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Takaichi's fiscal gamble comes into view

Key takeaways

- While the Takaichi government is still finalizing its growth strategy and basic policy, policy papers issued this week clarify how the government is preparing to ramp up spending in pursuit of Prime Minister Takaichi Sanae's vision of a "strong and prosperous Japan."
- The government outlined a sweeping public-private investment framework across a range of strategically important sectors. But while significant public outlays are likely, the government has not offered details on how much funding the state will provide.
- Takaichi is wagering that she can reassure markets that her plans will produce a "virtuous cycle" of higher growth and tax revenues; if investor confidence erodes she courts a spike in interest rates, higher inflation, and slower growth, risking the poorer, more insecure future she is determined to avoid.

The Takaichi government has begun unveiling the key documents that will guide its policymaking going forward, including its strategic growth strategy and the 2026 Basic Policy on Economic and Fiscal Management and Reform (the so-called *honebuto*). In these documents, the government will flesh out some of the details of the prime minister's commitment to "responsible fiscal expansion" – "breaking excessive austerity," as Prime Minister Takaichi Sanae has said repeatedly – in pursuit of her strategic autonomy and national resilience.

What may be most notable about the government's statements this week is how few surprises there are. There is no indication that the prime minister is prepared to scale back her ambitions; she is no less committed today to the idea that in order to safeguard Japan's future, the government needs to spearhead a process of industrial transformation now. In her remarks at a joint meeting of the Growth Strategy Council

and the Council on Economic and Fiscal Policy (CEFP) on 24 June, she effectively argued that it is up to political leadership to “overcome the delays and constraints of conventional policies and draw out truly effective policies based on new ideas and perspectives, including those from the private sector.”

Naturally, Takaichi continues to see the Ministry of Finance (MOF) as the single greatest constraint that needs to be overcome. In unveiling her government’s “Strong and Prosperous Japan Investment Framework” – a centerpiece of the forthcoming growth strategy – Takaichi said that there will be no “ceiling” on budgetary requests from ministries related to this framework and sectors critical for economic security funded out of special accounts. (Traditionally, MOF informs ministries of the maximum limit for their budgets when they prepare their requests during the budgetary process.) “What is important,” she said, “is the effect of fiscal spending on GDP growth, not the amount of fiscal spending. In the budget formulation process, we will scrutinize [a proposal’s] contribution to growth and [its] ability to stimulate private investment, and by focusing on truly effective measures, we will transform Japan’s budget to contribute to strengthening its growth potential.” She gestured towards fiscal sustainability, stating that the budget will be formulated with the goal of “steadily reducing the debt-to-GDP ratio,” but the implication is, as expected, that the Takaichi government’s programs will result in greater overall bond issuance, even if the new issuance is framed as “bridge bonds” tied to investment frameworks in specific technology sectors. The goal, Takaichi argues, is that the government will crowd in private investment, creating a virtuous cycle of growing capacity, rising employment and incomes, boosting consumer sentiment, raising profits, and increasing tax revenues and GDP, presumably all while leaving Japan more secure in an increasingly dangerous world.

The devil, of course, is in the details. The Strong and Prosperous Japan Investment Framework offers a headline target of JPY 370tn in total public and private investment in 62 major products and technologies across seventeen strategic sectors through FY 2040. As per [earlier](#) documents prepared by the Growth Strategy Council, the growth strategy is predominantly focused on a handful of sectors, including AI, semiconductors, quantum computing, information technology, cybersecurity, and defense. The government’s outline for investment appears to anticipate more than JPY 200tn of the JPY 370tn will be in these sectors; the figure will likely be higher since projections for defense industrial investment will depend on this year’s revisions of the three national security documents.

