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What we learned from Takaichi's stimulus package

Key takeaways

- The Takaichi government unveiled the largest stimulus package of the post-Covid era on Friday, 21 November.
- The government signaled that political leadership will guide fiscal policy, though Prime Minister Takaichi Sanae, despite her dovish inclinations, is still trying to reassure markets that her government will pursue "responsible" fiscal expansion.
- The process of drafting the FY2025 stimulus package and supplemental budget will likely serve as a preview for the government's approach to the FY2026 general budget, as the government will not only seek to include Takaichi's own priorities but will work with ruling and opposition parties to ensure their preferences are incorporated into the final draft.

he Takaichi cabinet approved a JPY 21.3tn (USD 136.25bn) stimulus package on Friday, 21 November that includes a JPY 17.7tn (USD 113.21bn) supplemental budget that will be submitted to the Diet for passage this session. The total amount, including loan guarantees and other non-budgetary measures, will be JPY 42.8tn (USD 273.77bn). This amounts to the largest stimulus package since the Covid-19 pandemic.

As anticipated, the stimulus package includes three pillars, the largest being a range of measures to provide relief to households and small businesses dealing with the rising cost of living (JPY 11.7tn). It also includes "strategic investments" in support of high-priority sectors – mainly shipbuilding, space, AI, semiconductors, and infrastructure – as part of the Takaichi government's growth strategy (JPY 7.2tn), and additional defense spending (1.7tn) to raise the overall level of defense spending to 2% of GDP in FY2025.

The size of the stimulus package and the process by which it was drafted offer several lessons into how Prime Minister Takaichi Sanae intends to govern.

First, the budget suggests that the government is trying to live up to its slogan of "responsible fiscal expansion." In announcing the stimulus package, the prime minister stressed that the overall level of debt issuance in FY2025 will be lower than in FY2024, indicating that while she is not afraid of delivering fiscal stimulus, she is mindful of the need to reassure markets that her government will not entirely disregard the need for fiscal restraint.

However, this lesson could be somewhat at odds with the second lesson of Takaichi's stimulus package, namely that the government has also signaled that political leadership will drive fiscal policy, not the Ministry of Finance (MOF). The prime minister reportedly disparaged MOF's initial draft, saying that the ministry had failed to address her priorities. What followed was a process whereby the government, in coordination with the Liberal Democratic Party (LDP) and Ishin no Kai, pushed hard for a larger package, making it as large as possible without increasing debt issuance or (according to its advisors) increasing inflation. This process also enabled the government to include some proposals to satisfy Ishin no Kai (a winter gas and electricity subsidy) and opposition parties (a supplemental child allowance payment). The latter could help streamline the passage of the budget through the Diet, seeing as how opposition party votes are still needed to ensure its passage. The implication, however, is that the Takaichi government may be consistently engaged in a kind of fiscal expansion two-step, reassuring markets that it is responsible while deferring to the preferences of fiscal doves on all sides in the drafting.

Accordingly, this is a particularly useful signal heading into the final stages of the FY2026 budgetary process. A similar ratchet – the prime minister's office and the ruling and opposition parties working together to increase the amount of spending over the objections of MOF – could prevail again. This process may already be unfolding in the drafting of the FY2026 tax plan, as the LDP's tax commission, its ranks now filled with Takaichi loyalists, began work this week alongside its Ishin no Kai counterpart and is leaning towards including various tax reductions desired by ruling and opposition party lawmakers. There may be some pushback from fiscal hawks in MOF and the LDP - over the course of drafting the supplemental budget LDP fiscal hawks, led by Asō Tarō, questioned the pressure to spend more – as the FY2026 budget takes shape, but the lesson of the drafting of the supplemental budget is that the most significant source of restraint may be not institutional (MOF) or political (LDP fiscal hawks) but rather Takaichi's own convictions (the stable reduction in the debt-to-GDP ratio, particularly the net ratio as previously discussed by Takaichi) in dialogue with financial markets. Whether this is reassuring will depend on beliefs in the prime minister's willingness to scale back her ambitions if conditions deteriorate. Specifically, will she scale back her ambitions in the face of lower-than-expected tax revenues – despite anticipated increases due to inflation – or lower-than-expected savings from spending reforms aimed at curbing "inefficient" spending? The rise in long-term bond yields over the

course of drafting the stimulus package suggests that Takaichi will need to provide continual reassurance that "responsible" fiscal expansion is not empty rhetoric.

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