Forex Medium-Term Outlook

July 31, 2026

Overview of Outlook

In July, USD/JPY continued to renew year-to-date highs before experiencing significant volatility toward the end of the month amid speculation about market intervention. Crude oil prices have rebounded as the turmoil in the Middle East, which had appeared to be subsiding, flared up again. As a result, a 2022-style JPY depreciation, where fears of worsening supply-demand conditions fuel JPY selling, remains a concern. Even as per initial projections, any improvement in Japan's trade balance from the release of crude oil reserves was expected only for March through June, but the deficit had already begun to widen by June, and there is a strong suspicion that the JPY supply-demand balance may have deteriorated further in July (JPY selling has intensified). This is a point that warrants immediate attention, given that JPY did indeed depreciate in July. Further, one cannot ignore the fact that interest rate hikes are the Fed and ECB's established monetary policy path going forward, meaning that BOJ rate hike expectations may be even less effective at curbing JPY depreciation than they previously were. On top of this, speculation is mounting in Japan about prospective consumption tax cuts and other expansionary fiscal policies, which may also be driving JPY selling. Conversely, there also emerged speculation in July that the Government Pension Investment Fund (GPIF) might revise its investment policy to tilt more heavily toward JPY-denominated assets. While the veracity and likelihood of this remain uncertain, those preparing for a risk scenario involving JPY appreciation would do well to pay attention to any such move that could directly alter supply-demand structures. In the very short term, speculative JPY selling has accumulated to extremely high levels, so there remains a significant risk that a trigger, such as currency intervention, could spark a sharp appreciation of the currency. That said, it is also true, from a long-term perspective, that such a move could present a good buying opportunity.

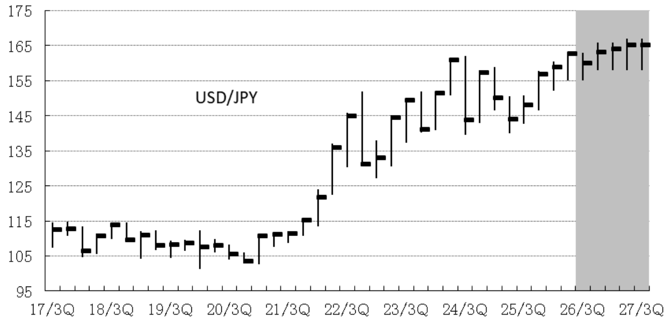
EUR lacked momentum in July. Although the ECB did resume interest rate hikes in June, it refrained from committing to successive hikes, resulting in a clear narrowing of the gap between its stance and that of the Fed, which has also signaled a rate hike as its next move. Consequently, EUR/USD, which is often driven by Europe-U.S. interest-rate differentials, is struggling to find a clear direction. With ECB President Christine Lagarde also noting tighter credit conditions in the region, the baseline expectation is likely for only one, or at most two, rate hikes within the year. However, Lagarde also acknowledged that geopolitical risks were not likely to subside soon, so a return to the situation prior to March, where expectations for rate cuts dominated the market, seems unlikely. A major event to watch during the forecast period is the French presidential election scheduled for the coming year. As reported, the leader of the far-right National Rally (RN) party, Marine Le Pen, expressed her intention to run in July. It remains to be seen whether France's fiscal position, already fragile, could withstand the pressure for expansive spending proposed by the RN. If an unintended rise in regional interest rates becomes normalized, the ECB will find it difficult to proceed with further rate hikes. This is a potential source of unexpected EUR selling to keep in mind in the latter half of the forecast period.

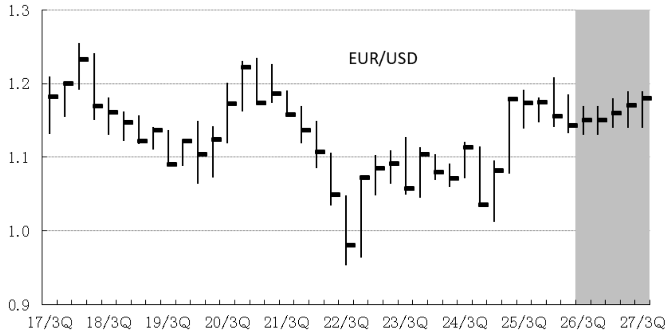
Summary Table of Forecasts

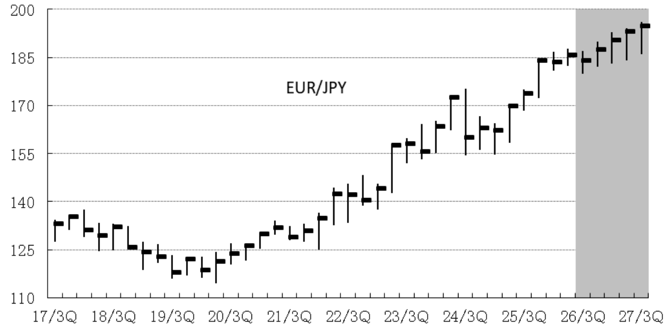
	2026 Jan-Jul (Actual)	Aug-Sep	Oct-Dec	2027 Jan-Mar	Apr-Jun	Jul-Sep
USD/JPY	152.10 ～ 163.99 (160.53)	155 ～ 163 (160)	158 ～ 166 (163)	158 ～ 166 (164)	158 ～ 167 (165)	158 ～ 167 (165)
EUR/USD	1.1325 ～ 1.2084 (1.1518)	1.13 ～ 1.17 (1.15)	1.13 ～ 1.17 (1.15)	1.14 ～ 1.18 (1.16)	1.14 ～ 1.19 (1.17)	1.14 ～ 1.19 (1.18)
EUR/JPY	180.84 ～ 187.95 (184.90)	180 ～ 187 (184)	182 ～ 190 (187)	183 ～ 193 (190)	184 ～ 194 (193)	186 ～ 196 (195)

(Notes) 1. Actual results released around 10 am TKY time on 31July 2026. 2. Source by Bloomberg
3. Forecasts in parentheses are quarter-end levels.

Exchange Rate Trends & Forecasts





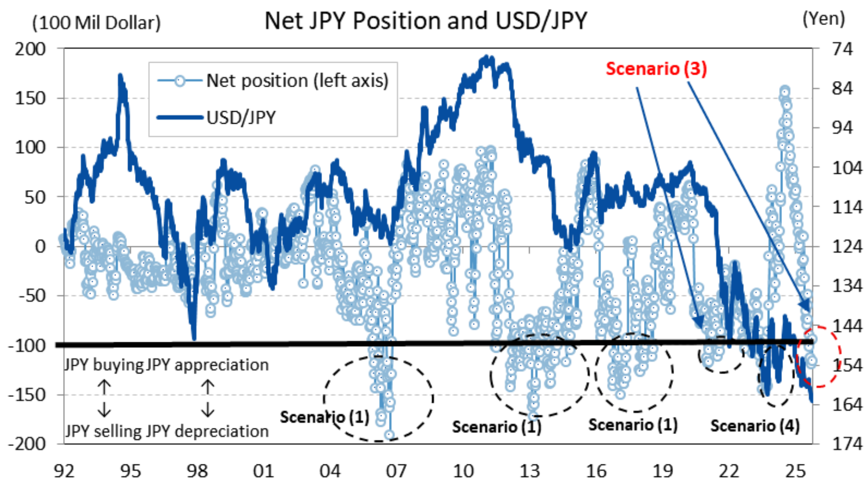


USD/JPY Outlook - Both Real Demand and Interest Rate Support JPY Depreciation

JPY Now and Going Forward: Understanding the Present from a Historical Perspective

Level of JPY Depreciation Against USD Not Seen in Nearly 40 Years

In July, USD/JPY drew attention for hitting a high (USD appreciation against JPY) last seen nearly 40 years ago. Market sentiment favoring JPY selling has taken hold, driven by pre-existing concerns regarding JPY supply and demand combined with speculation about the Fed's hawkish pivot. About 39 and a half years ago, in December 1986, JPY was in the midst of a forced appreciation against USD following the Plaza Accord. As I have previously argued in this report and my other writings, we are currently in the middle of a lengthy weak-JPY era, following the end of the strong-JPY era around 2012.



(Source) CFTC and Bloomberg; prepared by the Global Foreign Exchange Department, Mizuho Bank

That said, JPY has depreciated rather rapidly against USD since the Iran attacks in late February. Over the past five months, USD/JPY has climbed by just under 8% from its mid-February low (around 152) to its recent high. During this time, the Fed and ECB have switched from rate cuts to rate hikes and Japan's trade balance outlook has deteriorated significantly, which makes the movement toward further JPY weakness consistent with the economic fundamentals. Meanwhile, speculative JPY selling encouraged by the deterioration of the fundamentals has also risen. As of July 21, the net JPY short position in IMM currency futures had reached -USD11.65 billion. There have been very few instances since 1992, the earliest date for which data is available, when the net JPY short position has remained over USD10 billion for a sustained period (see dotted circles in the graph). Specifically, aside from two years ago (in 2024), the net JPY short position exceeded USD10 billion in 2017 following Donald Trump's victory in the November 2016 U.S. presidential election, when the "Trump Rally" drove a rapid appreciation of USD against JPY amid expectation of economic policies including massive tax cuts and infrastructure investment. Other instances when the net JPY short position exceeded USD10 billion include during 2013-2015, following the launch of the second Shinzo Abe administration (and its decision to implement "unprecedented monetary easing"), and around 2006-2007, during the phase often referred to as the "weak-JPY bubble." With the exception of 2024, every one of the aforementioned phases was followed by a phase of significant JPY appreciation as those positions were dissolved. In fact, JPY did appreciate significantly between July and September 2024, briefly dipping to below 140 from the 160 level, but the trend lacked staying power and appears insignificant when viewed as part of the longer-term trend.

