

Daiwa's Economic View

Outlook for fiscal, monetary policies with PM Ishiba stepping down

- LDP leadership race likely to center on Koizumi and Takaichi
- Whether election uses “full-scale” or “simplified” voting will impact timing of supplementary budget
- Fiscal policy: mild under Koizumi, coordination with DPP under Takaichi
- Monetary policy faces narrow path for Oct rate hike, contingent on administration continuity and political calendar

FICC Research Dept.

Koji Hamada

81-3-5555-8791

kouji.hamada@daiwa.co.jp

**Kenji Yamamoto**

81-3-5555-8784

kenji.yamamoto@daiwa.co.jp



Daiwa Securities Co. Ltd.

Prime Minister Shigeru Ishiba has announced his resignation and an election to choose the next president of the Liberal Democratic Party (LDP) will soon be held. Shinjiro Koizumi and Sanae Takaichi are seen as the top contenders. The timing for economic measures and supplementary budgets will vary depending on whether there is “full-scale” or “simplified” voting for this election. Fiscal policy will likely be mild if Koizumi wins. If Takaichi becomes party leader, fiscal policy would likely depend on cooperation with the Democratic Party for the People (DPP). As for monetary policy, conditions for hiking interest rates within this year have become uncertain. Indeed, even though the hurdle for a rate hike at the BOJ's October Monetary Policy Meeting has risen, the possibility of a “window of opportunity” remaining open still exists.

PM Ishiba announces his resignation

Japan's Prime Minister Shigeru Ishiba announced his resignation on 7 September. The reasons cited for stepping down included (1) US/Japan trade negotiations reaching a milestone, (2) need to take responsibility for the party's July Upper House election defeat, and (3) to prevent divisions within the party.

The primary reason was that the vote scheduled for 8 September, to decide whether to hold an extraordinary LDP presidential election, strongly indicated the election would likely proceed. On 4 September, several veteran lawmakers close to Ishiba held a meeting. It is presumed that they reached a consensus on requesting Ishiba's voluntary resignation to allow for an extraordinary party leadership election to move forward. Ishiba probably thought that even if he ran in an extraordinary party presidential election, his chances of winning were very slim. Apparently, there was also talk about the possibility of a snap general election. However, given the LDP's current weakened state, there's a good chance that it would lose its status as the largest party following such a snap general election. In any event, the main factor seems to have been that Ishiba realized it would be difficult for him to continue as prime minister.

Outlook for LDP presidential election: Koizumi and Takaichi as top contender

Once Ishiba announced his resignation, it was decided that a party leadership election would be held (without waiting for the 8 Sep vote to determine whether or not to move forward with a party leadership election). Media reports assume that the main contenders are Koizumi, Takaichi, Takayuki Kobayashi, Yoshimasa Hayashi, and Toshimitsu Motegi.

Koizumi is a minister in Ishiba's cabinet, but since Ishiba has decided not to run, the door is open for Koizumi to run without facing criticism. It remains to be seen whether Kobayashi will support Takaichi, as he is expected to compete with her for votes from conservative voters. Hayashi, like Koizumi, is a minister in the Ishiba cabinet, but he holds the key position of chief cabinet secretary, so some are saying that he should take more responsibility for the July Upper House election drubbing. Motegi is viewed as influential in terms of conducting policy, but his support among the public has not broadened. That said, it is important to keep in mind that Motegi and the DPP leader Yuichiro Tamaki share similar policies on strengthening the economy's supply side.

The outcome of the election will be impacted by whether there is “full-scale” voting (295 LDP Diet members and 295 rank-and-file party members [total of 590 votes]) or “simplified” voting (295 LDP Diet members and 141 prefectural party branch members [total of 436 votes]).

The “full-scale” voting method was used for last year’s LDP presidential election. In the first round of voting, Takaichi received 72 votes from LDP lawmakers and 105 votes from rank-and-file party members. Koizumi secured 75 votes from LDP lawmakers and 61 votes from rank-and-file party members. As such, Takaichi had stronger support from the regional vote.

This time, regardless of the voting method chosen, developments are expected to center around Koizumi and Takaichi, both of whom enjoy lofty expectations from the public. That said, according to a Jiji Press public opinion poll of LDP supporters (14 Aug), when asked who would be the best next prime minister, 21.2% picked Koizumi and 19.6% picked Takaichi. A poll released by the *Mainichi Shimbun* (24 Aug) reported that 13% picked Koizumi, while 15% chose Takaichi. A similar *Nikkei* poll (31 Aug) found that 32% supported Koizumi, while 17% picked Takaichi. So, it may not necessarily be true that Takaichi holds an advantage in regional areas.

Future schedule: Voting (simplified, full-scale) may impact supplementary budget timing

The LDP presidential election schedule is subject to change depending on whether the voting method is “simplified” or “full-scale.” Within the LDP, there appears to be the view that in order to convey to the general public a case for an LDP revival, the “full-scale” voting approach (including rank-and-file party members) should be implemented. Meanwhile, some have also argued that a simplified approach should suffice in order to prevent the political vacuum from growing any larger. The final decision can be made later.

Such “full-scale” voting would likely take place in early October, while “simplified” voting would likely take place sometime in September. Following that, the process will proceed with the formulation of economic measures, the compilation of a supplementary budget, and Diet deliberations. If the “full-scale” voting approach is used, compilation of the supplementary budget could be pushed back until December. That said, considering the need for early implementation of government measures to address high prices, the goal will likely be to pass the bill within this year.

Fiscal policy implications: In case of Takaichi, focus on whether she cooperates with DPP on budget matters

After the new LDP president is determined via the election, an extraordinary Diet session will be convened to officially designate the prime minister (head of cabinet), following policy discussions with the opposition parties.

