koizumi urged PM Ishiba to resign early due to concerns that the party might split over the issue of moving up the leadership election. If PM Ishiba resolved to resign, and leave his influence on the next administration, as a result of listening to Suga and Koizumi, Koizumi could also emerge as a strong candidate. Considering potential cooperation with parties like the Japan Innovation Party, we think that this appears to be a plausible path. If Koizumi were chosen as the next LDP president, the market would likely perceive it as a continuation of the status quo, limiting the impact on the market.

If the leadership election is held using the "full-scale” voting method, the convening of the extraordinary Diet session is expected to be delayed until late October. With the minority ruling coalition, key points of interest will be whether the new LDP president will be able to win the election for prime minister and whether the ruling coalition will be able to maintain power, and whether the new prime minister will decide to dissolve the House of Representatives for a general election. Komeito leader Tetsuo Saito reportedly told PM Ishiba during a dinner on the 2nd that a dissolution of the Lower House would be absolutely unacceptable, stating that the current situation was unfavorable for the ruling coalition. Given the outcome of the Upper House election, a dissolution of the House of Representatives would be an unlikely political decision. However, if a snap general election were to occur, speculation about the increased likelihood of opposition parties’ policies being implemented—as well as the possibility of a change of government—would likely make the market inclined to feel that the JGB yield curve might steepen and the yen depreciate.

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