# Mizuho Economic Outlook & Analysis

November 25, 2024

# *How should we evaluate the effects of economic measures?*

## *Estimated impact on GDP and CPI and reduction in household spending burden*


**< Summary >**

◆ The Ishiba Cabinet recently approved a comprehensive economic stimulus package. Fiscal expenditures and project size slightly exceed the previous year's plan. Benefits for low-income households, resumption and extension of energy subsidies, support for semiconductor and AI-related investment, and public works for land resilience account for the bulk of the latest package.

◆ The short-term economic impact by FY2025 is estimated to be around 5 trillion yen, an amount expected to boost GDP by +0.1% in FY2024 and +0.6% in FY2025. Energy subsidies will push down the core CPI by as much as -0.4% at the beginning of the year.

◆ The proposal by the Democratic Party for the People ("DPFP") for income tax and gasoline tax cuts will be deliberated through December, with a focus on the extent of tax cuts in terms of their impact on tax revenues and income redistribution. While the household spending burden will be lighter, there are concerns about the fiscal soundness.

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## 1. The Cabinet approved a comprehensive economic stimulus package, with fiscal expenditures and project size slightly exceeding the previous year's plan

On November 22, the Ishiba Cabinet approved the "Comprehensive Economic Measures to Foster the Safety and Security of Citizens and Sustained Growth" plan consisting of three pillars: (1) growth of Japan and regional economies, (2) overcoming high prices, and (3) ensuring the safety and security of the people. Fiscal expenditures total 21.9 trillion yen, and project size, including the private fund portion, 39.0 trillion yen, representing a slight increase over the "Comprehensive Economic Measures for Completely Break Free from Deflation" plan formulated in November last year (fiscal spending 21.8 trillion yen and project size 37.4 trillion yen) (**Chart 1**). The FY2024 supplementary budget, which will provide the necessary financial resources, is expected to generate 13.9 trillion yen in additional general account expenditures (last year's supplementary budget: 13.1 trillion yen in additional expenditures), and the ruling bloc aims to pass the FY2024 supplementary budget at the extraordinary Diet session to be convened on November 28.

Prime Minister Shigeru Ishiba had stated prior to the Lower House election that he intended to exceed the size of last year's economic stimulus package, and the ruling coalition's heavy electoral defeat has ramped up pressure to increase spending. Fiscal expenditures, project size, and additional general account expenditures each exceeded last year's outlays, albeit slightly, giving the strong impression of expanded spending, with Prime Minister Ishiba's stated intention in mind.

The main programs of the economic measures include benefits for households exempt from residential tax (30,000 yen per household, with an additional 20,000 yen per child for households with children); resumption of electricity and gas rate subsidies (January-March 2025); extension (to be gradually reduced) of gasoline subsidies; public support for semiconductor and AI-related industries (approximately 6 trillion yen for next-generation semiconductor R&D by FY2030, and more than 4 trillion yen in such financial support as capital contribution and debt guarantees by government

**Chart 1: Outline of economic stimulus measures**

(Unit: trillion yen)

| | Government spending | | Project size |
|---|---|---|---|
| | | National general account expenditure | |
| Growth of Japan and regional economies | 10.4 | 5.8 | 19.1 |
| Overcoming high prices | 4.6 | 3.4 | 12.7 |
| Ensuring the safety and security of the people | 6.9 | 4.8 | 7.2 |
| Total | **21.9** | **13.9** | **39.0** |

Source: Made by MHRT based on the Cabinet Office's materials.

agencies); and public works spending related to national land resilience and reconstruction support for the Noto Peninsula earthquake and heavy rainfall.

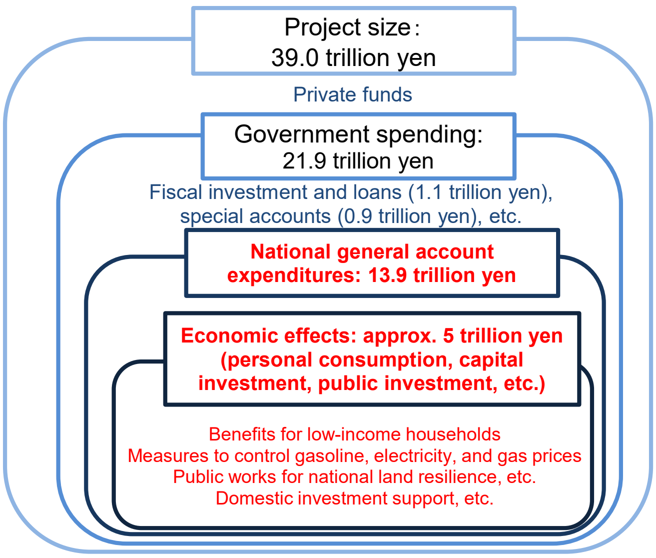
The DPFP's policy proposal for an income tax cut (to address the so-called "1.03 million yen barrier"), which has been the focus of much attention, was explicitly stated as "discussions will be held within the framework of FY2025 tax reform, and then we will raise this threshold," while for the gasoline tax cut, "a comprehensive review of automobile-related taxes will be carried out, and conclusions will be drawn." These issues are expected to be discussed as part of the tax reform process through December.