In the near term, sudden JPY appreciation triggered by specific factors (say a deterioration in U.S. economic indicators or JPY-buying intervention by Japan) is certainly a possibility. Indeed, movements suspected to be an intervention did trigger substantial JPY buying in late July. However, as in 2024, JPY appreciation triggered by an unwinding of speculative positions cannot be expected to sustain its momentum for very long given Japan's trade deficit (details later).

Understanding the Current State of USD/JPY Through Four Scenarios

Unlike in the past, why is JPY appreciation driven by the unwinding of speculative JPY short positions so short-lived today? My theory is that this is because the underlying real demand conditions have changed. The chart on the next page is taken from my 2024 book, *The True Nature of JPY Weakness: Japan Masquerading as a Surplus Nation*. The four scenarios shown in the chart are useful, in the context of Fed policy management, for gaining an overview of the landscape. For instance, scenario (1) corresponds to the period around 2006-2007 and 2017. Although temporary, Japan posted trade surpluses during 2016-2017 (see table), marking it an era that falls under scenario (1). Even in this trade surplus era (scenario (1)), JPY depreciated significantly due to speculative trading. However, when the Fed pivoted from rate hikes to rate cuts, JPY depreciation ended in alignment with real-demand JPY buying, resulting in sustained currency appreciation (entering scenario (2)). This was an era defined by trade surpluses.

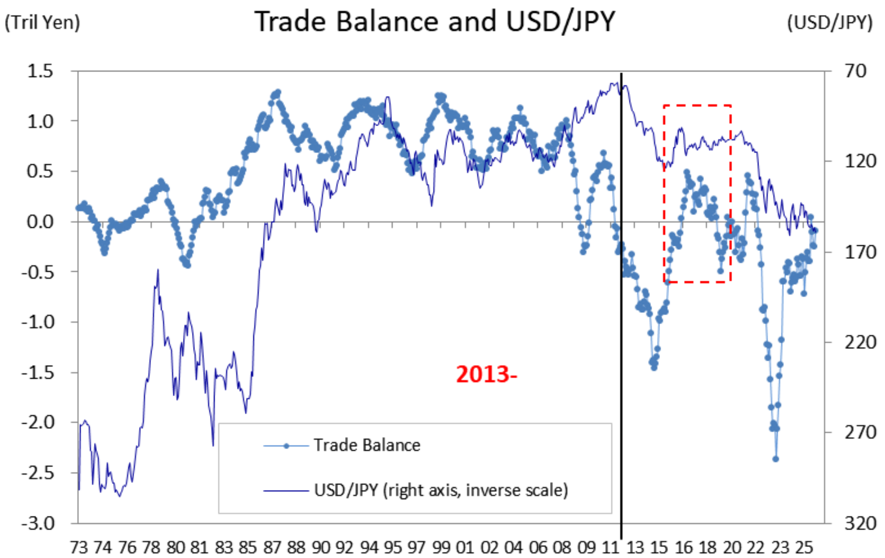
On the other hand, against a backdrop of trade deficits, JPY selling rises due to both speculation and real demand when the Fed enters a rate-hike phase, making a significant depreciation of the currency likely. This corresponds precisely to scenario (3), which was recently observed in 2022-23. From 2024 onward, the Fed shifted to rate cuts and speculative JPY buying became the norm through 2025 (scenario (4)), but there was no notable JPY appreciation. However, while a reversal toward a stronger JPY did not occur, USD/JPY movements during this period show that the depreciation trend did not accelerate either. In other words, this was a period when JPY depreciation was effectively contained. My interpretation is that, while the persistently large trade deficit remained a fundamental factor, other elements played a role from 2025 onward. These included a shift away from JPY alongside the move to de-dollarize (in what I call "shared-fate risk") and, from October 2025, renewed expectations for reflationary fiscal and monetary policies in Japan following the transition to the Takaichi administration. These factors likely made it difficult for JPY to appreciate (indeed, the net JPY position shifted from long to short around October 2025).

In any case, scenario (3), involving accelerated JPY depreciation and USD/JPY hitting new highs, is the scenario to fear, and the current situation does, objectively, appear to align with it. USD/JPY climbing to levels last seen roughly 40 years ago is not merely due to speculative trades; there are valid underlying reasons for it. For the time being, a long-term strategy betting on the persistence of JPY depreciation while anticipating temporary pullbacks caused by market interventions, similar to those seen between July and September 2024, is likely to prove profitable.

JPY Supply and Demand and Fed Policy Operation Scenarios

	Trade surplus		Trade deficit	
Scenario	①	②	③	④
Fed policy direction	Tighening	Easing	Tightening	Easing
Speculative trade	**JPY selling**	JPY buying	**JPY selling**	JPY buying
Actual-demand trade	JPY buying	JPY buying	**JPY selling**	**JPY selling**
Example period	*Around 2006-07 and 2017*	*Dec-07*	*2013-15, 2022-23, **2026-(?)***	*Around mid-2024*

(Source) Prepared by the Global Foreign Exchange Department, Mizuo Bank



(Source) Bloomberg; prepared by the Global Foreign Exchange Department, Mizuo Bank

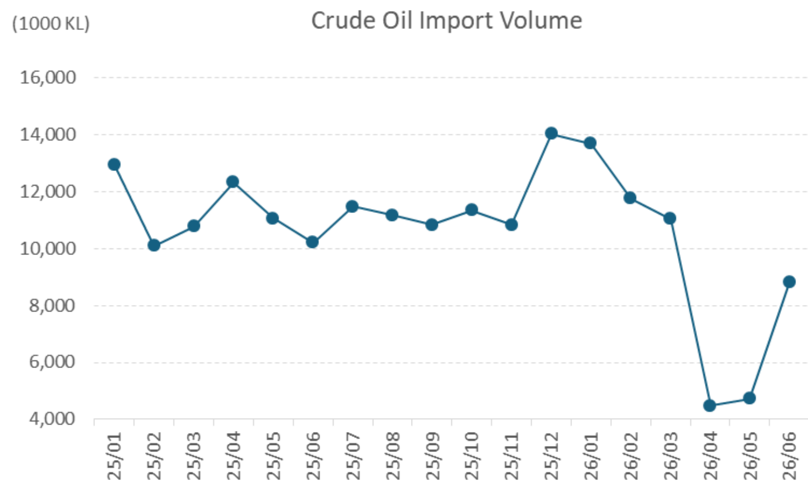
Note:The trade balance is shown with a six-month lead and presented as a six-month moving average.e balance is shown with a six-month lead and presented as a six-month moving average.

JPY Supply-Demand Climate: Demand Beginning to Deteriorate as Expected

Deficit Expanding as Predicted

There is likely more than one reason behind the renewed JPY rate volatility since the start of July. However, the situation I had previously expressed apprehensions about in this report appears now to be unfolding. The trade balance for June, announced on July 22, posted a significant deficit of JPY406.9 billion for the first time in five months. Since March, immediately following the attack on Iran, I have been conducting detailed simulations of the outlook for Japan's trade balance. My baseline scenario projected that the trade deficit would not widen, and might even improve, during the March through June (reported in July) period thanks to the release of oil reserves, but that the trend would be difficult to sustain from July (reported in August) onward. Events are proceeding largely as predicted; I believe we are seeing the anticipated deterioration in JPY supply and demand following a brief improvement. Further, I suspect it is precisely because this scenario was foreseeable that speculative JPY selling has persisted.

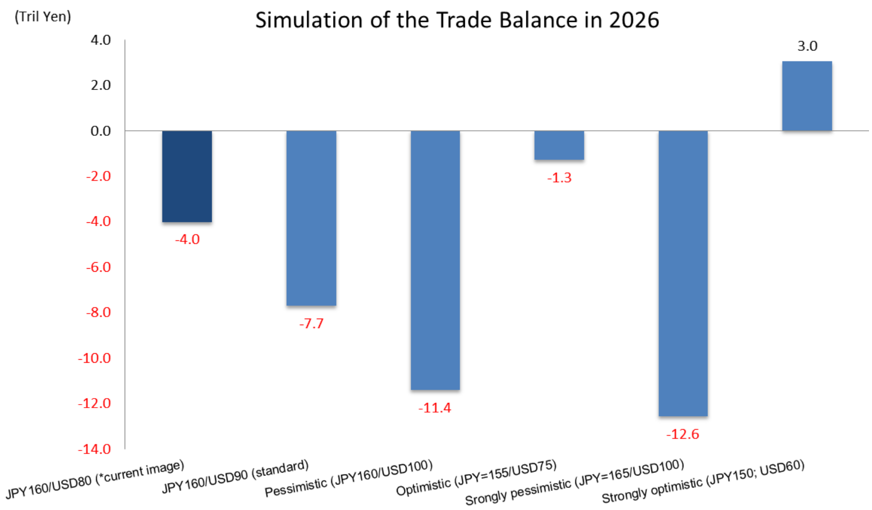
Let me explain in detail. Starting mid-March, Japan released crude oil reserves covering a total of 65 days' worth of supply. A simple calculation suggests this would have met demand through the end of May, leaving open the possibility that imports would resume on a significant scale from June onward. Indeed, the June crude oil import volume surged by 86.5% mom (see graph). As discussed later, the volume of crude oil imports should normalize from July onward, when alternative procurement is expected to reach 100%, and a commensurate widening in the trade deficit is highly likely as a result. However, while the release of Japan's national reserves has ceased, the Ministry of Economy, Trade and Industry (METI) announced on July 15 that it would maintain a special measure (initiated in March) that lowers private oil companies' mandatory reserve days from 70 to 55 (effectively a release of 15 days' worth of supply into the market) for the time being. In short, the accurate picture for June is that, while the large-scale drawdown of national reserves has stopped due to the securing of procurement routes, ongoing supply support through the utilization of private-sector reserves remains in effect. In other words, a deficit exceeding JPY400 billion has been posted despite some level of policy-based subsidies. Of course, the suppression of import volumes due to the release of strategic reserves was the anomaly, so the widening of the deficit is, in this sense, a sign of the return to normalcy.



