

Japan

- **LDP supermajority shifts focus to fiscal trajectory**
- **We expect fiscal policy to become more expansionary...**
- **...with priority on strategic investment spending**
- **Wages and sentiment soften in early 1Q**
- **Next week: Solid 4Q25 GDP; PMI broadly stable in February**

The LDP achieved a historic landslide victory, winning 316 seats—more than two-thirds of the 465 seats in the Lower House—in this week’s snap elections. As a result, the LDP can now not only override bills rejected by the Upper House but also initiate constitutional amendments in the Lower House. The outcome ends a difficult period for the LDP as a minority ruling party, and greatly increases policy flexibility. In a post-election interview, PM Takaichi indicated that she would largely retain the current cabinet and stated that, regarding a two-year limited consumption tax reduction on food and the introduction of a refundable tax credit, a cross-party national council would be established for further discussion.

Market attention will now shift to the fate of the food tax holiday. Even within the LDP, there has been opposition to the temporary tax cut, which Takaichi had called her “long-cherished wish.” Reflecting this, her own statements on the issue became increasingly muted during the campaign. As a result, many thought that if the ruling coalition won, a consumption tax cut would likely not be implemented. With the LDP winning more seats than expected, simply shelving the pledge may have become more difficult.

While discussions will now proceed on a cross-party basis, such an overwhelming victory makes it hard for the Takaichi administration to delay decisions by blaming opposition resistance. Ultimately, the LDP will have to take responsibility for deciding whether or not to implement the consumption tax cut. Even though there are no national elections scheduled until autumn 2028, PM Takaichi may face a difficult decision which impacts her own approval rating.

LDP landslide puts spotlight on fiscal path

The election result can be interpreted as a public endorsement of the Takaichi administration’s “responsible and proactive fiscal policy.” With an overwhelming majority in the Lower House, even if the Special Deficit-Financing Bond Law—previously seen as a constraint on deficit bond issuance from FY2026 onward—is rejected in the Upper House, the administration can pass it again in the Lower House. While the public’s main concern appears to be fiscal expansion as a mea-

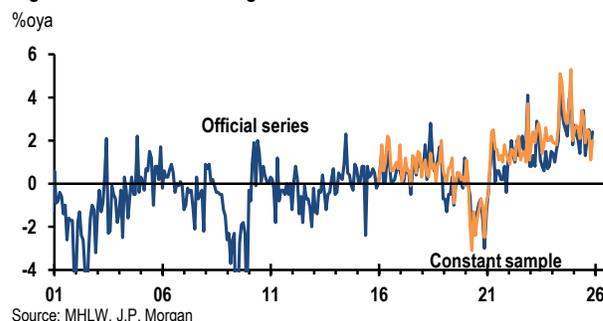
sure against rising prices, PM Takaichi seems to prioritize allocating fiscal resources to strategic investment areas rather than focusing solely on a consumption tax cut. In any case, the advocated fiscal expansion is likely to proceed.

Naturally, such moves will further push up underlying inflation. While the BoJ’s main opinions after the January meeting suggested the possibility of a faster pace of rate hikes, tensions with a government that remains negative toward rate hikes are likely to persist. As a result, the dynamic in which yen depreciation supports the case for rate hikes is unlikely to change, and as fiscal policy becomes more expansionary, delays in the BoJ’s policy response are likely to become even more apparent.

Dec wages soften on bonus payments

Headline wages rose 2.4%oya in December, falling short of our expectation of a 3.2% increase (Figure 1). Special payments, which account for more than half of December wages due to winter bonus payments, rose 2.6%oya. This represents a moderation from 6.2%oya growth in December 2024. While media reports indicate that winter bonuses for large firms were solid, today’s report suggests that bonus payment growth for SMEs may be comparatively sluggish. In the constant sample series, which removes some sampling volatility, total wages rose 2.0%oya, with special payments up just 1.8%oya.

Figure 1: Total cash earnings



Base pay growth remained solid, with scheduled earnings rising 2.2%oya. Scheduled earnings for full-time employees increased 2.5%oya, maintaining a narrow range of growth over the past three quarters (Figure 2). Part-timers’ scheduled hourly wages also posted a solid 3.4%oya increase. We expect base pay growth to remain strong through the year, as we anticipate similarly positive results in the upcoming spring wage negotiations as last year. Whether SMEs can catch up with the current wage momentum and close the gap with large companies will be important to achieve these outcomes.

