# Japan Q&A: is Sanaenomics a reflationary policy?

- **Is "Sanaenomics" a reflationary policy?**
- **What is the difference between Abenomics and Sanaenomics?**
- **How do you view concerns that a cautious approach to BoJ rate hikes could accelerate inflation and JPY depreciation?**
- **How would the Takaichi administration respond to markets concerned about inflation and JPY depreciation?**
- **How do you view the lack of clarity over funding for measures such as VAT cuts?**

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***Question 1:*** *Ministers in the Takaichi cabinet have made a series of statements distancing the administration from reflationary policies. Regarding "reflationary policies", which favour monetary easing and fiscal stimulus, Minister of State for Economic and Fiscal Policy Minoru Kiuchi stated at a press conference that "Abenomics-style reflationary policies are over". Finance Minister Satsuki Katayama also stressed during a television appearance that "PM Sanae Takaichi is not a reflationist". Last month, US Treasury Secretary Scott Bessent made the unusual demand that Japan abandon reflationary policies. The view that PM Takaichi is a "reflationist" has spread in the US and financial markets. Is "Sanaenomics" a reflationary policy?*

**Our view:** Let us define reflationary policies as policies that simply boost aggregate demand. Sanaenomics is substantially different: it aims to boost aggregate supply by expanding investment through public-private strategic investment and industrial policy. The expansion of aggregate supply through increased investment would drive potential growth higher and translate into strong real wage growth through improvements in labour productivity. Sanaenomics recognises that Japan's economic stagnation is caused by insufficient domestic investment, a matter of will, rather than an inevitable shortage of aggregate demand resulting from deteriorating demographics. If it were inevitable, it could not be changed. If it is a matter of will, it can be changed. The Takaichi administration's Japan Growth Strategy sets out that will and the plan to act on it.

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***Question 2:*** *As PM Takaichi has shown a strong commitment to fiscal stimulus and monetary easing, financial markets have viewed her administration as strongly inclined towards reflation even after it took office. Finance Minister Katayama says PM Takaichi told her, "I am not a reflationist, so please say that". Minister of State for Economic and Fiscal Policy Minoru Kiuchi also explained that, regarding the economic policies pursued by the Takaichi administration, "reflationary policies in the Abenomics sense of continuously easing monetary policy and deploying fiscal policy flexibly are over". What, then, is the difference between Abenomics and Sanaenomics?*

**Our view:** Abenomics aimed to overcome deflation caused by weak aggregate demand. It implemented large-scale monetary easing, known as the "Kuroda bazooka", named after then-BoJ Governor Haruhiko Kuroda. Fiscal policy, however, was contractionary, with the VAT rate raised twice and a primary surplus pursued. The substantial expansion of fiscal policy following the pandemic created a reflationary policy mix of monetary easing and fiscal expansion, turning nominal GDP from stagnation to growth. However, insufficient domestic investment meant that the economy quickly approached its aggregate supply ceiling, causing inflation. Reflationary policies that merely expand demand have already run their course. In



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the next stage, to sustain strong economic growth with stable inflation, Sanaenomics would aim to expand aggregate supply through public-private strategic investment, raise real growth from below 1% to the 1-2% range, and pass the benefits on to the public through rising real wages.

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***Question 3:*** *Financial markets nevertheless retain considerable concerns about the Takaichi administration's economic policies. Regarding PM Takaichi's "responsible proactive fiscal policy", there are concerns about how much fiscal spending and government bond issuance would actually increase, and whether a cautious approach to BoJ rate hikes could accelerate inflation and JPY depreciation. How do you view these concerns?*

