# Japan Q&A: labelling Sanaenomics as reflationary policy reveals a lack of understanding

- **Are the 17 strategic investment sectors in the Japan Growth Strategy too numerous? Should investment targets be narrowed down?**
- **Are the Takaichi administration's proactive public finance and other reflationary policies leading to a Honebuto shock and fiscal concerns?**

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***Question 1:*** ***Are the 17 strategic investment sectors in the Japan Growth Strategy too numerous? Should investment targets be narrowed down?***

**Our view:**

The administration of PM Sanae Takaichi believes that the cause of Japan's structural economic stagnation is not deteriorating demographics but an overwhelming shortage of domestic investment (capital input) by the public and private sectors. It considers structural economic stagnation not an inevitable consequence of demographic trends but a matter of insufficient willingness to invest, which can be changed. The Japan Growth Strategy sets out this determination and the plan to implement it, while the Honebuto (Basic Policy on Economic and Fiscal Management and Reform) has been adopted to guide the formulation of the FY27 government budget that would put the strategy into practice. If domestic investment is overwhelmingly insufficient, investment needs to expand across a broad range of sectors, and priority should initially be given to the total amount of investment rather than the selection and concentration of investment targets. Net financing demand (corporate savings rate plus fiscal balance, % of GDP, four-quarter moving average, with a more negative figure indicating stronger demand), which represents the combined spending power of corporations and the government, stood at +3.3% in Q226, indicating that it remains virtually non-existent. Achieving public-private investment of more than JPY370trn by FY40, equivalent to around JPY25trn annually, is the scale required to overcome the domestic investment shortage, primarily through the 17 strategic sectors, build a strong economy and raise the potential growth rate. Furthermore, the growth trajectory envisaged by the Japan Growth Strategy encompasses "crisis management investment", targeting economic security, food security, energy & resource security, health & medical security, national resilience measures and cybersecurity, among other areas. "Growth investment" targets advanced technologies spanning multiple sectors, including science and technology and AI transformation (AX). Therefore, the criticism that 17 strategic sectors are too numerous is unfounded.

Under the Japan Growth Strategy, strategic investment would be expanded as a portfolio centred on the 17 sectors to secure economic growth potential and public safety & security, sustainably expand the size & supply capacity of the economy, increase incomes & corporate profits and generate a virtuous cycle of a "strong economy" in which tax revenues rise naturally, ultimately ensuring fiscal sustainability. The 17 strategic sectors and 62 major products and technologies encompass different time horizons, including current sources of earnings, the next major earnings drivers and the seeds of future growth. Specifically, these comprise (1) the commercialisation and mass-production stage, where businesses are already operating (current sources of earnings: 37 items); (2) the demonstration stage, where technologies are in the process of being commercialised (the next major earnings drivers: 20 items); and (3) the research and development stage, where technologies are being created (the seeds of future growth: five items). As this is a portfolio approach, the policy is designed to accommodate differences in investment horizons and outcomes. Progress would be assessed against roadmaps, with adjustments and revisions made as necessary, including increasing or decreasing investment in individual sectors. If additional "major

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products and technologies" are identified in the future, the corresponding public-private investment amounts are also expected to be added.

The Japan Growth Strategy states that, "Given the high degree of uncertainty surrounding technologies and markets, support measures would be adjusted in response to changing circumstances, including the possibility that developments may not proceed as initially expected, in order to increase the likelihood of success". Furthermore, to ensure that the strategy does not remain merely a plan on paper, it states that "a PDCA mechanism would be implemented regularly under the Council for Japan's Growth Strategy, including during the forthcoming budget request and formulation processes, to specify measures spanning multiple years and refine or revise them in light of implementation progress and technological developments". The policy is to treat the strategic sectors as an overall portfolio while flexibly evaluating and replacing individual projects.