## 2. Impact on GDP: +0.1% in FY2024 and +0.6% in FY2025 as short-term economic effects

What are the economic effects of this economic stimulus package? Funding for projects is a massive 39.0 trillion yen, but as shown in **Chart 2**, "fresh water," or national general account expenditure, is limited to only a portion of this amount (13.9 trillion yen in the general account). Furthermore, even for fresh water, the whole amount appropriated in the budget does not directly induce new demand, and the GDP boost will only be partial if the propensities to consume and invest are taken into account. Currently, we estimate an economic impact of about 5 trillion yen (about 0.7% of GDP) in value terms in FY2024-25.

First, in terms of support for households, in addition to benefits for low-income households, a 1.3 trillion yen energy-related subsidy is budgeted, including the extension of measures to reduce the impact of surging gasoline and other fuel oil prices and the resumption of subsidies for electricity and gas rates. These measures are expected to underpin personal consumption in the January-March period of 2025, boosting GDP by about +0.1% in FY2024. (Same method of estimation as Sakai and Yasukawa (2023). The marginal propensity to consume is assumed to be 0.3 for low-income households and 0.25 for average households.)

**Chart 2: Project size and "fresh water" for economic stimulus measures**




Source: Made by MHRT based on the Cabinet Office's materials.

In addition, public capital investment related to national land resilience and disaster prevention/mitigation are expected to push up the nation's GDP by about +0.5% in FY2025. Given the time lag in the progress of public works projects, the full effects are expected to be realized around mid-2025. (It should be noted, however, that the economic effects may fall short of our report's estimates if public works are delayed by construction labor shortages.)

In addition, public support for semiconductor and AI-related industries will be spent over the medium to long term in the amount of 10 trillion yen by FY2030, and we believe the short-term economic effects (boosting private capital investment, etc.) will be less significant than the size of the budget. As for support for domestic investment in semiconductors and other products, some companies are strengthening their domestic production bases as they restructure their global supply chains. However, unless various structural issues are resolved, including low growth expectations for the domestic market and labor and power shortages, government subsidies alone will not likely be sufficient to spur a return to domestic production in Japan.

As mentioned above, at present the short-term economic effects of the current economic measures are expected to boost the economy by a total of about 5 trillion yen, or 0.7% of GDP, as shown in **Chart 3**. The Economic Outlook by Mizuho Research & Technologies (2024), released in October, already incorporates the continuation of the national land resilience project, etc. The upside to the growth rate in FY2024 (projected at +0.4% before the stimulus announcement) is expected to be around +0.1%pt, and the upside to the growth rate in FY2025 (projected to be +1.0%) is expected to be roughly +0.1 %pt.

However, the government data released on November 22 does not provide detailed information on the scale of expenditures for each measure, so we need to take a broad view of the scope of expenditures. The government estimates the impact of the economic stimulus measures to be around 21 trillion yen, but the estimate may differ from the assumptions made in this report regarding consumption and investment propensities, and may also include medium- to long-term spillover effects not incorporated in this report.

The estimates shown in **Chart 3** do not include the impact of the tax cut measures expected to be discussed toward the end of the year. The Liberal Democratic Party, Komeito, and the DPFP are expected to continue talks on the design of the income tax cut, gasoline tax cut, and other programs, and we need to keep a close eye on these developments. If tax reform is implemented from FY2025, it will probably affect the Japanese economy, price trends, and other factors. For example, if the basic income tax deduction is raised from 1.03 million yen to 1.78 million yen, as the DPFP demands, according to government estimates, the total annual national and local revenues would decrease by about 7.6 trillion yen. In other words, it would mean a tax cut of about 7.6