(Source) macrobond; prepared by the Global Foreign Exchange Department, Mizuo Bank

Future Outlook and Potential Risks from Alternative Procurement

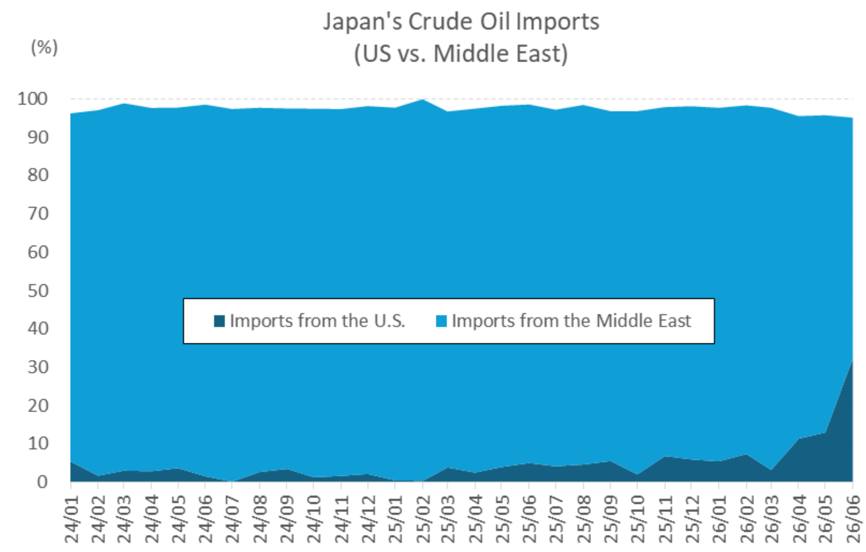
Repeatedly running simulations amid volatile crude oil prices is not the most prudent approach. Having said that, if we assume that all special measures related to reserve releases are terminated from July onward, and that crude oil prices remain around USD80 per barrel and USD/JPY stays around 160, a trade deficit of ≈JPY4 trillion is projected for this year (see graph). If crude prices remain around USD90, which is the prevailing price at the time of writing this report, the deficit would be just under JPY8 trillion. While this outcome might seem minor given the shocks actually experienced, the figure exceeds last year's deficit (≈JPY2.9 trillion) and will inevitably promote sustained JPY depreciation. Realistically, after factoring in a projected services deficit of ≈JPY3 trillion, the combined trade and services deficit could exceed JPY10 trillion, a level historically seen only three times before (2013, 2014, and 2022). Notably, each of those years was marked by significant JPY depreciation.



(Source) Ministry of Finance; prepared by the Global Foreign Exchange Department, Mizuo Bank
*March-June: Assuming reduction in imports (-JPY 3.8 trillion) due to release of stockpiles; July-December: Assuming impact (+JPY 2.3 trillion) of stockpile reple

U.S. Sourcing Increases Tenfold in Three Months

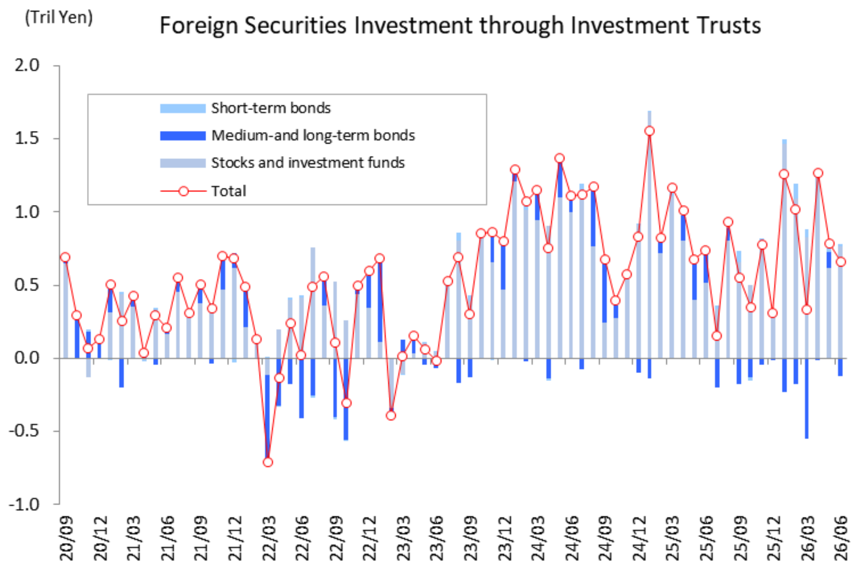
According to the Japanese government, the proportion of crude oil imports sourced via routes that bypass the Strait of Hormuz is expected to reach 100% starting in July. An analysis of import dependency by country and region from March to June reveals that while reliance on the Middle East dropped from 94% to 63%, reliance on the U.S. surged from 3% to 32% (see graph). If this shift toward U.S. sourcing persists even after the uncertainty due to the turmoil in the Middle East clears, it could create long-term complications for JPY supply-demand dynamics. Specifically, if U.S. crude carries a higher unit price than Middle Eastern crude, Japan faces the risk of a permanent increase in its payment obligations, even after the current turmoil subsides. While it is easy to focus on short-term fluctuations in the balance of payments, we must bear in mind that a structural rise in the deficit level, compounded by JPY depreciation, represents a shift that erodes the fundamental strength of the Japanese economy.



(Source) macrobond; prepared by the Global Foreign Exchange Department, Mizuo Bank

Household JPY Selling Continues at Annual Pace of JPY10 Trillion

According to the Ministry of Finance's International Transactions in Securities for June (released July 8), foreign securities investment via investment trust management companies, a proxy for household JPY selling, recorded a net purchase of JPY663.3 billion. By asset class, equity and investment fund shares and short-term debt securities recorded net purchases of JPY766.6 billion and JPY16.7 billion, respectively, while long-term debt securities recorded a net sale of JPY120.0 billion. Aggregating the figures for 1H of the year (January through June), equity and investment fund shares and short-term debt securities posted net purchases of JPY6.018 trillion and JPY284.9 billion, respectively, while long-term debt securities posted a net sale of JPY973.9 billion, resulting in an overall net purchase of JPY5.329 trillion. As in previous years, the trend of continued household sector investment in overseas (primarily U.S.) equities via investment trusts is evident. Annualizing the above figure gives a net purchase exceeding JPY10 trillion, which is a pace comparable to last year's figure of JPY9.0447 trillion. Incidentally, the net purchase for 1H of 2025 was JPY5.9666 trillion, indicating a slight slowdown this year. However, 2H of 2025 saw purchases decelerate to JPY3.0781 trillion, likely resulting from a period of stagnation in U.S. stocks around October-December, combined with the sharp rise in JPY against USD (following the inauguration of the Takaichi administration), which prompted some investors to brace for the possibility of JPY appreciation. Of course, there is also a seasonal factor at play. Investment flows tend to taper off in 2H as some investors exhaust their NISA growth investment quotas during 1H of the year. This pattern was especially pronounced in 2025.



(Sourcemacrobond; prepared by the Global Foreign Exchange Department, Mizuo Bank

Risk of Japan's Fate Becoming Inextricably Linked with the U.S.: Securities Investment Holdings

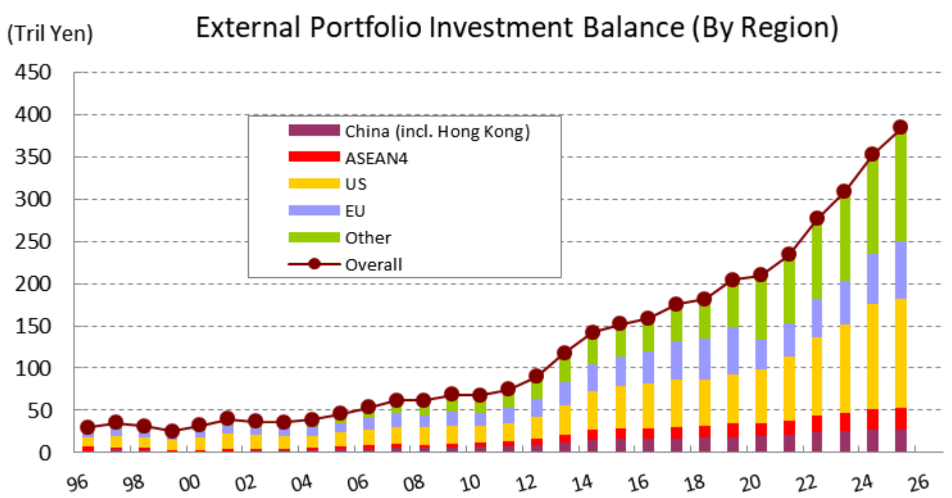
Minor fluctuations aside, the underlying structure, in which roughly JPY10 trillion flows annually from the Japanese household sector to the U.S. corporate sector, is unlikely to change significantly in the near future. Such skewed investment behavior could exacerbate the risk of Japan's economic fortunes becoming inextricably linked to those of the U.S., which is a concern. It is worth noting that the Ministry of Finance's International Investment Position (IIP) report allows for an analysis of Japan's external portfolio investment balances by currency of denomination. While the discussion above focused on investment flows, this section addresses investment stocks (outstanding balances). As shown in the chart, at the end of 2025, USD-denominated assets accounted for 60% of all external portfolio investments, with EUR-denominated assets following at ≈10%, a figure that pales in comparison. Of course, the substantial volume of U.S. Treasury holdings held by the Japanese government plays a significant role in these results, since the total balance figures include government forex reserves. Having said that, the chart also shows that equity and investment fund shares account for ≈52% of outstanding external assets, which is larger than the roughly 48% held in bonds, and 59.8% of equity holdings are USD-denominated. Assuming that government forex reserves do not include foreign equities, it would appear that roughly 60% of the private sector's equity investments are concentrated in the U.S., the outstanding balance of which now surpasses that of bonds. In terms of Japan's overall investment behavior, this suggests a pattern where the government investments lean toward U.S. treasuries, while private sector investments lean toward U.S. equities.

