



Fiscal policy in Japan

Round-table discussion on fiscal policy in Asian and the Pacific

The Eighth Tokyo Fiscal Forum

June 6, 2023

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Disclaimer: The views in the presentation slides are those of the presenter and do not reflect the view of the organizations to which he belongs.

■ Inflation in Japan: unprecedented situation in decades

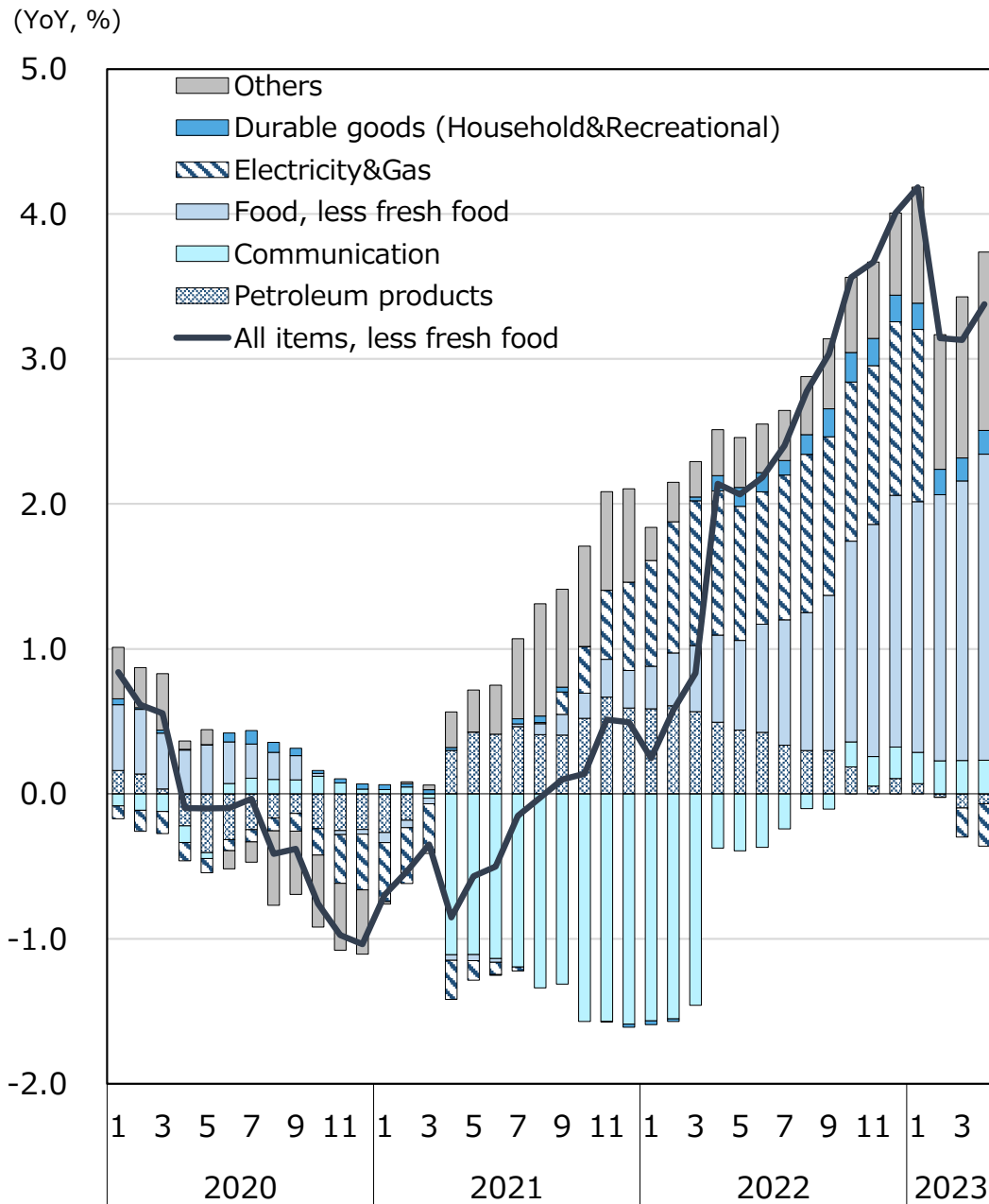
- ✓ Recent updates of inflation
- ✓ Mitigating measures by fiscal instruments
- ✓ Price and wage dynamics: past and future

