

Reinforcing Takaichi's Castle

A landslide victory for fiscal expansion



Key Messages

- PM Takaichi-san has secured a landslide victory, securing a two-third supermajority for her party.**
- We expect that the LDP to use the new-found strength to increase fiscal programs and boost public spending via a "Japan growth Strategy". Japan is looking to increase its strategic autonomy and indispensability.
- The resulting impact should provide tailwinds to the impacted sectors and the overall market. Valuations are advanced but we see room for further earnings growth.**

A historic victory

Japanese Prime Minister Sanae Takaichi is the undisputed winner of this election. Her ruling Liberal Democratic Party (LDP) has achieved the biggest post-war victory for a single-party in a general election in Japan, securing a so-called "supermajority". The party won 316 seats, an increase of 118 seats compared with its pre-election tally and more than two-thirds of the 465-seat chamber. With the seat count of coalition partner Japan Innovation Party (Ishin), rising to 36 seats (up by 2), the ruling alliance now holds 352 seats. The two-thirds super-majority means that it will be much easier for the ruling bloc to pass legislation as it can now override any rejection of a regular bill in the upper house by passing the measure again in the lower house.

Crucially, the current number of seats in the lower house is making the LDP much less dependent on its partner, resulting in a higher leverage within the Diet. Moreover, Prime Minister Takaichi's support base inside the party, previously considered fragile, should have been reinforced by the results. The landslide victory also creates a sizable cohort of newly-elected MPs who are likely to back her agenda.

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The "17 arrows" of Sanaeconomics

We expect the LDP to use the new-found strength to increase fiscal programmes and boost public spending. To fuel economic growth through public-private investments focused on economic security, the Takaichi administration established the "Japan Growth Strategy Headquarters" working on 17 designated strategic fields. *"We will firmly advance a growth strategy that will fundamentally reinforce the country's supply structure and realize a 'robust economy',"* Prime Minister Sanae Takaichi [told](#) the inaugural meeting of the Headquarters for Japan's Growth Strategy on 4 November.

The initiative will rely on two pillars: "crisis management investment" to strengthen supply chains in national security-related sectors and "growth investment" in advanced technologies. In other words, Japan is looking to increase its strategic autonomy and indispensability, i.e. reducing dependencies on specific countries while making its own technologies and industries essential to global value chains. The 17 strategic sectors which are the cornerstone of this approach include AI, semiconductors, digital infrastructure, and cybersecurity, along with shipbuilding –an area emphasised in the recent US.-Japan summit— and advanced defence technologies.

The latter is especially noteworthy as the defence industry is seen as a growth sector. Japan will review its National Security Strategy this year and measures to strengthen the defence industry and related technologies which are expected to be included. A critical shift under discussion is the potential elimination of export restrictions under the "Five Categories" of the defence equipment transfer guidelines. Removing these restrictions would allow the export of lethal systems, expanding markets for Japanese defence manufacturers and positioning defence production as a driver of economic growth.

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Running it hot

During a [press conference](#) after the election, Takaichi-san confirmed the need to depart from “excessive fiscal austerity”. She also reinforced the plan to exempt food and beverage items from the consumption tax for a two-year period. Although there’s still dissent within the LDP on this issue, the party’s landslide victory is likely to amplify Takaichi’s voice and diminish the fiscal-conservative bloc’s influence.

We thus expect the government to continue to expand fiscal outlays. The FY2026 supplemental budget is likely to be sizable, and the FY2027 initial budget will expand markedly, in our view. Takaichi had already signaled that the draft budget for fiscal year 2026 of JPY 122.3 trillion does not reflect her intention to deviate from a budget process that requires the preparation of additional budgets.

Good news for equities

We reiterate our Overweight call for Japanese equities as our positive scenario (see [here](#)) is playing out nicely. While Japanese equities are no longer cheap, earnings and cashflow estimates recently inflected higher. We expect the growth initiatives, advocated by the LDP and JIP, will further 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 0.5%pts with a constant cost of capital (r) would already point to an increase of the P/E ratio by 1x.

While a short-term correction is always possible, we continue to see an attractive risk return profile in Japanese equities. We continue to like industries benefitting from the Japan Growth Strategy and its consequences. Examples are Banks, Nuclear Power, Defence, Industrials and Construction.

