Japan: major challenges and expectations for Finance Minister Satsuki Katayama in formulating a government budget that truly embodies responsible proactive fiscal policy



Takuji Aida
Chief Economist Japan
+81 3 4580 5360
takuji.aida@ca-cib.com



Ken Matsumoto
Market Strategist Japan
+81 3 4580 5337
ken.matsumoto@ca-cib.com

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- PM Sanae Takaichi delivered her policy speech in both the Lower and Upper Houses. She reiterated that the global economic policy trend has shifted from quantitative growth through efficiency gains under neoliberalism, which relies excessively on market mechanisms, towards value-added growth that addresses economic and social challenges through public-private strategic investment and industrial policy, and that competition in industrial policy is intensifying. As also set out in Honebuto and other policy documents, she emphasised a bold review of budget formulation policy, with the "Japan Growth Strategy" and the "Regional Future Strategy" as its two pillars, to strongly stimulate private domestic investment by boldly advancing "crisis management investment" that anticipates risks and challenges shared across the world, as well as "growth investment". Expanding domestic investment through public-private strategic investment and industrial policy would raise aggregate supply and potential growth. Achieving both "strong economic growth" and "stable price increases" by raising aggregate supply is the Takaichi administration's unified message.

- Under the strong leadership of Minister of State for Economic and Fiscal Policy Minoru Kiuchi, the Takaichi administration has fundamentally shifted its economic policy direction through the Japan Growth Strategy and Honebuto, from prioritising fiscal consolidation through retrenchment born of resignation towards pursuing economic growth through the challenge of investing. Taking the baton from the policy shift accomplished by Minister Kiuchi, Finance Minister Satsuki Katayama is now required to demonstrate leadership by incorporating this economic policy direction into a government budget based on responsible proactive fiscal policy and giving it the capacity and momentum to deliver. Finance Minister Katayama faces major challenges in formulating a government budget that truly embodies responsible proactive fiscal policy and ensuring that markets properly understand both the shift in economic policy direction and the government budget.

- In formulating the FY27 government budget towards the end of the year, Finance Minister Katayama needs to (1) reform the Ministry of Finance, (2) address the shortcomings of the traditional single-year approach and (3) implement strategic budgetary measures spanning multiple years. Establishing the "Strong and Prosperous Japan" investment framework requires a mechanism without a ceiling that can flexibly accommodate truly effective investment support measures. Finance Minister Katayama therefore faces major challenges, with high expectations for her decisiveness and ability to deliver. Assessing the investment impact would be important when reviewing budget allocations under the "Strong and Prosperous Japan" investment framework. Budgets must not be cut at the sole discretion of the Ministry of Finance's budget examiners, as they have been in the past. Reform of the institutional framework for budget assessment is required so that the process involves collaboration with members of the Japan Growth Strategy Council, which would compile the Japan Growth Strategy Action Plan by the end of the year. If budget assessment continues under existing methods and conventions, there is a risk that

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the Japan Growth Strategy would remain a plan on paper. Reforming budget assessment is Finance Minister Katayama's first priority in reforming the Ministry of Finance.

- **The Takaichi administration aims to overcome the severe shortage of domestic investment and achieve a "strong economy" through public-private collaboration. Bringing together the expertise of specialists on the Japan Growth Strategy Council, with Minister Kiuchi at its centre, has produced a grand design – the Japan Growth Strategy – that demonstrates the determination to achieve a "strong economy" by expanding public-private strategic investment. Finance Minister Katayama's strong leadership would be key to translating the Japan Growth Strategy into concrete budgetary measures and steadily delivering the more than JPY370trn of investment in the public-private investment roadmap. Through the "Strong and Prosperous Japan" investment framework, sufficient and predictable fiscal spending needs to be secured for public-private strategic investment and industrial policy to support private companies' investment decisions. Only when the Japan Growth Strategy and budget management work together would it become possible to break the longstanding vicious cycle in which insufficient investment holds back economic growth, which in turn leads to further underinvestment.**