External Portfolio Investment Balance by Currency of Denomination (Assets; Unit: JPY1 billion; As of 2025 End)

Currency	Total	Share in total	*Equity and investment fund shares*	*Share*	*Bonds*	*Share*
USD	**461,167**	**60.0%**	*239,831*	*59.8%*	*221,335*	*60.2%*
CAD	**8,819**	**1.1%**	*5,000*	*1.2%*	*3,819*	*1.0%*
AUD	**22,355**	**2.9%**	*3,584*	*0.9%*	*18,772*	*5.1%*
EUR	**83,836**	**10.9%**	*21,183*	*5.3%*	*62,653*	*17.0%*
GBP	**18,463**	**2.4%**	*7,879*	*2.0%*	*10,584*	*2.9%*
DKK	**2,008**	**0.3%**	*1,047*	*0.3%*	*961*	*0.3%*
SEK	**1,563**	**0.2%**	*1,198*	*0.3%*	*365*	*0.1%*
CHF	**3,724**	**0.5%**	*3,661*	*0.9%*	*63*	*0.0%*
CNY	**4,383**	**0.6%**	*383*	*0.1%*	*3,999*	*1.1%*
HKD	**5,395**	**0.7%**	*5,373*	*1.3%*	*22*	*0.0%*
JPY	**134,577**	**17.5%**	*97,648*	*24.3%*	*36,929*	*10.0%*
Other	**22,364**	**2.9%**	*14,342*	*3.6%*	*8,022*	*2.2%*
Total	**768,654**	**100.0%**	*401,129*	*100.0%*	*367,524*	*100.0%*

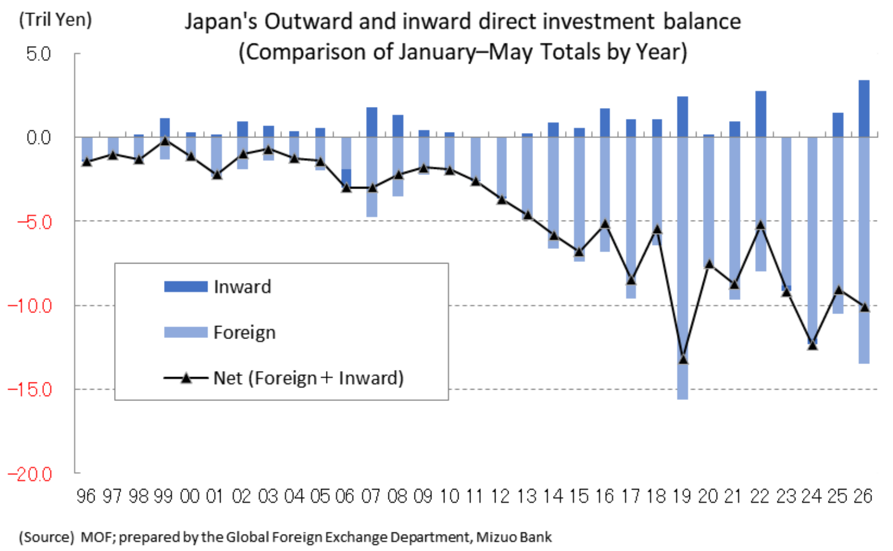
(Source) Ministry of Finance; prepared by the Global Foreign Exchange Department, Mizuo Bank

Incidentally, looking at Japan's outstanding foreign direct investment (FDI) by country and region, the U.S. accounts for over 30%, a figure unmatched by any other destination as in the case of portfolio investment trends. This underscores the extent to which Japan's fate is linked to the U.S. political and economic landscape, and also suggests a possibility that this reliance is contributing to a decoupling from JPY amid the broader trend of de-dollarization. While it would be premature to make a value judgment about this, it is easy to see the practical constraints facing both the public and private sectors in the absence of other viable alternatives. At the same time, however, we must recognize the structural reality, in the unforgiving forex market, of investor reluctance to invest in JPY amid the continuing trend of de-dollarization.



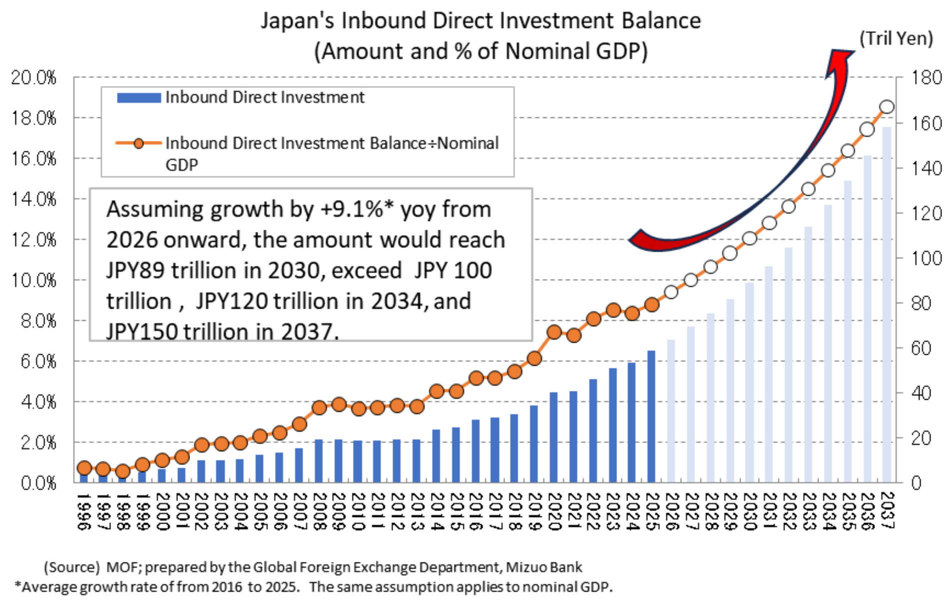
(Source) Bank of Japan and Ministry of Finance; prepared by the Global Foreign Exchange Department, Mizuo Bank

Record High Pace of Inward Direct Investment



The portfolio investment discussed above are part of Japan's financial account, but direct investment trends play a more fundamental role in shaping the financial account. In this context, Reuters ran an article titled "M&A Targeting Japan Accelerates; Up 30% in First Half of 2026 Driven by Sense of Undervaluation Due to JPY Weakness." The article noted that while acquisitions of overseas companies by Japanese firms declined, investment deals targeting Japanese companies by foreign entities increased by ≈30%, underpinned by factors such as historical JPY weakness. These trends were already evident in the balance of payments statistics. Looking at the balance of payments data available at the time of writing, inward direct investment into Japan surged to JPY3.4263 trillion for the January-May 2026 period, more than double (2.3 times) that during January-May 2025. The Reuters report cited data from the RECOF Corporation's M&A database, highlighting that "out-in" M&A deals (foreign companies acquiring Japanese firms) rose by 27.5% to 232 transactions, setting a new record. Notably, the aforementioned JPY3.4263 trillion represents the highest level of inward direct investment for the January-May period since the start of records (see graph). Historically, the low level of inward direct investment in Japan compared to other nations was often attributed to such investments leaning more heavily toward greenfield investments rather than M&A, a characteristic rather typical of developing economies. However, as of the end of 1H of 2026, a shift in this trend seems obvious.

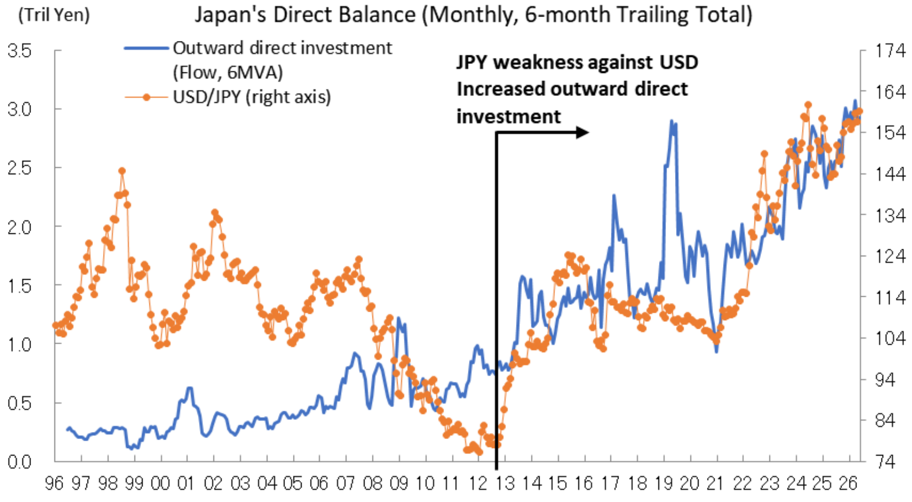
JPY150 Trillion Mark to be Crossed Around 2037?