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***Question 2:* Are the Takaichi administration's proactive public finance and other reflationary policies leading to a Honebuto shock and fiscal concerns?**

**Our view:**

Reflationary policy refers to policies that simply boost aggregate demand. Sanaenomics differs fundamentally because it aims to increase aggregate supply through investment expansion driven by public-private strategic investment and industrial policy. Expanding aggregate supply through investment would raise the potential growth rate and lead to strong real wage growth through improvements in labour productivity. Sanaenomics is based on the recognition that Japan's economic stagnation is not an inevitable consequence of insufficient aggregate demand caused by deteriorating demographics, but a matter of insufficient willingness to undertake domestic investment. While an inevitable outcome cannot be changed, a matter of willingness can be addressed. The Takaichi administration's Japan Growth Strategy sets out this determination and the plan to implement it. The Japan Growth Strategy states that "although the output gap has reached 0%, the economy is not yet sufficiently strong, and the benefits of the economic recovery have not yet spread to regional economies and small and medium-sized enterprises". The strategy is to raise the output gap through investment demand to create a "high-pressure economy", with investment subsequently translating into an expansion of aggregate supply, thereby achieving both "strong economic growth" and "stable inflation". Labelling Sanaenomics as reflationary policy would merely expose a failure to keep up with the evolution of policy discussions (in other words, a lack of understanding).

An output gap of 0% merely means that the economy has caught up with its previously weak trend and is insufficient to generate a strong expansion in domestic corporate spending, including investment and wages. A "high-pressure economy" with an output gap exceeding 2% is necessary. Sanaenomics aims to raise the output gap by expanding investment demand through public-private strategic investment and industrial policy. While investment primarily boosts demand in the short term, it translates into increased supply over the longer term. The resulting expansion of aggregate supply would raise the potential growth rate, allowing inflation to stabilise at 2% alongside strong economic growth. If inflation stabilises, the BoJ's policy rate terminal rate would be expected to settle at around 2.50%, implying a slightly positive real policy rate, and this would gradually be priced in by markets, while long-term interest rates would also stabilise.

According to the BoJ's Flow of Funds Accounts, the corporate savings rate (% of GDP, four-quarter moving average) stood at +4.5% in Q226, indicating that the abnormal situation of excess corporate savings (a positive savings rate) persists. Meanwhile, the fiscal balance stood at -1.2% in Q226. Compared with Europe and the US, where fiscal deficits are around 5% of GDP, Japan's fiscal deficit is exceptionally small. This reflects Japan's lag behind Europe and the US, where industrial policies promoting public-private strategic investment are already being implemented and fiscal spending is substantial. Furthermore, the fact that Japan's investment expansion remains weaker than that of Europe and the US is the cause of JPY depreciation.