■ Fiscal management in Japan: medium- and long-term challenges ahead

- ✓ Recent updates of budgetary framework for expenditure items
- ✓ Uncertainties: medium- and long-term projection and output gap estimation

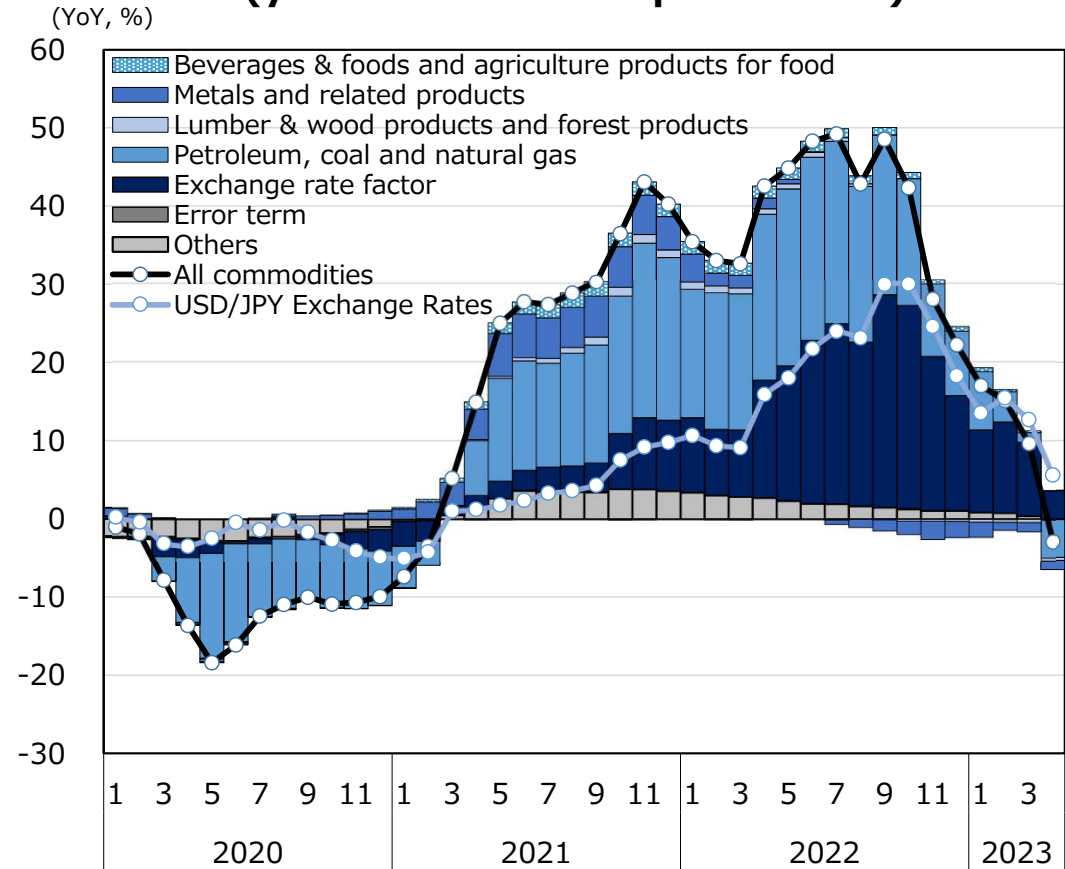
Inflation: CPI and import price index in Japan

