

Economic Research View:

Economic Policy by the New Prime Minister Ishiba

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Following the Liberal Democratic Party's presidential election on the 27th, the Ishiba administration will be established on October 1*. This commentary summarizes the economic policies of the Ishiba administration based on previous information and statements.

The following are the key points of interest:

1. The strong stance on wage increases promoted by the Kishida administration will remain unchanged, with references to raising the labor share of income as a method; however, how to actually raise the labor share remains somewhat unclear.
2. The fiscal policy is expected to be more flexible, although the goal of fiscal health will likely remain in mind.
3. A broad increase in taxation on investment income is unlikely to progress; rather, it is more probable that initiatives like the proposed increase in the iDeCo (individual-type Defined Contribution pension plan) contribution upper limits by Mr. Katsunobu Kato, who is planned to be appointed Finance Minister, will further encourage shifting from savings to investment.
4. There are plans to establish a crisis response organization for the economy, finance, and markets within the Cabinet Office; while specific details are not yet clear, there is a possibility that the perspectives of market participants will be included.
5. In terms of monetary policy, it is expected that decisions will primarily be left to the Bank of Japan, and it seems unlikely that the administration will take a stance that promotes interest rate hikes, as some have suggested.

*Note: The commentary was written on September 30th. On October 1, Mr. Shigeru Ishiba was appointed Prime Minister of Japan

- In the Liberal Democratic Party (LDP) presidential election on the September 27th, Mr. Shigeru Ishiba defeated Ms. Sanae Takaichi, the Minister of State for Economic Security, who had initially led in the first round of voting, securing the position of new president. According to reports, support for Ishiba in the runoff came from Shinjiro Koizumi's camp and the Kochikai faction (former Mr. Fumio Kishida's faction). Ultimately, it appears that Prime Minister Kishida held the casting vote. Furthermore, reports suggest that the possibility of a general election being held as early as October 27, previously considered the fastest date, has increased.
- In this commentary, I would like to discuss the direction of economic policies under the Ishiba administration and their implications for the market. Although uncertainty remains high, I will analyze based on available information and statements thus far. Overall, it seems that Ishiba's economic policies will largely take on the Kishida administration's approach, maintaining an emphasis on wage increases. In a press conference after his election victory, he stated, "We must ensure that the efforts of Prime Minister Kishida to escape deflation are solidified," and expressed a desire to accelerate "new capitalism." I believe that the promotion of regulatory reforms, common to former Prime Minister Yoshihide Suga, new LDP President Shigeru Ishiba, former Environment Minister Shinjiro Koizumi will be incorporated.
- Looking at the market fluctuations on the day of the presidential election, it is evident that Ishiba is less inclined toward fiscal expansion and monetary easing compared to Takaichi. Therefore, I do not expect significant impacts on the bond and currency markets. On the stock market side, if perceptions grow that investment income taxation and corporate tax rate hikes are unlikely, this could lead to increased expectations for the advancement of defense-related and digital-related policies, resulting in a positive evaluation.

Personnel Lineup of the Ishiba Administration

- First, let's confirm the current lineup of the Ishiba administration as it has become generally understood.
 - Within the Liberal Democratic Party (LDP), following appointments have been made: Mr. Hiroshi Moriyama, Acting Chairperson, LDP General Council, has been appointed Secretary-General, Mr. Itsunori Onodera, the former Defense Minister, has taken on the role of Chairman of the Policy Research Council, Mr. Shunichi Suzuki, the Finance Minister, has become the Acting Chairperson of General Council, Mr. Shinjiro Koizumi, the former Environment Minister, will lead the Election Strategy Committee, and former Prime Minister Yoshihide Suga has been designated as Deputy President. Moriyama's appointment is seen as a move towards party unity, while Koizumi is expected to be a prominent figure in the upcoming House of Representatives election in late October and the Senate election around July 2025, as well as in the Tokyo Metropolitan Assembly elections. The Policy Research Council is responsible for investigating, researching, and drafting the party's policies. Onodera has demonstrated expertise in security matters, having served as the Prime Minister in simulations concerning emergencies in Taiwan conducted by private think tanks. However, he seems to lack expertise in economic policy, leaving us unclear about who will take the lead in economic policy within the party at this time.
 - Next, regarding the Cabinet, it has been reported that Mr. Yoshimasa Hayashi will remain as Chief Cabinet Secretary, Mr. Katsunobu Kato, the former Chief Cabinet Secretary, will be the Minister of Finance, Mr. Takeshi Iwaya, the former Minister of Defense, will be named Minister of Foreign Affairs, Mr. Gen Nakatani, another former Defense Minister, will be the Minister of Defense, Masaaki Taira, State Minister of Cabinet Office, will serve as Minister for Digital Transformation, and Mr. Ryosei Akazawa will be the Minister of State for Economic

