Japan Q&A: what has changed with Honebuto and the Japan Growth Strategy

- **How should Honebuto be assessed? Is the more than JPY370trn in public and private investment set out in the Japan Growth Strategy achievable?**
- **Has industrial policy not failed in the past? Wouldn't the Japan Growth Strategy also fail?**

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Question 1: ***How should Honebuto be assessed? Is the more than JPY370trn in public and private investment set out in the Japan Growth Strategy achievable?***

Our view:

The first Honebuto under PM Sanae Takaichi's administration fundamentally reformed the guidelines for budget formulation through a "Copernican revolution in the very approach to economic and fiscal management": a shift from the geocentric view that prioritises fiscal consolidation, constrained by the austerity-oriented belief that the fiscal balance must be in surplus, to the heliocentric view of proactive fiscal policy that restores national strength through greater investment. Under the principle of responsible proactive fiscal policy, economic policy and the government budget would be fully mobilised to expand domestic investment, the shortage of which has caused Japan's economic stagnation. This responds to the transition from neoliberalism focused on efficiency to an era of intense global competition in industrial policy involving large-scale, long-term fiscal spending through public-private partnerships. Strategic investment in "crisis management investment" and "growth investment" would be advanced through public-private partnerships, returning the corporate sector from a savings surplus, characterised by cost-cutting, to an investment surplus and shifting the economy towards a new growth model.

The Japan Growth Strategy would expand strategic investment as a portfolio centred on 17 sectors, securing the economy's growth potential and the public's safety and peace of mind. It would sustainably expand the size of the economy and supply capacity, increase incomes, raise corporate profits and create a virtuous cycle of a "strong economy" in which tax revenues rise organically, thereby making public finances sustainable. By moving away from an austerity mindset and turning the public's capabilities into a driver of growth, it would establish economic growth rates above 1% in real terms and above 3% in nominal terms at an early stage, and then raise them further. As it takes time for the benefits of the economic recovery generated by greater investment to reach households, the VAT rate on food would be reduced to 1% as an interim measure to support households. The VAT cut is not a handout, but part of the investment strategy under a fiscal policy that has undergone a Copernican revolution.

This represents a major shift from the resignation of the administration of former PM Shigeru Ishiba, which emphasised "fiscal space and fiscal consolidation", to the challenge embraced by the Takaichi administration, which emphasises "investment and growth". It was already clear that Honebuto would signal a shift towards proactive fiscal policy and a dual mandate for the BoJ, combining strong economic growth with stable price increases. Describing it as a "Honebuto shock" therefore suggests that political developments had not been followed closely enough.

Public and private investment under the Japan Growth Strategy would exceed JPY370trn by FY40, or around JPY25trn annually. However, net domestic fund demand in Q226 – the combined spending capacity of businesses and the government, measured as the corporate savings rate plus the fiscal balance, as a

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percentage of GDP on a four-quarter moving average basis, with a more negative figure indicating greater strength – was +3.3%, meaning that it remains absent. Net domestic fund demand provides the force that expands the economy and channels income to households. Expanding strategic investment through public-private partnerships and industrial policy would allow net domestic fund demand to return to sufficiently negative territory and restore an economy in which income flows reliably and autonomously to households. The annual public and private investment envisaged in the Japan Growth Strategy is not excessive; it is the minimum scale required to keep net domestic fund demand sufficiently negative.

Sanaenomics is based on the recognition that Japan's economic stagnation is not an inevitable outcome of insufficient aggregate demand caused by deteriorating demographics, but a matter of will reflected in insufficient domestic investment. If it were inevitable, it could not be changed, but if it is a matter of will, it can be changed. The Japan Growth Strategy sets out that will and the plan to act on it. Sustained, substantial improvements in total factor productivity (TFP) arise from the accumulation of domestic investment, rather than neoliberal policies such as cost-cutting, deregulation and a reduced government role. If the public and private sectors work together to develop and adopt physical AI, attract inward foreign direct investment and expand investment in science, technology and innovation (R&D), improvements in TFP would make the government's potential growth rate of around 1.5% achievable.