TABLE 1: 17 STRATEGIC SECTORS ACCORDING TO THE JAPAN GROWTH STRATEGY

AI & Semiconductors	Disaster prevention and national resilience
Shipbuilding	Drug discovery and advanced medicine
Quantum technology	Fusion energy
Synthetic biology and biotechnology	Materials (critical minerals and component materials)
Aviation and space	Port logistics
Digital and cybersecurity	Defence industry
Content industry	Information and communications
Food tech	Marine and ocean
Resource, energy security and green transformation	

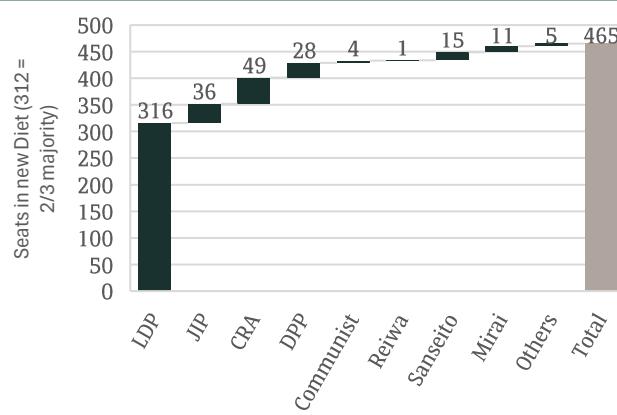
Source: BNP Paribas, ashi.com

TABLE 2: JAPAN’S EXPECTED POLITICAL EVENTS IN 2026

Date	Event
Feb 8th	General Election
Feb. 18th	Parliament reconvenes
March 19th	PM Takaichi to meet D. Trump in Washington
April	Annual budget passage
Spring	Revision of national defence strategies
Summer	Formulation of basic economic & fiscal policy
July 17th	Parliament adjourns
November	APEC summit
December	Conclusion of Social Security Reform Council

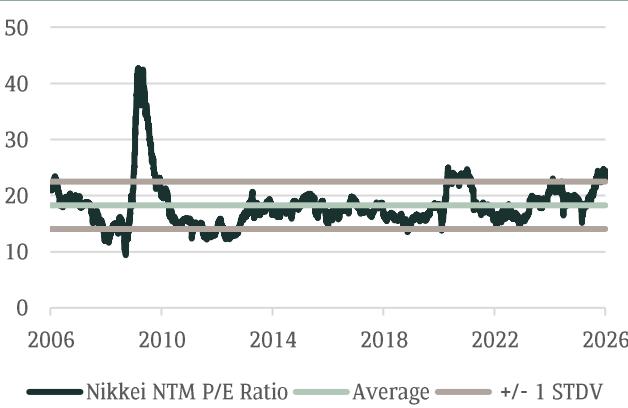
Source: BNP Paribas, Nikkei Asia

CHART 1: A LANDSLIDE VICTORY FOR THE LDP AS IT SECURED > 2/3 OF THE SEATS



Source: BNP Paribas

CHART 2: VALUATIONS ARE CLOSE TO THE PANDEMIC HIGHS...



Source: BNP Paribas, Bloomberg



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Renewed pressure on the Bank of Japan

We continue to observe the government's preference for low interest rates, yet an expansionary fiscal stance in an environment of full employment is likely to exert upward pressure on inflation while weakening the currency. In our view, policymakers recognise that the inflationary and exchange rate effects of such fiscal expansion must be offset, at least partly, by monetary tightening. Moreover, the administration is likely to be cautious about a sharp depreciation of the yen, which could strain Japan's relationship with the United States. The next rate hike is expected in April, with further increases roughly every four to five months, aiming for a terminal policy rate of about 2% by late 2027. Because fiscal policy is projected to remain expansionary, the risk of a faster-than-anticipated tightening path and of a terminal rate that exceeds the 2% target remains material. We do not rule out the possibility that the Bank of Japan could bring the next hike forward to March, depending on currency movements. We believe government bond yields still have upside potential, especially if the planned consumption tax cut proceeds. This, together with an expected rise in the bond risk premium should keep yields elevated. Accordingly, we raise our 12-month target for the 10-year government bond yield from 2.10% to 2.40%.

Prime Minister Takaichi cannot ignore market dynamics. Should the yen weaken sharply or long-term yields spike, the government may postpone the tax cut. It appears that the prime minister views investment in economic security and defence upgrades as a higher priority than a reduction in the consumption tax.

More limited potential for the Yen to rebound

We believe the yen's outlook will be increasingly shaped by long-term factors such as debt and inflation dynamics rather than by yield differentials alone. As the chart below shows, real yields (after adjusting for inflation) have been a principal driver of the USD/JPY exchange rate. We anticipate further rate hikes in Japan while the Fed is likely to cut rates twice, which should narrow the yield differential. Nonetheless, concerns about a resurgence of inflation and rising government debt ratios are expected to cap the yen's upside. Accordingly, we revise our 3-month USD/JPY target to 158 and our 12-month target to 155 (price of one US dollar).

