

2026 Outlook - Foreign Exchange Market

Yen Expected to Appreciate to 146 Yen per Dollar by Year-End

December 22, 2025



Key Messages

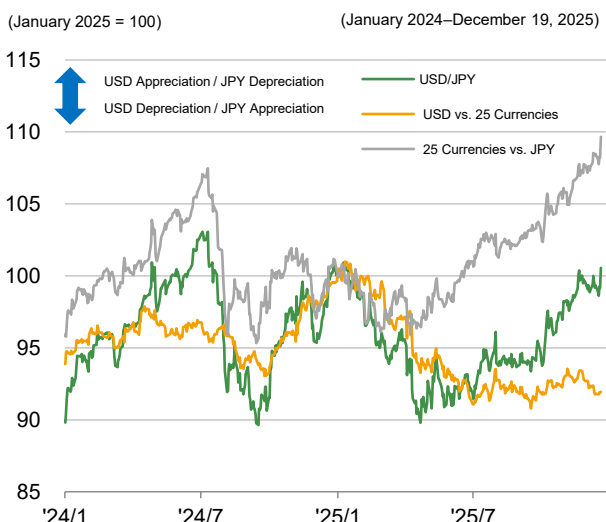
- Yen is expected to appreciate to around 146 per USD by the end of 2026
- The Japan-US interest rate differential will continue to narrow on a real basis, supporting Yen strength and USD weakness
- Risk-on driven Yen depreciation will slow, and exchange rates will move closer to levels consistent with the interest rate gap
- Downside risk for Yen comes from “strong global economic growth”, while upside risk comes from “potential US pressure to correct Yen weakness”

Y2025 Currency Review – Yen and USD Weaken, USD/JPY Edges Higher

In 2025, USD/JPY started at 157.18, reached a high of 158.87 on January 10, and a low of 139.86 on April 22, standing at 157.77 as of December 19. Against currencies other than US Dollar and Yen, both **Yen and US Dollar weakened**. So far, Yen weakness has slightly exceeded US Dollar weakness, resulting in USD/JPY being marginally higher compared to the beginning of the year.

From January to April, **concerns over US Trump tariffs** pushed US interest rates lower and weakened the US Dollar. At the same time, global equity declines led to Yen appreciation in cross-Yen pairs. From April to June, as concerns over US tariffs eased, Yen shifted from risk-off appreciation to risk-on depreciation, but continued US Dollar weakness limited gains in USD/JPY. From July to September, further easing of tariff concerns and **rising expectations for US rate cuts** drove equities higher and accelerated risk-on Yen depreciation. After Ms. Takaichi was elected LDP president in October, Yen depreciation accelerated on expectations of delayed BOJ rate hikes and **concerns over fiscal deterioration**, while **easing US-China trade tensions** also contributed to Yen weakness and US Dollar strength.

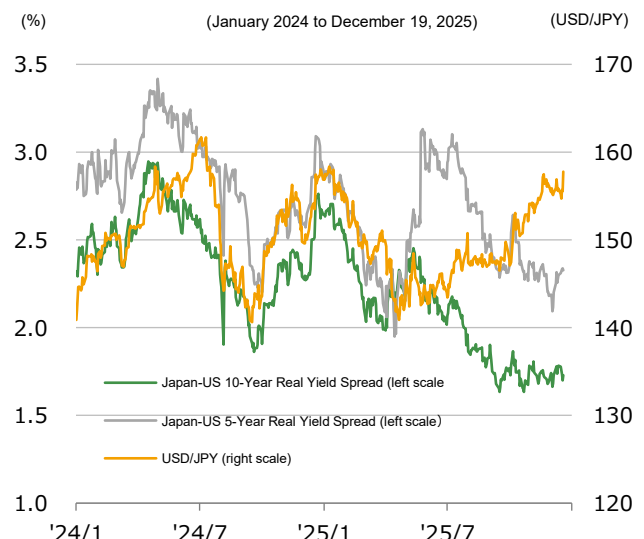
Exchange Rates for USD/JPY and Other Currencies



※Weighted average of exchange rates for 25 currencies based on April 2022 trading volumes

Source: BIS and LSEG; Compiled by Daiwa Asset Management

USD/JPY and Japan-US Real Interest Rate Differential



Source: LSEG; Compiled by Daiwa Asset Management

2026 FX Outlook – Yen Appreciation Driven by Narrowing Japan–US Real Rate Gap and Slower Risk-On

In 2025, US real interest rates for 5- and 10-year maturities declined, while Japan's real interest rates rose, narrowing the Japan–US real rate differential. Although this led to Yen appreciation and USD weakness in the first half of the year, the second half saw Yen depreciation and USD strength. This was likely due to persistent risk-on pressure for Yen weakness alongside global equity gains. For USD/JPY in 2026, **not only the Japan–US real rate differential but also market risk appetite** will be key factors.