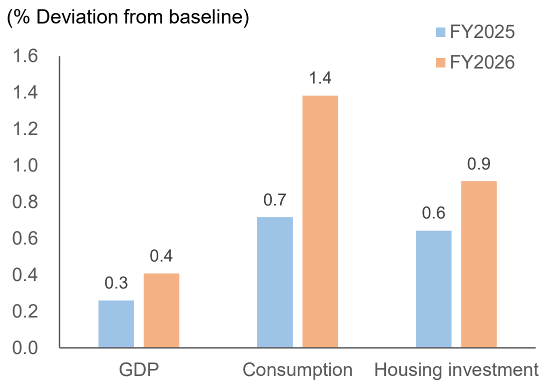
trillion yen for the Japanese households, and the impact on personal consumption, etc. would not be small. Using Cabinet Office's macroeconomic model we estimate that an income tax cut of about 7.6 trillion yen would boost the real GDP by about +0.3% (**Chart 4**). In addition, lifting the freeze on the trigger clause related to gasoline tax cut would see tax revenues decrease by more than 1.5 trillion yen at the national and local levels, which is expected to boost GDP by about +0.1%. (See below for the mechanism of the trigger clause system and the effect of unfreezing the trigger clause on consumer prices.)

**Chart 3: Short-term GDP boost due to economic stimulus measures**

| | Economic effects (% to GDP) | |
|---|---|---|
| | FY2024 | FY2025 |
| **Total** | **0.1** | **0.6** |
| Personal consumption | 0.1 | 0.0 |
| Capital investment | 0.0 | 0.1 |
| Public investment | 0.0 | 0.5 |
| Government consumption | 0.0 | 0.0 |

Note: At this point, the breakdown of the budget size for each individual measure is not available, so it is necessary to take a broader view. Effects of the tax reduction measures are not included.
Source: Made by MHRT based on the Cabinet Office's materials.

**Chart 4: Short-term GDP boost due to income tax cuts**



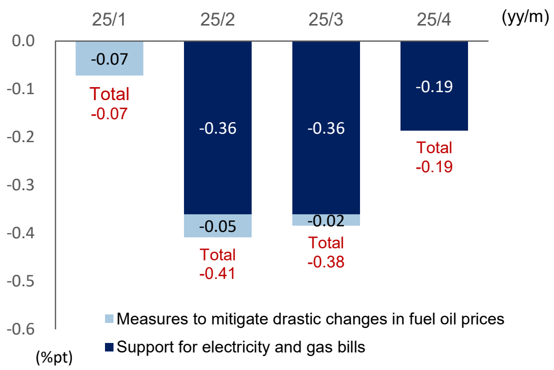

Note: Estimated using the Cabinet Office's macroeconomic model multipliers based on the assumption that tax cuts will be implemented in FY2025.
Source: Made by MHRT based on various media reports.

## 3. Impact on CPI: Resumption and extension of energy subsidies will push down the core CPI by up to -0.4 %pt

As mentioned above, the current economic stimulus package includes the resumption and extension of energy subsidies in response to high prices, as was the case last year. In this section, we estimate the impact of energy subsidies on the CPI.

As shown in **Chart 5**, we expect the resumption of electricity and gas price support to tamp down the core CPI by about -0.19-0.36%pt in February-April 2025, and the extension of measures to ease drastic changes in fuel oil prices to lower the core CPI by about -0.02-0.07%pt in January-March 2025. Our assumption is that electricity and gas price support will be subsidized at 2.5 yen/kWh for the February-March 2025 CPI-reflected period and at 1.3 yen/kWh for the April 2025 CPI-reflected period. Regarding measures to mitigate drastic changes in fuel oil prices, it is assumed that regular gasoline prices will be curbed at 185 yen/liter in January 2025, and that subsidies for prices exceeding 185 yen will be reduced to 2/3 in February and to 1/3 in March. The calculations are based on this assumption, using the outlook for crude oil prices in yen terms in Mizuho Research & Technologies (2024). The core CPI will be pushed down by a maximum of -0.4%pt in February-March 2025, when the effects of the two factors become apparent. As for the full FY2024, downward pressure will be about -0.1% (**Chart 6**).

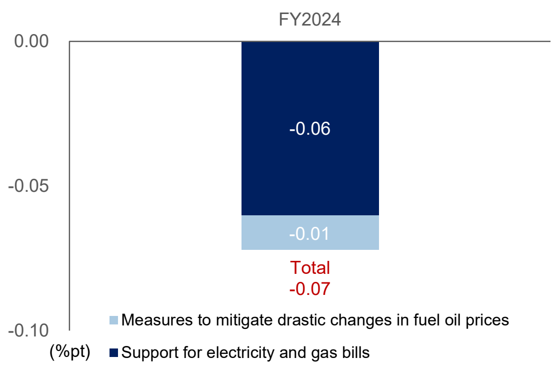
**Chart 5: Downward effect of energy subsidies on the core CPI**




Note: "Support for electricity and gas bills" estimates the effects of pushing down electricity and city gas bills, assuming that subsidies on electricity bills will be 2.5 yen/kWh from February to March 2025 and 1.3 yen/kWh in April 2025. "Measures to mitigate drastic changes in fuel oil prices" estimates the downward effect on gasoline and kerosene prices based on forecasted crude oil prices in yen terms, assuming that regular gasoline prices will be suppressed to 185 yen/liter in January 2025 and subsidies for regular gasoline exceeding 185 yen will be reduced to 2/3 in February and to 1/3 in March.

