FLASH OCTOBER 2025

Takaichi's Castle

The impact of "Sanaenomics" on Japanese Equities

Key Messages

1. **A paradox:** Sanae Takaichi has been elected as Japan's first female prime minister. While the move symbolises diversity in leadership, Ms Takaichi is a conservative traditionalist.
2. We expect her to pursue a balanced **pro-growth and proactive fiscal strategy** which strengthens our **constructive view on Japanese equities.**
3. **The two arrows of Sanaenomics:** an acceleration of earnings growth and a renewed focus on corporate reforms, which should provide further upside potential. Stay overweight!

A Japanese paradox

Having Sanae Takaichi, President of the Liberal Democratic Party (LDP), reached a coalition with the Japan Innovation Party (JIP), she has been elected Japan's first female prime minister. The appointment is somewhat a paradox: while it could be viewed as a symbolic event representing progress in gender equality, the reality may be very different. Takaichi-san is a staunch conservative, opposing fundamental reforms that are central to Japan's gender equality debate. Like her mentor and a former prime minister of Japan, Shinzo Abe, she claims to empower women in the workforce yet refuses to confront the entrenched structural and cultural biases that impede gender equity in Japan. The share of female cabinet members (16%), including her, might be a proof in case. Thus, we should expect a rather conservative albeit expansionary fiscal policy in Japan going forward.

Fiscal stimulus ahead

Since the LDP-JIP coalition does not command a sufficient majority, political support needs to be brokered on a case-by-case basis. Such a backdrop often encourages horse trading about political projects. These projects are usually related to spending more money and should thus encourage fiscal expansion.

Overall, we expect a balanced pro-growth and proactive fiscal strategy thus strengthening our constructive view on Japanese equities.

Building Takaichi's castle

The need for fiscal measures to support households that have been hit by soaring (rice) prices (see Chart 1) and to counter US tariff hikes is broadly recognised across the political spectrum. This should help Ms. Takaichi to pursue an expansion in fiscal policies against fiscal hawks within the LDP. Among the proposals listed in the coalition agreement are a gasoline tax cut and an increase of the minimum personal income taxable base. We anticipate that reductions in social security contributions will likely be implemented.

Conversely, an immediate cut in the consumption tax appears unlikely. Although this issue is included in the coalition agreement, the two parties have only committed to creating a joint discussion committee on the matter, without setting a timeline for its resolution. Consequently, it does not appear to be a high priority, especially since Takaichi-san is eager to avoid having her own "Liz-Truss Moment": There is a potential risk of destabilising the Japanese government bonds (JGB) market if the consumption tax is reduced simultaneously with cuts in social security contributions and income tax.

Another area of interest for Ms. Takaichi is national security. She wants to move quickly on revisions to three key national security policy documents, with a view to raising defence expenditure. Fitting into that broader theme is the expected restrictive stance on migration. The JIP have even proposed a government cap on the percentage of foreign residents at 10% of the total population.

Stephan Kemper

Chief Investment Strategist
BNP Paribas Wealth Management-
Private Banking Germany

Growth, wages and rates

The Japanese economy is already close to full employment (see Chart 2) and Ms. Takaichi's stance on migration could worsen the situation. We therefore think that any additional fiscal stimulus is unlikely to have a material effect on real economic growth. The main impact is rather likely to fuel upward pressure on prices. This would, in turn, increase pressure on the BoJ to resume its rate-hiking path as it cannot indefinitely postpone rate hikes while inflation remains above target. We retain our call that the next rate hike will occur in December, and we forecast the policy rate to reach about 1.5 % by Q4 2026. There is, however, a sizeable risk that the BoJ, under a Takaichi administration, might temper rate hikes out of political considerations.

Such a move would keep inflation overshooting, consequently forcing the BoJ to lift rates more aggressively in the future. Thus, we think that Ms. Takaichi-san will not mount strong opposition to moderate rate hikes as long as growth remains solid and asset prices keep rising.

Against the backdrop of low unemployment and rising inflation, next year's spring wage negotiations should result in sizeable wage increases, like this year's outcome (see Chart 3). This should strengthen domestic consumption.

The two arrows of "Sanaenomics"

Looking at Japanese equities, we admit that valuations are no longer cheap. After a strong rally since Takaichi-san became LDP's leader, the Nikkei 225 has rallied almost 10% so far in October. When we published this paper (22 October 2025), the NTM P/E ratio was at ~ 23x (see Chart 4), trading in line with the valuation of the S&P 500. While the P/E ratio is above its own 20-year average, there is still some room for a re-rating against the S&P 500 (Chart 5). We think there are three pillars driving a potential further re-rating.

Acceleration of earnings growth...

We expect the growth initiatives advocated by the LDP and JIP to enhance expectations for corporate earnings growth. A higher EPS growth rate should also support higher P/E multiples. Applying the Gordon Growth Model, an increase of long-term growth (g) of 50 bps with a constant cost of capital (r) would already point to an increase of the P/E ratio by 1x.