As generally known, the government and ruling coalition are actively promoting inward direct investment as one of the few strategies to capitalize on JPY weakness. Current targets aim for an outstanding balance of JPY120 trillion by 2030 and JPY150 trillion as early as possible in the first half of the 2030s. Achieving these targets may be somewhat challenging at the pace as of 2025 (see graph), but projections indicate that the JPY150 trillion milestone (a figure exceeding 18% of nominal GDP) will likely be reached by 2037. Given that some of the G7 nations, including Germany and Italy, fall in the 20-25% range, attaining 18% would soften criticism against what tends to be derided as Japan's "capital isolationism." The Reuters report acknowledged that government-led corporate governance reforms and the Tokyo Stock Exchange's calls for improved capital efficiency were beginning to bear fruit, but also cited comments from M&A advisory firms that JPY weakness was a contributing factor; that they often heard overseas investors say that the relative decline in corporate value within the Japanese market had made it easier to invest. While JPY weakness has not yet triggered a significant repatriation of Japanese companies' operations, it has stimulated interest among foreign firms.

Outward FDI Still Twice as Large

That said, even with inward foreign direct investment (FDI) hitting a record high for the January-May period, the volume of outward FDI remains more than double that figure. For the January-May period as a whole, outward FDI from Japan to overseas markets grew by JPY3.001 trillion yoy, hitting JPY13.5026 trillion, the second-largest volume on record. Consequently, in net terms, the fundamental structure, where the scale of outward FDI dictates the overall capital outflow pattern within the financial account, remains unchanged. It is undeniable that this persistent capital outflow involves significant JPY selling, which contributes to the structural trend of JPY depreciation that has persisted for the past four years. While it is unclear whether outward FDI has reinforced JPY weakness, or if outward FDI has continued despite JPY weakness, the relationship between the two remains highly stable (see graph). At the very least, it is clear going by the observed phenomena that JPY weakness is not a decisive factor that could trigger a repatriation of business operations.



(Source) MOF; prepared by the Global Foreign Exchange Department, Mizuho Bank

If Japanese companies persist in prioritizing the capture of overseas growth through outward FDI rather than channeling their earnings into domestic capital investment or human capital, the domestic capital stock will inevitably become susceptible to hollowing out. There would still be hope if the earnings generated abroad were repatriated to Japan. However, as I have repeatedly discussed in this report, such earnings are frequently reinvested locally rather than being paid out as dividends to Japan (a phenomenon that lies at the heart of why I say Japan is masquerading as a surplus nation). If funds fail to flow back into the domestic economy and the foundations for productivity growth and innovation remain neglected and fragile, it will be impossible to avoid a future where the long-term potential growth rate faces persistent and strong downward pressure.

Are Vast External Assets Truly a Sign of National Wealth?

Of course, the upward trend in inward direct investment observed during January-May is a positive development. However, the fundamental issue remains that real, autonomous growth for the Japanese economy will remain elusive unless Japanese companies themselves shift gear toward greater domestic investment (profits generated by foreign firms are ultimately repatriated to their home countries, limiting the economic benefits distributed within Japan). Of course, the continued accumulation of overseas assets does result in a statistical increase in “net foreign assets,” effectively boosting national wealth by that metric.

However, it has become increasingly clear in recent years that this does not directly translate into improvements in the Japanese public’s standard of living. We are entering an era where the accumulation of vast overseas assets must be viewed somewhat critically, and the very concept of “national wealth” must be redefined as part of the process of considering policies to revitalize the Japanese economy.

U.S. Monetary Policy Now and Going Forward: Challenging Times Ahead for Curbing JPY Depreciation

September Rate Hike Highly Likely: “Two Hikes by Next April”

At the Federal Open Market Committee (FOMC) meeting held on July 28-29, the federal funds (FF) rate, which is the policy interest rate benchmark, was left unchanged at 3.50-3.75% for the fifth consecutive meeting. However, the decision was not unanimous; Cleveland Fed President Beth Hammack, Minneapolis Fed President Neel Kashkari, and Dallas Fed President Lorie Logan advocated for a 25-bp rate hike, resulting in a 9:3 vote in favor of the status quo. Following the meeting, Fed Chair Kevin Warsh stated that the focus had been on assessing the momentum of inflation taking high crude oil prices and other factors into account, and hinted at future actions by noting that maintaining the status quo was “the beginning of the story, not the end,” and that the Fed would “not hesitate to act” “where necessary and appropriate.” Overall, the recent meeting suggested that a rate hike at the September 15-16 meeting was highly probable. Market pricing for a September rate hike remains at a high level, and the baseline expectation is shifting toward “two hikes by next April.”

Challenging Times Ahead for Curbing JPY Depreciation

This presents a difficult situation for Japan, which seeks to curb the weakening of JPY in forex markets. As discussed in my report yesterday, policymakers will need to make decisions regarding not only July but also September while carefully assessing factors such as the impact of the Kumamoto earthquakes and the gap between the BOJ and government’s stances. At the very least, the contrast between the BOJ, which may find it difficult to raise rates given current circumstances, and the Fed, which is shifting toward rate hikes, is becoming increasingly stark, resulting in a significant upside risk for USD/JPY. To counter this, it is necessary for the BOJ to project a hawkish stance while maintaining the status quo; the only option is to keep expectations for rate hikes alive by hinting at the risk of the

underlying inflation rate overshooting the "2% price stability target," or, in other words, the risk of falling "behind the curve." However, as actual rate hikes remain elusive, the market sees through this strategy, creating an environment where JPY-selling pressure tends to mount.
At this stage, one may even hope for U.S. President Donald Trump to check rate hikes, viewing such intervention as a way to curb JPY depreciation. In this regard, while Trump praises Warsh, whom he personally nominated, he has criticized other Fed officials advocating for rate hikes, accusing them of harboring ill intent. That said, his tone appears more subdued than it was during the Powell era, and it seems unlikely that he will influence decisions made by the Fed under Warsh.

Strong Focus on Communication
Regarding reforms to the Fed's communication strategy under Warsh, and acknowledging the market and media's intense focus on forward guidance, Warsh has stated that he "takes seriously" the need for a transition period before scaling back forward guidance and has confirmed that the post-meeting press conferences, previously slated for reduction, will continue at least through the end of the year. Any major overhaul of the communication framework, therefore, may only occur after the start of the new year.
Nevertheless, Warsh indicated a strong commitment to communication and the shaping of market expectations, mentioning these topics several times during his recent press conference. For instance, regarding the sharp rise in market interest rates following the June meeting, Warsh remarked, "Market participants are learning to play the ball, not the referee – and market prices will continue to respond in the direction and magnitude they see fit. This is, in my view, a change for the better – and we are just getting started." While the policy rate remained unchanged at the June meeting, marking the launch of the Warsh era, the Fed made clear its intention to significantly limit future communications (a shift that included simplifying the post-meeting statement). The fact that interest rates rose following the meeting, suggesting that price movements were driven by market participants forming expectations based on daily information and their own independent analysis, rather than simply reacting to every move by the Fed, appears to align with the very shift Governor Warsh intends to bring about.
Indeed, Warsh stated, "After all, the central bank need not always and everywhere be the center of attention. I understand the desire for rolling forecasts and commentary from this Committee. But for our part, we need to observe market reaction to developments, direct and unfiltered," a sentiment appearing to emphasize the need for market participants to think for themselves. Given these remarks, it is likely that, in addition to the already announced reduction in the frequency of the Chair's press conferences, there will be a fundamental review of the dot plot and potentially also the nature of staff projections. Former Fed Vice Chair Alan Blinder once derided this market dynamic "wherein the market reacts, or rather overreacts, to perceptions about what the central bank might do, and the central bank looks to the markets for guidance about what it should do (essentially looking at its own reflection in a mirror)," thereby creating a "dog chasing its tail" situation. While such a situation was desirable for avoiding market shocks, it was also concerning because it prevented the central bank from maintaining its ability to take the initiative. The reforms under the Warsh regime aim to address this issue.
Although the focus is currently on the FOMC's pivot to a more hawkish stance, the move to fundamentally alter the relationship between the Fed and market participants stands out as the most interesting aspect of the new administration.