Source: Made by MHRT based on the Ministry of Internal Affairs and Communications, *Consumer Price Index*.

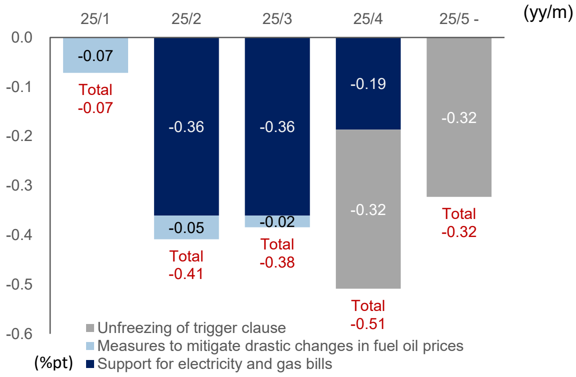
**Chart 6: Downward effect of energy subsidies on the core CPI (FY2024)**




Source: Made by MHRT based on the Ministry of Internal Affairs and Communications, *Consumer Price Index*.

In addition, unfreezing the trigger provision in the FY2025 tax reform would place downward pressure on the core CPI in FY2025. The trigger clause is a mechanism under which the gasoline tax is reduced by 25.1 yen if gasoline prices exceed 160 yen per liter for three consecutive months. Gasoline prices are currently hovering around 190 yen per liter in the absence of subsidies under the fuel oil price mitigation measures, and the likelihood of a sharp decline in gasoline prices in the short term is low due to the yen's depreciation and other factors. There are strong calls for lifting the trigger clause freeze as a countermeasure against high prices. Assuming that the trigger is unfrozen from April 2025 and that regular gasoline prices are curbed by 25.1 yen, the core CPI is expected to drop by about -0.3%pt as shown in **Charts 7 and 8**.

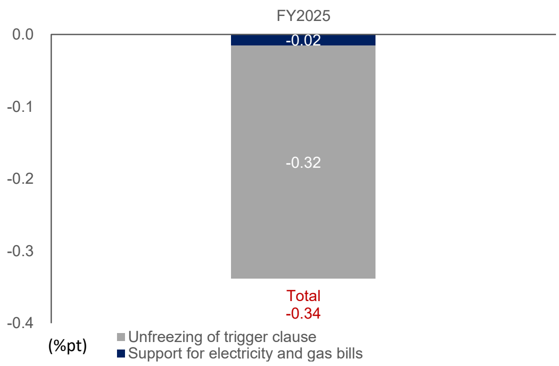
**Chart 7: Downward effect on the core CPI with energy subsidies and trigger clause unfrozen**




Note: "Support for electricity and gas bills" and "Measures to mitigate drastic changes in fuel oil prices" are estimated based on the same assumptions as in Chart 5. The effects of lifting the trigger clause freeze are estimated based on the assumption that the price of regular gasoline will be suppressed by 25.1 yen.

Source: Made by MHRT based on the Ministry of Internal Affairs and Communications, *Consumer Price Index*.

**Chart 8: Downward effect on the core CPI with energy subsidies and trigger clause unfrozen (FY2025)**




Source: Made by MHRT based on the Ministry of Internal Affairs and Communications, *Consumer Price Index*.

## 4. Impact on the household spending burden: Energy subsidies will reduce the household burden by 4,000 yen, and tax cuts will be the focus

### (1) Effects of the resumption and extension of energy subsidies on the household spending burden

We then estimate the effect of energy subsidies on households. As discussed in the previous section, subsidies for electricity and gas bills will resume under the current economic stimulus package, and subsidies for gasoline and other fuel oils will also be extended, which is expected to exert downward pressure on the CPI after the new year and reduce households' energy-related spending burden.

As shown in **Chart 9**, each household's expenditure burden in FY2024 is expected to drop by about 4,000 yen. Although soaring rice prices and the ongoing yen depreciation will continue to push up consumer prices, in light of the downward pressure on the CPI discussed in the previous section, the year-on-year change in real wages in the January-March 2025 period is expected to remain in the positive territory, albeit modestly (**Chart 10**). Combined with the expected high growth of winter bonuses,[1] real improvement in living standards in the second half of the year is expected to support consumer spending.

