Daiwa Securities

# Daiwa's Economic View

## Examining market concerns about "responsible, proactive fiscal policy"

- Excessive austerity, reflationary/high-pressure economic policy, change to fiscal consolidation target
- Entirely new economic/fiscal policy framework, growth/crisis management investment
- Cost-of-living measures, defense spending

FICC Research Dept.

**Koji Hamada**
81-3-5555-8791
kouji.hamada@daiwa.co.jp

**Kenji Yamamoto**
81-3-5555-8784
kenji.yamamoto@daiwa.co.jp

Daiwa Securities Co. Ltd.

Market views are divided on the Takaichi administration's "responsible, proactive fiscal policy." Some see fiscal spending as likely to be smaller than feared, while others remain firmly on guard.

Markets reacted strongly to Prime Minister Sanae Takaichi's comments about "excessive austerity," but she used it in the context of advancing investments in "crisis management and growth."

Expectations for reflationary or high-pressure economic policies gained traction given their association with the positions held by private-sector experts appointed to two advisory bodies. However, these positions are separate from the administration's official policy decisions.

The change to the fiscal consolidation target also drew attention, but the new target has long featured in the government's medium- to long-term projections.

Much of the supposedly major shift in economic and fiscal policy in fact overlaps with the Kishida cabinet's approach.

A key uncertainty is the scale of growth and crisis management investment, which will be managed separately from other budget items. Together with the new fiscal targets, it will likely feature in the Basic Policy on Economic and Fiscal Management and Reform (basic policy) to be published in June.

The government's approach to cost-of-living measures will affect the size of the FY26 supplementary budget.

The three defense strategy documents, due for revision this year, will set the direction of defense spending from FY27.

### Excessive austerity

At her press conference announcing the snap Lower House election on 19 January, Takaichi said she would put an end to excessive austerity. Markets read this as a declaration of plans to sharply increase government spending and went on high alert.

However, Takaichi has invariably followed mentions of "excessive austerity" with a warning about "underinvestment in the future." Read in full, her message is that excessive austerity has resulted in insufficient forward-looking investment, and that the government will therefore pursue spending on "growth and crisis management."

We would therefore avoid focusing on the phrase "excessive austerity" in isolation.

## Reflation and high-pressure economic policy

After Takaichi took office, she appointed private-sector experts who advocate reflationary or high-pressure economics to the Council on Economic and Fiscal Policy (CEFP) and the newly established Japan Growth Strategy Council. This fueled market concerns that the government intended to pursue a similar path on policy.

However, private-sector experts on the CEFP are not there to make policy decisions, and academic research supports this view. Their primary role is to present macroeconomic theories and analytical frameworks and to clarify the issues that underpin policy judgments.

The Japan Growth Strategy Council sits under the Japan Growth Strategy Headquarters and serves as an entry point for policy deliberations. It is the Headquarters that will formally decide on growth and crisis management investments, including public-private partnerships and the direction regarding growth sectors (which we discuss in detail below).

Takaichi's official statements and policy briefing materials to date contain no mentions whatsoever of "reflation" or "high-pressure economy."

## Change to fiscal consolidation target

The government's change in its fiscal consolidation target, from achieving a primary balance surplus to reducing the debt-to-GDP ratio, also sparked market debate.

However, the Cabinet Office publishes projections for the debt-to-GDP ratio alongside the primary balance in its "Economic and Fiscal Projections for Medium to Long Term Analysis." We therefore do not see this as a particularly abrupt shift.

We would also note that while a primary balance surplus has been the government's fiscal consolidation target, it has not automatically acted as a constraint on the budgeting process, particularly for supplementary budgets, where it appears not to have been used as a yardstick. The primary balance target has been in place since 2001, but the government has repeatedly pushed back the target timeframe for achieving it.

That said, the nominal growth rate can only go so high, making an unrestrained increase in fiscal spending impossible. Reducing the debt-to-GDP ratio also requires keeping an eye on the primary balance. Whether the new target is effective in disciplining the budgeting process remains to be seen.

## Entirely new economic/fiscal policy framework

Takaichi has stated (e.g., at her 19 Jan press conference) that she will launch an entirely new economic and fiscal policy framework. In practice, however, many of the policies overlap with those of the Kishida cabinet, and not all appeared out of the blue.