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***Question 2:* Has industrial policy not failed in the past? Wouldn't the Japan Growth Strategy also fail?**

Our view:

Establishing a macroeconomic strategy to revitalise Japan's economy has become essential to promoting proactive, large-scale strategic investment through public-private partnerships that helps address shared global challenges. Pursuing efficiency without a macroeconomic strategy would perpetuate a "deflationary, cost-cutting economy" based on neoliberal thinking that relies excessively on market forces. The new global trend in economic policy is to strengthen national capabilities by expanding strategic domestic investment through stronger public-private partnerships. Incorporating this shift into the government's macroeconomic strategy is important, because Japan's economic stagnation has been caused by insufficient domestic investment by the public and private sectors, rather than deteriorating demographics.

The shift in global economic policy is also evident in the move towards support for industrial policy among international institutions that have historically been critical of it. The World Bank report "Industrial Policy for Development", published on 17 March, noted that "the report that rejected the effectiveness of industrial policy around 30 years ago is no longer valid because of changes in the economic environment". Under previous neoliberal policies, governments were encouraged to leave outcomes to market mechanisms without directing markets or erecting trade barriers, keep inflation low and maintain small fiscal deficits. However, drawing on a growing body of analysis, the report states that "industrial policy is far more replicable than previously thought and should be considered as a policy option by all countries".

Various risks and social challenges – including economic security, food security, energy & resource security, health & medical security, national resilience, cybersecurity and declining birth rates & population aging – are shared globally. Simply leaving them to a private sector under strict cost constraints within a small-government framework risks insufficient investment and Japan falling behind in global competition. Japan must also confront economic coercion intended to force other countries to comply with another country's demands. As Honebuto states, "industrial policy involving large-scale, long-term fiscal spending through public-private partnerships has become a major trend in addressing challenges that cannot be resolved by leaving them to markets alone". If Japan is left behind by this global trend, its technology, human resources and industrial base would become dependent on other countries, and domestic investment, which has been overwhelmingly insufficient, would remain inadequate.

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The Japan Growth Strategy consists of two pillars: “crisis management investment” and “growth investment”. Crisis management investment is investment that prepares proactively for the various risks Japan faces. It covers stable access to energy and resources, food security, economic security, health and medical security, national resilience and cybersecurity. It is, in effect, defensive investment to protect an “autonomous Japan” that does not yield to economic coercion from other countries. Growth investment is offensive investment that concentrates funding in 17 strategic sectors – including AI & semiconductors, quantum technology, maritime industries, shipbuilding, new materials, drug discovery and advanced healthcare – to bring Japan’s industrial competitiveness to the global forefront. The 17 strategic sectors would be managed as an investment portfolio, with progress assessed against roadmaps and adjustments made accordingly. Economic security would be established by reducing Japan’s dependence on other countries through crisis management investment, while increasing other countries’ dependence on Japan by making Japan indispensable through growth investment. Institutions and regulations that hinder investment would then be reformed. Investment would be supported by eight cross-cutting reforms, including support for start-ups, human resource development, labour market reform and the creation of an environment conducive to wage increases.