- **Exchange rate stability is an important factor directly affecting people's lives and companies' business activities, and plays an essential role in attracting investment into Japan. As globalisation progresses, deepening international cooperation, including between Japan and the US, is an urgent priority. Finance Minister Katayama's extensive knowledge and diplomatic skills, grounded in trusting relationships with her overseas counterparts, are expected to facilitate smooth coordination of the two countries' economic policies. Ensuring that US Treasury Secretary Scott Bessent properly understands the Takaichi administration's economic policy direction and does not unsettle markets with remarks that create misunderstandings is also an important responsibility. If markets misunderstand the policy, correcting those misunderstandings requires patiently explaining its true nature, without narrowing policy options by presenting the Takaichi administration's economic policy direction in a way that panders to markets. As PM Sanae Takaichi stated, it is necessary to "enhance market confidence in the government through a straightforward approach". Finance Minister Katayama would be able to meet the high expectations at home and abroad through her capabilities and advance the implementation element of PM Takaichi's call for "decision, challenge and execution".**

PM Sanae Takaichi delivered her policy speech in both the Lower and Upper Houses. She reiterated that the global economic policy trend has shifted from quantitative growth through efficiency gains under neoliberalism, which relies excessively on market mechanisms, towards value-added growth that addresses economic and social challenges through public-private strategic investment and industrial policy, and that competition in industrial policy is intensifying. Honebuto also called for a bold review of budget formulation policy, with the "Japan Growth Strategy" and the "Regional Future Strategy" as its two pillars, to strongly stimulate private domestic investment by boldly advancing "crisis management investment" that anticipates risks and challenges shared across the world, as well as "growth investment". Expanding investment through public-private strategic investment and industrial policy would raise aggregate supply and potential growth. Achieving both "strong economic growth" and "stable price increases" by raising aggregate supply is the Takaichi administration's unified message.

Under the strong leadership of Minister of State for Economic and Fiscal Policy Minister Minoru Kiuchi, the Takaichi administration has fundamentally shifted its economic policy direction through the Japan Growth Strategy and Honebuto, from prioritising fiscal consolidation through retrenchment born of resignation towards pursuing economic growth through the challenge of investing. So far, Finance Minister Satsuki Katayama has had little room to exercise leadership, and the task

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of ensuring that markets understand the shift in economic policy direction remains unfinished. Taking the baton from the policy shift accomplished by Minister Kiuchi, Finance Minister Katayama is now required to demonstrate leadership by incorporating this economic policy direction into a government budget based on responsible proactive fiscal policy and giving it the capacity and momentum to deliver. The mindset of prioritising fiscal consolidation through retrenchment born of resignation remains deeply rooted, creating a risk that the government budget would be insufficient to provide the capacity and momentum needed to implement public-private strategic investment and industrial policy. Finance Minister Katayama faces major challenges in formulating a government budget that truly embodies responsible proactive fiscal policy and ensuring that markets properly understand both the shift in economic policy direction and the government budget.

As set out in her book, "*Doubling salaries: a plan for nominal GDP of JPY1,000trn!*", Finance Minister Katayama had a clear vision for economic security and nominal GDP of JPY1,000trn even before the Takaichi administration came into office. Under a finance minister who explicitly advocates sustained nominal GDP expansion, seeking a natural increase in tax revenue through growth in the size of the economy, rather than tax increases, represents an approach previously absent from the Ministry of Finance. For Japan to remain competitive globally, it is urgent to steadily implement, with predictability, the more than JPY370trn of investment set out in the Japan Growth Strategy's public-private investment roadmap through public-private strategic investment and industrial policy. Under Minister Kiuchi's leadership, the Japan Growth Strategy and Honebuto clearly set out a direction of boldly and strategically advancing "crisis management investment" and "growth investment" under the principle of "responsible proactive fiscal policy", strengthening medium- to long-term growth potential to break the pattern of underinvestment and respond to an era of intense global competition in industrial policy. The Japan Growth Strategy set targets of nominal GDP of JPY1,100trn and private investment of JPY250trn by FY40.

