



J A P A N

F O R E S I G H T

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## The three stories that will shape Japan in 2025

### Key takeaways

- Three major stories will influence Japan's economy and markets in 2025: the ongoing uncertainty in Japan's political system, the challenges of the second Trump administration, and the difficulties facing monetary policy normalization.
- Amidst uncertainty, the Japanese government's policymaking will be predominantly reactive as a fragile Ishiba government seeks to navigate this environment.

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Japan has returned from its New Year holiday, with Prime Minister Ishiba Shigeru holding the customary New Year's press conference on Monday, 6 January. But after an eventful 2024 – which featured the Bank of Japan's (BOJ) beginning the process of exiting from more than a decade of unconventional monetary policy, a change of prime minister following an unprecedented nine-candidate Liberal Democratic Party (LDP) leadership race, and the birth of the first-ever LDP-led minority government – there will be little respite for Ishiba and Japan's government in 2025.

Accordingly, here are the three biggest stories that will shape Japan in 2025.

# JAPAN'S POLITICAL CALENDAR

## Major events in H1 2025



### January

**9-12:** Ishiba travels to Malaysia and Indonesia  
**20:** US presidential inauguration  
**24:** BOJ policy board decision  
**24:** Ordinary Diet session opening (*expected*)

### April

**1:** FY 2025 begins  
**13:** World Expo opens in Osaka  
**29:** Golden Week holidays begin

### February

- House of Representatives debates budget  
- Ishiba visits US to meet Trump (*expected*)  
- *Shuntō* wage negotiations proceed

### May

**1:** BOJ policy board decision  
**5:** Golden Week holidays conclude

### March

**2:** Deadline for House of Representatives to pass budget to ensure approval before fiscal year ends  
**19:** BOJ policy board decision  
- *Shuntō* concludes in first half of March

### June

**15:** G7 summit  
**17:** BOJ policy board decision  
**22:** Ordinary Diet session closing (*expected*)  
**22:** Sixtieth anniversary of the establishment of Japan-South Korea relations  
- Government finalizes FY2026 budget outline

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## The new political (dis)order

The birth of the LDP-led minority government in November 2024 marked the beginning of a new era in Japanese politics and government, as Japan transitions from the top-down system that prevailed since 2012 – in which the prime minister dominated the government and the LDP, and the LDP dominated the political system over a host of weak opposition parties – into a new, more uncertain arrangement.

The Ishiba government managed to work with the leading opposition parties during the extraordinary session of the Diet to pass a supplemental budget and a political reform bill, but the situation remains tenuous heading into the **ordinary session of the Diet that is expected to open on 24 January**.

The most immediate challenge for the government is passing a budget before **the fiscal year ends on 31 March**. The government approved a JPY 115.5tn (USD 732.9bn) general budget on 25 December. However, it did so without prior [agreement](#) of either the Democratic Party for the People (DPFP), the Constitutional Democratic Party (CDP), or Ishin no Kai, one of whose votes will be needed to pass the budget in the House of Representatives. Kōmeitō, the LDP's junior partner in government, has already conceded that the budget will likely be revised due to inter-party negotiations and parliamentary deliberations. Talks between the ruling parties and the DPFP over plans to raise the income tax exemption for part-time workers and the ruling parties and Ishin no Kai over eliminating tuition fees for secondary education will continue in the new year. The CDP, meanwhile, has questioned whether it would be possible to reduce wasteful spending from the budget, which could make for more protracted deliberations in the CDP-controlled lower house budget committee than in the past.

Despite these challenges, the government will likely manage to get the budget through the Diet on schedule – **the lower house needs to pass it by 2 March** to ensure its approval before the end of the fiscal year – even if it is forced to make some potentially significant concessions to opposition parties to ensure its passage. The more significant question, therefore, is not whether the government is able to pass its budget, but rather whether the frustrations of the new system result in efforts to break the political stalemate and create a more stable government. In recent days, Ishiba has separately hinted at the possibility of a snap lower house election if the Diet refuses to pass the budget or passes a no-confidence motion in the government and alluded to the possibility of a grand coalition. The latter is likely a non-starter, certainly before the **upper house elections in July**; the former is possible, particularly to coincide with the upper house elections, but Ishiba could face significant resistance from within the LDP if he tries to call a snap election, particularly following a no-confidence motion. That said, despite continuing low approval ratings, Ishiba starts the year relatively secure. If he is able to avoid a rift with the opposition parties that results in failure to pass a budget or the successful passage of a no-confidence motion, he may be able to survive through the upper house elections. LDP upper house members may prefer an alternate leader, but if Ishiba's approval ratings do not get much worse and if there is not a triggering action like a no-confidence motion, he will be difficult to unseat before the July vote.