Figure 2: Scheduled earnings composition: full-timers

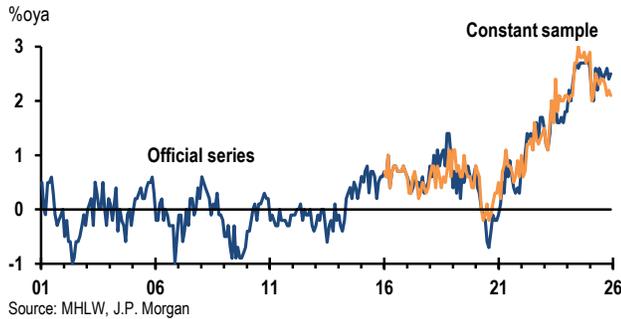
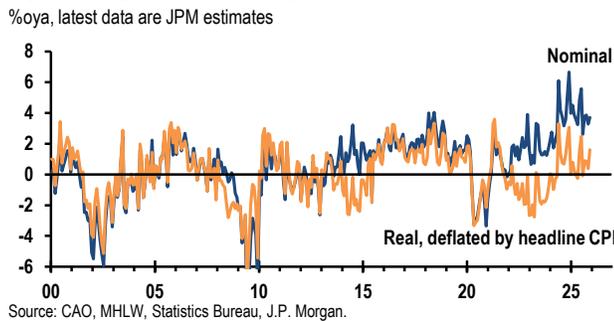


Figure 3: Wage income of employees

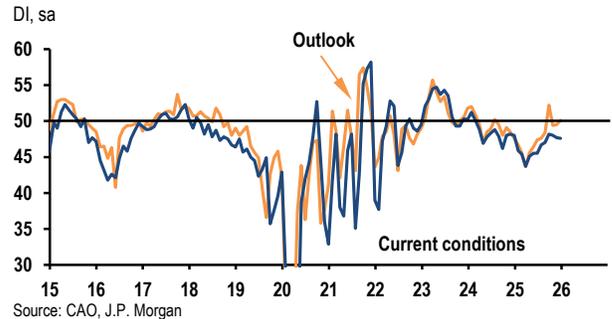


Real income conditions improved in December. Supported by moderating headline inflation, reported real wages rose 0.3%oya in December. Total wage income for employees, which excludes noise caused by annual sampling fluctuations, increased a strong 3.7%oya, resulting in a 1.6%oya gain in real wage income (Figure 3). With headline inflation expected to soften further to below 2%, real income growth is likely to accelerate at the start of this year, supporting households' purchasing power and underpinning resilient domestic demand growth.

Sentiment slips among SMEs

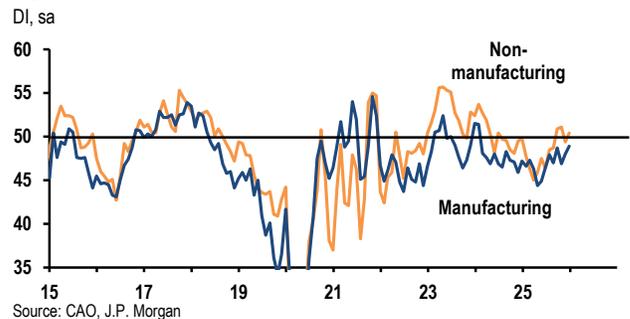
In the January Economy Watchers Survey, sentiment among small and medium enterprises (SMEs) regarding current conditions fell a tick to 47.6, weaker than our expectation of a 0.3pt decline (prior months were revised due to annual revisions related to seasonal adjustment). This marks the third consecutive monthly decline following a strong recovery through October. But last month's decline was partly attributed to temporary weather factors, specifically heavy snowfall. Details were mixed, with some sectors reporting positive activity, particularly for business activity-related sectors. This aligns with manufacturers' projections suggesting solid output growth at the start of this year. The outlook for the next 2-3 months was also relatively positive, as the headline index rose 0.5pts to 50.1 (Figure 4). Excluding temporary noise, the report suggests sustained gradual growth in SME activity, supported by recovering domestic demand.

