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Economic Research View:

Economic, Financial and Market Impact by the New Regimes in the US and Japan

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The United States and Japan have reached a political turning point. In the US, former President Trump won the presidential election, and the Republican Party took control of both the House and Senate. In Japan, as a result of the House of Representatives election, the ruling Liberal Democratic Party and its coalition party Komeito's number of seats fell below the majority, leading to the new Ishiba administration becoming a minority ruling party for the first time since 1994.

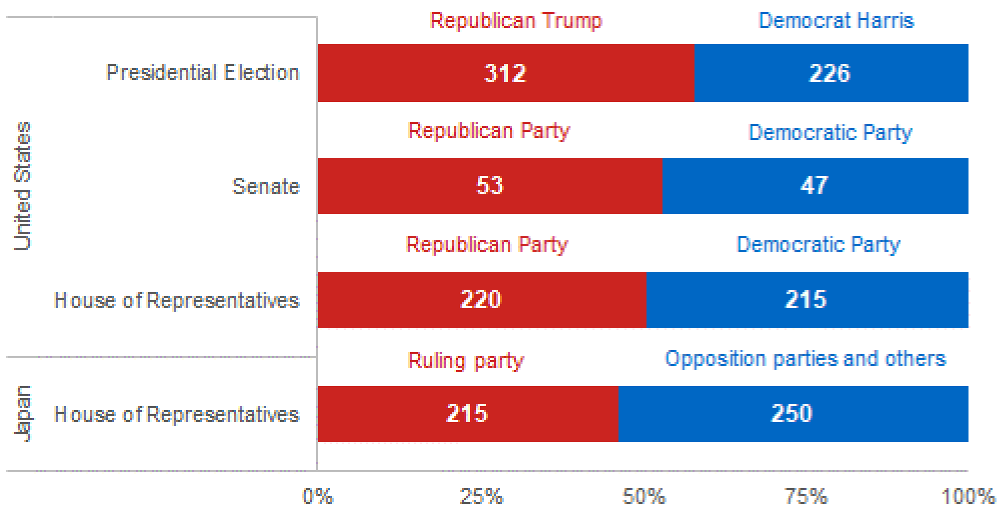
The second Trump administration is likely to propose expansionary fiscal policies, along with protectionist trade policies and restrictive immigration policies. While uncertainty is high, there is a possibility that these measures could have a positive impact on the US economy. The Ishiba administration aims to improve income through measures such as addressing rising prices, tax reforms, and increasing the minimum wage, leading to expectations of stable growth in consumer spending.

The policies of the Trump administration are expected to have a downward effect on economies outside the US, including Japan, which may lead to a divergence in monetary policies between the US and other countries and regions. As a result, it may become difficult to reduce the interest rate differential with the US, and the upward pressure on the US dollar could continue to linger.

The United States and Japan at a Political Turning Point

This autumn, the US and Japan faced a political turning point (see Figure 1). In the US, former President Donald Trump, the Republican nominee, won the presidential election held on November 5, and the Republican Party also secured control of both houses of Congress on the same day, resulting in a "red sweep" government. One reason for the former president's victory was that Vice President Kamala Harris, the Democratic candidate, was unable to address voters' dissatisfaction and concerns regarding rising prices and immigration. Although Harris' campaign attempted to regain momentum by focusing on the issue of abortion and mobilizing celebrities, it seemingly did not resonate with voters. In fact, there were indications that the latter strategy might have had an opposite effect.

Figure 1. US and Japan Election Results



(Note) The numbers related to the U.S. presidential election indicate the number of electoral votes won, while the others represent the number of seats gained.
(Source) Nomura Asset Management based on information from NHK and AP.

In Japan, the results of the House of Representatives election held on October 27 showed that the number of seats gained by the Liberal Democratic Party (LDP) and its junior coalition party Komeito fell below a majority. In the prime ministerial election, LDP leader Shigeru Ishiba was selected after a runoff, leading to the formation of the second Ishiba administration; this marked the first minority ruling party since the Hata administration in 1994. Since the ruling party cannot pass the budget solely with its own votes, some cooperation from opposition parties will be necessary. Currently, there are ongoing collaborations with the Democratic Party For the People (DPP), which made a commitment to increase "take home pay" and has been gaining momentum since.

Is the Trump administration a positive for the US economy?

