

Research @ Citi Podcast, Episode 66: Japan General Election and Macro Implications

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Transcript:

Erica Poon Werkun (0:00)

Welcome to the Research @ Citi podcast. I'm your host, Erica Poon Werkun, Head of Research for JANA and Asia South at Citi. The Japan lower house election on Feb. 8 produced a landslide win for the ruling parties. The Liberal Democratic Party, or LDP, alone won more than two-thirds of the seats. This gives Prime Minister Sanae Takaichi a major boost in pushing ahead with her policy agenda. Investors believe the election results will stabilize the foundation of the government and lower political risks. This supports share price, and market reacted positively.

To understand better the market outlook from the Japan election, today I'm delighted to invite two of my colleagues to this podcast: Ryota Sakagami, our Japan Equity Strategist, and Tomohisa Fujiki, our G10 Rate Strategist for Japan. Sakagami-san and Fujiki-san, welcome to the show.

Let me first turn my questions to Sakagami-san. So, Sakagami-san, what do you think about the impact of the general-election results on the stock market from short-term and also medium- to long-term perspectives?

Ryota Sakagami (1:15)

It's no surprise that the market responded with a short-term rally as investors are clearly relieved to see a more stable political foundation. However, we need to stay realistic. The currency market currently views 160 yen to the dollar as a hard line for government intervention. And because of this, we don't expect to see the yen weaken much further in the short term.

This means the immediate upside for stock prices probably has a ceiling. But here's the more important part, the mid-, long-term outlook. There is a growing sense of confidence that the Takaichi administration will remain mindful of fiscal discipline. And more importantly, we expect to see a real sense of urgency behind growth strategies and potential consumption tax cuts. These factors are major positives for Japanese equities.

To wrap up, our position remains unchanged. We are fundamentally bullish on Japan, looking toward the end of the year. We believe that Nikkei 225 has the potential to climb as high as 65,000 yen.

Erica Poon Werkun (2:30)

Well, definitely a very exciting time for Japan at this point. Well, Sakagami-san, assuming the general-election results are positive, as you said, for Japanese stocks, what are the future risk factors?

Ryota Sakagami (2:43)

While our outlook is bullish, we must keep a close eye on the domestic fiscal risk. There is a possibility that the Takaichi administration might not prioritize the fiscal discipline. If the market begins to fear deteriorating of the fiscal position, we could see a massive sell-off in bonds. This would drive up long-term interest rates significantly, putting heavy pressure on the equity market or through the shrink of the valuation of equities.

Erica Poon Werkun (3:16)

Got it. And what do you think are the economic policies to watch for under the current Takaichi administration?

Ryota Sakagami (3:23)

The first one is the details of the growth strategy. The government is expected to finalize its comprehensive growth strategy around this summer. As we approach that deadline, we anticipate the steady increase in news flows and media coverage regarding specific policy measures. This will be a critical period for market sentiment as investors digest the actual substance of Sanaenomics.

Secondly, we must pay close attention to the scale and specifics of the capex incentives. The Takaichi administration has made digitalizing of the domestic investment a cornerstone of the policy agenda. If they implement a truly robust and effective framework, it has the potential to trigger significant surge in domestic capex. And this isn't just about the small upgrades; it's about sifting the mindset of Japanese corporations toward aggressive long-term growth.

Erica Poon Werkun (4:31)

Sakagami-san, you mentioned some growth strategies. So, when exactly will the Takaichi administration's growth strategy be announced? And what kind of content is it likely to contain?

Ryota Sakagami (4:42)

The administration is on track to finalize and unveil its growth strategy by this summer. And we already have a roadmap with 17 strategic sectors designated for growth. The key

pillars among them include the next-generation technology, specifically AI and semiconductors, and national security, strengthening our defense capabilities and energy and resource development.

But it's not just about spending, it's about structural reform. We expect to see bold moves in the labor market, such as deregulation working our restrictions and implementing the policies that facilitate the labor mobility. These reforms are designed to ensure that the human capital flows to the most productive sectors of the economy.

Erica Poon Werkun (5:41)

Sakagami-san, you highlighted a few sectors. So, from an equity-strategist point of view, what are the themes and sectors would you be focusing on for this year?

Ryota Sakagami (5:54)

Focusing on the growth strategy, the AI, semiconductors, the defense, energy, all these sub-sectors included in the growth strategy, and also the domestic infrastructure investment, and also de-incentivize the domestic capex or these two, the domestic investment or the related sectors like machinery and construction take benefit from that.

Erica Poon Werkun (6:23)

Definitely a lot to look out for under the Takaichi administration. So, thank you so much, Sakagami-san, for answering my questions. Let me now turn to Fujiki-san — a few questions for you as well.

So, first one. How did the JGB market react after the election? And what are the key factors to watch in the coming months?