If Ishiba survives the ordinary session of the Diet, he will then have to find a way to defend the ruling coalition's sixteen-seat majority in the House of Councillors. The proportionality of the upper house means that this margin is defensible, depending on whether the opposition parties are able to coordinate their candidates in the thirty-two single-member constituencies. Thus far, however, the parties are far apart, with Ishin no Kai wanting a "primary" process of selecting unity candidates for each constituency and

the DPFP wanting a policy accord as the foundation for electoral coordination. Nevertheless, if the ruling parties lose their majority in the upper house as well as the lower house, it could truly disrupt the system, triggering not only a change of prime minister but perhaps also producing a new ruling coalition that can manage both houses of the Diet.

## **Foreign policy in the age of Trump**

While Ishiba navigates a delicate political situation at home, he will also have to [manage the start of Donald Trump's second administration](#) in the United States. Ishiba's efforts to meet with Trump before his inauguration have not succeeded; while it appeared that a January meeting between the prime minister and president-elect might be possible after Abe Akie, widow of the late Abe Shinzō, visited Mar-a-Lago in December, those plans have been shelved. In contrast to 2017, when Abe's personal diplomacy with Trump helped delay or otherwise ameliorate some of Trump's threats to what he perceives as an "unfair" relationship between the US and Japan, Ishiba will not be able to use this playbook again.

The US-Japan relationship is not necessarily a high priority for the incoming administration, but it is unlikely that Japanese businesses will be able to avoid the impact of tariffs, both directly on Japanese imports and indirectly on other US trading partners (e.g. Canada and Mexico) where Japanese companies have invested to sell to the United States. The Japanese government will also likely face demands to spend more on its own defense – notwithstanding existing plans to raise defense spending to two percent of GDP by FY2027 – and contribute more to the costs of stationing US forces in Japan. These latter discussions, however, will play out over the next several years; for example, the current special measures agreement (SMA) governing host-nation support for US forces runs through Japan's FY2026. That said, the Ishiba government will be keen to negotiate with Trump on minimizing the impact of tariffs, perhaps following a **possible summit between Ishiba and Trump in February**.

Tokyo is watching how the second Trump administration's policies will affect Japan directly, but it faces a bigger challenge as it tries to determine the direction of US foreign policy under the new administration, particularly in the Indo-Pacific region. Will Trump heighten competition with China or pursue a grand bargain with Beijing that weakens the US commitment to Taiwan? Will Trump explore diplomacy with North Korea again? Will his administration prioritize the western hemisphere over security in Asia or Europe? Will there be any efforts to work with other major economies to bolster global economic governance or will the second Trump administration's pursuit of tariffs prompt a wave of beggar-thy-neighbor policies? While the Ishiba government will continue to prioritize the bilateral relationship with the United States, the uncertainty surrounding the second Trump administration will likely lead to hedging, particularly in global economic cooperation, as Japan looks to partners in Asia (including China) and Europe to preserve a rules-based economic order that facilitates trade and investment flows.

## **The bumpy road to monetary policy normalization**

The Bank of Japan (BOJ) faces its own challenges managing the transition to a new administration in the United States. BOJ Governor Ueda Kazuo [highlighted](#) uncertainty about the impact of the new administration's policies on Japan's economy in December, when the bank passed on raising interest rates again. While a rate hike remains a possibility at the bank's **23-24 January policy board meeting** – and Ueda and his staff believe that there is additional room to raise rates – the BOJ has softened its stance on normalization while it waits for clarity on how Trump will approach trade and fiscal policy in the early months of his administration. Ueda, speaking at a New Year's meeting of the Japanese Bankers Association on 6 January, suggested that normalization will continue if economic conditions continue to improve, but also sounded a cautionary note about the “great uncertainty” surrounding US policy.

Ultimately, monetary policy normalization will continue to be a stop-start process, as the bank monitors the impact of US policy on exchange rates – the yen begins 2025 near the JPY 160/USD barrier that proved uncomfortable for households in 2024 – and the outlook for **spring wage negotiations between major employers and labor unions**, the latter of which will not be unaffected by the Trump administration's tariffs and exchange rate movements.

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