The Trump administration will officially begin in January 2025. Under a "red sweep" government, it seems that the new administration will have a broader range of feasible policies. When considering the impact on the economy and financial markets, the fiscal, trade, and immigration policies will be particularly important.

First, concerning fiscal policy, Trump has advocated for an expansionary approach, including extending the personal income tax cuts he introduced in 2017, eliminating taxes on social security benefits such as pensions, and lowering the corporate tax rate. Under certain assumptions, the implementation of these policies is expected to increase the fiscal deficit by approximately $8 trillion (cumulative over ten years), primarily boosting the US economy (see Figure 2).

Figure 2. The Impact of the Trump Administration's Policies on the Fiscal Deficit

(USD, tn)

Tax Cuts and Spending Increases	
Extend and Modify the 2017 Trump Tax Cuts	5.35
Exempt Overtime Income from Taxes	2.00
End Taxation of Social Security Benefits	1.30
Exempt Tip Income from Taxes	0.30
Lower Corporate Tax Rate to 15% for Domestic Manufacturers	0.20
Others	1.25
Total	10.40
Revenue Increases and Spending Reductions	
Establish a Universal Baseline Tariff and Additional Tariffs	2.70
Reverse Current Energy/Environment Policies and Expand Production	0.70
Others	0.30
Total	3.70
Net Increase in Fiscal Deficit by	7.75

(Note) The cumulative change in the fiscal deficit over the ten years following the change in the system. The impact on expenditures and revenues is based on estimates from the 'Committee for a Responsible Federal Budget (CRFB)' (central scenario). The mentioned expansion of the fiscal deficit is not solely the sum of tax cuts and increased expenditures or tax increases and decreased expenditures.
(Source) Nomura Asset Management based on the data from CRFB.

Regarding trade policy, Trump has proposed a blanket tariff of 10-20% on all US imports. If such protectionist policies are implemented, they could depress the US economy, raise domestic prices, and potentially affect other countries' economies and prices through trade and financial markets. If uncertainty surrounding trade increases, as it did during the previous Trump administration, it could amplify negative impacts on both the US and foreign economies through a deterioration of corporate sentiment and turmoil in the financial markets.

On the immigration front, Trump has strongly criticized the influx of unauthorized immigrants. If the new administration introduces stricter measures to curb this influx compared to the current administration, it is likely to weigh on the US economy and raise domestic prices.

The ultimate impact of these Trump policies on the US economy will depend on the details and timing of the policies that are realized, resulting in a high level of uncertainty at this point. However, we believe that the economic boosting effect of fiscal policy may not only mitigate the negative effects of trade and immigration policies but could also, in some cases, exceed them, potentially leading to a positive impact on the US economy.

The Ishiba administration aims to expand take-home pay

On the other hand, on November 22, the Ishiba administration announced a "Comprehensive Economic Measures for National Safety, Security, and Sustainable Growth." As immediate countermeasures against rising prices, the plan includes the resumption of measures to alleviate the impact of high electricity and gas fees from January to March 2025, as well as subventions for households exempt from residence tax (see Figure 3).

Figure 3. Japan's Comprehensive Economic Measures

3 Pillars of Comprehensive Economic Measures	Fiscal Expenditure
Pillar 1: Growth of the Japanese and local economies	Approximately JPY 10.4tn
Support for creating an environment for raising the minimum wage, promotion of the use of tax systems to promote wage increases, promotion of labor-saving and digitalization investments, steady implementation of the "Income Tax Threshold and Support Enhancement Package," realization of "Regional Revitalization 2.0," Japan as "Investment Nation" and "Asset Management Center" etc.	
Pillar 2: Overcoming high prices	App. JPY 4.6tn
Support for low-income earners, support for reducing the burden of electricity and gas charges, and measures to mitigate drastic changes in fuel oil prices	
Pillar 3: Ensuring the safety and security of the people	App. JPY 6.9tn
Recovery and reconstruction from natural disasters, national resilience, support for children and child-rearing, etc.	

(Source) Nomura Asset Management based on the materials by the Japan Cabinet Office (https://www.cao.go.jp/)

In this context, it holds the stance that "a virtuous cycle of growth and distribution" has begun to take shape, aiming for an economy where wage increases consistently outpace price increases. Specific points outlined include: (1) discussions to raise the so-called "1.03 million yen wall" within the 2025 tax reform, and (2) aiming for a nationwide average minimum wage of 1,500 yen by the 2020s.