Figure 4: Economy Watchers Index



The household activity-related index on current conditions slipped 0.1pt to 47.1, with mixed details across sectors. The services sector index fell 3.0pts to 47.9, ending a streak of six consecutive monthly gains. The decline is likely temporary, as respondents cited heavy snow as a factor dampening leisure demand. Supporting this view, the outlook index for services rose 1.7 pts to 53.1. The housing sector index also fell 4.5pts to 42.6, possibly reflecting soft demand due to higher loan interest rates and rising property prices. On the flip side, improved consumer confidence may be reflected in the goods sectors, as the retail index and the food index rose 1.8pts to 47.4 and 0.5pts to 45.8, respectively.

Figure 5: Current conditions index - Corporate



The business activity-related index on current conditions rose 0.9pts to 49.5, reflecting similar-sized gains in both the manufacturing and non-manufacturing indices (Figure 5). The manufacturing index rose to 48.9, and its outlook index climbed 1.5pts to 51.5, both reaching their highest levels since February 2024. Survey commentary highlighted active capex momentum and sustained demand growth. On the flip side, some respondents expressed concerns about higher input costs due to wage growth, yen depreciation and higher interest rates. So far, SMEs have managed to pass on these input costs, as noted in the commentary, but a continued rise in input costs could further fuel inflationary pressures.

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Data releases and forecasts

Week of February 16 - 20

Mon	GDP - 1st estimates			
Feb 16	%q/q, saar			
8:50am	2Q25	3Q25	4Q25	
Real GDP	2.1	-2.3	<u>1.2</u>	
Private consumption	1.0	0.8	<u>0.5</u>	
Residential investment	1.7	-29.0	<u>8.0</u>	
Bus. capital investment	5.4	-0.8	<u>2.5</u>	
Government consumption	1.4	0.6	<u>-1.0</u>	
Public investment	0.2	-4.2	<u>0.0</u>	
Exports	8.0	-4.9	<u>4.0</u>	
Imports	5.7	-1.8	<u>-1.0</u>	
%pt contrib. to q/q saar GDP growth				
Domestic final sales	1.9	-1.1	<u>0.8</u>	
Net exports	0.4	-0.6	<u>0.9</u>	
Inventories	-0.1	-0.7	<u>-0.5</u>	
GDP deflator (%oya)	3.3	3.4	<u>3.2</u>	

We expect the first estimate of 4Q25 GDP to be a solid 1.2%/q/q saar, as residential investment recovers from a one-off plunge due to a hangover from front-loaded construction related to new regulation starting in April. Private consumption growth is expected to moderate, partly reflecting unfavorable weather conditions which reduced demand for seasonal goods, while business capex is likely to increase, indicating sustained resilience in domestic demand. Net trade is expected to push up headline GDP by 0.9%pt, driven by a recovery in exports. The contribution from inventory accumulation is likely to remain negative.

Wed	Reuters Tankan survey			
Feb 18	Diffusion index			
8:00am	Nov	Dec	Jan	Feb
Manufacturing	17	10	7	<u>6</u>
Nonmanufacturing	27	33	32	<u>30</u>

We expect manufacturing sentiment to decline slightly in February, on concerns about external demand and the ongoing China-Japan tensions. Non-manufacturing sentiment is expected to remain elevated, supported by resilient demand.

Wed	Customs-cleared international trade				
Feb 18	%m/m sa				
8:50am		Oct	Nov	Dec	Jan
Balance (JPY bn sa)		78	8	-209	<u>80</u>
Exports		0.6	3.3	-0.5	<u>3.1</u>
Imports		-3.3	4.1	1.8	<u>0.0</u>
Balance (JPY bn nsa)		-232	311	113	<u>-1843</u>
Exports (%oya)		3.6	6.1	5.1	<u>7.0</u>
Imports (%oya)		0.7	1.4	5.2	<u>-3.3</u>
BoJ real export index		-3.7	6.7	-3.8	<u>2.0</u>
BoJ real import index		-4.1	2.0	1.1	<u>-1.0</u>

Preliminary data suggest that the trade balance will turn to a small positive in January. We expect real exports to recover on the month.