In formulating the FY27 government budget towards the end of the year, Finance Minister Katayama needs to (1) reform the Ministry of Finance, (2) address the shortcomings of the traditional single-year approach and (3) implement strategic budgetary measures spanning multiple years. Establishing the "Strong and Prosperous Japan" investment framework requires a mechanism without a ceiling that can flexibly accommodate truly effective investment support measures. Finance Minister Katayama therefore faces major challenges, with high expectations for her decisiveness and ability to deliver. Assessing the investment impact would be important when reviewing budget allocations under the "Strong and Prosperous Japan" investment framework. Budgets must not be cut at the sole discretion of the Ministry of Finance's budget examiners, as they have been in the past. Reform of the institutional framework for budget assessment is required so that the process involves collaboration with members of the Japan Growth Strategy Council, which would compile the Japan Growth Strategy Action Plan by the end of the year. If budget assessment continues under existing methods and conventions, there is a risk that the Japan Growth Strategy would remain a plan on paper. Reforming budget assessment is Finance Minister Katayama's first priority in reforming the Ministry of Finance.

The traditional bureaucrat-led budget formulation process based on a single-year approach has made it difficult for private companies to make medium- to long-term business decisions and has impeded growth across the Japanese economy. Finance Minister Katayama needs to play a major role in addressing this structural problem and promote the introduction of multi-year budget frameworks and strategic fiscal allocations. These reforms would substantially improve predictability for private companies when formulating business strategies, stimulate their appetite for long-term investment and encourage a shift from excess saving, associated with a cost-cutting model, towards investment exceeding saving, associated with an investment and growth model. Finance Minister Katayama's efforts to further improve the predictability of the government budget to stimulate private domestic investment, and to conduct budget management that supports private business decisions, would carry an extremely important role and responsibility in achieving sustained growth in the Japanese economy.

The Takaichi administration aims to overcome the severe shortage of domestic investment and achieve a "strong economy" through public-private collaboration. Bringing together the expertise of specialists on the Japan Growth Strategy Council,

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with Minister Kiuchi at its centre, has produced a grand design – the Japan Growth Strategy – that demonstrates the determination to achieve a "strong economy" by expanding public-private strategic investment. Finance Minister Katayama's strong leadership would be key to translating the Japan Growth Strategy into concrete budgetary measures and steadily delivering the more than JPY370trn of investment in the public-private investment roadmap. Through the "Strong and Prosperous Japan" investment framework, sufficient and predictable fiscal spending needs to be secured for public-private strategic investment and industrial policy to support private companies' investment decisions. Only when the Japan Growth Strategy and budget management work together would it become possible to break the longstanding vicious cycle in which insufficient investment holds back economic growth, which in turn leads to further underinvestment.

Expanding long-term investment requires a stable supply of long-term funding, as well as sufficient fiscal spending to stimulate private investment. With financial and fiscal challenges remaining in advancing the growth strategy, Finance Minister Katayama must draw on her many years of policymaking experience to maximise the synergies between monetary and fiscal policy through close coordination with the BoJ. Addressing the stable supply of long-term funding, in particular, requires a multifaceted approach, including the use of government-affiliated financial institutions, coordination with the GPIF, strategic deployment of the Fiscal Investment and Loan Programme and efforts to encourage private financial institutions. Budget management informed by Finance Minister Katayama's extensive knowledge would enable the growth strategy to deliver its full benefits by creating an environment that stimulates private investment. The Japan Growth Strategy and Honebuto fall within Minister Kiuchi's remit, while creating an environment that strengthens the capacity and momentum to implement public-private strategic investment and industrial policy, through budget formulation and the development of financial conditions, falls within Finance Minister Katayama's remit and constitutes a major responsibility entrusted to her.