The income thresholds related to residence tax liability, social insurance payments, as well as dependency deductions and spousal deductions, are referred to as the "income wall." The Democratic Party for the People (DPP) has argued for raising the threshold for residence tax liability from "1.03 million yen" to "1.78 million yen." While there is high uncertainty regarding how much of the DPP's claims will be incorporated into the tax reforms in December, it is expected that movements towards increasing disposable income will take place. Moreover, to achieve the target indicated in the economic measures for minimum wage, an annual average increase of over 7% will be necessary (see Figure 4).

Figure 4. Minimum Wage Trends in Japan

(Source) Nomura Asset Management based on the data from Ministry of Health, Labor and Welfare (https://www.mhlw.go.jp/index.html), and by the Independent Administrative Institution Research and Training Institute for Labor Policy

Although the hurdle is high, the regulatory reform promotion council has also raised the issue of reviewing the decision-making process for minimum wage, and as labor demand continues to tighten, the groundwork for sustained wage increases is being established.

Taking these points into account, the Ishiba administration is aimed at improving the real income environment for households, suggesting that stable consumption growth can be expected when looking solely at domestic factors.

Impact on Financial Markets

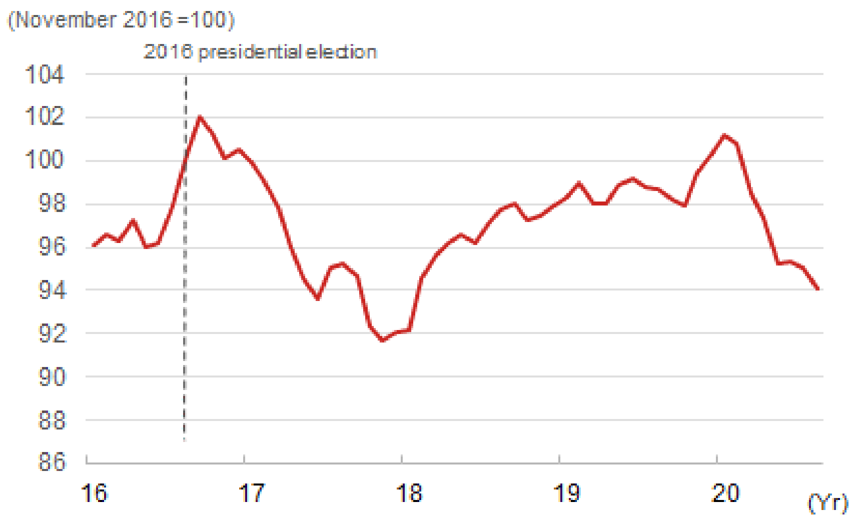
When considering the impact on financial markets, the timing and scale of the Trump administration's policy implementation will be crucial. While the US economy may benefit from the tailwind of expansionary fiscal policy, the uncertainty surrounding trade policies could have a negative effect on the economies of countries outside the US, including Japan, primarily by weighing down external demand and capital investment.

Compared to a scenario where a Trump administration does not materialize, divergence in monetary policy may also arise between the US and other countries/regions. Given that Trump's policies are expected to push up US prices, the "red sweep" government is likely to suggest a more hawkish stance in monetary policy. In other words, there is a higher chance for the US to slowdown the current pace of rate cuts.

On the other hand, many major countries and regions may trend towards more dovish policies. In this context, the interest rate differentials between the US and other countries/regions are unlikely to narrow significantly, leading to persistent upward pressure on the US dollar. If the Trump administration's trade policies turn out to be more hardline than financial market participants expect, significant turmoil could occur in the financial markets. This decline in risk tolerance could further support preference for the US dollar.

While the new president may aim for a weaker dollar, seeing a stronger dollar as problematic for US manufacturing, conditions may not evolve towards a weaker dollar as seen during the previous Trump administration (see Figure 5).

Figure 5. USD Nominal Effective Exchange Rate



(Source) Nomura Asset Management based on data from the Bank for International Settlements (BIS)

In the bond and equity markets overall, it is also highly likely that the specifics of the Trump administration's policies have not yet been fully priced in. Adjustments in asset prices might occur as the policies become more concrete and their impacts on the economy, prices, monetary policy, and corporate earnings are evaluated.

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