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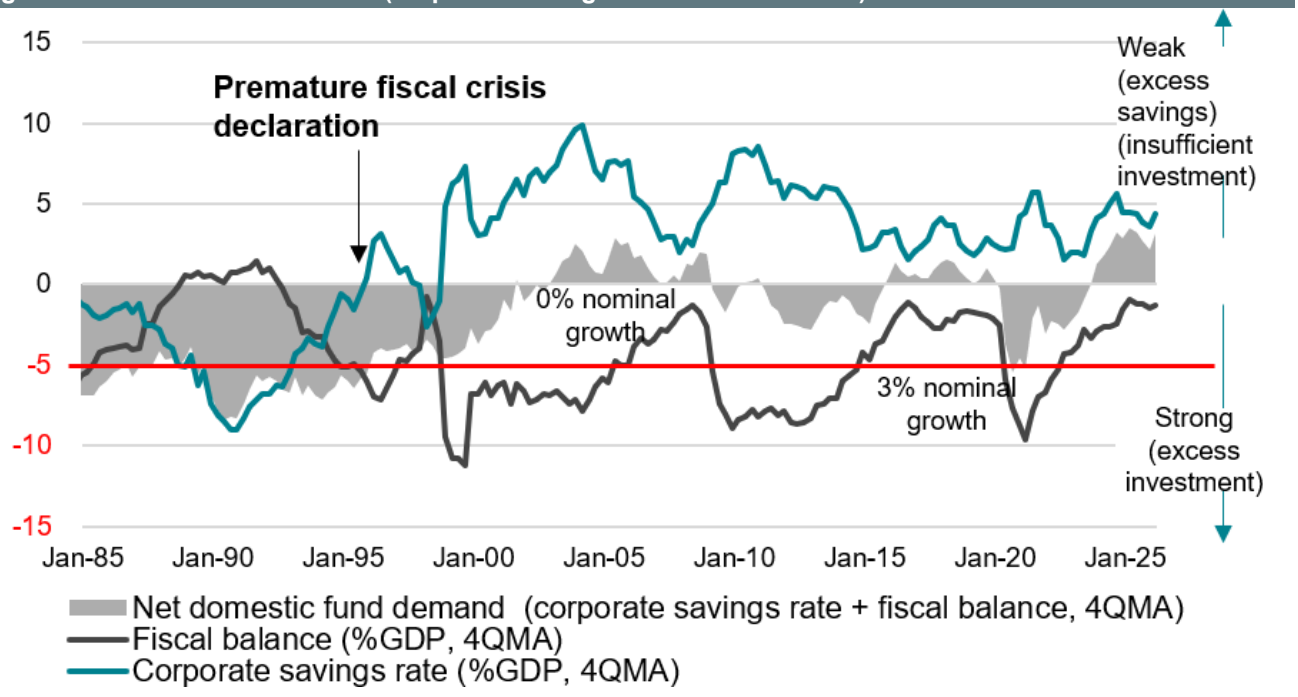
The FY27 initial budget would be expansionary compared with FY26, reflecting the transfer of recurring expenditure from supplementary budgets to the initial budget and the addition of an investment allocation for a "strong and prosperous Japan". However, the FY26 budget was formulated under the Honebuto adopted by the administration of former PM Shigeru Ishiba, which restrained initial budget spending. Furthermore, as recurring expenditure is transferred from supplementary budgets to the initial budget, large supplementary budgets would also be curtailed, meaning that expenditure and government bond issuance are expected to decline compared with FY25. It would be incorrect to characterise the FY27 initial-budget figures for new government bond issuance and calendar-based market issuance as a "shock" simply because they represent a substantial expansion compared with FY26. Given that they are expected to be slightly below the levels recorded after the FY25 supplementary budget, they would by no means constitute a "shock".

New government bond issuance in FY27 is forecast at around JPY40trn, broadly in line with the level following the FY25 supplementary budget. However, as debt redemption expenditure under the 60-year government bond redemption rule, which is inconsistent with global standards, is projected at JPY18.9trn, genuine new government bond issuance excluding refinancing (net new government bonds) would amount to JPY21.5trn, slightly below the level following the FY25 supplementary budget.

The Cabinet Office assumes that nominal GDP would increase by JPY27trn in FY27 from the previous fiscal year, substantially exceeding net new government bond issuance of JPY21.5trn after deducting debt redemption expenditure. The government debt-to-GDP ratio, the central target of fiscal management, would therefore decline. Furthermore, the increase in GDP would exceed the BoJ's annual government bond purchases of JPY24trn from April FY27 onwards. Indeed, the BoJ's purchases could even be considered insufficient relative to the natural increase in private-sector money accompanying economic growth. Even assuming that nominal GDP growth settles at around 3% from FY27 onwards, there would be no difficulty whatsoever in absorbing government bonds in the market. As the budget formulation process progresses, it would finally become understood that the expansion of fiscal expenditure represents an increase in investment rather than indiscriminate handouts. The criticism that the Takaichi administration's economic policies have triggered a "Honebuto shock" or fiscal concerns is therefore unfounded.