CPI: composition

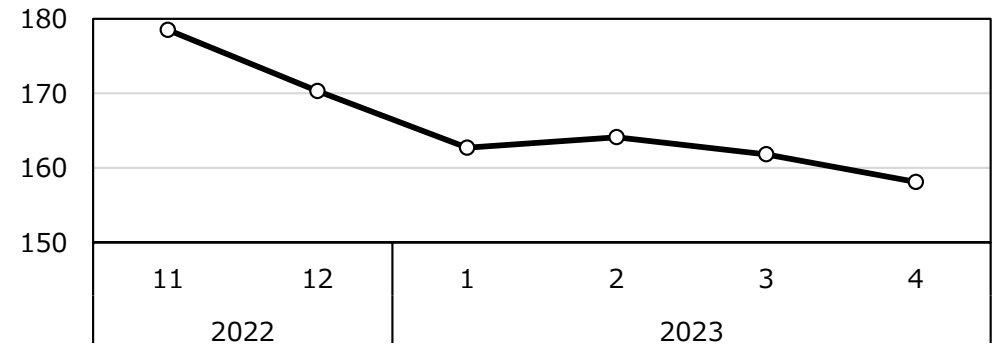


(Source) Ministry of Internal Affairs and Communications

Import price index (yen-denominated price index)

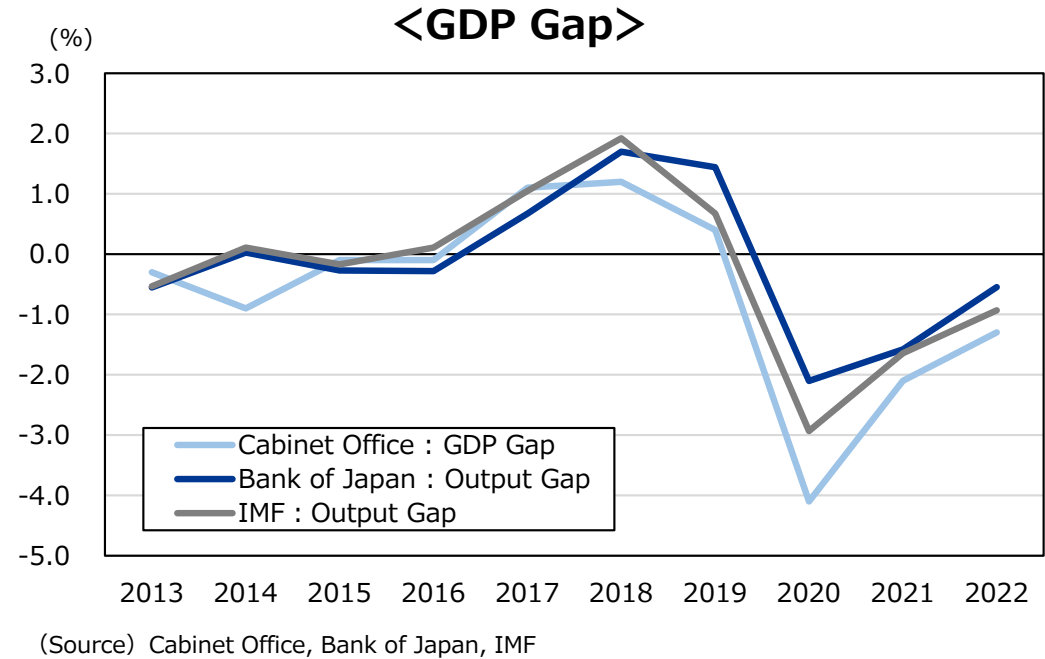
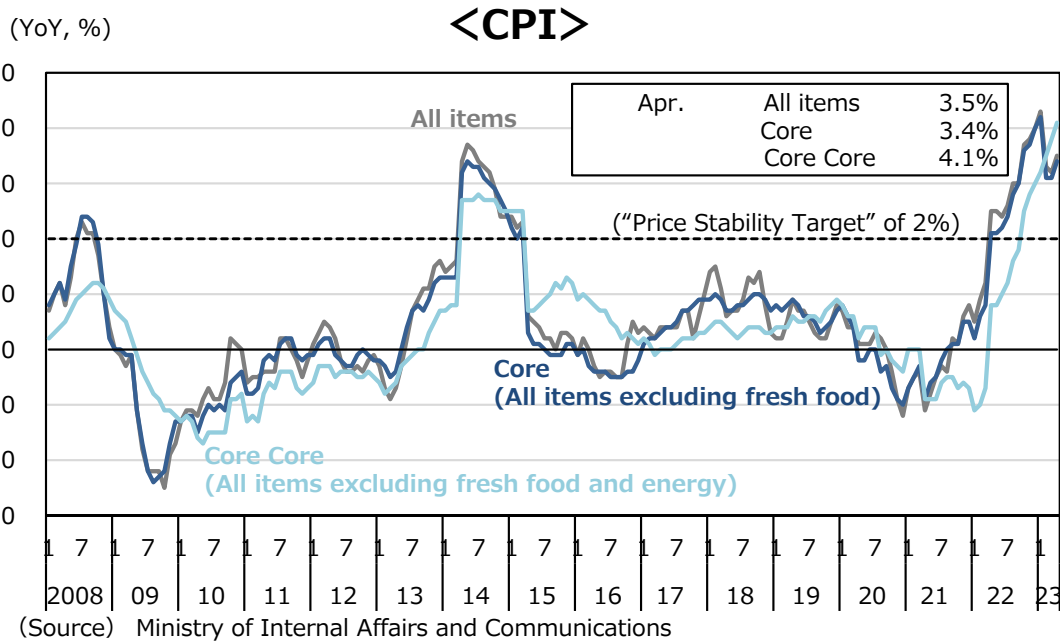