[1] In addition to a steady increase in scheduled cash earnings, which are the basis for calculating bonuses, we expect the number of months in which bonuses are paid will also increase due to strong corporate profits. MHRT forecasts a 3.5% year-on-year increase in winter per capita bonuses paid by private-sector companies. Refer to Imai (2024) for details of the forecast.

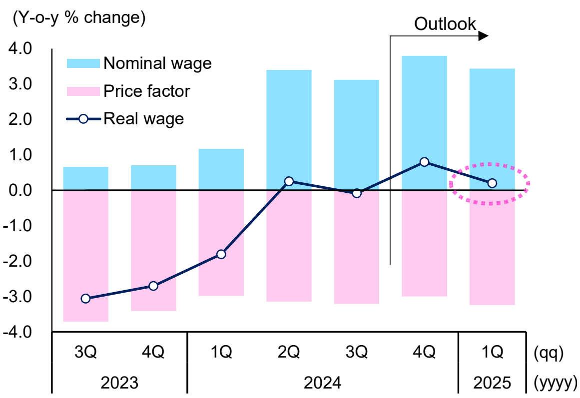
On the other hand, as Sakai and Yasukawa (2023) point out, we must keep in mind that this is not a cost-effective policy in terms of benefiting households as a whole, including those with high incomes. It is not practical to continue spending trillions of yen in subsidies to curb energy prices indefinitely; it would be more appropriate to provide separate allowances for low-income households and to reduce the subsidies as soon as possible. We believe it is reasonable for the current economic stimulus package to include a future policy for reducing the subsidies for gasoline.

**Chart 9: Reduction in household expenditure burden due to energy subsidies (FY2024)**

| Annual income | Reduction in household expenditure burden (yen) | | |
|---|---|---|---|
| | Gasoline, kerosene | Electricity, gas | Total |
| Less than JPY3m | 450 | 2,845 | 3,295 |
| JPY3-4m | 494 | 3,111 | 3,605 |
| JPY4-5m | 497 | 3,363 | 3,861 |
| JPY5-6m | 513 | 3,380 | 3,893 |
| JPY6-7m | 538 | 3,584 | 4,122 |
| JPY7-8m | 486 | 3,517 | 4,003 |
| JPY8-0m | 497 | 3,837 | 4,334 |
| JPY9-10m | 513 | 3,945 | 4,459 |
| More than JPY10m | 442 | 4,128 | 4,570 |
| Average | 489 | 3,438 | 3,927 |

Note: Estimated reduction in household expenditure burden from January to March 2025 due to the resumption and extension of energy subsidies.
Source: Made by MHRT based on the Ministry of Internal Affairs and Communications, *Family Income and Expenditure Survey*, among others.

**Chart 10: Real wage outlook**




Note: Realized using the CPI for all items excluding imputed rent.
Source: Made by MHRT based on the Ministry of Health, Labour and Welfare, and the Ministry of Internal Affairs and Communications.

## (2) Effects of DPFP's tax reduction measures on households

Next, we estimate the reduction in the household spending burden if the DPFP's demands to unfreeze the trigger clause and cut income taxes (to address the "1.03 million yen barrier") are met in the FY2025 tax reform.

As shown in **Chart 11**, unfreezing the trigger clause in FY2025 would reduce the household spending burden by about 14,000 yen as gasoline prices come down. Considering that the effects of resumed subsidies on electricity and gas bills will continue to materialize, the calculation shows the reduced spending burden to be around 15,000 yen. As with the gasoline subsidies, it should be noted that the reduced burden is smaller for lower-income households, and that households not owning a gasoline-powered vehicle do not directly benefit from the program, which is problematic in terms of efficiency and fairness as a policy. If the trigger clause were invoked, the subsidy would not be terminated unless gasoline prices fell below 130 yen per liter, but a fall below 130 yen is not predicted unless the dollar-yen exchange rate drops below 60 yen per dollar and crude oil prices dip below 40 dollars per barrel. This situation is not expected to materialize in the foreseeable future, and there are concerns that the tax cut will effectively become permanent. The fiscal impact will be significant, with national and local tax revenues expected to fall by more than 1.5 trillion yen. In order to support the livelihood of households in the face of high prices, it would be more desirable to provide separate benefits to low-income households and promote such policies as shifting consumer demand away from gasoline vehicles to EVs and other energy-saving products in light of the current trend toward decarbonization.