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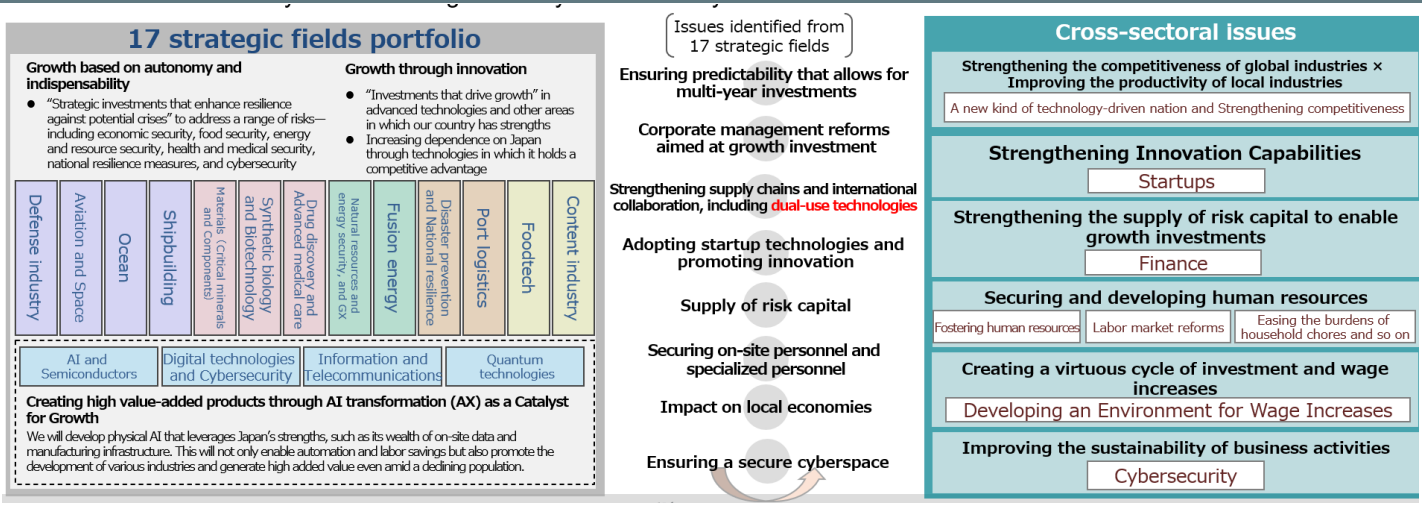
**Fig 1. Net domestic fund demand (corporate savings rate + fiscal balance)**




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

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## Fig 2. Basic Principles of Japan's Growth Strategy




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

## Fig 3. Transition from reflation to Sanaenomics

Abenomics: Bold monetary easing ✚ Fiscal expansion after Covid

Reflation policy (aggregate demand expansion)

⬇

Nominal GDP started expanding
Ceiling of aggregate supply due to insufficient domestic investment