(2020 = 100)

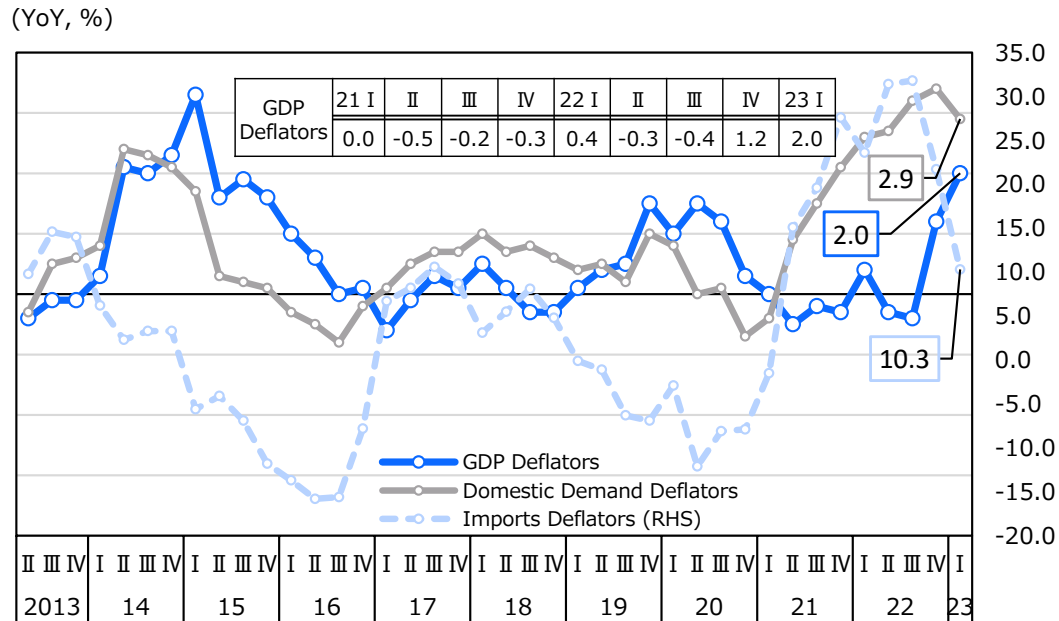


(Source) Bank of Japan, Bloomberg

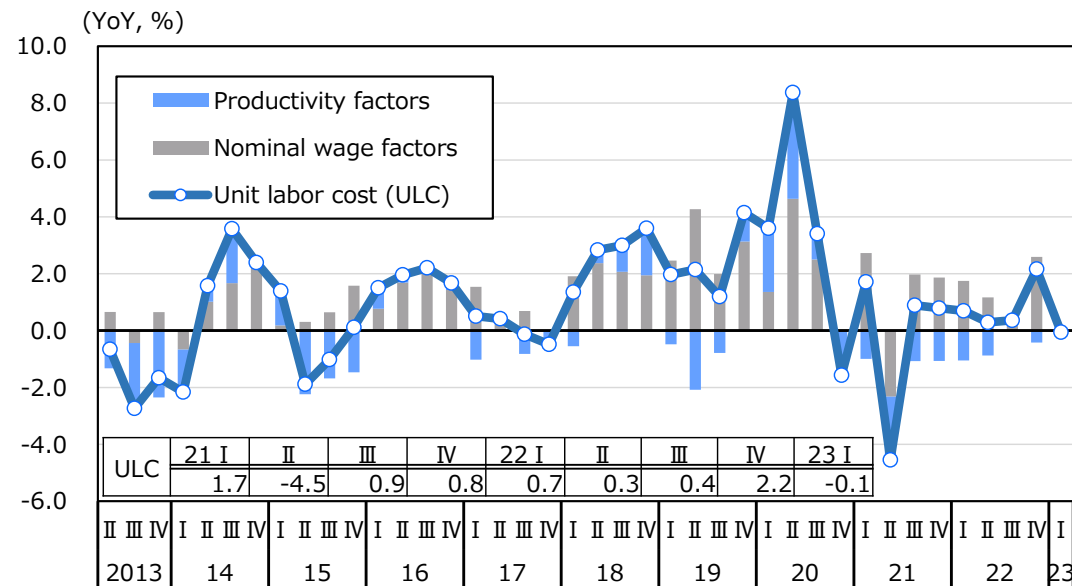