Risks to My Main Scenario – JPY Appreciation Risks related to Public Pension Portfolio Adjustments

Need to Redefine "National Wealth"
During July there were periods when Japanese Finance Minister Satsuki Katayama's statement that she – "wishes to pursue measures to encourage households and pension funds, including the Government Pension Investment Fund (GPIF), to increase their investments in Japanese financial assets" – was viewed as a financial market-moving factor, and speculation regarding the possibility of such measures continues to linger. As the specific policy changes implied by this statement, as well as their timing, remained unclear at the time this article was written, I will refrain from discussing them in detail.
Regardless of the specific measures under consideration, however, it should be recognized that there is indeed a need to encourage a return flow of Japanese overseas funds into domestic investments. As I have long argued in this column and in my books, Japan is a country recording "masked surpluses" owing to the fact that the government, corporations, and households hold abundant foreign-currency-denominated assets that are not flowing back into Japan, and there is a fundamental need for policies that address that situation. Japan is among the world's top countries regarding the magnitude of its net external assets, and that strong net external asset position is undoubtedly a source of the country's wealth, but if that wealth is not benefiting the Japanese people, then there is a clear need to redefine the meaning of "national wealth". The fact that Japan holds a large amount of assets outside its borders was once generally understood to be a factor contributing to JPY's strength, but since the beginning of 2026 I have been emphasizing in various venues that, given the current high level of recurrent and new geopolitical risk factors, the high level of foreign assets can become a forex discount factor rather than a premium factor for JPY. We need to seriously examine why the value of JPY is declining in both nominal and real terms despite Japan's massive positive net balance of foreign assets. Based on an understanding of that situation, I believe greater consideration of how to encourage overseas fund repatriation is, in principle, a step in the right direction, regardless of whether the focus is on the management of pension assets or on other issues.

Attention on Public Pension Fund Management for over a Year

It should be noted that the possibility of structural adjustments to the investment portfolios of the GPIF and other major pension funds has been discussed intermittently since last year, so it is not really a new issue. It first drew attention in June 2025, when the newly released U.S. Semiannual Report on International Economic and Exchange Rate Policies (IEERP) stated that – “government investment vehicles, such as large public pension funds, should invest abroad for risk-adjusted return and diversification purposes, and not to target the exchange rate for competitive purposes.” I speculated in a previous edition of this article that that portion of the IEERP might lead to public pension portfolio restructuring, but it attracted little attention at the time.

The next time the issue drew attention was three months later, on September 12, 2025, when the Joint Statement by the U.S. and Japanese Finance Ministers (Scott Bessent and former Japanese Finance Minister Katsunobu Katō) was released. They agreed that such government investment vehicles such as pension funds should to invest abroad for risk-adjusted return and diversification purposes and not target exchange rates for competitive purposes, which is basically the same as the IEERP prescription. So the fact that U.S. monetary authorities have been taking an increasingly strong interest in the portfolio of Japan’s public pension funds has been a topic of considerable attention for more than a year already.

Potential for Mid-Term Portfolio Reviews

Incidentally, while some observers seem to think it might be difficult to adjust the GPIF’s investment portfolio now that GPIF has already entered its fifth medium-term target period (FY2025–2029), it is important to note that this is not necessarily the case. The GPIF’s FY2026 Plan states that – “the Management Committee will consider reviewing the basic portfolio when deemed necessary, such as in the event of potential rapid market fluctuations.” In fact, during the GPIF’s second medium-term target period (FY2010-2014), the shares of foreign stocks and bonds were increased from 12% to 25% and from 11% to 15%, respectively, in October 2014, before the target period ended (on March 31, 2015). Setting aside the question of whether this timing was influenced by political considerations, there clearly is a precedent for revising the GPIF’s basic portfolio structure midway through target periods.

Given the current potential for rapid market fluctuations in forex or bond markets, it cannot be entirely ruled out that the GPIF portfolio might be adjusted before the end of fiscal 2029, even if the likelihood is low. For example, if the pace of BOJ interest rate hikes exceeds expectations and causes Japanese government bond yields to rise to a level deemed stable and sufficient for sustaining pension finances, there would clearly be a diminished need for the GPIF to burden itself with foreign exchange risks by continuing to hold foreign currency assets accounting for roughly 50% of its investment portfolio. If the real economy or interest rate environment undergoes unexpectedly large changes, the very premises of the portfolio may be undermined, providing a strong justification for a mid-term portfolio review.

Portfolio Rebalancing Simulations

target period (2025-2029) plan stipulates that foreign bonds and foreign stocks will each account for 25% of the total investment portfolio, so that foreign currency-denominated assets collectively account for 50% of the portfolio. What kind of impact should be expected if the foreign stocks and foreign bonds proportions were each reduced by 10 percentage points, lowering the overall proportion of foreign currency-denominated assets from 50% to 30%? The investment portfolio values of the three leading mutual aid associations that that adhere to GPIF’s portfolio structure adjustments – the Federation of Local Government Employees’ Mutual Aid Associations (PAL: JPY21,052.6 billion, as of the end of March 2026), the Federation of National Government Employees’ Mutual Aid Associations (KKR: JPY11,490.2 billion, as of the end of December 2025), and The Promotion and Mutual Aid Corporation for Private Schools of Japan (PMAC: JPY4,786.6 billion, as of the end of December 2025) – total approximately JPY37.3 trillion. The GPIF’s investment portfolio was worth approximately JPY293.6437 trillion (as of the end of March 2026), so the combined assets under management of the GPIF and three leading mutual aid associations is JPY330.9731 trillion (approximately JPY331 trillion; see table). Of course, since there are other pension funds that emulate the GPIF investment portfolio structure, the actual figure of investments that would be affected by t GPIC portfolio restructuring would be even larger. In the case that GPIF portfolio allocation is changed as mentioned above (foreign currency assets reduced from 50% to 30%), for example, we can assume that foreign-currency-denominated assets before the change amounted to

Various Institutions' Assets Under Management

Name of institution	Assets under management (JPY trillions)	Notes
Government Pension Investment Fund (GPIF)	293.6	Dec end, 2025
Pension Fund Association for Local Government Officials (PAL)	21.1	Mar end, 2026
Federation of National Public Service Personnel Mutual Aid Associations (KKR)	11.5	Dec end, 2025
Promotion and Mutual Aid Corporation for Private Schools of Japan	4.8	Dec end, 2025
Total assets under management (1)	331.0	
[Reference]		
Current ratio of foreign currency-denominated assets (2)	165.5	Assuming 50%
Target ratio of foreign currency-denominated assets (3)	99.3	Assuming 30%
JPY buying associated with portfolio rebalancing (4=2-3)	**66.2**	

(Source) Various reports; preparedby the Global Foreign Exchange Department, Mizuo Bank

Assumed JPY Buying Amount

Time required for rebalancing	JPY buying per year (JPY trillions)
5	**13.2**
4	16.5
3	22.1
2	33.1
1	66.2

(Source) Various reports; preparedby the Global Foreign Exchange Department, Mizuo Bank approximately JPY165.5 trillion (50% of the approximately JPY331 trillion total) and foreign-currency-denominated assets after the change (reduced to a 30% portfolio share) would amount to approximately JPY99.3 trillion. The approximately JPY66.2 trillion reduction (JPY331 trillion - JPY99.3 trillion) would manifest itself as JPY purchases. The annual scale of JPY purchases would vary depending on the timeframe over which the adjustment is carried out, but assuming the adjustment is carried out steadily over the five-year medium-term investment period, one can anticipate annual JPY purchases amounting to JPY13 trillion or more (roughly equal to 66.2/5) are projected (see table on previous page). To put that into perspective, one may note that the foreign currency-denominated asset share of the GPIF investment portfolio structure during the first medium-term target period (FY2006–FY2009) was set at 17%, comprising 8% in foreign bonds and 9% in foreign stocks.

In the case that GPIF reduces its foreign currency asset share 30 percentage points, from the current level to 20%, a total of approximately JPY99.2 trillion in JPY buying would be anticipated. Assuming the rebalancing is completed over five years, this would cause approximately JPY20 trillion in JPY purchases per year. Japan's largest trade deficit ever, recorded in 2022, was approximately -JPY20 trillion, and the country's second-largest deficit was approximately -JPY13 trillion in 2014. A GPIF policy decision to reduce the proportion of its foreign currency-denominated assets by 20 to 30 percentage points would create structural upward pressure on JPY on an annual basis that would offset even these deficits, and the upward pressure would persist for several years. There is great room for debate regarding the merits and demerits of such a policy change, but if implemented, the policy change would undoubtedly have to be considered a very strong factor promoting JPY appreciation.

EUR Outlook – Volatile Interest Rate Hike Expectations

EUR Area Monetary Policies Now and Going Forward – Is One More Rate Hike the Limit?

Continued Inflation Concerns Dictate "Next Move" Will be Interest Rate Hike

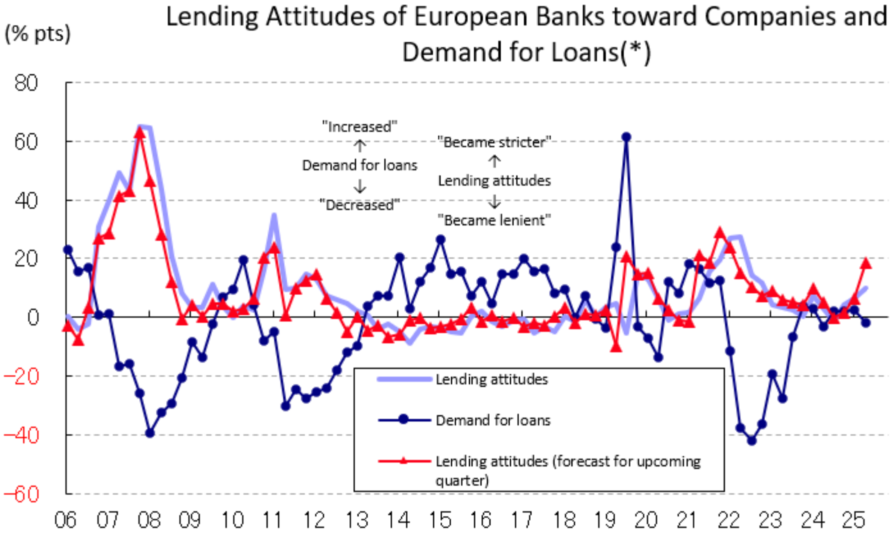
The ECB's July 23 Governing Council meeting decided to keep the deposit facility rate unchanged at the current 2.25% level. The current inflation rate was assessed as being far lower than expected, so it was acknowledged that there was little urgency to raise interest rates, and the decision to maintain the status quo was unanimous. At the post-meeting press conference, however, President Lagarde noted that – "there were some governors who asked themselves whether we should not consider a hike – in other words, raising the three interest rates on the occasion of that meeting." Regarding second-round effects – a key point of debate at recent Governing Council meetings – President Lagarde stated – "Second-round effects: we are not seeing it. Believe me, we are really scrutinising the emergence of second-round effects, but we are not seeing it." – although she prefaced that by acknowledging that inflationary pressures are already becoming visible in certain sectors, saying – "It goes without saying that there are indirect effects, when you look at the price of, say, transportation, for instance, pretty obvious." It also is worth noting that concerns were raised the July Governing Council meeting not only about Middle East factors, but also about the heatwave sweeping across continental Europe.