⬇

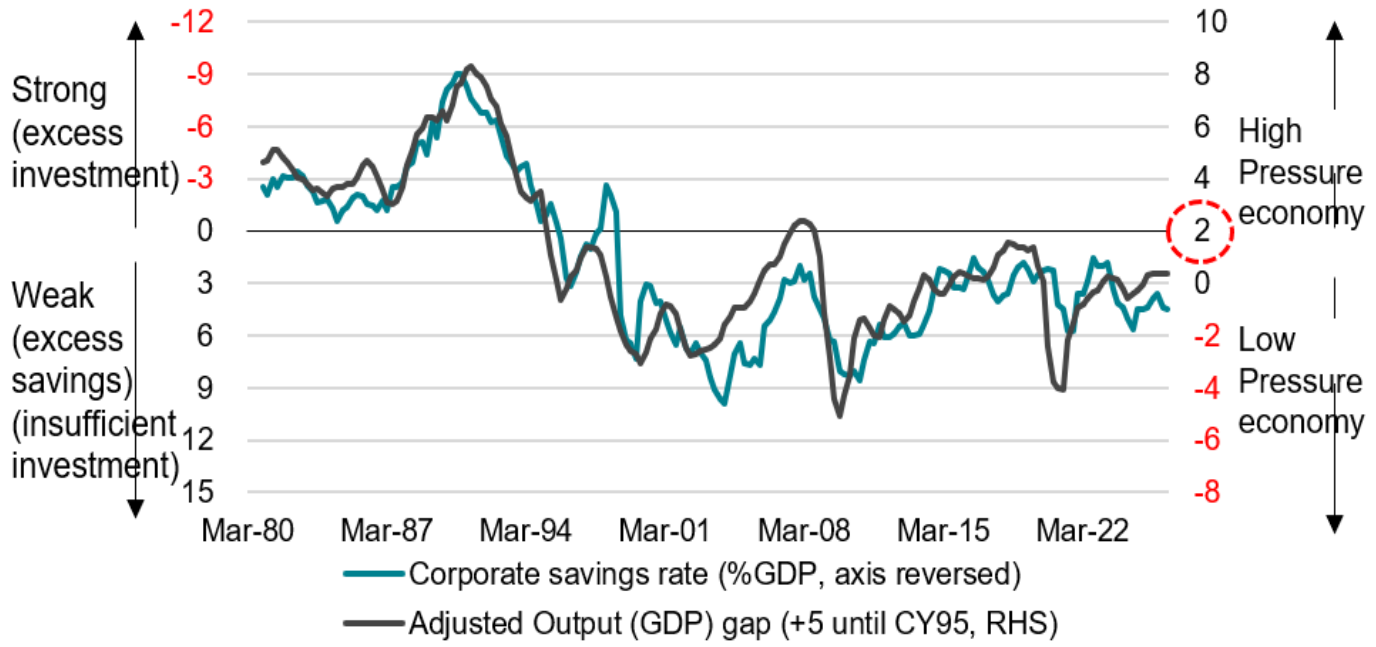
Sanaenomics:
Expanding aggregate supply through public-private strategic investment

"Establish growth exceeding 1% in real and 3% in nominal terms as early as possible and raise it further, under 2% price stability target." (Honebuto)

*Source: Crédit Agricole CIB*

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**Fig 4. Corporate savings rate and output gap**




*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*

**Fig 5. Image of JGB issuance based on the "Strong and Prosperous Japan" investment framework**

＜Breakdown by Legal Grounds (JPYtrn)＞

| Breakdown | FY25 initial | FY25 supplementary | FY26 initial | FY26 supplementary | FY27 initial (forecast) |
|---|---|---|---|---|---|
| Newly-issued bonds ① | 28.6 | 40.3 | 29.6 | 32.7 | 40.4 |
| Debt redemption costs ② (ex compensation bonds) | 17.3 | 18.5 | 17.9 | 17.9 | 18.9 |
| Net newly-issued bonds (1)=①-② (%GDP) | 11.3 (1.7) | 21.9 (3.3) | 11.7 (1.7) | 14.8 (2.1) | 21.5 (3.0) |
| Growth strategy bridging bonds | - | - | - | - | 2.0 |
| Others | 148.2 | 149.2 | 151.1 | 151.1 | 151.0 |
| Total | 176.9 | 189.6 | 180.7 | 183.8 | 191.4 |
| Nominal GDP increase (2) | | 27.5 | | 20.2 | 27.0 |
| Debt issuance capacity (2-1) | | 5.6 | | 5.4 | 5.5 |

- FY27: General account expenditures include an additional expenditure of JPY18trn (transfer from supplementary to initial + general account increase from "Strong and Prosperous Japan" investment framework), plus an additional amount to cover nominal economic growth.
- "Strong and Prosperous Japan" investment framework includes 13trn from general account, 2trn from special account (breakdown to be determined in the budget formulation process; increase in special accounts = decrease in new government bond issuance)
- Tax revenue + other income is estimated using the nominal GDP growth forecast (with 1.2 tax elasticity) and 5trn from FX fund special account.