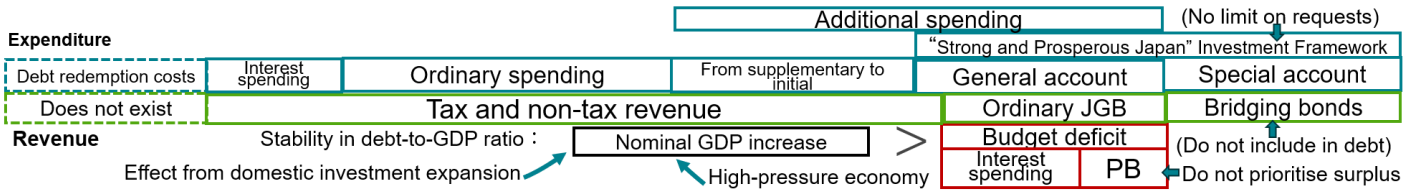
Expanding public-private strategic investment requires coordination with regulatory and institutional reform as well as funding. Finance Minister Katayama needs to work closely with Minister Kiuchi and the relevant ministries and agencies to introduce budgetary measures that improve the investment environment, while building an institutional foundation that enables private companies to make investment decisions from a long-term perspective. Under the Takaichi administration's fundamental stance that "a country that does not take on challenges has no future", Finance Minister Katayama's budget management would bring about a structural transformation of the Japanese economy by strongly supporting the expansion of public-private strategic investment and industrial policy. Her vision of nominal GDP of JPY1,000trn is more than a target for an economic indicator; it is a strategic objective for Japan to secure a leading position in global economic competition and ensure prosperity and security for its people. Strengthening Japan's economic foundations is also urgent from the perspective of economic security, and Finance Minister Katayama's budget management would be central to achieving this objective. Under the Takaichi administration, Finance Minister Katayama's ability to break with the Ministry of Finance's conventional thinking and achieve both growth and fiscal soundness would play an important role in determining the future direction of the Japanese economy.

Exchange rate stability is an important factor directly affecting people's lives and companies' business activities, and plays an essential role in attracting investment into Japan. As globalisation progresses, deepening international cooperation, including between Japan and the US, is an urgent priority. Finance Minister Katayama's efforts to advance strategic dialogue by drawing on her strong relationship with US Treasury Secretary Bessent would also be extremely important in safeguarding Japan's economic security. Finance Minister Katayama's extensive knowledge and diplomatic skills, grounded in trusting relationships with her overseas counterparts, are expected to facilitate smooth coordination of the two countries' economic policies. She is expected to continue actively engaging in the necessary communication and strategic outreach to advance Japan's national interests and achieve a strong economy. Ensuring that US Treasury Secretary Bessent properly understands the Takaichi administration's economic policy direction and does not unsettle markets with remarks that create misunderstandings is also an important responsibility. If markets misunderstand the policy, correcting those misunderstandings requires patiently explaining its true

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nature, without narrowing policy options by presenting the Takaichi administration's economic policy direction in a way that panders to markets. As PM Takaichi stated, it is necessary to "enhance market confidence in the government through a straightforward approach". Finance Minister Katayama would be able to meet the high expectations at home and abroad through her capabilities and advance the implementation element of PM Takaichi's call for "decision, challenge and execution".

Fig 1. Conceptual framework for radical reform of the government budget



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Note: Takuji Aida is a member of the Japan Growth Strategy Council. The content is a personal opinion and does not necessarily reflect the government's view.

