

Forex Market View

Forex pattern for US midterm elections in 2018

- Past moves in USD/JPY on US midterm election results
- Forex trend differs depending on which political party is in power when opposition party gains a majority
- If 2018 midterm election results in a split Congress, USD/JPY may decline

USD/JPY forecast range (latest: noon New York time)

11 Oct – 9 Nov: Y109.0-114.0/\$ (Y112.71/\$ as of 10 Oct)

Forex Market View DSFE185

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Daiwa Securities Co. Ltd.

Past moves in USD/JPY on US midterm election results

Past moves in USD/JPY on US midterm election results

Less than a month to go until the US midterm elections on November 6. In this report, we look at the USD/JPY market around the time of previous US midterm elections and search patterns in the relationship between election results and USD/JPY changes. There have been a total of 11 midterm elections since the USD/JPY moved to a floating exchange rate regime in 1973. For each of these 11 elections, the table below shows the party in power (in the White House), the party with the majority of seats in the House and Senate before and after the election, and the percentage change in USD/JPY 25 days before and after the election.

Scenarios based on the ruling party keeping its majority or suffering defeat

The upper panel in the table below shows scenarios of the ruling party having majority control of both legislative chambers prior to the election and either maintaining control of both chambers, losing control of one to create a split Congress, or losing control (the opposition party gets majority control) of both chambers, as well as of Congress being split prior to the election and the ruling party losing control (the opposition party gaining a majority) in both chambers after the election. These are the scenarios that should be relevant, given that the November 2018 midterms will be held when the ruling Republican Party has a majority of seats in both chambers. We also included a scenario of ruling party defeat in which Congress switches from a split Congress to one in which the opposition party gains control of both chambers. These seven different scenarios are depicted in graphic format on the following pages in order to tease out the pattern of USD/JPY change that is likely for each election result.

Table: Majority Parties in Senate and House Around US Mid-term Election, and Change in USD/JPY

Ruling party having majority control both in Senate and House → Ruling party y having majority control both in Senate and House/Split Congress/Opposition party having majority control both in Senate and House
Split Congress → Opposition party having majority control both in Senate and House ∅

US Mid-term Election	President	Ruling party	Before mid-term election		After mid-term election		Change in USD/JPY during 25 days before election (%)	Change in USD/JPY during 25 days after election (%)
			Senate*	House*	Senate*	House*		
7-Nov-78	James Carter	Democrats	Democrats	Democrats	Democrats	Democrats	2.22	3.21
4-Nov-86	Ronald Reagan	Republican	Republican	Democrats	Democrats	Democrats	0.48	-0.81
8-Nov-94	William Clinton	Democrats	Democrats	Democrats	Republican	Republican	-2.21	3.50
5-Nov-02	George W. Bush	Republican	Republican	Republican	Republican	Republican	-1.12	3.21
7-Nov-06	George W. Bush	Republican	Republican	Republican	Democrats	Democrats	2.44	-0.25
2-Nov-10	Barack Obama	Democrats	Democrats	Democrats	Democrats	Republican	-2.48	3.03
4-Nov-14	Barack Obama	Democrats	Democrats	Republican	Republican	Republican	3.45	4.79

Opposition party having majority control both in Senate and House → Opposition party having majority control both in Senate and House

Split Congress → Split Congress

US Mid-term Election	President	Ruling party	Before mid-term election		After mid-term election		Change in USD/JPY during 25 days before election (%)	Change in USD/JPY during 25 days after election (%)
			Senate*	House*	Senate*	House*		
5-Nov-74	Gerald Ford	Republican	Democrats	Democrats	Democrats	Democrats	0.78	-0.24
2-Nov-82	Ronald Reagan	Republican	Republican	Democrats	Republican	Democrats	2.56	-12.33
6-Nov-90	George H. W. Bush	Republican	Democrats	Democrats	Democrats	Democrats	-7.05	3.77
3-Nov-98	William Clinton	Democrats	Republican	Republican	Republican	Republican	-13.74	3.51

*Indicates majority party.

Source: compiled by Daiwa Securities.