The policies of each candidate must be confirmed as campaign pledges during the LDP presidential election. That said, if Koizumi wins, he may focus more on regulatory reforms than fiscal stimulus. In that case, his views would be very close to those held by the Japan Innovation Party. In terms of being cautious about fiscal stimulus, there is also the possibility of budget cooperation with the Constitutional Democratic Party of Japan (CDP). In any event, concerns among JGB market participants about fiscal expansion will probably settle down to some extent.

In the case of Takaichi, we would expect more expansionary fiscal policy. That said, the DPP’s fiscal policy is far too expansive given the current fiscal situation. Can Takaichi and the DPP reach an agreement on fiscal policy? Whether cooperation with other parties is possible is something we want to reassess after hearing their policies and assertions (positions) during the leadership election. Concerns among JGB market participants about fiscal expansion will remain elevated for the time being. Still, as fiscal policy and cooperation with opposition parties begin to materialize, corrections are likely to proceed accordingly.

BOJ monetary policy implications: Key points are continuity of new administration, political calendar

Implications for the BOJ's monetary policy following Ishiba's resignation are likely to be complicated. As we said in our 5 August report ([“What are the potential obstacles to BOJ raising rates in 2025?”](#)), it is easy to see how domestic political uncertainty could constitute an obstacle for BOJ rate hikes.

However, considering that soaring prices are causing a decline in households' real wages (take-home pay), which has become a political issue, simply extending the timeline for interest rate hikes will not solve the problem—it could even worsen the situation. In fact, amid speculation about an early LDP party leadership election, super-long JGBs fell sharply and yen selling intensified. [The recent meeting between Ishiba and BOJ Governor Kazuo Ueda also confirmed a heightened tone of caution regarding financial market trends, including even exchange rates.](#) The BOJ's current monetary policy stance of “raising interest rates as economic and price conditions improve (Ueda),” is not expected to change.

Still, following the resignation of Ishiba, the “window of opportunity” for a BOJ rate hike within the year—possibly as early as the October meeting—may narrow. The key points going forward are the continuity of the new administration and the political calendar. From here, the LDP will discuss the specifics of its leadership election process. A proposal has emerged to hold “full-scale” voting involving rank-and-file party members in early October. If the presidential election is held using the “full-scale” voting method, the convening of an extraordinary Diet session would likely be pushed back until late October.

If the opposition parties unite, there could be a scenario in which the LDP-Komeito coalition is ousted through the prime minister designation process, albeit that possibility is slim. The CDP, the largest opposition party, has not yet finalized its vision for governing. If the prime minister nomination election follows the same pattern as last fall, the LDP-Komeito coalition government is expected to remain in power. Still, given that the BOJ must establish a new line of communication with the new administration, the hurdle for gaining understanding for a rate hike at the October meeting has become higher compared to conditions under the Ishihara administration.

However, considering that both the ruling and opposition parties feel that a “political vacuum should be avoided,” the LDP leadership election may adopt a simplified form of voting. In that case, the political schedule could be brought forward to allow implementation within two to three weeks (in September), potentially keeping open the BOJ's “window of opportunity.” The longer the delay in holding the presidential election, the tighter the schedule for the subsequent supplementary budget and FY26 budget formulation processes, due to policy talks between ruling and opposition parties, the convening of an extraordinary Diet session followed by the prime minister's designation, and formation of a cabinet. As such, this “window of opportunity” could become even smaller, not only in October, but in December as well.

On that point, regardless of the political schedule, who becomes the LDP president (and prime minister if LDP-Komeito coalition is maintained) will be extremely important for the BOJ from the perspective of “continuity” in terms of the administration and policy. If a candidate willing to continue the policy direction of the Ishiba administration (such as Koizumi) were to become the next LDP president, that might not pose a significant constraint from the perspective of the BOJ's communication with the new administration, as mentioned above.

Meanwhile, if there are growing expectations that a new LDP president/prime minister will call for maintaining the current monetary policy, while implementing more expansionary fiscal policies, [market participants will become more aware of a possible situation in which the BOJ “falls behind the curve.”](#) However, given that rising prices have been a potential factor behind the ruling party's election defeats since last year, and considering Japan's relationship with the US regarding currency issues, we do not believe that the new LDP president will stress dovish rhetoric and constrain the BOJ's actions.

IMPORTANT DISCLOSURES

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Securities Co. Ltd. retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.

Ratings

Issues are rated 1, 2, 3, 4, or 5 as follows:

- 1: Outperform TOPIX/benchmark index by more than 15% over the next 12 months.
- 2: Outperform TOPIX/benchmark index by 5-15% over the next 12 months.
- 3: Out/underperform TOPIX/benchmark index by less than 5% over the next 12 months.
- 4: Underperform TOPIX/benchmark index by 5-15% over the next 12 months.
- 5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

Benchmark index: TOPIX for Japan, S&P 500 for US, STOXX Europe 600 for Europe, HSI for Hong Kong, STI for Singapore, KOSPI for Korea, TWII for Taiwan, and S&P/ASX 200 for Australia.

Target Prices

Daiwa Securities Co. Ltd. sets target prices based on its analysts' earnings estimates for subject companies. Risks to target prices include, but are not limited to, unexpected significant changes in subject companies' earnings trends and the macroeconomic environment.

Disclosures related to Daiwa Securities

Please refer to https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/e_disclaimer.pdf for information on conflicts of interest for Daiwa Securities, securities held by Daiwa Securities, companies for which Daiwa Securities or foreign affiliates of Daiwa Securities Group have acted as a lead underwriter, and other disclosures concerning individual companies. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/credit_ratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)

If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.

Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108

Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association, Japan Security Token Offering Association