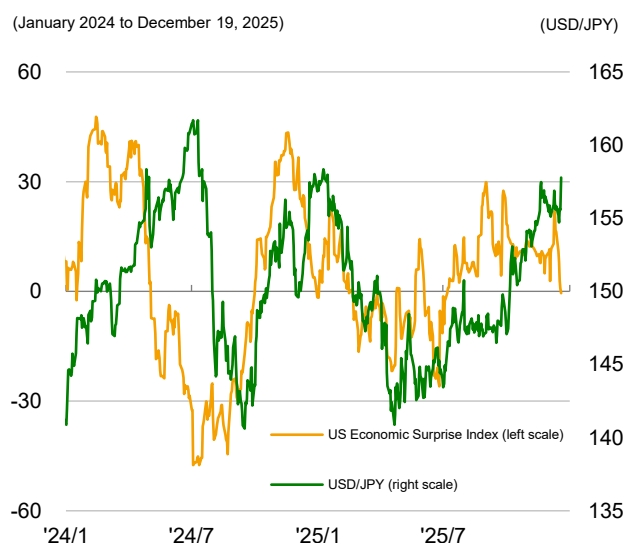
We expect the Japan–US real rate differential to continue narrowing in 2026. In the US, expected inflation is trending lower and rate cuts are anticipated, while in Japan, real rates remain low and rate hikes are expected, leading to a relative rise in Japan's real interest rates. Based on the current 5- and 10-year **real rate differential, the USD/JPY level consistent with fundamentals is estimated at around 141–144 Yen**, but by the end of 2026, we expect USD/JPY to move to a weaker USD level than that.

Currently, USD/JPY is more than 13 Yen above the level implied by the real rate differential. This gap has widened due to risk-on sentiment and the launch of the Takaichi administration. However, as risk-on pressure for Yen weakness fades, the gap is likely to narrow. US economic indicators increasingly fall short of market expectations, signaling a weakening of the strong data that has supported risk-on sentiment. The lingering negative impact of US tariffs may also weigh on global growth, **slowing risk-on driven Yen depreciation**. Furthermore, the Takaichi administration is expected to view excessive Yen weakness, high prices, and rising long-term rates as problematic, **limiting further Yen depreciation driven by fiscal expansion and higher rates**. We forecast USD/JPY to move closer to the level implied by the real rate differential, appreciating to around **146 Yen by the end of 2026**.

Factors that could lead to greater-than-expected Yen weakness and USD strength include **“strong global economic growth”**. If countries benefit from lower inflation and interest rates and global growth exceeds market expectations, risk-on sentiment and rising US rates could push USD/JPY higher. Conversely, factors that could lead to greater-than-expected Yen strength and USD weakness include **“US demands to correct Yen weakness”**. President Trump criticized Japan, China, and others for pursuing currency depreciation policies in March, April, and July this year. Currently, the Yen has fallen to a weaker level against the USD than at that time, and if Yen weakness persists, the US administration may demand corrective measures on Yen weakness and BOJ policy, creating a risk of Yen appreciation and USD depreciation.

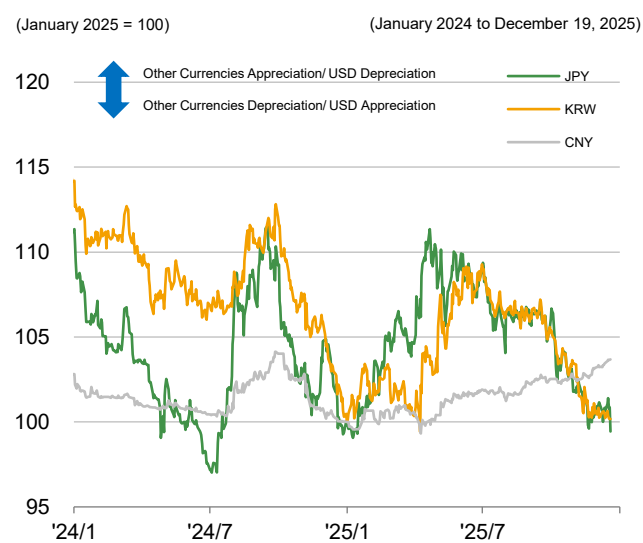
(Written by Yuji Kameoka, Research Department)

US Economic Surprise Index and USD/JPY



Source: Citi and LSEG; Compiled by Daiwa Asset Management

USD Exchange Rates for JPY, KRW, and CNY



Source: LSEG; Compiled by Daiwa Asset Management

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