Scenarios in which the opposition party either maintains its majority or Congress remains split

The lower panel of the table below shows scenarios of the opposition party having majority control of both legislative chambers prior to the election and maintaining that control after the election, as well as of Congress being split before the election and remaining split after the election. After the three elections in which the opposition party maintained majority control (1974, 1990, 1998), a pre-election decline and a post-election rise in USD/JPY were notable. In 1998, however, a decline in US share prices and interest rates caused by the collapse of Long-Term Capital Management, a major US hedge fund, had pushed USD/JPY lower prior to the election. This contrasts with the 1982 midterms, when Congress remained split and USD/JPY declined after the election. With the unemployment rate high and President Reagan's approval ratings low, the Republican Party lost 26 seats in the House (but gained one seat and maintained its majority in the Senate). Long-term rates had already declined on concerns over the US economy weakening, and the USD/JPY declined, partly in a pullback from its previous rise.

Forex trend differs depending on which political party is in power when opposition party gains a majority

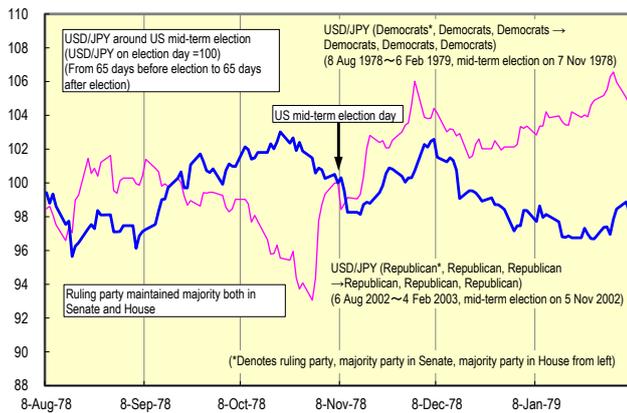
USD/JPY has been firm when the ruling party keeps its majority in both chambers

The two elections (1978 and 2002) where the ruling party maintained its majority in both chambers each had a different trend in the USD/JPY prior to the election. In 1978, under the Democratic administration of Jimmy Carter, the USD/JPY was falling (the yen was appreciating) amid a growing current account surplus for Japan and growing current account deficit for the US, but the USD/JPY rebounded sharply when President Carter announced on November 1 measures to defend the dollar (a coordinated forex intervention through an expansion of swap lines with the central banks of Japan, Germany, and Switzerland, a 1ppt increase in the official discount rate, and a 2ppt increase in the deposit reserve ratio). In 2002, under the Republican administration of George W. Bush, the USD/JPY had been strong but declined on uncertainty immediately prior to the election. The USD/JPY rose after the election in both 1978 and 2002. Although 1978 had the anomaly of the dollar protection measures, the USD/JPY tends to be strong under both Republican and Democratic administrations when the ruling party maintains its majority in both chambers following the midterm election.

Forex trend differs depending on which political party is in power when opposition party gains a majority

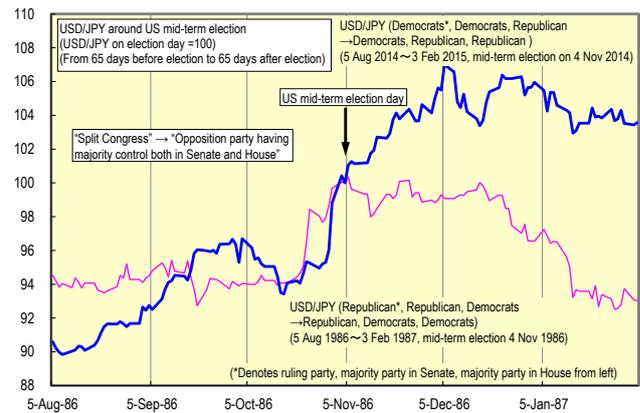
There was a similar rise in the USD/JPY prior to the election for the two midterms (1986 and 2014) that produced a change from a split Congress to the opposition party controlling both chambers after the election, but their post-election USD/JPY trends were different. Under the Republican Reagan Administration in 1986, the USD/JPY had been rising prior to the election but it peaked afterward, although the dollar's weakening following the September 1985 Plaza Accord may have had an impact. In contrast, under the Democratic Obama administration in 2014, the USD/JPY continued rising after the midterms. This difference in their forex trends despite having the same conditions of the ruling party being hurt by a shift from a split Congress to the opposition party controlling both chambers may be attributable to the difference in which party was taking control of Congress. This may be because the majority view is that a Republican majority is going to provide more stimulus to the US economy and markets via tax cuts and is more likely to trigger a rise in US stocks and strengthening of the dollar by encouraging capital inflows from overseas. Another factor may be the majority view that a Democratic majority is more likely to pursue protectionist trade and forex policies aimed at making US industry more internationally competitive.