Inflation: price indices in Japan



<GDP Deflators>

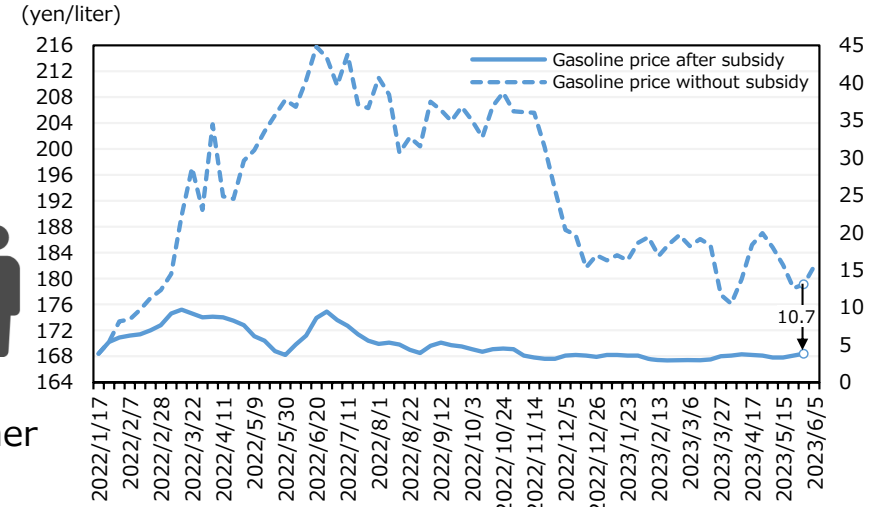
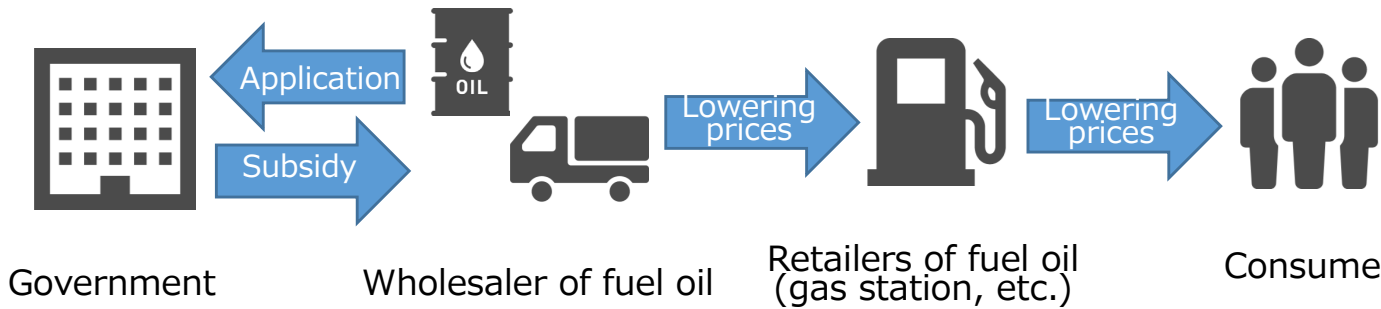