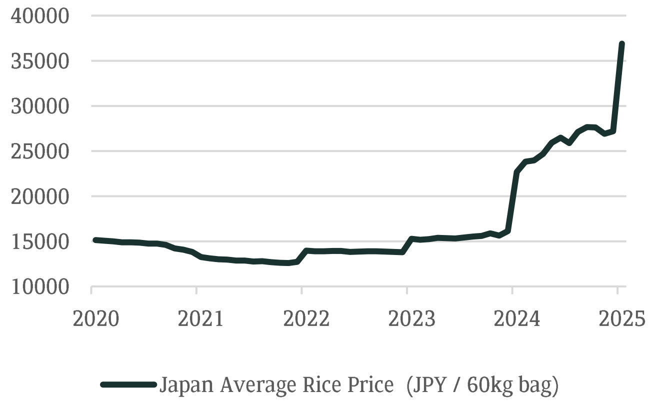
...and a renewed focus on corporate reforms

Takaichi-san is a strong advocate of corporate governance reforms with a special focus on retained earnings. In her 2021 book titled "Toward a Beautiful, Strong , and Growing Nation", she emphasised the possibility of taxing those earnings, a measure she also mentioned during her leadership campaign. This brings her on a par with the TSE´s push for more effective use of corporate cash. If her government successfully intensifies reforms, the ROE of Japanese companies could potentially rise. Consequently, the capital costs should fall in such a scenario. Assuming they do by 50 bps, the P/E would again rise by 1x (assuming constant growth).

We reiterate our Overweight rating

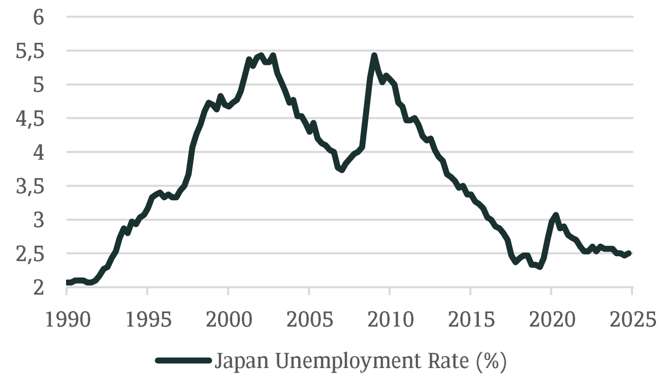
While a short-term correction is always possible, we continue to see an attractive risk return profile in Japanese equites. After outsized gains for AI/ semiconductor stocks, the rally could broaden in the light of prospects of more measures supporting domestic demand. We continue to like exposure to the domestic economy, such as Banks, Consumption, Construction and Electric Utilities.

CHART 1: THE PRICE OF RICE – A MAJOR STAPLE IN JAPAN – SPIKED SHARPLY



Source: BNP Paribas, Bloomberg

CHART 2: JAPAN'S ECONOMY IS CLOSE TO FULL EMPLOYMENT

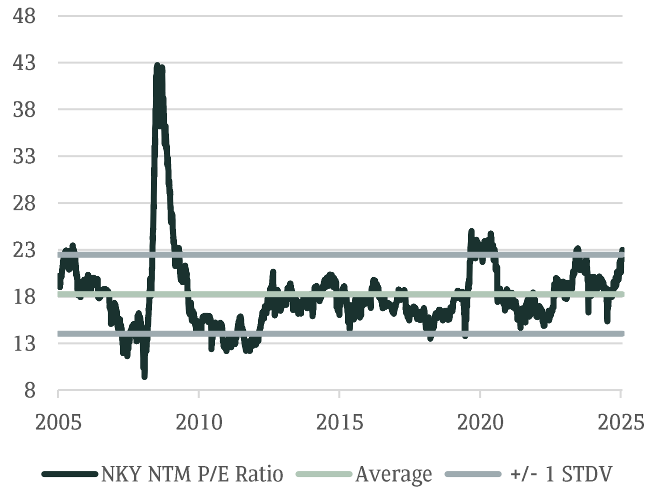


Source: BNP Paribas, Bloomberg

CHART 3: WAGE GROWTH IN JAPAN IS AT THE HIGHEST LEVEL SINCE 20+ YEARS

Source: BNP Paribas, Bloomberg

CHART 4: THE NIKKEI 225 LOOKS EXPENSIVE AGAINST ITS OWN HISTORY

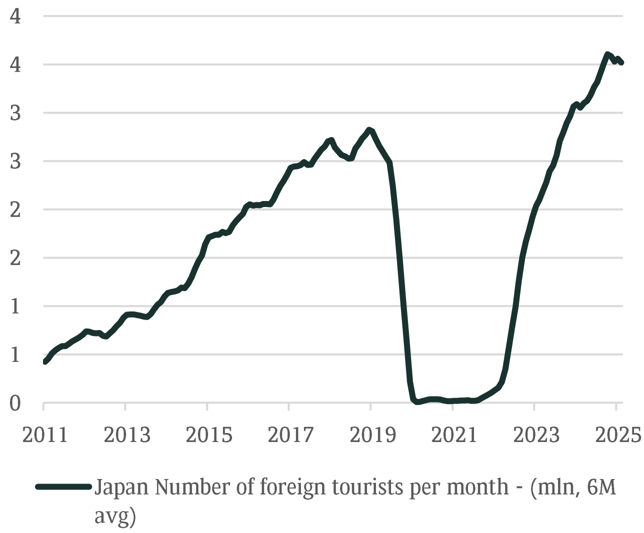


Source: BNP Paribas, Bloomberg

CHART 5: VALUATIONS ARE LOOKING MUCH MORE BENIGN AGAINST THE S&P 500

Source: BNP Paribas, Bloomberg

CHART 6: TOURISM HAS REBOUNDED SHARPLY, SUPPORTING DOMESTIC GROWTH



Source: BNP Paribas, Bloomberg

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Edmund SHING
Global Chief Investment Officer

Isabelle ENOS
Senior Investment Advisor

Charles GIROT
Senior Investment Advisor

ITALY

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Chief Investment Advisor

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