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Trump's interest in yen increases Takaichi's troubles

Key takeaways

- Prime Minister Takaichi Sanae told reporters that US President Donald Trump raised the yen's undervaluation and its impact on the US economy when they met in New York.
- While she claimed he did not mention Japan's macroeconomic policies, an intensification of US interest in the yen squeezes Takaichi between her commitment to "responsible fiscal expansion" and growing bilateral friction over exchange rates.

Prime Minister Takaichi Sanae confirmed on Friday, 25 September that when she met US President Donald Trump in New York, he expressed concern about the yen's undervaluation and its impact on US trade. He did not, she said, discuss Japan's fiscal and monetary policies. Meanwhile, after a video conference Friday between Finance Minister Katayama Satsuki and US Treasury Secretary Scott Bessent, Katayama affirmed that both sides view the weak yen as a problem.

To the extent that perceptions about the direction of Japan's fiscal and monetary policies have contributed to the yen's weakness, this issue will remain an irritant in the bilateral relationship. While Takaichi was telling reporters that Trump had mentioned the yen's value in their meeting, she also reiterated that her government is fully committed to using "responsible fiscal expansion" in pursuit of a "strong and prosperous Japan." There is no indication whatsoever that the Takaichi government is prepared to scale back its fiscal ambitions; in fact, the Nikkei Shimbun reported Thursday that the Ministry of Finance (MOF) is dissatisfied that ministries did not indicate how the spending they proposed to fund via "bridging bonds" in the new Strong and Prosperous Japan investment framework will deliver tax revenue increases to cover their future redemption. Even if these bonds will not be counted towards budget deficits, the result

could nevertheless be a surge of new issuance that investors treat as deficit bonds in all but name, producing higher yields.

As has become increasingly apparent, absent a fiscal U-turn, the Takaichi government will try to muddy the waters to avoid friction with the US and an adverse market reaction due to its fiscal policies. For example, Kiuchi Minoru, the economic revitalization minister, said Friday that “the phase of Abenomics-style reflationary policy is over” and that Takaichi’s fiscal policies are “not reflation policy.” But there is nothing new in Kiuchi’s remarks, in that it has been apparent from the beginning of the Takaichi government that she has been aiming to use fiscal measures not for macroeconomic policy but for industrial policy. Meanwhile, despite the Bank of Japan’s (BOJ) interest rate hike last week, there is virtually no sign from the Takaichi government that it is prepared to tolerate larger and faster rate hikes.

Trump’s involvement in exchange rate issues with Japan – despite an understanding between Trump and the late Abe Shinzō that the matter would be “left to the experts” – places Takaichi in an increasingly uncomfortable position. On the one hand, she cannot just abandon her economic program, because, first, doing so would be politically fatal (particularly at the behest of the United States); second, she cannot, for procedural reasons, just scrap the budget taking shape even if she wanted to; and, finally, she fundamentally believes that her program is necessary to save Japan from a perilous situation. On the other hand, presidential involvement could make it more difficult for the prime minister to simply brush off comments from US officials and press ahead with her plans. The government may continue to intervene in foreign exchange markets and pursue other short-term fixes to keep markets off balance and US attention on other matters, but to the extent that Takaichi’s policies are contributing to exchange rate movements, exchange rates will remain a source of friction on the bilateral agenda.

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