**Chart 12** shows an estimate of the income tax reduction by annual income if the basic exemption is raised by 750,000 yen to 1.78 million yen. Higher income households facing higher income tax rates will receive larger tax cuts (and lower income households will pocket smaller tax cuts), which is problematic from an income redistribution perspective, similar to unfreezing the energy subsidies and trigger clause mentioned above.

The marginal income tax rate increases as nominal income rises, even if real wages do not rise on the back of wage increases commensurate with price hikes (bracket creep), and this suppresses the growth of disposable income. Therefore, from the perspective of raising personal consumption, we believe it is rational to revisit the taxation system that is regulated by nominal amounts, such as the taxable minimum (1.03 million yen), in line with actual price increases. On the other hand, a permanent decrease in tax revenue of 7.6 trillion yen for the national and local governments would have a significant impact on fiscal management, and the appropriateness of raising the basic exemption to the 1.78 million yen level may be debatable. From the viewpoint of revising the system's threshold in keeping with actual price increases, as mentioned above, the increase in consumer prices (approximately 1.13 times the CPI as a whole and 1.24 times for basic expenditure items) could be considered instead of the minimum wage (approximately 1.73 times the 1995 level), so the rise in the threshold would be smaller (**Chart 13**). For example, if the basic tax credit is increased by the same amount as the increase in basic expenditure items (by 250,000 yen to 1.28 million yen), as shown in the estimate in **Chart 12 (2)**, the tax cut for households by income bracket would be smaller, and the total reduction in revenue would be within a few trillion yen. In addition, when considering targeting tax cuts for low-income households, for example, as shown in the estimate in **Chart 12 (3)**, the minimum taxable annual income of 1.03 million yen could be raised to 1.78 million yen by raising the minimum salary income deduction (550,000 yen) instead of the basic income deduction (480,000 yen) by 750,000 yen out of the "1.03 million yen barrier." Furthermore, recent media reports indicate that a separate proposal has been made to raise the basic income tax deduction (480,000 yen) but not the basic inhabitant tax deduction (430,000 yen), in consideration of the financial resources of local governments. In this case also, the scale of the tax reduction can be reduced as estimated in **Chart 12 (4)**. It is expected that a "compromise" will be sought in future discussions regarding the extent of the increase and size of the deduction, and we will continue to monitor developments closely.

**Chart 11: Reduction in household expenditure burden with energy subsidies and trigger clause unfrozen (FY2025)**

| Annual income | Reduction in household expenditure burden (yen) | | |
|---|---|---|---|
| | Gasoline, kerosene | Electricity, gas | Total |
| Less than JPY3m | 11,048 | 530 | 11,578 |
| JPY3-4m | 12,789 | 580 | 13,368 |
| JPY4-5m | 13,726 | 626 | 14,352 |
| JPY5-6m | 15,222 | 630 | 15,852 |
| JPY6-7m | 15,958 | 668 | 16,626 |
| JPY7-8m | 15,365 | 656 | 16,021 |
| JPY8-0m | 15,717 | 713 | 16,430 |
| JPY9-10m | 16,491 | 735 | 17,226 |
| More than JPY10m | 14,306 | 766 | 15,072 |
| Average | 14,045 | 640 | 14,685 |

Note: Estimated reduction in expenditure burden from April 2025 to March 2026 with the resumption of energy subsidies and the lifting of the trigger clause freeze.
Source: Made by MHRT based on the Ministry of Internal Affairs and Communications, *Family Income and Expenditure Survey*, among others.

**Chart 12: Tax reductions due to income tax cuts**

| Annual income (mil. yen) | Tax reduction amount (10,000 yen) | | | |
|---|---|---|---|---|
| | (1) Basic deduction raised by 750,000 yen | (2) Basic deduction raised by 250,000 yen | (3) Minimum salary income deduction raised by 750,000 yen | (4) Basic deduction raised by 750,000 yen only for income tax |
| 300 | 11.3 | 3.8 | 4.8 | 3.8 |
| 400 | 11.3 | 3.8 | 0.9 | 3.8 |
| 500 | 13.4 | 5.1 | 0.0 | 5.9 |
| 600 | 15.2 | 5.1 | 0.0 | 7.7 |
| 700 | 19.0 | 7.6 | 0.0 | 11.5 |
| 800 | 22.8 | 7.6 | 0.0 | 15.3 |
| 900 | 22.8 | 7.6 | 0.0 | 15.3 |
| 1,000 | 22.8 | 7.6 | 0.0 | 15.3 |

Note: We estimated the tax reduction amount (total of income tax, special income tax for reconstruction, and inhabitant tax) considering the basic deduction, deduction for employment income, and deduction for social insurance premiums in the following cases: Case (1) assumes the basic deduction is increased by 750,000 yen in line with the minimum wage increase. Case (2) assumes a 250,000 yen increase in the basic deduction to match the increase in the CPI's basic expenditure items. Case (3) assumes the minimum amount of payroll deduction is increased by 750,000 yen to match the minimum wage increase. Case (4) assumes that only the basic income tax deduction is increased by 750,000 yen in line with the minimum wage increase (the basic inhabitant tax deduction is not increased).
Source: Made by MHRT based on the Ministry of Finance, among others.