**Our view:** The most misunderstood concept is that of a "high-pressure economy". The Japan Growth Strategy stated that "although the output gap has reached 0%, the economy is not sufficiently strong, and a sense of economic recovery has yet to spread to regional economies and small and medium-sized enterprises". An output gap of 0% merely means that the economy has caught up with its previous weak trend. It is insufficient to generate a strong expansion in companies' domestic spending, including investment and wages. A "high-pressure economy" with a positive output gap of more than 2% is necessary. However, there is a misconception that this "high-pressure economy" would be created through reflationary policies that simply boost aggregate demand, such as indiscriminate handouts. Sanaenomics would raise the output gap by expanding investment demand through public-private strategic investment and industrial policy. Investment constitutes demand in the short term and turns into supply in the long term. In a "high-pressure economy" driven by expanding investment demand, the subsequent expansion of aggregate supply would raise potential growth, enabling high economic growth with inflation stable at 2%. If companies expand investment while the economy is improving, the output gap would rise above 0%. If economic policy were tightened with a bias towards austerity, treating an output gap of 0% as a ceiling, the recovery would slow, investment would fail, and efforts to take on new challenges would go unrewarded. Based on the belief that "a country that does not take on challenges has no future", a "high-pressure economy" that accommodates a rise in the output gap driven by expanding investment demand is necessary.

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***Question 4:*** *PM Takaichi would deliver a speech on the opening day of the extraordinary Diet session convened on 5 October. A draft of her policy speech has emerged, and she is expected to emphasise, regarding "responsible proactive fiscal policy", that "if the economy or markets move differently from our expectations, we would analyse the impact and respond flexibly". How would the administration respond to markets concerned about inflation and JPY depreciation?*

**Our view:** Even when driven by investment demand, a rise in the output gap would keep inflation elevated. It takes considerable time for the benefits of increased investment to reach households through improvements in labour productivity and strong real wage growth. Increased investment is necessary for strong real wage growth, but because it increases demand in the short term, it would keep inflation elevated in the short term. The JPY is currently weak because Japan has lagged behind Europe and the US in public-private strategic investment and industrial policy, and its investment expansion remains weak. It would be natural for the JPY to appreciate as investment expands. With the prospect of increased investment expanding supply capacity, the weak level of JPY would not be a major problem. However, until the JPY appreciates, its weakness would burden households. During this period, the administration would "respond flexibly" to ease the burden on households through proactive fiscal policy, including VAT cuts. VAT cuts are an important component of the strategy to revitalise Japan's economy through increased investment, rather than indiscriminate handouts. To markets simply concerned about inflation and JPY depreciation, the administration would clearly explain Sanaenomics' macroeconomic strategy for revitalising Japan's economy and that the required government bond issuance would not be enormous compared with past levels. If interest rates moved substantially, the administration would also be expected to "respond flexibly" by adjusting its government bond issuance plan.