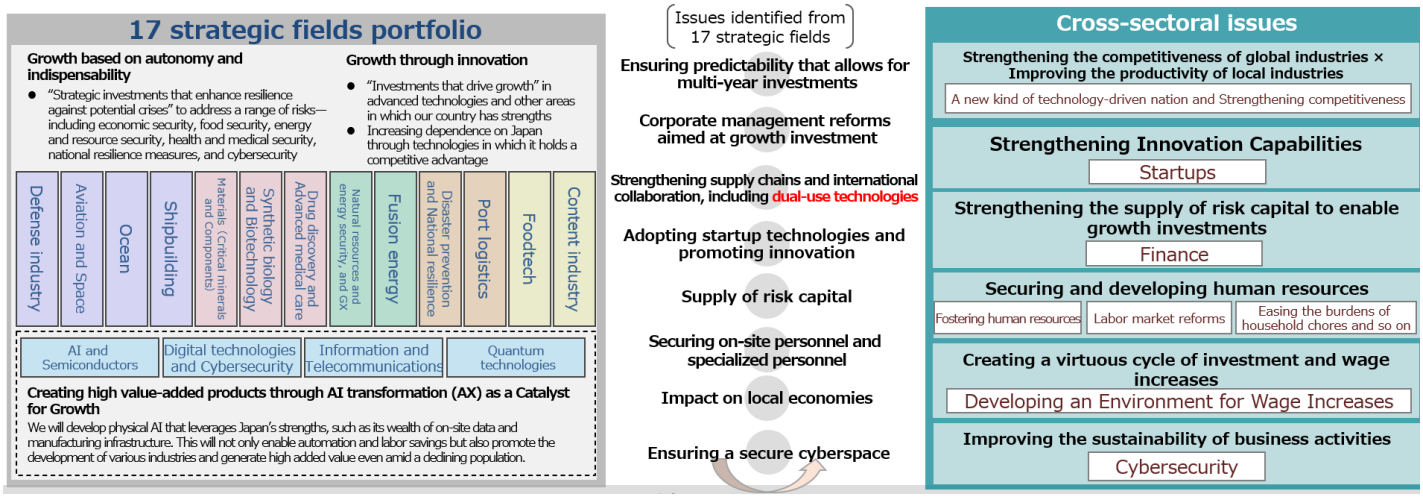
For example, attention has focused on how the content industry, one of the 17 strategic sectors, differs from the previous “Cool Japan policy”. In practice, the public-private Cool Japan Fund had been virtually the only policy tool available under the Cool Japan policy. Its underlying philosophy was the neoliberal idea of “complementing the private sector”, functioning as a financial investment vehicle while avoiding crowding out private business. This was a wasteful approach that forced policy into the framework of financial investment. Policy objectives also remained qualitative and abstract, with no quantitative targets until the “New Cool Japan Strategy” was formulated in 2024. The “Japan Growth Strategy: Public-Private Investment Roadmap for the Content Sector”, approved by the Cabinet in July, and the recently published “Entertainment and Creative Industry Strategy 2026” represent a major policy shift reflecting these developments. The biggest difference is the shift from a “public-private fund (financial investment)” to “public and private investment (direct investment in the real economy and subsidies)”.

Based on the view that subsidies do not constitute crowding out private business, the fundamental approach is for both the public and private sectors to take a step forward and act on the real economy, including services in areas of cooperation such as measures against piracy. Reducing losses from piracy would ensure that existing gains are captured and lead to a virtuous cycle of higher overseas sales of legitimate content and reinvestment. Subsidies may be criticised for distorting markets, but in the face of China and South Korea’s rapid advances, the judgment is that a shift towards industrial policy involving active government participation is inevitable. There are also new features in the policy’s design. By combining content categories – games, anime, manga, music and live-action productions – with stages of the value chain – creators, production, distribution and overseas expansion – it makes resource allocation visible as a portfolio. The Cool Japan Fund also had an investment portfolio, but it did not set out a resource allocation framework encompassing the value chain of the industry as a whole. This is an important design principle for improving policy effectiveness. The revision of the Cool Japan policy demonstrates that the Japan Growth Strategy’s 17 strategic sectors can also be managed as a portfolio, with adjustments made as the strategy progresses.