Chart: USD/JPY Around US Mid-term Elections (in 1978 and 2002)



Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: USD/JPY Around US Mid-term Elections (in 1986 and 2014)



Source: Thomson Reuters; compiled by Daiwa Securities.

In the event of a ruling party defeat, USD/JPY rises under a Republican majority and declines under a Democratic majority

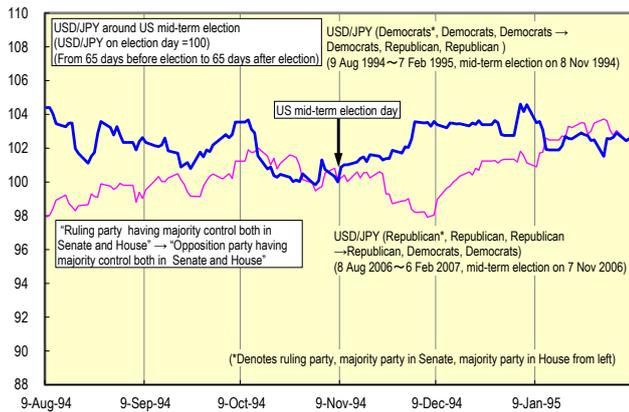
If 2018 midterm election results in a split Congress, USD/JPY may decline

Those midterm elections (1994, 2006) where the ruling party had control of both chambers prior to the election and the opposition party took control of both afterward shared the same trend of the USD/JPY softening slightly prior to the election but showed a different USD/JPY trend following the election. Under the Democratic Clinton Administration in 1994, the USD/JPY rose after the midterms gave the Republican Party control of both the House and the Senate. In contrast, under the Republican Bush administration in 2006, the USD/JPY declined after the Democrats won control of both chambers. As already noted, these differences in the post-election forex trend despite the similarity of congressional control turning in an unfavorable direction for the ruling party can probably be attributed in part to the difference in which political party took control of Congress.

If 2018 midterm election results in a split Congress, USD/JPY may decline

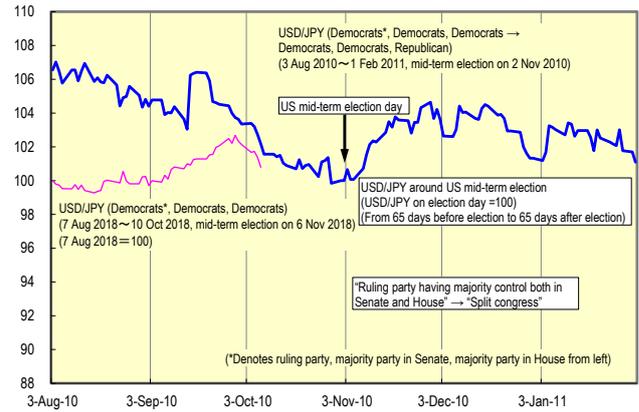
For the election (2010) that triggered a change from the ruling party controlling both chambers to a split Congress, the USD/JPY declined prior to the election and then rose afterward. The reason the USD/JPY rose even though a split Congress would be expected to reduce the administration's ability to enact policy was probably that Congress went from both chambers being controlled by a Democratic majority under the Democratic Obama administration to the Republicans winning control of the House. In other words, the USD/JPY did not always decline when Congress shifted from both chambers being controlled by the ruling party to either a split Congress or both chambers being controlled by the opposition party, but rather the direction exchange rates took depended on whether the Republican Party lost power. In 2018, the ruling Republican Party has a majority in both chambers, but there is a possibility that the Republicans will lose seats and cede control to the Democrats in the House, where every seat is up for reelection. We think it likely that the USD/JPY will rise if the Republicans maintain their control of both chambers but fall if it loses its majority in either the House or the Senate.