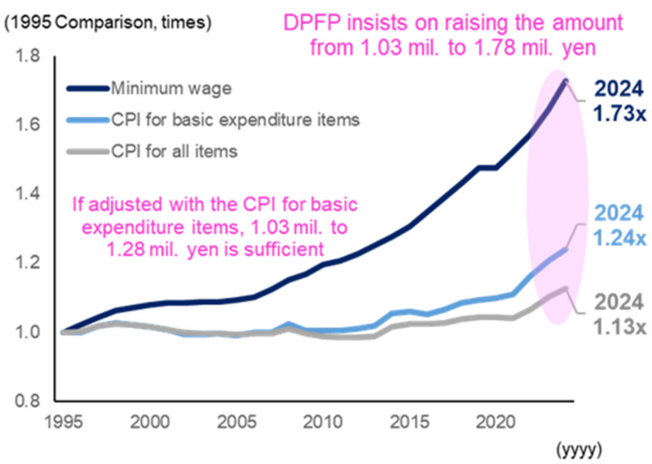
## 5. Growing concerns about fiscal management with continued large-scale fiscal stimulus

As mentioned above, the scale of this year's comprehensive economic stimulus measures exceeded last year's package. Even if it is necessary to deal with high prices, the extension of energy subsidies and the unfreezing of the trigger clause will benefit even high-income households and have a strong "handout" flavor. It is desirable to provide more targeted and focused assistance to low-income people whose livelihoods are particularly strained by rising prices of food and other daily necessities. Next year, depending on the policy management of US President-elect Donald Trump, the yen is at risk of rapidly depreciating, and there are concerns that energy subsidies may be extended repeatedly if energy and other import prices rise. It is necessary to shift the focus to households that truly need support by developing the infrastructure to enhance income redistribution through public finance by promoting the digitalization of government administration.

In addition, with regard to income tax reductions (measures against the "1.03 million yen barrier") advocated by the DPFP, the effect generally attracting attention due to the "barrier" name is the response to employment adjustments (i.e., people refraining from working), but there is no basis to the claim that take-home pay decreases when income exceeds 1.03 million yen per year. Given that the so-called "barriers" of 1.06 million and 1.3 million yen in social insurance premiums will continue to exist, the elimination of the 1.03 million yen barrier is not expected to have a significant impact on promoting employment. We believe it is important to design a system that is neutral to the way people work from the perspective of addressing labor shortages, but to promote employment it is necessary to consider this in conjunction with social insurance system reform. The DPFP's proposal to address the "1.03 million yen barrier" (raising the basic exemption, etc. to 1.78 million yen) should be viewed as a purely large-scale tax cut measure, and in that light, it makes little sense to implement such a large-scale tax cut at a time when supply constraints due to labor shortfalls are a critical issue for the Japanese economy, as Sakai (2024a) has pointed out. In addition to the significant impact that a permanent tax cut would have on fiscal management in terms of the size of revenue reduction, it is also problematic from the perspective of income redistribution because, as mentioned above, the higher the tax rate, the larger the tax cuts would be for high-income households.

If large-scale fiscal stimulus measures, including tax cuts, and monetary easing continue under supply constraints that limit growth, the yen could weaken and the terms of trade worsen, depending on the external environment (e.g., President-elect Trump's policy management increases inflationary pressure in the US and interest rates rise as a result), and the risk of "high inflation under low growth," or