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Fig 1. Basic Principles of Japan's Growth Strategy



Source: Cabinet Office, Crédit Agricole CIB (the English translation is provisional)

Fig 2. Boosting TFP growth rate through growth strategies

Sector	Area	Mid-term (~2031)	Long-term (~2036)	Assumptions for the estimates
Investment	Adopting AI【New】	approx. 0.2%pt	approx. 0.2%pt	• Pace of AI adoption is expected to accelerate due to the growth strategy. • OECD study (Filippucci et al. (2025)): Japan's accelerated pace of AI adoption would lead to a 0.2 ppt increase in TFP growth. • This is a priority in our growth strategy and is expected to show effects in the medium term.
	Large-scale investment (renewing capital)【New】	approx. 0.1%pt	approx. 0.1%pt	• Based on public-private investment roadmap of the growth strategy, the proportion of large-scale investments (investments 20% or more of a corporate's capital) would rise from 13.5% to 21%, same level as in Euro and the US, and that the capital age would be reduced by 2.6 years. • Fiorietal (2025) estimates that a one-year reduction in capital age results in a 0.34%pt increase in TFP. It is assumed that an increase of approximately 0.9%pt (2.6 years × 0.34%pt) would occur over a period of about 10 years. • As a priority in the growth strategy, investments based on the public-private investment roadmap would be implemented sequentially from FY27 onwards, and it is expected that the effects would become apparent in the medium term.
	Foreign direct investment in Japan	approx. 0.1%pt	approx. 0.1%pt	• Direct investment balance %GDP would rise by approx 0.9%pt annually by 2030, compared to a scenario where remains at its current level. • According to Baltabaev (2014), a 1%pt increase in direct investment balances as a %GDP corresponds to a TFP increase of approx 0.17%pt. • Since the spillover of technology from direct investment companies is expected to occur relatively early, mainly with technologies in the implementation phase, we anticipate that the effects would become apparent in the medium term.
Intangible assets investment	Investing in people (educational training investment)	approx. 0.1%pt	approx. 0.1%pt	• Corporate investment in education and training (stock per employee) are assumed to increase by approx 3.0% annually. • Morikawa (2021): 1% increase in investment in education and training leads to roughly 0.03% increase in labor productivity. • Effects are expected to be apparent in the medium term.
	Science technology and innovation (R&D investment)	approx. 0.0%pt	approx. 0.2%pt	• We assume that by FY30, public and private investment would increase R&D investment as a %GDP by approx 0.7 %pt annually, compared to a scenario where it remains at its current level. • Morikawa (2015): if R&D investment as a %GDP increases by 1%pt, TFP growth rate increases by 0.3 to 0.4%pt. • The effects are assumed to manifest over the long term.
Others	Efficiency of production resource allocation【New】	approx. 0.1%pt	approx. 0.2%pt	• Efficiency of production resource allocation would improve through a transformation of employment structures adapted to the social implementation of AI, changes in future industrial structures in line with 17 strategic fields, and renewal driven by the expansion of startups. • OECD study (Filippucci et al. (2025)) predicts that even with accelerated AI adoption, there would still be 0.2%pt difference in TFP growth between major developed countries and Japan, but that this gap would be closed through growth strategies. • Since structural changes are assumed to take time, it is assumed that about half of the effects would be realized in the medium term, and the full effect would be realised in the long term.
Total (current projection case comparison)		approx. 0.6%pt	approx. 0.9%pt	• The above is added to the current projection case's TFP increase rate of 0.6%. • Taking into account the possibility of overlapping effects: medium-term increase of approx. 1.1% and a long-term increase of approx. 1.4%.