Chart: USD/JPY Around US Mid-term Elections (in 1994 and 2006)



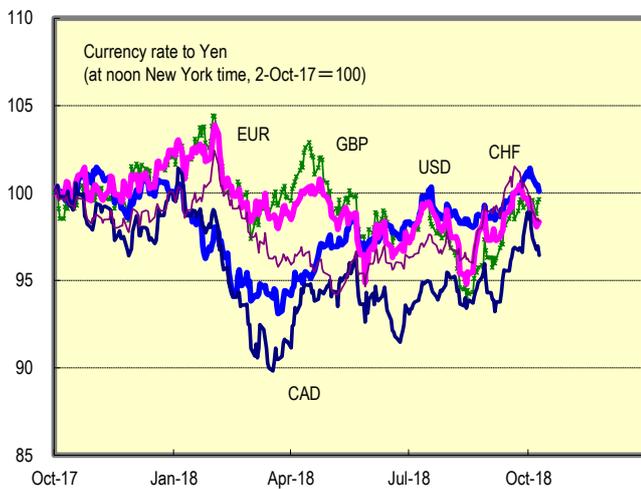
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: USD/JPY Around US Mid-term Elections (in 2010 and 2018)



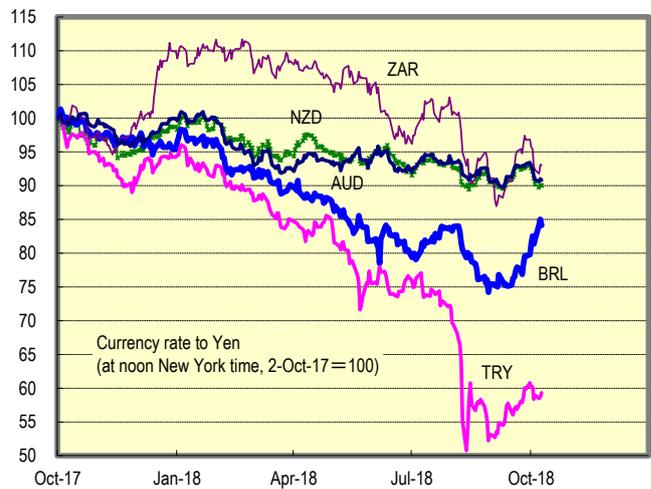
Source: Thomson Reuters; compiled by Daiwa Securities.

Chart: Major Currencies/JPY FX Index



Source: Fed, Thomson Reuters; compiled by Daiwa Securities.

Chart: EM Currencies/JPY FX Index



Source: Fed, Thomson Reuters; compiled by Daiwa Securities.

Chart: Currency Exchange Rate Forecasts

	Actual		Forecast				
	29 Jun 2018	28 Sep 2018	Oct-Dec 2018	Jan-Mar 2019	Apr-Jun 2019	Jul-Sep 2019	Oct-Dec 2019
USD-JPY	110.7	113.7	110.0	108.0	110.0	108.0	107.0
			108-115	105-113	105-113	105-113	104-112
EUR-JPY	129.3	131.9	129.0	124.5	129.0	125.5	123.0
			124-134	122-133	122-133	122-133	120-131
AUD-JPY	81.9	82.1	79.0	75.5	79.0	76.5	75.0
			77-84	74-83	74-83	74-83	72-81
CAD-JPY	84.3	88.0	85.5	82.5	85.5	83.0	82.0
			83-90	80-89	80-89	80-89	79-88
NZD-JPY	74.9	75.2	72.5	69.0	72.5	70.0	68.5
			70-77	67-76	67-76	67-76	66-75
TRY-JPY	24.1	18.8	18.5	17.0	18.5	17.5	16.7
			16-21	15-21	15-21	15-21	14-20
ZAR-JPY	8.1	8.0	7.5	7.0	7.5	7.2	7.0
			7.1-8.1	6.7-7.9	6.7-7.9	6.7-7.9	6.5-7.7
BRL-JPY	28.6	28.1	27.5	25.7	27.5	26.4	25.5
			25-30	24-30	24-30	24-30	23-29
KRW-JPY (100 KRW)	9.9	10.2	9.8	9.5	9.8	9.6	9.4
			9.5-10.3	9.2-10.2	9.2-10.2	9.2-10.2	9.1-10.1
CNY-JPY	16.7	16.5	15.9	15.4	16.2	15.6	15.3
			15.5-16.7	15.2-16.7	15.2-16.7	15.2-16.7	14.8-16.3

Source: BIS, Fed, Thomson Reuters; compiled by Daiwa Securities.

Notes: 1) Actual shows market rates at noon NY time.

2) Forecast upper row; as of quarter end, lower row; range during quarter.

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[Standard & Poor's]

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- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

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