<Unit Labor Cost>



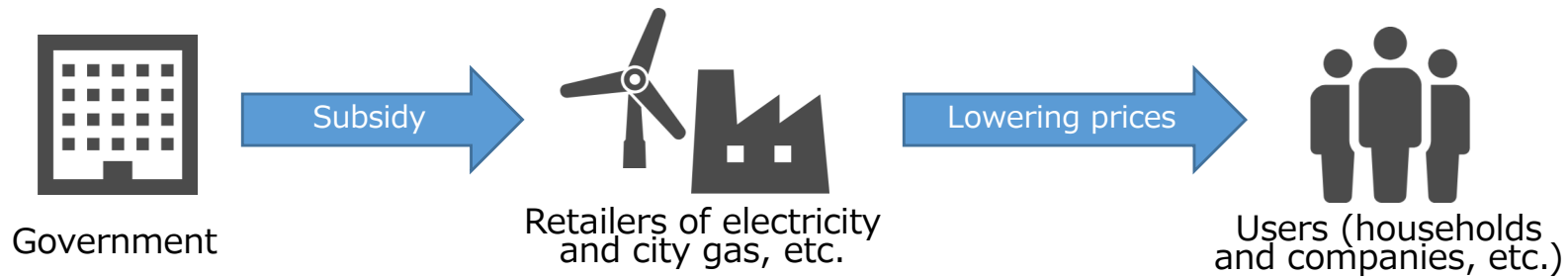
Inflation: mitigating measures for surging energy price

Mitigating measures for fuel oil price changes



(Source) Agency for Natural Resources and Energy, Ministry of Internal Affairs and Communications