Source: Cabinet Office, Credit Agricole CIB

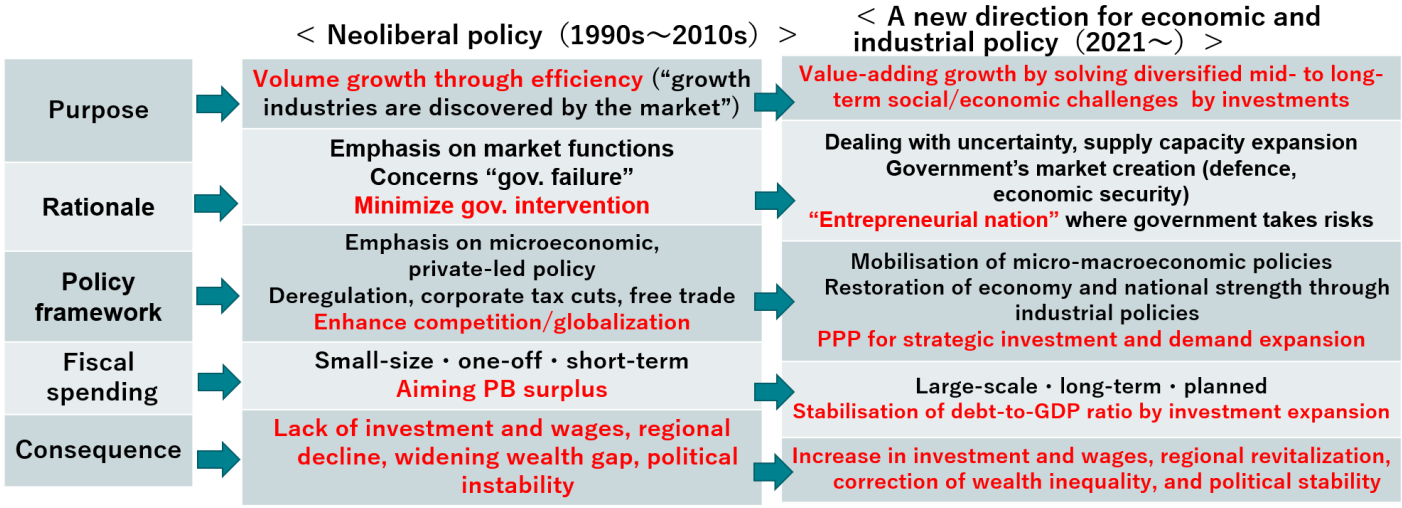
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Fig 3. A Copernican Revolution: from neoliberalism and fiscal austerity to industrial policy and expansionary fiscal policy



Source: World Bank, Crédit Agricole CIB

Fig 4. A shift in economic policy based on global trends = "A new direction for economic and industrial policy"



Source: METI, Crédit Agricole CIB

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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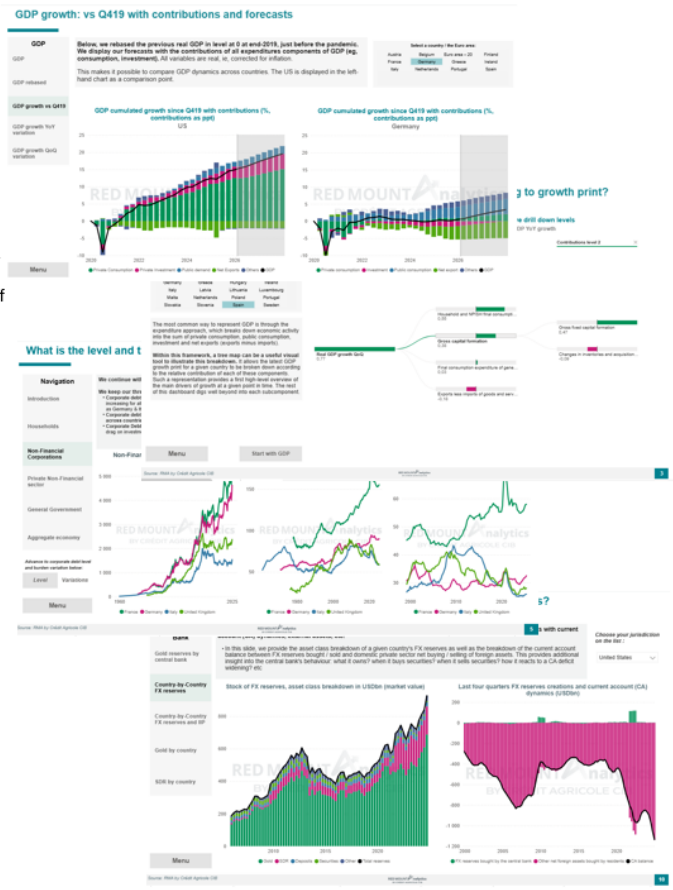
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