Thu	Machinery orders				
Feb 19	%m/m sa				
8:50am		Sep	Oct	Nov	Dec
Total		3.9	-6.8	8.5	—
Core private domestic orders ¹		4.2	7.0	-11.0	<u>3.5</u>
Manufacturing		23.3	-13.3	-10.8	—
Core nonmanufacturing		-8.7	28.8	-10.7	—
Public		7.3	22.9	67.8	—
Foreign		9.7	-21.8	5.3	—

1. Domestic private sector, ex for ships and from utilities

We look for a rebound in monthly core private domestic orders in December. Machinery orders would suggest sustained solid momentum in business capex, consistent with resilient business sentiment.

Fri	Nationwide consumer prices				
Feb 20	2020-based				
8:30am		Oct	Nov	Dec	Jan
%oya					
Overall		3.0	2.9	2.1	<u>1.6</u>
Core (ex. fresh food)		3.0	3.0	2.4	<u>2.1</u>
Core (ex. fresh food and energy)		3.1	3.0	2.9	<u>2.7</u>
Core (ex. food and energy)		1.6	1.6	1.5	<u>1.5</u>
%m/m, sa					
Overall		0.3	0.3	-0.1	<u>-0.1</u>
Core (ex. fresh food)		0.3	0.3	-0.1	<u>-0.1</u>
Core (ex. fresh food and energy)		0.4	0.2	0.1	<u>0.0</u>
Core (ex. food and energy)		0.4	0.1	0.1	<u>0.0</u>

In the January nationwide CPI, the core index (ex. fresh food) is expected to decline further due to the government price control measures on energy and services.

Fri	Markit manufacturing/ services PMI				
Feb 20	Diffusion index, sa				
9:30am		Nov	Dec	Jan	Feb
	Manufacturing (headline)	48.7	50.0	51.5	<u>50.5</u>
	Services (business activity)	53.2	51.6	53.7	<u>53.5</u>

We expect the February flash PMI to decline, as a solid output growth projected in January moderates. Despite that, the PMI is expected to indicate sustained growth in business activity.

Producer prices index (Feb 12)

%oya, nsa, 2020-based

	Nov	Dec	Jan	
Domestic PPI	2.7	2.4	<u>2.4</u>	2.3
(%m/m)	0.2	0.0	<u>0.0</u>	0.2
Export prices	2.8	4.9	—	6.6
Import prices	-1.9	0.0	—	0.5

Sources for all data tables: ADA, BoJ, CAO, JCSA, JDASA, JFA, JLM, VMA, Markit, METI, MHLW, MILT, MoF, Reuters, Statistics Bureau, J.P. Morgan forecasts.

Review of the past week's data

Employers' survey – preliminary (Feb 9)

%oya, official base

	Oct	Nov	Dec	
Monthly wages per employee	2.5	1.7	<u>3.2</u>	2.4
Scheduled earnings	2.4	1.9	—	2.2
Full-timers' monthly	2.6	2.4	—	2.5
Part-timers' hourly	3.2	4.0	—	3.4
Overtime payments	2.1	1.2	—	0.9
Special payments	6.4	-1.5	—	2.6
Real wages (total)	-0.5	-1.2	—	0.3

*Real wages deflated by headline CPI

See main text.

Bank lending (Feb 9)

%oya

	Nov	Dec	Jan	
Bank lending	4.5	4.8	—	4.9
%m/m, sa by J.P.Morgan	0.5	0.6	—	0.5

Balance of payments (Feb 9)

JPY bn, sa

	Oct	Nov	Dec	
Current account	2476	3138	<u>3234</u>	2697
Trade balance	86	451	—	56
Exports	9000	9479	—	9332
Imports	8915	9029	—	9276
Services	-243	-283	—	-452
Primary income	3013	3284	—	3501
Secondary income	-380	-314	—	-408
Current account (nsa)	2833	3674	<u>4072</u>	729

Economy Watchers survey (Feb 9)

DI, sa

	Nov	Dec	Jan	
Current conditions	48.7 48.0	48.6 47.7	<u>49.0</u>	47.6
Households	48.5 47.6	48.2 47.2	—	47.1
Business	49.5 49.0	49.2 48.6	—	49.5
Employment	48.4 47.8	49.5 48.6	—	47.2

See main text.

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