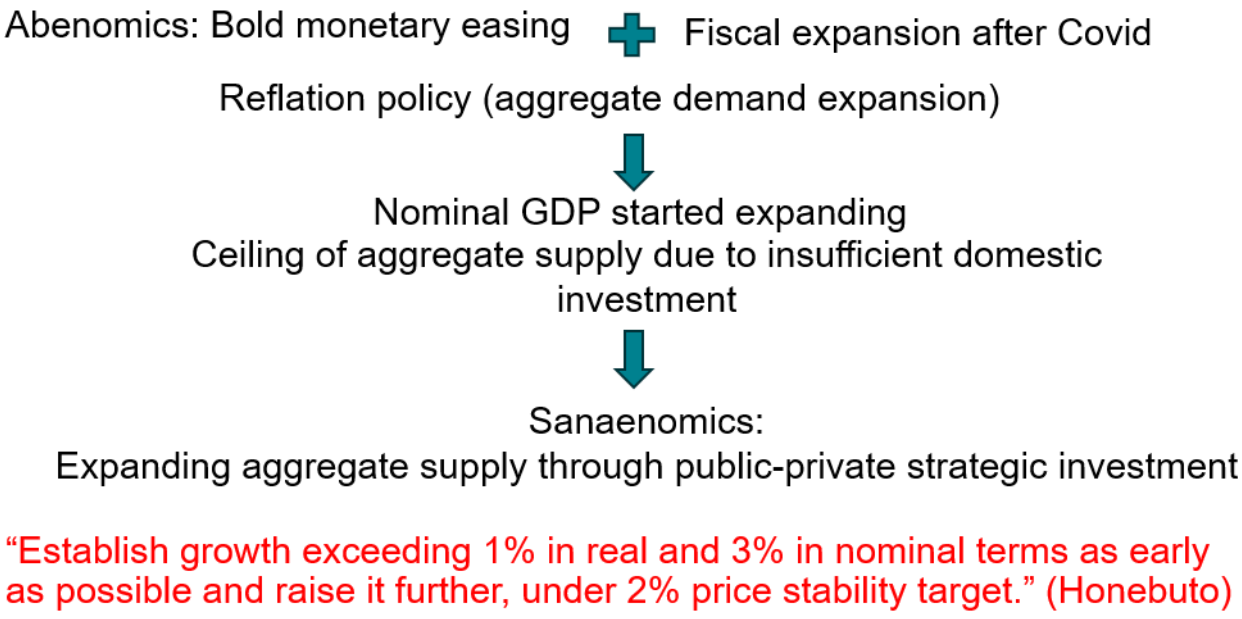
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***Question 5:*** *Markets are also concerned about the lack of clarity over funding for the VAT cut on food and beverages planned for next April and the new benefit scheme to be introduced in full from FY29. In her speech, PM Takaichi plans to stress that "we would secure funding without relying on deficit-financing bonds, to earn market confidence. There is no need for concern". How do you view the lack of clarity over funding?*

**Our view:** It takes time for investment to translate into rising real wages and for household fundamentals to recover. Fiscal policy needs to support households in the meantime. If domestic demand falters, companies unable to generate profits domestically would hold back on investment. It is therefore reasonable to support households by reducing the VAT rate on food in FY27 and FY28. Thereafter, the introduction of income-linked benefits and a virtuous cycle driven by rising real wages would begin to take effect. Tax and non-tax revenue in FY27 is projected at JPY98.8trn, an increase of JPY6.1trn from JPY92.7trn in the initial FY26 budget, and actual revenue is increasingly likely to exceed that projection. Moreover, because the Ministry of Finance habitually underestimates revenue in the initial budget, revenue exceeding the initial estimate by around JPY8.8trn by the final accounts – the average for FY24 and FY25 – has become the norm. Transfers of around JPY5trn from sources such as the special account holding foreign exchange reserves, including profits from foreign exchange intervention, would also be entirely feasible. In total, around JPY20trn in funding would become available in FY27. Even if the VAT rate on food were reduced to 1%, lowering tax revenue by just under JPY5trn, it is clear that this could be achieved without relying on new government bonds. These funding sources would become clear during the preparation of the FY27 government budget by the end of the year. As a result, even with increased investment under proactive fiscal policy and VAT cuts, new government bond issuance in FY27 would be expected to remain around its FY25 level, with no risk of an unprecedented increase in issuance.