and Fiscal Policy. Similar to Onodera's appointment as Policy Research Council Chairman, this lineup places significant emphasis on security and national defense, suggesting that Ishiba's focus is centered on these issues, as well as the establishment of a Disaster Prevention Ministry. It is noteworthy that Taira and Akazawa belong to Ishiba's faction and have served as the faction's Public Relations Chair and Policy Chair, respectively.

- In Ishiba's policy platform during the presidential election, he emphasized strengthening the government's AI policy coordination, utilizing blockchain technology and non-fungible tokens to enhance and maximize the diverse analog values of local foods and tourism experiences on a global market scale. This seems to align with Taira's advocacy. Akazawa, elected from Tottori Prefecture, appears to adopt a stance aimed at promoting sustainable socioeconomic development by breaking the concentration of resources in Tokyo and fostering regional revitalization.

Economic Policy of the Ishiba Administration

- Next, regarding the economic policies of the new administration, it is fundamentally viewed as a continuation of the Kishida administration with a stronger focus on regulatory reform. I will outline five key points.
 - The stance of demanding wage increases that outpace inflation remains unchanged. In Ishiba's policy platform, he discusses a virtuous cycle of wage increases and alleviation of labor shortages: 1. wage increases, 2. consumption expansion, 3. investment expansion, 4. productivity improvement and reduction of labor shortages, 5. corporate profit growth, 6. further wage increases. However, the question remains: how will wages be raised? During his appearance on a TV program on September 27, he stated that he would raise the labor share of income. While the specifics on how to achieve this are not yet clear, he aims for a nationwide average minimum wage of 1,500 yen in the 2020s, which could be one of the policies. If the minimum wage reaches 1,500 yen by 2029, it would reflect an annual average increase of over 7%. With the structural labor shortage, raising the minimum wage is expected to put upward pressure on wages for those earning around that level. Katsunobu Kato, likely to become Minister of Finance, was one of the candidates in this presidential election, advocating strongly for a doubling of national income. He argues for creating a new virtuous cycle starting from wage increases, pushing for early attainment of the 1,500 yen minimum wage goal and enhanced support aimed at reaching 2,000 yen. This means there will be a Minister of Finance in the cabinet who share Ishiba's perspectives.
 - While fiscal discipline appears to be emphasized, there will likely be spending for immediate inflation countermeasures and recovery efforts in Noto Peninsula. Statements such as "fiscal action when necessary" have been prominent. In his writings, he mentions, "The sustainability of national finances is directly linked to the sustainability of the social security system. It is questionable to view this as something that can be overlooked." It seems probable that while he aims to maintain the primary balance surplus goal, he will focus their efforts more on genuinely supporting those in need, such as low-income groups and small to medium enterprises, rather than distributing resources broadly.
 - Regarding tax policy, he repeatedly emphasizes the importance of a fair and equitable tax system. During the early stages of the election campaign, he referred to strengthening taxation on financial income, and later to increasing corporate tax rates. Among the policies proposed by Ishiba, he has shown particular fervor for areas related to security and the establishment of a Disaster Prevention Ministry. Since these policies will utilize political capital, it is considered challenging to simultaneously implement tax reforms that would lead to tax increases. The significant drop in stock futures on the day of the election indicates that

he is unlikely to push policies that would severely impact financial markets. Katsunobu Kato, designated to be the Minister of Finance, also proposed bold reforms such as increasing the contribution upper limits for iDeCo during the election.