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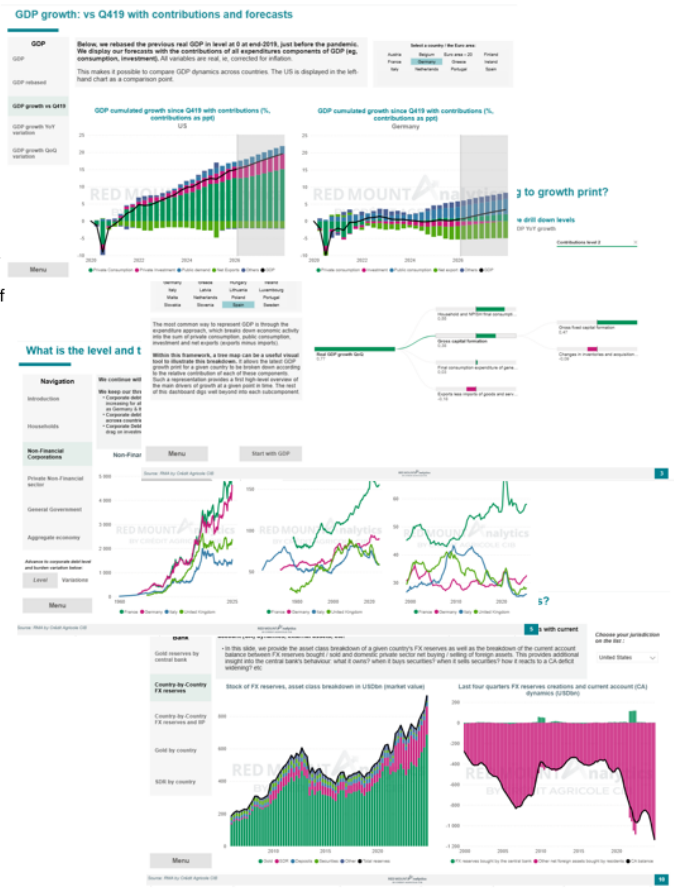
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Global Markets Research contact details

Jean-François Paren Head of Global Markets Research +33 1 41 89 33 95

	Asia (Hong Kong, Singapore & Tokyo)		Europe (London & Paris)		Americas (New York)
Macro Strategy	Takuji Aida Chief Economist Japan +81 3 4580 5360	Ken Matsumoto Macro Strategist Japan +81 3 4580 5337	**Louis Harreau** **Head of Developed Markets Macro & Strategy** **+33 1 41 89 98 95**	Valentin Giust Global Macro Strategist +33 1 41 89 30 01	Nicholas Van Ness ** Chief US Economist +1 212 261 7601
Interest Rates			**Jean-François Perrin** **Head of Rates and Inflation Research & Strategy** **+33 1 41 89 73 49** Matthias Loise Inflation Strategist +33 1 41 89 20 06	Guillaume Martin Interest Rates Strategist +33 1 41 89 37 66 Riccardo Lamia Interest Rates Strategist +33 1 41 89 63 83 Monna Dimitrova Interest Rates Strategist +33 1 41 89 05 61	Alex Li ** Head of US Rates Strategy +1 212 261 3950
Emerging Markets	Xiaojia Zhi Chief China Economist Head of Research, Asia ex-Japan +852 2826 5725 Eddie Cheung CFA Senior Emerging Market Strategist +852 2826 1553	Jeffrey Zhang Emerging Market Strategist +852 2826 5749 Yeon Jin Kim Emerging Market Analyst +852 2826 5756	**Sébastien Barbé** **Head of Emerging Market Research & Strategy** **+33 1 41 89 15 97**		Olga Yangol ** Head of Emerging Market Research & Strategy, Americas +1 212 261 3953
Foreign Exchange	David Forrester Senior FX Strategist +65 6439 9826		**Valentin Marinov** **Head of G10 FX Research & Strategy** **+44 20 7214 5289**	Alexandre Dolci FX Strategist +44 20 7214 5064	
Quant Research			Alexandre Borel Data Scientist +33 1 57 87 34 27		

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Andrew Taylor MiFID II Research contact andrew.taylor@ca-cib.com	Please send your questions on MiFID II to: research.mifid2@ca-cib.com

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