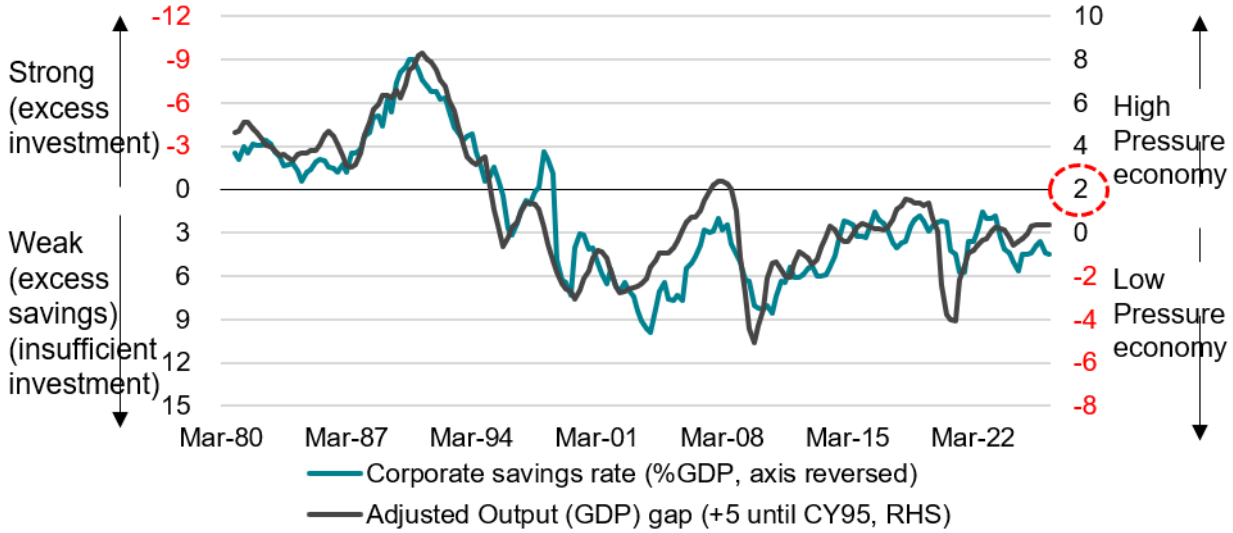
**Fig 1. Transition from reflation to Sanaenomics**




*Source: Crédit Agricole CIB*

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**Fig 2. Corporate Savings Rate and Output Gap**




"Although the output gap has narrowed to around zero, the economy is not strong enough, and the sense of economic recovery has yet to spread to regional areas and SMEs." (Japan Growth Strategy)

**GDP Gap** (%) = (**Actual GDP - Potential GDP**) / **Potential GDP.** GDP at the level of factor inputs that is average relative to past trends.

*Note: Due to the revision of the GDP standard, the output gap before 1995, including the financial bubble period, is adjusted by +5*

*Source: BoJ, Cabinet Office, Crédit Agricole CIB*

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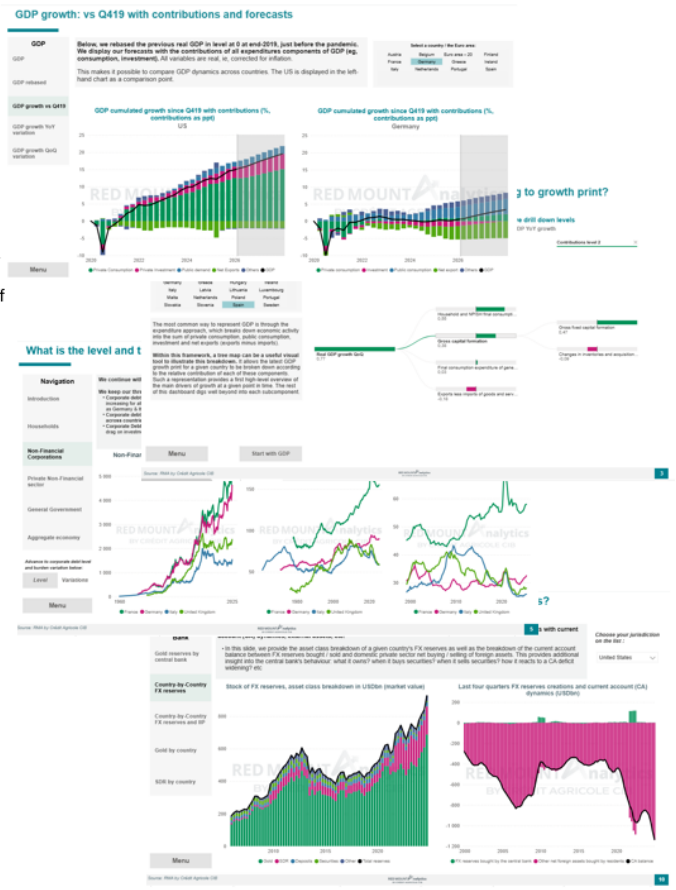
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