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Takaichi pursues state-led transformation amidst macroeconomic pressures

Key takeaways

- The Takaichi government is preparing a supplemental budget that will not only provide relief from cost-of-living increases but will also include some early "strategic investments" in priority sectors.
- The latter measures will reflect the new government's plans to use industrial policy to promote self-sufficiency and strategic autonomy.
- Inverting Abenomics, Takaichi's growth strategy will shape macroeconomic policies, suggesting that it will seek greater fiscal flexibility despite pledges of "responsible" spending.

After managing a crowded diplomatic calendar in her first two weeks in office, Prime Minister Takaichi Sanae has begun fleshing out her government's economic program. Her government has not only begun signaling the outline of the supplemental budget that will be submitted to the Diet during the current extraordinary session but also convening the council that will draft the government's growth strategy.

A stimulus package takes shape…

The question of what a stimulus package should look like has been one of the most significant questions in Japanese politics over the course of 2025, virtually from the moment the United States announced its significant tariff increases in April. After extensive debates over whether to include a consumption tax cut or to use cash payments, the Takaichi government is preparing an outline with three pillars.

First, it will likely include a mix of tax measures – eliminating the provisional gasoline tax – and subsidies to help households, small businesses, and local governments cope with the rising cost of living.

Second, it could include some initial “strategic investments” in high-priority sectors, including AI, semiconductors, and shipbuilding. These items would effectively be a down payment on the prime minister’s priorities for a new growth strategy next year (see below).

Third, following Takaichi’s pledge to US President Donald Trump last week, it will include roughly JPY 1tn in additional spending to bring Japan’s total defense spending for FY2025 to 2% of GDP, achieving the 2022 target ahead of schedule and clearing the way for the government to develop a new plan in 2026.

This budget is expected to be at least JPY 10tn, though the question remains whether it will top last year’s JPY 13.9tn supplemental budget. In a press conference on Thursday, 6 November, Liberal Democratic Party (LDP) policy chief Kobayashi Takayuki stressed that it is important to include whatever is necessary without “imposing caps.” Against this backdrop – and given the prime minister’s high approval ratings – it is unlikely that budget and related legislation will have a difficult time moving through the Diet, notwithstanding the LDP-Ishin no Kai partnership’s lack of majorities in either house.

That said, the government has also not indicated how it will fund the supplemental budget, though it will likely rely on higher tax revenues due to inflation. Meanwhile, absent some change to the broader structural drivers of cost-of-living increases experienced by voters – lingering effects of supply-side commodity shocks and a weaker yen that has contributed to higher prices for imported food and energy – it is unlikely that this budget will meet Takaichi’s political need to deliver meaningful relief to households.

But so does a longer-term strategy

While the government and ruling parties are moving closer to finalizing a draft stimulus package, Takaichi also took some important steps in articulating a broader vision for her government’s economic policies. She is prepared to orient her government’s entire program around the need for promoting self-sufficiency and strategic autonomy in the face of threats to Japan’s security and prosperity. Whereas her predecessors acknowledged that the age of neoliberal globalization had passed – “Against the backdrop of the fluid international situation, strengthening economic security, including energy and food security, is a prerequisite for the New Capitalism,” argued the Kishida government’s “New Capitalism” vision paper in 2022 – they sought to pursue these goals alongside other priorities. As new agreements for economic security cooperation with the United States indicate, the goal is not autarchy but resilience, developing new capacity at home but also strengthening ties with like-minded countries.

The Takaichi government, however, is prepared to use not only more indirect industrial policy tools but also fiscal policy – i.e., "strategic investments" – in pursuit of this fundamental transformation, what one lawmaker has told me amounts to Japanese "state capitalism."

To this end, Takaichi convened her Japan Growth Strategy Headquarters (JGSH) for the first time on Tuesday, 4 November. Superseding the Kishida-era headquarters for promoting his "New Capitalism" vision, the new headquarters, under the formal leadership of Takaichi, Chief Cabinet Secretary Kihara Minoru, and Economic Revitalization Minister Kiuchi Minoru, has been tasked with outlining proposals for promoting public and private investment in seventeen strategic sectors spanning critical technologies (AI, semiconductors, quantum computing, information technology), defense-related industries (including also shipbuilding, space and aerospace, and cybersecurity), and essential infrastructure (including agriculture, energy security and the green transformation, fusion energy, and disaster preparedness). The drafting process will also consider cross-cutting areas, including strengthening competitiveness, fostering human capital, encouraging start-up formation, labor market reform, and supporting an environment that promotes wage increases.

In starting the growth strategy drafting process now – with a strategy not expected until later in the first half of 2026, around the time that the government will finalize its basic policies for the FY2027 budget – Takaichi is acknowledging that Abenomics did not do enough to bolster long-term economic growth and competitiveness. Indeed, in a parliamentary debate on 4 November, Takaichi admitted that while Abenomics had boosted growth and overcome deflation, she said that the results of Abe's growth strategies had been "insufficient in terms of stimulating private investment."

Thus, she may be inverting Abenomics. Instead of a "third arrow" that follows in the wake of macroeconomic stimulus, the Takaichi government's macroeconomic policies are effectively downstream of this growth strategy; the prime minister's pursuit of national security will shape its macroeconomic policymaking. As such, although Takaichi has named prominent "reflationists" to posts on both the JGSH and the CEFP – former Abe-era Bank of Japan (BOJ) policy board members Kataoka Gōshi and Wakatabe Masazumi respectively – her goal is not reflationism for its own sake. Instead, she wants to yoke expansionary macroeconomic policy to her growth strategy cart. The upshot is that while her government is unlikely to throw caution entirely to the wind – a concession to fears of a "Takaichi shock" to rival the UK's "Truss shock" – it will look to maximize its flexibility.

That said, while Takaichi and members of her government have repeatedly touted the government's "responsible fiscal expansion" slogan, the combination of Takaichi's new industrial policy priorities, higher defense spending, and the inexorable increase of social security outlays could all overcome the government's intentions to spend responsibly. There is limited political appetite for higher taxes – though there have been whispers about raising corporate taxes to pay for higher defense spending – and while the LDP's junior partner Ishin no Kai has pushed for a "Department of Government

Efficiency”-like effort to trim wasteful spending, it is unclear how substantial these savings could be. The government is also relying on automatic increases in tax revenues due to inflation to continue, but these gains may not offset the increases in spending. At the same time, while the government may tread carefully in its messaging to the BOJ, it may nevertheless prefer that it maintain accommodative monetary policies for longer to facilitate the government’s strategic investments.

Ultimately, the Takaichi government is running the risk that it can achieve its strategic goals – the structural adaptation of Japan’s economy to the new age of geopolitical competition – without triggering either adverse bond or foreign exchange market reaction; higher inflation, which could erode Takaichi’s political base; or dramatically higher interest rates, which could raise the costs of the government’s growth strategy while discouraging private investment. The Takaichi government is therefore likely to continue to send conflicting messages about fiscal policy as it simultaneously tries to reassure markets while trying to overcome resistance to its spending plans from fiscal hawks in the Finance Ministry and within the ruling parties.

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