For example, the Kishida cabinet advanced the concept of multi-year fiscal commitments and greater predictability for public-private investment in areas such as semiconductors and GX (green transformation), including establishing funds and issuing Y20tn in GX economic transition bonds over a 10-year period. The Kishida-era idea of "sound finances built on a strong economy" also overlaps in places with the Takaichi cabinet's "responsible, proactive fiscal policy."

## Growth and crisis management investment

Uncertainties remain about growth and crisis management investment. It is the Takaichi cabinet's top-priority policy, but has not been a major item in budgets to date. It will be targeted by new initiatives for which the necessary spending will appear in the initial rather than supplementary budget, and will be managed as a separate category from FY27.

The amounts are not yet clear. A roadmap will be published from March, with figures likely appearing in the basic policy in June. This will be the key near-term focus for markets.

As noted, the Japan Growth Strategy Headquarters will decide the details and amounts. The Prime Minister chairs the Headquarters, and all cabinet ministers are members. Task forces covering 17 strategic sectors and five overarching themes will prepare roadmaps, each led by the responsible ministry. A key question will be whether ministries develop budgets through a bottom-up process of coordination with fiscal authorities, or Takaichi sets them from the top.

## Cost-of-living measures

Uncertainties also surround cost-of-living measures. Takaichi typically leads with growth and crisis management investment when explaining her policies, but cost-of-living measures are sometimes positioned as the top priority, for example in her policy speech to the extraordinary Diet session in October 2025 and in the LDP's manifesto for the February 2026 Lower House election. Cost-of-living measures have made up a large part of the Takaichi cabinet's budgets to date.

Rising prices have resulted in a prolonged y/y decline in real incomes that has put pressure on households' livelihoods. Cost-of-living measures rank first among the policies the public wants. Given that the ruling coalition does not have a majority in both chambers of the Diet, we think it makes political sense for the Takaichi administration to prioritize cost-of-living measures and increase their budget allocations.

What happens next is less clear. Much will depend on inflation trends, but we think the lack of a major national election in the immediate future gives the Takaichi cabinet considerable leeway to influence the size of the FY26 supplementary budget.

## Defense spending

Uncertainty also remains about planned increases in defense spending. In December 2022, the Kishida cabinet fundamentally revised the three defense strategy documents (the foundation of Japan's defense strategy) and substantially increased defense spending from the FY23 budget. The Takaichi cabinet will again revise the three documents during 2026 and will likely increase defense spending further from the FY27 budget.

Drastically strengthening Japan's security policy is seen as a separate issue from responsible, proactive fiscal policy. The revision to the defense strategy documents, due during 2026, will significantly affect budgets from FY27.

**IMPORTANT DISCLOSURES**

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Securities Co. Ltd. retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.

**Ratings**
Issues are rated 1, 2, 3, 4, or 5 as follows:
1: Outperform TOPIX/benchmark index by more than 15% over the next 12 months.
2: Outperform TOPIX/benchmark index by 5-15% over the next 12 months.
3: Out/underperform TOPIX/benchmark index by less than 5% over the next 12 months.
4: Underperform TOPIX/benchmark index by 5-15% over the next 12 months.
5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

Benchmark index: TOPIX for Japan, S&P 500 for US, STOXX Europe 600 for Europe, HSI for Hong Kong, STI for Singapore, KOSPI for Korea, TWII for Taiwan, and S&P/ASX 200 for Australia.

**Target Prices**
Daiwa Securities Co. Ltd. sets target prices based on its analysts' earnings estimates for subject companies. Risks to target prices include, but are not limited to, unexpected significant changes in subject companies' earnings trends and the macroeconomic environment.

**Disclosures related to Daiwa Securities**
Please refer to https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/e_disclaimer.pdf for information on conflicts of interest for Daiwa Securities, securities held by Daiwa Securities, companies for which Daiwa Securities or foreign affiliates of Daiwa Securities Group have acted as a lead underwriter, and other disclosures concerning individual companies. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

**Explanatory Document of Unregistered Credit Ratings**
This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/credit_ratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

**Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law**
(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)
If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- 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.
** The ratio of margin requirements etc. to the amount of the transaction 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.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.
Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108
Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association, Japan Security Token Offering Association