However, while the council’s documents describe a process of extensive consultations between government officials, experts, and business leaders to identify bottlenecks and draw up roadmaps for each sector, the government did not indicate what portion of the JPY 370tn in investment will be provided by public funding and what portion will come from private investment. The prime minister suggested, based on a Cabinet Office projection of the fiscal impact of the growth strategy, that one possible figure for additional government spending on “strategic investments” could be JPY 10tn per year, i.e. an increase equal to roughly 10% of the current budget that comes before natural increases in social security spending, new welfare benefits, and larger defense budgets.

Notably, this JPY 10tn could also be in addition to strategic investments made through the special investment frames. The long-term government commitments to invest in semiconductors, AI, and quantum computing may in fact enable greater private investment in these sectors, replicating the Rapidus model, though investment decisions will also be affected by the geopolitical environment, the global investing environment, labor shortages, and other factors beyond the government's plans. Naturally, the government hopes that investments in physical AI can have an outsized impact insofar as they can alleviate the impact of the declining working-age population and mitigate the need for immigration. Meanwhile, Japan's defense sector will likely be the biggest beneficiary of this program, and the government will invariably hope for technology spinoffs from defense spending. But ultimately the roadmap is not a plan; businesses will not be compelled to invest.

Ultimately, as Takaichi herself has indicated, the key to her program is a credible commitment to spend more on strategic investment over the long term, hence the importance of reforming how budgets get made. The government's forthcoming "Basic Policy on the New Budgetary Process," being prepared by Economic Revitalization Minister Kiuchi Minoru and Finance Minister Katayama Satsuki, may be the single most important policy document of the coming weeks. There are other documents coming, including the growth strategy itself, which will outline plans for eight cross-cutting policy areas, and the 2026 *honebuto*. But the new budgeting basic policy will provide more insight into how the government will approach fiscal sustainability if it is no longer using prevailing metrics. The CEFP met on Thursday, 25 June and specifically discussed these issues. In a document submitted by Katayama, she outlines some of the new principles for budgeting – based on ideas articulated by the CEFP's private members – including: (1) steadily reducing the debt-to-GDP ratio; (2) reforming budgeting to reflect rising inflation and nominal GDP; (3) providing for the "Strong and Prosperous Japan" framework; and (4) eliminating the dependence on supplemental budgets. Interestingly, whereas the private members include a fifth principle regarding communication to ensure market confidence – emphasizing the need for "transparent and consistent explanations" to investors and rigorous analysis of a range of metrics – Katayama's fifth principle refers briefly to reviewing tax measures and subsidies, arguably a reference to Japan's equivalent to the US "Department of Government Efficiency" (DOGE), instead of stressing the importance of communication with market players.

The most important piece of Katayama's submission to the CEFP, however, comes in one of her paper's footnotes, in which she notes that even as the annual primary balance will be downgraded in importance, "bridge bonds" issued to fund strategic investments as part of the "Strong and Prosperous Japan" framework will not be included in primary balance calculation in the first place. This echoes comments by the prime minister herself on 24 June. The reasoning given is that the bridge bonds will be amortized by unspecified "additional non-tax revenues," on the model of GX bonds (which will be redeemed by future carbon-pricing revenue), and therefore are not comparable to ordinary government bonds. But this redemption source does not currently exist, as a lengthy and at best ambiguous answer Katayama delivered to a question about financing in a press conference Friday suggests. The government does

not have a clear plan for redeeming these bonds. The need for clear communication from the Takaichi government about its fiscal program stressed by the CEFPP's private members could be an ongoing challenge.

For that reason, the fact remains that Takaichi is running an enormous gamble, both over the short term and the long term. Over the long term, she is betting that government investment has been the missing piece to the puzzle and will finally convince corporate Japan to deploy their cash holdings. Over the short term, she is betting that she can make initial investments without losing investor confidence, since rising bond yields would not only inflate the government's borrowing costs but would also squeeze households, damage small businesses (including start-ups), and erode the value of the yen, exacerbating persistent cost-of-living issues and presumably devastating Takaichi's political support well before the weaker yen might begin to deliver offsetting economic benefits in terms of Japanese businesses bringing investment home.

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