＜Breakdown by Financing Methods (JPYtrn)＞

| Breakdown | FY25 initial | FY25 supplementary | FY26 initial | FY26 supplementary | FY27 initial (forecast) |
|---|---|---|---|---|---|
| JGB market issuance (calendar base) | 171.8 | 178.7 | 168.5 | 168.5 | 177.5 |
| (T-Bills) | 40.8 | 49.2 | 40.8 | | |
| Others | 5.6 | 10.9 | 12.1 | 15.3 | 13.9 |
| Total | 176.9 | 189.6 | 180.7 | 183.8 | 191.4 |
| Total (%GDP) | - | 28.3 | - | 26.6 | 26.7 |

＜General account expenditure and revenue (JPYtrn)＞

| General account budget | FY25 initial | FY25 supplementary | FY25 actual | FY26 initial | FY26 supplementary | FY26 actual (forecast) | FY27 initial (forecast) |
|---|---|---|---|---|---|---|---|
| General account expenditure | 115.2 | 133.5 | 131.4 | 122.3 | 125.4 | - | 147.3 |
| Tax | 78.4 | 80.7 | 84.2 | 83.7 | 83.7 | 91.3 | 92.5 |
| Other revenues | 8.5 | 9.7 | 10.7 | 9.0 | 9.0 | 9.0 | 14.4 |
| Bond issuance | 28.6 | 40.3 | 33.7 | 29.6 | 32.7 | - | 40.4 |

Note: FY25 supplementary + FY26 initial general account expenditure was 141trn

- The projected decrease in VAT revenue (JPY5trn) is 3.4trn for national government and 1.6trn transfer to local governments to offset tax decrease.
- New issuance and calendar-based market issuance are expected to be around the same level after supplementary budget for FY25.

*Source: MoF, Cabinet Office, 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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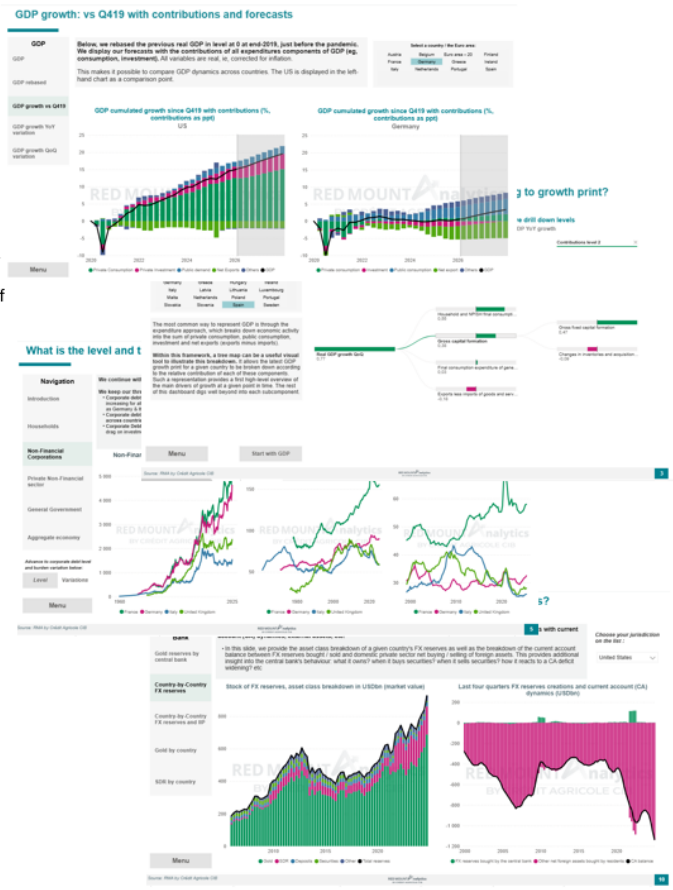
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