The meeting's statement mentioned that – "Extreme weather events – as illustrated by the ongoing heatwaves – and the unfolding climate and nature crises more broadly, could drive up food prices by more than expected." Overall, it is clear that the ECB policy of raising interest rates has not been shelved, and it is still reasonable to assume that the ECB's "next move" will be an interest rate hike.

Closely Monitoring the Credit Environment Tightening

While attention tends to focus on rising inflation concerns and associated expectations of interest rate hikes, it's important to note that the meeting's statement also mentioned a tightening of the credit environment, saying – "Overall financial conditions have become slightly tighter since our previous meeting, consistent with the increase in the key ECB interest rates. [...] Credit standards for mortgages tightened in the second quarter as banks became more concerned about the economic risks faced by their customers and less willing to take on risks themselves. Demand for mortgages decreased on the back of deteriorating consumer confidence and higher interest rates." The ECB's latest bank lending survey found that credit standards for business loans were also tightened in the second quarter. As the graph shows, a significant tightening of banks' lending attitudes is expected, and corporate borrowing demand is declining. Given that these effects are already becoming apparent amid the supply shocks seen since March and following the June interest rate hike, the ECB may hesitate to implement further significant rate hikes from this point. It is unclear whether the current credit conditions tightening aligns with the ECB's expectations or exceeds them slightly. Given the time lag before the effects of monetary policy move emerge, however, it appears that there will still be one or two additional ECB rate hikes.

Lending Attitudes of European Banks toward Companies and Demand for Loans(*)



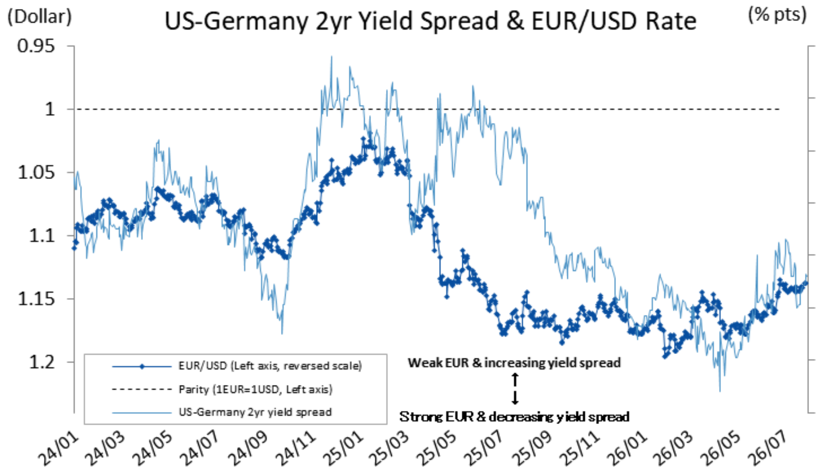
(Source) Datastream; prepared by the Global Foreign Exchange Department, Mizuo Bank
(*)Demand for loans in corporate sector

As President Lagarde Anticipated

The early July this article discussed the possibility of the ECB's optimistic "Milder scenario" becoming a reality, given the stabilization of the Middle East situation and the resulting decline in resource prices. Since then, however, the pattern of mutual attacks between the United States and Iran has resumed, and at the time of this article was written, crude oil prices had recovered to just over USD80 per barrel, and natural gas prices to around EUR55 per MWh. The "Milder scenario" assumes that energy prices will fall to USD88 per barrel for crude oil and EUR41 per MWh for natural gas in the third quarter of 2026 and remain 15-20% lower than the baseline scenario thereafter. While the current situation roughly aligns with this, it is by no means stable, so it is therefore logical that the ECB feels it can not yet abandon its stance on additional interest rate hikes. For the "Milder Scenario" to materialize, the U.S.-Iran conflict would have to be resolved very quickly, the global oil and gas markets would have to normalize rapidly, and prices would have to return to pre-war levels by the end of 2026, but it is impossible to confidently predict that these things will happen.

In light of the volatility of the past month, the ECB does not appear to be in a hurry to make assumptions about the future. In her introductory speech at the ECB Forum on Central Banking 2026 in Sintra (Portugal) on June 29, President Lagarde noted that a – "feature of these [recent supply] shocks is their capacity to escalate sharply, but also to swiftly unwind. The war in the Middle East is a case in point." Considering that crude oil prices were around USD70 per barrel and natural gas prices were around EUR45 per MWh at the beginning of July, it appears that the past month has indeed seen the "escalate sharply, but also to swiftly unwind" pattern that President Lagarde predicted. At the post-meeting press conference, President Lagarde suggested that the turmoil in the Middle East is unlikely to subside anytime soon, stating – "Remember how fast energy prices went down after the announcement of the Memorandum of Understanding. Now, once burned twice shy, it could well be that another announcement of such Memorandum of Understanding will not have a similar impact. Because there is rising uncertainty, and it applies across the board." So "supply-shock-driven inflation" appears set to remain a key issue for the foreseeable future.

Under these circumstances, the ECB has hinted that its "next move" will be a rate hike at the next Governing Council meeting (on September 10), and it is still quite probable that it will raise its deposit facility rate to 2.50%. However, since there are no clear signs yet of resource prices, employment, or wage conditions strong enough to justify consecutive rate hikes – and given that credit conditions are tightening – we expect the ECB to shift toward a slightly more dovish tone regarding rate hikes from October. In that case, perhaps one more interest rate hike is the limit for the ECB. On the other hand, the Fed is showing no sign of a significant shift away from its hawkish stance, so it remains likely that the Fed will also raise interest rates roughly one more time. With both the ECB and the Fed expected to follow similar interest rate trajectories, EUR/USD is likely to face resistance on the upside and enter a period of directionless trading for the remainder of the year.



(Source) macrobond; prepared by the Global Foreign Exchange Department, Mizuo Bank

European Politics Now and Going Forward – French Presidential Election; **Storm on the Horizon**

Le Pen Returning to the Political Arena

On July 7, Marine Le Pen, leader of France's far-right National Rally (RN) party, announced her intention to run in the French presidential election in the spring of 2027. Although she was found guilty in an appeals court trial that same day regarding allegations of fraudulent receipt of European Parliament funds – a case that had drawn significant attention – she has filed a further appeal, and she will proceed with her presidential campaign on that basis. Whether it is personified by Le Pen or by the current RN leader, Jordan Bardella, the RN party has maintained an extremely high level of public support, and Le Pen's return to the political arena – given her high profile – is likely to provide a further boost.

It should be noted that a French appeals court has ordered Le Pen to be barred from holding public office for 15 months, to wear an electronic ankle monitor for one year for surveillance purposes, and to pay a fine of EUR100,000 (approximately JPY18.5 million). The first-instance verdict handed down in March 2025 – one year and four months ago – had imposed a five-year ban on holding public office, which has now been reduced to 15 months. Since the suspension period is calculated from the date of the first-instance ruling, Ms. Le Pen's eligibility to run for office has now been officially restored. Le Pen has made an additional appeal to the Cour de Cassation, which acts as France's supreme court for criminal matters, and she will not have to wear an electronic monitoring bracelet during the Cour de Cassation appeal period, allowing her to move about freely as she campaigns for the presidency.

French Presidential Election Situation Heating Up

Meanwhile, ECB President Lagarde was asked in a July 3 interview with the French business newspaper Les Échos that if she might depart from her ECB post before her term expires in October 2027, and she replied – "It's possible. I believe that a European voice needs to be heard in the French presidential debate. If this debate were to reveal a more limited vision of France's place within Europe, I think it would be necessary to explain why that would be a painful path for our country and for our fellow citizens." That statement suggests that she would seek to counter the rightward shift in domestic public opinion. While presenting herself as a spokesperson for Europe, her intention to position herself as a counterweight to the strongly anti-EU Le Pen is clearly evident. Of course, President Lagarde has not officially announced her candidacy for the French presidency, and at the press conference following the ECB's July 23 Governing Council meeting she dismissed the possibility of leaving "before 2027", but seemed to leave open the possibility of a departure in early 2027, prior to the April 2027 French presidential election. She said – "When there are clouds on the horizon, the captain stays on the ship, and this captain is staying on this ship as long as there are clouds on the horizon." – and some interpret that as meaning she might feel free to leave so long as the ECB's operations are stable and secure.