CHART 3: BUT LOOK FAR LESS EXTREME VS THE S&P 500



CHART 4: EARNINGS AND CASH FLOW EXPECTATIONS ARE PICKING UP

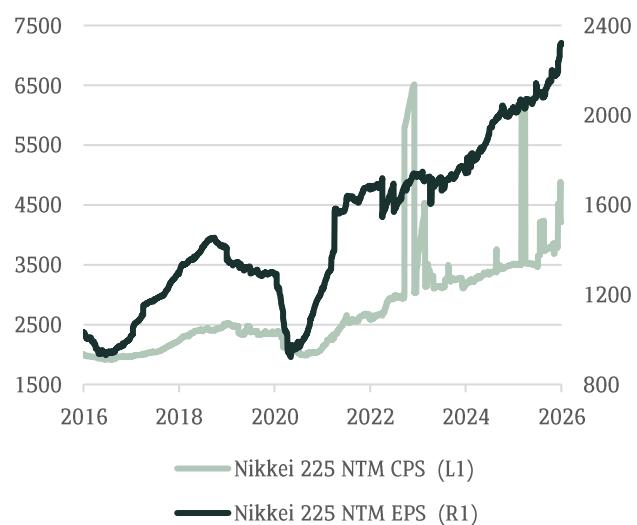
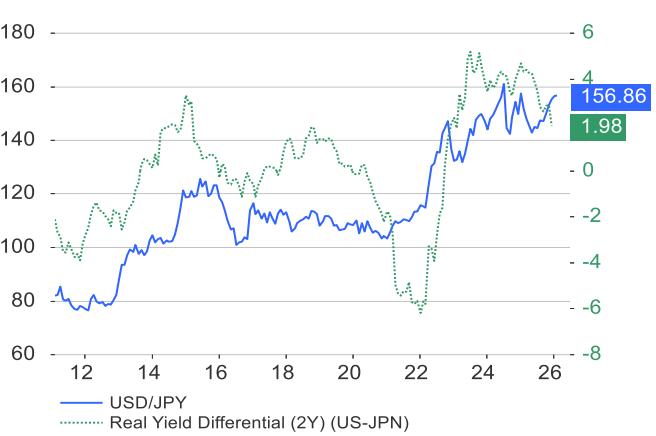


CHART 5: REAL YIELD DIFFERENTIAL VERSUS USD/JPY



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TABLE 3 & 4: FX FORECASTS

Country	Spot 08/02/2026	Trend	Target 3 months (vs. EUR)	Trend	Target 12 months (vs. EUR)
North America	United States	EUR / USD	1.18	Neutral	1.18
	United Kingdom	EUR / GBP	0.87	Neutral	0.87
	Japan	EUR / JPY	185.39	Neutral	186
	Switzerland	EUR / CHF	0.92	Negative	0.94
	Australia	EUR / AUD	1.69	Negative	1.79
	New-Zealand	EUR / NZD	1.96	Neutral	1.97
	Canada	EUR / CAD	1.61	Neutral	1.63
	Sweden	EUR / SEK	10.66	Neutral	10.80
	Norway	EUR / NOK	11.44	Neutral	11.60
Asia	China	EUR / CNY	8.20	Neutral	8.26
	India	EUR / INR	107.16	Neutral	106.20
Latam	Brazil	EUR / BRL	6.18	Negative	6.37
	Mexico	EUR / MXN	20.46	Negative	21.24

Country	Spot 08/02/2026	Trend	Target 3 months (vs. USD)	Trend	Target 12 months (vs. USD)
North America	Eurozone	EUR / USD	1.18	Neutral	1.18
	United Kingdom	GBP / USD	1.36	Neutral	1.36
	Japan	USD / JPY	156.86	Neutral	158.00
	Switzerland	USD / CHF	0.78	Negative	0.80
	Australia	AUD / USD	0.70	Negative	0.66
	New-Zealand	NZD / USD	0.60	Neutral	0.60
	Canada	USD / CAD	1.36	Neutral	1.38
Asia	China	USD / CNY	6.94	Neutral	7.00
	India	USD / INR	90.67	Neutral	90.00
Latam	Brazil	USD / BRL	5.23	Negative	5.40
	Mexico	USD / MXN	17.31	Negative	18.00
EMEA	South Africa	USD / ZAR	16.05	Negative	16.50
	USD Index	DXY	97.63	Neutral	98.09

Source: BNP Paribas, Refinitiv Datastream. As at 9 February 2026

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