**Chart 13: Minimum wage and CPI**



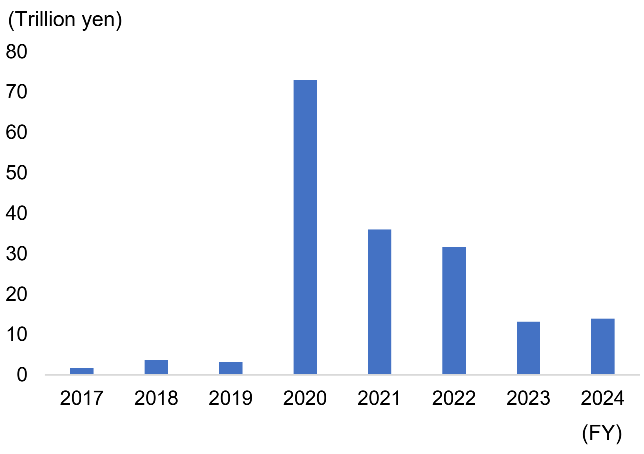

Note: The CPI for all items and CPI for basic expenditure items for 2024 are averages for January-October 2024.
Source Made by MHRT based on the Ministry of Health, Labour and Welfare, and the Ministry of Internal Affairs and Communications.

stagflation, may intensify. The yen's depreciation would greatly improve the profit margins of large manufacturers, as their high export ratios and dividends from overseas subsidiaries would expand. But it would also exert downward pressure on corporate earnings, especially for small and midsized manufacturers that cannot fully pass on higher prices to customers as well as the service industry dependent on domestic demand. There are also concerns that higher prices for frequently purchased goods, such as food and energy, will cause personal consumption to stagnate as households become thriftier.

A more concerning factor, however, is the impact on public finances. While tax revenues have increased due to rising wages, prices, and nominal GDP, the government continues to compile huge supplementary budgets compared with previous years, and even with the pandemic's end, public finances have not returned to "ordinary times" and fiscal consolidation remains a long way off (**Chart 14**). If the bulk of the FY2024 supplementary budget, mainly for public works projects related to national land resilience, is implemented in FY2025, and income tax cuts and other tax reduction measures are implemented in FY2025 as well, achieving the goal of returning the national and regional primary balances to a surplus in FY2025 will prove difficult.

The high likelihood that the scale of fiscal stimulus will continue to balloon amid the instability of the ruling parties' power base is a major cause for concern. In addition to the expectation that medium-term spending will increase in areas such as defense and addressing the falling birthrate, if wages and prices were to rise continuously, the possibility would arise for systemic revisions related to nominal value thresholds in various areas other than the taxable minimum. Also, upward pressure would be exerted on expenditures (nominal value) for public works, education, science promotion, and other areas as a result of higher personnel costs and other expenses. While Prime Minister Ishiba's policy of increasing subsidies for regional development has been announced, the specific details of these measures are unclear, and it will be necessary to examine the cost-effectiveness of these measures, including those related to the Vision for a Digital Garden City Nation, to ensure they are not simply handouts to the regions. Furthermore, we must not forget

**Chart 14: Additional expenditures in the general account supplemental budget**




Source: Made by MHRT based on the Ministry of Finance.

that social security costs are expected to climb due to the aging of Japan's population. By 2025, all "baby boomers" will be aged 75 or older, known as the "older elderly," and the increase in social security benefits is expected to accelerate as per capita medical and long-term care costs soar for the older elderly. While pressure to increase spending is expected to be intensive in various areas, we hold that a delay in action toward fiscal consolidation, without deeper discussions on the benefits and burdens amid unstable management of the administration, could prove a major risk to the Japanese economy.

If the nominal economic growth rate remains much higher than long-term interest rates, as it is now, and tax revenues continue to increase as the government's primary balance (PB) improves, it seems unlikely that the risk of fiscal deterioration will materialize immediately. However, as Sakai (2024b) points out, in the coming "world with interest rates," simply achieving a PB surplus is not enough; if a certain level of PB surplus cannot be maintained over the medium term, the government debt-to-GDP ratio is likely to continue its upward trend. If the outstanding debt continues to grow faster than the economy, it is quite possible that the market will grow worried about the government's fiscal discipline. If the market perceives fiscal management as a "Japanese version of Truss,"[2] the nation's currency will lose credibility, leading to its sharp depreciation and rising inflation, which would have a major impact on people's daily lives. Lost confidence in JGBs would cause interest rates to rise sharply, with the risk increasing of foreign rating agencies downgrading JGBs. If this occurs, we need to understand that the government will eventually be forced to make the tough decision of improving the fiscal balance by drastically cutting spending and raising taxes in order to stabilize the market.

[2] The UK's Liz Truss administration came into office promoting an expansionary fiscal policy, but was criticized for announcing a "growth strategy" without supporting financial resources or an economic and fiscal outlook conducted by an independent fiscal institution. Immediately after the policy's announcement on September 23, 2022, the market fell into disorder, with interest rates soaring and the GBP plummeting.

## Reference

**Refer to the original Japanese report by clicking the URL below for the reference material.**
**https://www.mizuho-rt.co.jp/publication/2024/pdf/insight-jp241125.pdf**