Calls for her candidacy are understandable, however, given the current reality that no other candidate is expected to have greater name recognition or popularity than President Lagarde, nor the ability to win over support from both far-right and far-left factions. To summarize the current situation, the far-right RN appears likely to consolidate its support behind Marine Le Pen's fourth attempt, and will likely continue to benefit from financial instability and anti-establishment sentiment. Even if Ms. Le Pen's legal risks were to resurface, given that the highly popular party leader Bardella stands ready to step in, we should consider the RN to be closer than ever to taking power. It appears that the RN will be able to make thorough preparations leading up to the election campaign.

On the other hand, the opposing centrist and pro-European (roughly equivalent to the center-right) faction still lacks a clear successor to President Emmanuel Macron. While former Prime Ministers Gabriel Attal and Édouard Philippe have been mentioned as potential candidates, no particular candidate stands out as a clear frontrunner. It is precisely because of this situation that President Lagarde's strong reputation and name recognition appears to be needed as a trump card to unite the centrist forces. Compared to the peak of Iran-related tensions, oil prices have already plummeted, pressure on the ECB to raise interest rates has eased, and there are no signs of wage inflation in the euro area. The situation has changed considerably since this past April, when concerns about rising inflation expectations following the outbreak of the war in Iran and subsequent oil-price shocks caused her to reverse her tentative thoughts of retirement expressed in February and state during an April 14 interview with Bloomberg TV that – "When there [are] big clouds on the horizon, the captain does not leave the ship." Against this backdrop, it is worth noting that the left-wing camp has not yet formed a cohesive bloc comparable to the RN. While Jean-Luc Mélenchon, positioned as a radical leftist, has already announced his candidacy, declarations are also expected from figures like Raphaël Glucksmann, who follows a pro-European, social democratic (roughly center-left) line. This suggests a fragmented political landscape in which left-wing forces will compete among themselves for votes. This kind of simple assessment of the current situation makes it clear that the RN has a relatively solid footing.

2027 French Presidential Election Potential Candidates

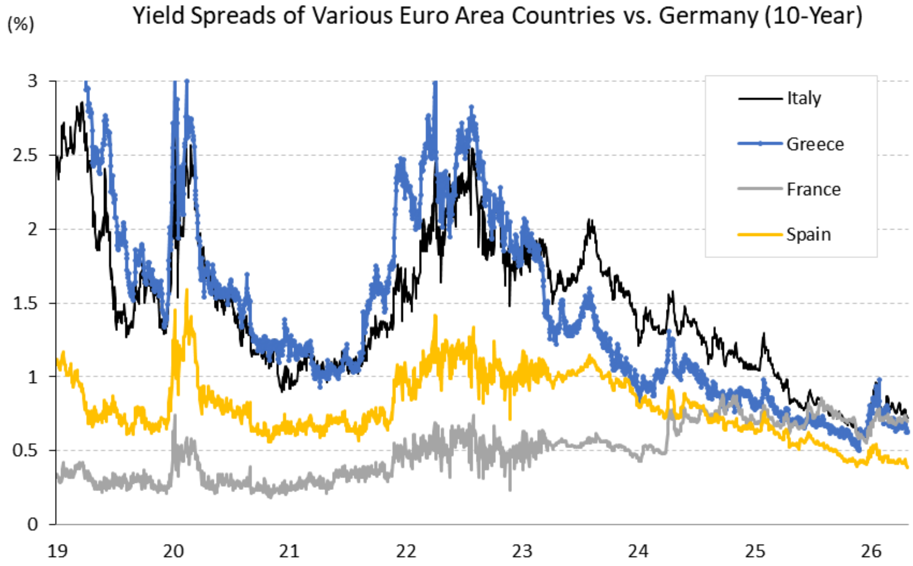
(*Includes those not yet officially declared but widely anticipated or considered potential candidates)

Name	Political party	Economic Stance
Marine Le Pen	National Rally (RN): Far-right	Prioritizes protecting domestic industry and cutting taxes; advocates boosting workers' purchasing power
Jordan Bardella*	National Rally (RN): Far-right	Populist stance advocating energy tax cuts and tax exemptions for young people.
Gabriel Attal*	Renaissance (RE): Centrist to center-right	Continuation of the Macron agenda; aims for full employment and supply-side reforms.
Edouard Philippe	Horizons (HOR): Centrist to center-right	Prioritizes fiscal consolidation; proposes extending working hours and cutting public spending.
Raphaël Glucksmann*	Place Publique (PP): Center-left	Advocates reindustrialization at the European level and investment in the green transition; emphasizes social justice, such as taxing excess profits.
Jean-Luc Mélenchon*	La France Insoumise (LFI): Left-wing to radical left	Supports wealth redistribution and increased taxing of the wealthy; advocates lowering the retirement age to 60.
Christine Lagarde*	Independent: Centrist to center-right	Liberal stance emphasizing currency stability and economic predictability.

(Source) Various reports; preparedby the Global Foreign Exchange Department, Mizuo Bank

What Will Happen if the RN Takes Power?

It may be a bit premature to discuss this, but it is worth considering what will happen if the RN takes power in 2027. While it is difficult to make precise predictions at this point, we should be wary of the potential impact on both France and the rest of the world. Broadly speaking, we should keep a close eye on two key issues: (1) the impact on France-EU relations, and (2) the impact on France's domestic economy. For most people, the concern that intuitively comes to mind is likely to be issue (1). As is well known, Ms. Le Pen has a history of vehemently advocating for radical anti-EU policies, such as leaving the euro and exiting the EU (so-called "Frexit"). Although she has since retracted those extreme positions, she continues to advocate for the "primacy of national law over European law" and "reductions in EU budget contributions". Both are major points of contention in EU politics, and if she seriously pursues them, frictions with the European Commission will be inevitable. Furthermore, given her support for stricter border controls – which would effectively render the Schengen Agreement (free movement within the EU without border checks) meaningless – and for scaling back military aid to Ukraine, concerns about the stability of EU unity and the accompanying security framework are unavoidable. That said, while these are long-term challenges that could hinder EU integration, they do not appear likely to be viewed as significant factors affecting financial markets in the near term.

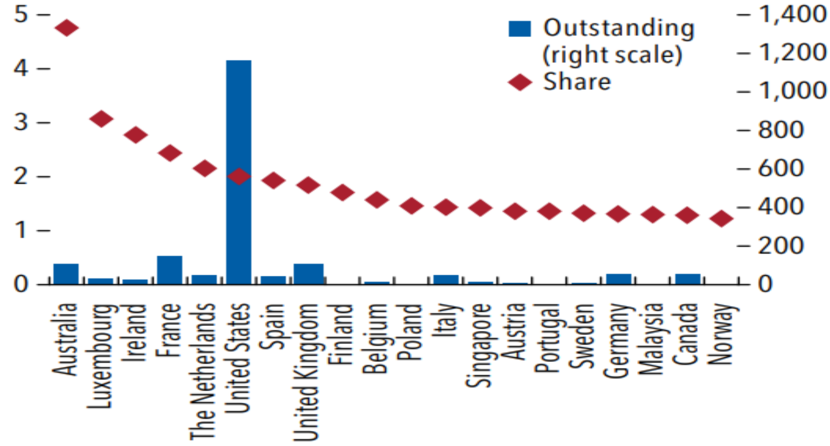


(Source) macrobond; prepared by the Global Foreign Exchange Department, Mizuo Bank

Issue (2) has much greater potential ramifications over both the short and longer terms. In particular, there are growing grounds for concern about France's fiscal situation, as this could weaken EUR. The RN's economic policy pledges are notably populist and involve expansionary fiscal measures, such as a reduction in the value-added tax (VAT) aimed at boosting purchasing power and the reversal of the pension reform pushed by the Macron administration (lowering the retirement age). To begin with, the French government bond market is prone to scrutiny due to its vulnerability – the fiscal deficit exceeds the Maastricht criterion of -3% of GDP, placing France in a position where it faces a correction recommendation from the European Commission. For example, the yield on French 10-year bonds is higher than that on Spanish or Greek bonds and is approaching that on Italian bonds. Given this already fragile situation, the question of whether the bond market can withstand the pressure from the expansionary spending measures proposed by the RN is bound to become a point of contention.

Incidentally, the French government bond market is known for the significant presence of Japanese institutional investors, prompting the IMF to issue a warning in its April 2026 Global Financial Stability Report (GFSR). As the BOJ is implementing a series of interest rate hikes, it is important not to overlook the potential threat that Japanese institutional investors could at some point withdraw their funds from French bonds, leading to a sudden spike in French bond yields. Under these circumstances, if an RN administration pushes through its campaign promises, it could trigger a downgrade of French government bonds and a resulting rise in yields (i.e., a widening of the spread against German bonds), which could prompt a sell-off of EUR. Of course, given that the Eurosystem now has a variety of safety nets in place, there is no need to anticipate turmoil on the scale of the European debt crisis. However, if unintended rises in interest rate levels become commonplace within the euro area, it can be expected that the ECB will also find it difficult to implement interest rate hikes. It should be noted that the French presidential election has now emerged as an factor that could unexpectedly lead to a EUR sell-off in 2027. There remains some time before the election campaign actually begins, but it is advisable to keep a close eye on related trends.

4. Japan's Outstanding Debt Securities Holdings and Share to Market Cap at the End of 2024
(Percent, left scale; billions of dollars, right scale)



(Source) IMF "GFSR, Apr 2026"; prepared by the Global Foreign Exchange Department, Mizuo Bank

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