

## The many challenges facing Japan's new Prime Minister

Sanae Takaichi, the Liberal Democratic Party leader, is now officially Japan's first female prime minister. She's running a minority government; her policy plans may be compromised. Increased fiscal spending is expected, but we anticipate a limited impact on the current direction of policy normalisation



Sanae Takaichi officially became Japan's first female Prime Minister on Tuesday

### The new ruling coalition still seeks supports from oppositions

Following three weeks of political turbulence caused by Komeito leaving the LDP coalition after 26 years of political partnership, Sanae Takaichi formed a new alliance with the Japan Innovation Party (Ishin) and won both House votes this Tuesday. She becomes the first female prime minister, making a significant milestone in the nation's political landscape. However, she will have to confront a variety of challenges, such as addressing inflationary pressures, managing regional geopolitical tensions, and navigating ongoing domestic political instability. The LDP-Ishin coalition is also two seats shy of a Lower House majority, so more support will be needed if her policy agenda, including budgets and bills, is going to pass.

The two parties share more common ground on diplomacy, defence, and national security than on economic policies. Both parties will push for more 'Japan First' diplomacy, and so we expect a

stronger nationalistic agenda than the former Ishiba government.

## More expansionary fiscal policy is expected

We believe that the coalition with Ishin should limit the degree of fiscal spending increases. As Ishin favours a smaller government, deregulation, and structural reform, their spending preference should stay away from cash handouts and expanding social welfare programs, but more targeted spending on investment to better support industry.

Both parties are likely to pursue some form of tax cuts to reduce the social security burden. We expect a larger subsidy for energy and fuel to be implemented, which will likely ease inflationary pressures in the near term.

## Monetary policy will remain on its normalisation path

The new government is expected to maintain a neutral stance on monetary policy, marking a departure from Takaichi's earlier advocacy for a looser approach. USDJPY surpassing 150 could drive inflation higher, a challenge that previous leaders struggled to manage. Japan's inflation is again expected to rise towards 3%, providing little reason to oppose rate hikes. Additionally, Ishin has expressed support for achieving price stability in line with evolving economic conditions.

Takaichi's power depends on weak political alliances and LDP backing. Several LDP members are unlikely to support Ishin's reform request, which includes reducing parliamentary seats and tightening political funding rules. Therefore, her main priority in the near term should be to maintain political stability rather than intervening in monetary policy.

## BoJ watch

We believe that the Bank of Japan will stay on its policy normalisation path, and we still expect an October hike, though our confidence is quite limited. Market expectations indicate a more than 50% probability of a rate increase in December, so markets seem to believe there is a limited impact of the new government on monetary policy; it's just the timing which could be delayed.

We believe that there's a growing view among BoJ board members about the need to adjust policy rates - we saw some dissenting views at the last Bank meeting. Since then, the uncertainty surrounding US trade has diminished, and upside risks to inflation have increased due to the recent weakness of the JPY. There are still another two weeks before the BoJ meets, and we'll be watching the yen's moves closely.

It's worth mentioning that tomorrow's September export numbers are expected to rebound, and CPI inflation is set to rise again towards 3%, which we believe supports any decision by the BoJ to hike rates.

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