- As for statements made during the election were not particularly friendly to financial markets, but the policy platform contains plans to establish a crisis response organization for the economy, finance, markets, etc., within the Cabinet Office. In his writings, he views issues such as the deterioration of the Bank of Japan's finances, the paralysis of fiscal discipline, and the decline in banks' resilience as macro-level crises. He suggests creating a permanent organization, akin to a Japanese version of the National Economic Council, which would advance discussions beyond the Economic and Fiscal Policy Council and prepare for crises in macroeconomic management as well as economic security. While specifics have yet to be laid out, it appears this organization would assess the market impact of policies and the feedback these policies receive. If market participants' perspectives are included, it is likely that occurrences similar to what we refer to as the "Ishiba shock" will be less likely.
- Regarding monetary policy, while Takaichi clearly expressed opposition to interest rate hikes, there are speculations that Ishiba might support relatively early rate hikes. He indeed pointed out in his writings that "the prolonged zero interest rate leads to adverse effects," and that "under zero interest rates, companies lose their ability to create added value due to interest burdens." His hawkish stance is evident. During a Reuters interview in early August, he evaluated the July interest rate hike by the Bank of Japan, stating, "It's the right policy to gradually bring about a world with interest rates while fundamentally maintaining monetary easing," indicating that it may contribute to lowering import prices. However, it seems one reason for his support of rate hikes was the yen's depreciation. Rising prices due to a weaker yen tend to reduce public support, so with a stable exchange rate, there is likely less political incentive to prompt early rate hikes. In this interview, he mentioned the exchange rate, saying, "It's commonly believed that a range of 110-140 yen is appropriate," suggesting that the lower 140 yen range does not heighten his alertness. On September 27 during a TV program, he stated, "The fundamentals of monetary easing will basically remain unchanged," and emphasized, "I don't view the Bank of Japan as a subsidiary of the government. I will not make particular requests." On September 29 in another television program, he stated, "We must maintain the current direction of easing. We cannot judge that we have escaped deflation yet. This is not the time to be discussing interest rates." Therefore, it is expected that he will not strongly advocate for interest rate hikes while remaining within the boundaries of monetary easing. As long as concerns about yen depreciation do not intensify, he likely wishes to maintain the current situation. Considering the political landscape and the trends in the financial markets leading up to the presidential election, we believe the earliest feasible date for the next rate hike is December. A more appropriate outlook may align with January 2025, as we gather more data on pricing after the October price revisions and labor-management positions for the spring labor negotiations in 2025. Some view the emergence of the Ishiba administration as a potential precursor to earlier rate hikes, but taking into account the evolution of his remarks and the context of market trends, we do not believe the likelihood of a rate hike this year will be significantly increased due to Ishiba's factors.

The Ishiba Administration – Summary on Economic Policy and Financial Market Impact

- To summarize the economic policies:
 1. The strong stance on demanding wage increases, which has been promoted by the Kishida administration, remains unchanged. While Ishiba has mentioned raising the labor share of income as a method, there are still uncertainties about how this will be achieved.
 2. Fiscal action is expected to be flexible, while it seems that the goal of fiscal health will still be kept in mind.
 3. A broad increase in taxation on investment income is unlikely, and it is more probable that initiatives like increasing the contribution upper limits for iDeCo proposed by Finance Minister Kato will further encourage the shift from savings to investment.
 4. There are plans to establish a crisis response organization within the Cabinet Office for the economy, finance, and markets; while specifics have yet to become clear, there is potential for the inclusion of market participants' perspectives.
 5. In terms of monetary policy, it is expected that decisions will largely be left to the Bank of Japan, and it seems unlikely that the administration will take a stance that promotes interest rate hikes.
- Regarding the impacts on the financial markets, since interest rate decisions are fundamentally left to the Bank of Japan and significant fiscal expansion is not anticipated, we do not foresee a scenario where risks in the bond market lead to rising interest rates or accelerated yen depreciation in the currency market. Thus, we currently believe that the Ishiba administration will have a limited impact on both the bond and currency markets. On the other hand, references to taxation on investment income and corporate tax have likely raised caution in the stock market. However, given that these are not areas of primary interest for Ishiba, and considering his differing views from the Kishida administration's policy-making members and the market reactions on the day of the election, we think the possibility of rapidly advancing tax increases is low. If communication in this area improves, the stock market may enter a phase of seeking positive signals from the Ishiba administration.

*This commentary is based on personal views of the author and does not necessarily represent Nomura Asset Management house view.

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