Tomohisa Fujiki (6:44)

So interest rates rose sharply at the start of the week, but the 10-year JGB yield remained within the recent range and closed below 2.3%. The flattening of the yield curve also suggests that there are no concerns about excessive fiscal policies yet. The near-term focus will be on the consumption tax cut and its financial resources, as the government is trying not to rely on additional JGB issuance.

This is important because investors generally expected some extent of fiscal discipline, and some believe that the consumption tax cut will be shelved. But this may still take some time, as the interim report is likely to be published only before summer.

Erica Poon Werkun (7:29)

Got it. Prime Minister Takaichi advocates responsible and proactive public finances. If sizable spending is coming, then what would be the risks to the JGB market increase again?

Tomohisa Fujiki (7:42)

Great question. We expect it will be the April to June quarter, especially June. This is because the government will set the basic policies for economic and fiscal management and reform, so-called *Honebuto-no hōshin* in Japanese. We think this will include a big increase in defense spending. For example, raising defense spending to only 3% of GDP would require an increase of about 10 trillion yen from the current level. Even raising defense spending only gradually would be a fiscal drag.

This size of spending will become permanent, in our view. Additional funding could be found by reducing unnecessary spending and recovering various reserve funds, but this may not cover the whole cost in the future.

Erica Poon Werkun (8:36)

Thanks, Fujiki-san. With all the spendings, the Takaichi administration certainly has been seen as strongly reflationary, with some expecting policy rates to be kept low. So will the election results change the outlook for monetary policy?

Tomohisa Fujiki (8:52)

Thank you. The short answer is no, because the forex rate will ultimately be a key. It is clear that the weak yen has been a factor of high inflation in Japan, and it has also affected the approval ratings of past administrations. If the independence of monetary policy is undermined, there is a risk of accelerated yen selling. So the government is likely to avoid clear intervention.

Having said that, the selection of the new policy board members is worth monitoring. The current member Asahi Noguchi's term will end on March 31 and Junko Nakagawa on June 29. If PM Takaichi controls the appointment, we are likely to see candidates who more strongly favor reflationary policy. Further into the future, two hawkish members: Hajime Takata and Naoki Tamura's terms will end on July 23, 2027.

As such, maybe it will be only until the June 2027 meeting that the BOJ is able to proactively hike its policy rate. If this is correct, the policy rate could not rise further than 2%, even if the pace of rate hikes is accelerated.

Erica Poon Werkun (10:14)

Right. Well, looking back, interest rates rose sharply in January after the 20-year JGB auction. So, if selling of JGBs accelerates again, what will the BOJ and the Ministry of Finance do?

Tomohisa Fujiki (10:28)

Thank you. I think that the MOF would be fast to react. Discussions about reducing the issuance of super-long bonds, which is the 10-year-plus bonds, will likely intensify,

although this is a blunt tool for curbing market turmoil. As in last year, the MOF may just send out an ad hoc questionnaire to the dealers. Buybacks should have a larger impact, but the military finance may remain reluctant to do so.

The BOJ is continuing with QT, and a change in its trajectory looks unlikely. Monetary policy controls the entire curve only under YCC [yield curve control], and if there's a distortion in supply demand, it is the MOF that should respond. If the BOJ actively suppresses the rising interest rates triggered by public finances, there's a risk that the yen depreciation could even accelerate.

Erica Poon Werkun (11:25)

Thank you, Fujiki-san. One more question from me. With rising yen interest rates, some speculate that Japanese investors might undertake large -scale repatriation. Do you think this is a likely scenario?

Tomohisa Fujiki (11:40)

Indeed, this is a hot topic. But I think full-blown repatriation is unlikely in the near term. As for public pension funds, investment strategies may not change so soon, so a large-scale JGB purchase looks unlikely. Lifers already sold falling bonds in 2022 as the FX hedging costs became punitive, but since then the reduction pace is very slow. This has been the case even as the JGB yield flows sharply. In some cases, they have longer duration risk in asset size than liability, and with a bit of negative convexity risk they are facing, the demand for duration should remain sluggish.

Large banks have been benefiting from the rise in policy rates, and no rush to secure duration here as well. At some points, the BOJ may hint that they are approaching the end of the rate-hike cycle, and in such case, banks may finally start buying JGBs in size. If banks are constrained by interest-rate risk on their books — the IRBV regulation — there may be selling of foreign bonds. But most of the positions are funded by repo, so it will be not a cash repatriation, but rather a risk repatriation in our view.

Erica Poon Werkun (13:02)

Thank you, Fujiki-san. And with that, we will now wrap up today's podcast. This episode of Research at Citi was recorded on Tuesday, Feb. 10, 2026. I'm your host, Erica Poon Werkun. Thank you for listening.

Disclaimer (13:18)

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