Mitigating measures for electricity and gas price changes



Electricity bill

Households and companies with low voltage agreement, etc.
7yen/1kWh

Companies with high voltage agreement, etc.
3.5yen/1kWh

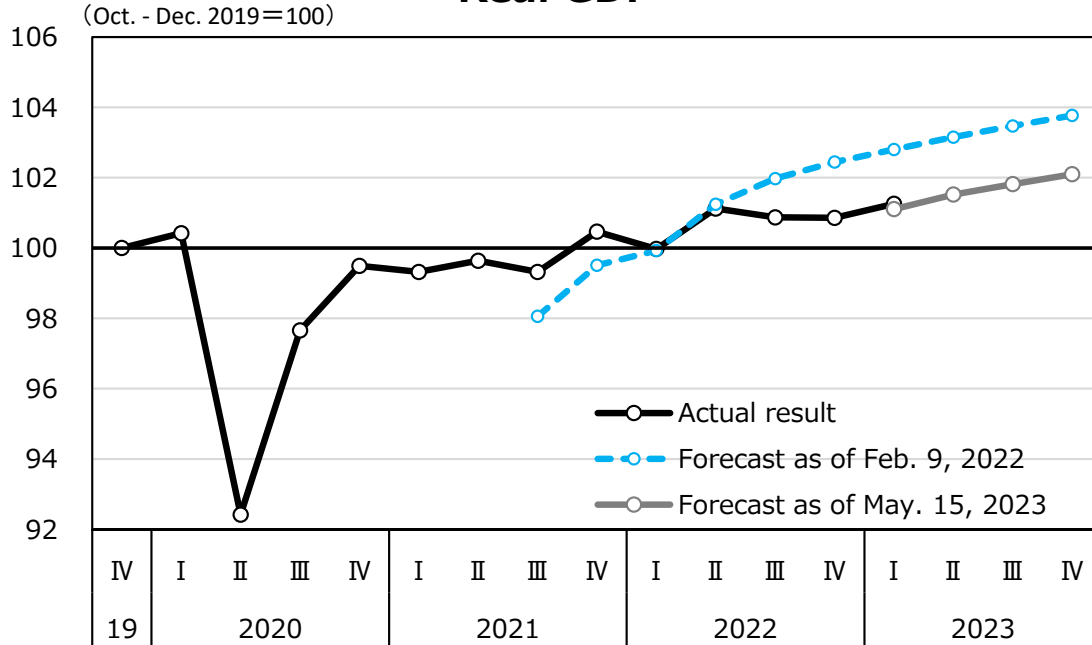
City gas bill

Households and companies with less than 10 million m³ use, etc.
30yen/1m³

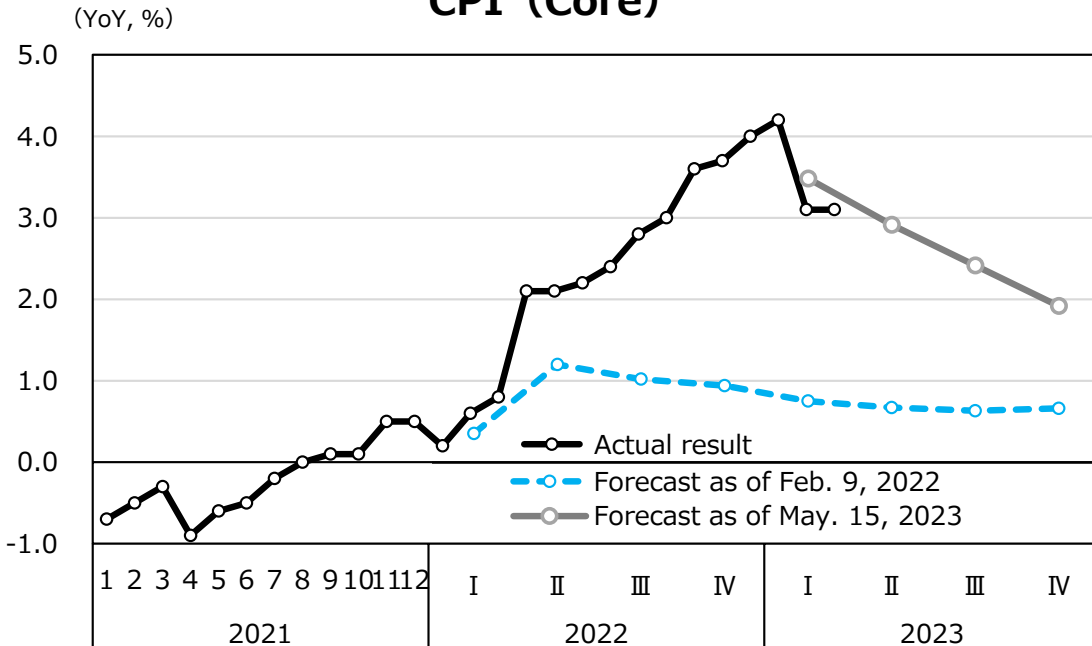
Effects of mitigating measures for electricity and gas are estimated to be lowering CPI by **1.0%pt.** (April 2023, All items)

Inflation: quarterly outlook for GDP and CPI in Japan

Real GDP



CPI (Core)



Real GDP Growth rate (YoY) Forecasts

	(A) Before Russia's aggression against Ukraine As of Feb. 9, 2022	(B) The latest outlook As of May. 15, 2023	(B) - (A)
FY2021	2.44%	2.6% (Actual result)	+ 0.16%pt
FY2022	3.03%	1.2% (Actual result)	▲ 1.83%pt
FY2023	1.45%	1.00%	▲ 0.45%pt

Nominal GDP Growth rate (YoY) Forecasts

	(A) Before Russia's aggression against Ukraine As of Feb. 9, 2022	(B) The latest outlook As of May. 15, 2023	(B) - (A)
FY2021	1.61%	2.4% (Actual result)	+ 0.79%pt
FY2022	3.50%	1.9% (Actual result)	▲ 1.60%pt
FY2023	2.00%	3.09%	+ 1.09%pt

CPI (Core, YoY) Forecasts

	(A) Before Russia's aggression against Ukraine As of Feb. 9, 2022	(B) The latest outlook As of May. 15, 2023	(B) - (A)
FY2021	0.01%	0.1% (Actual result)	+ 0.09%pt
FY2022	0.99%	3.0% (Actual result)	+ 2.01%pt
FY2023	0.68%	2.31%	+ 1.63%pt

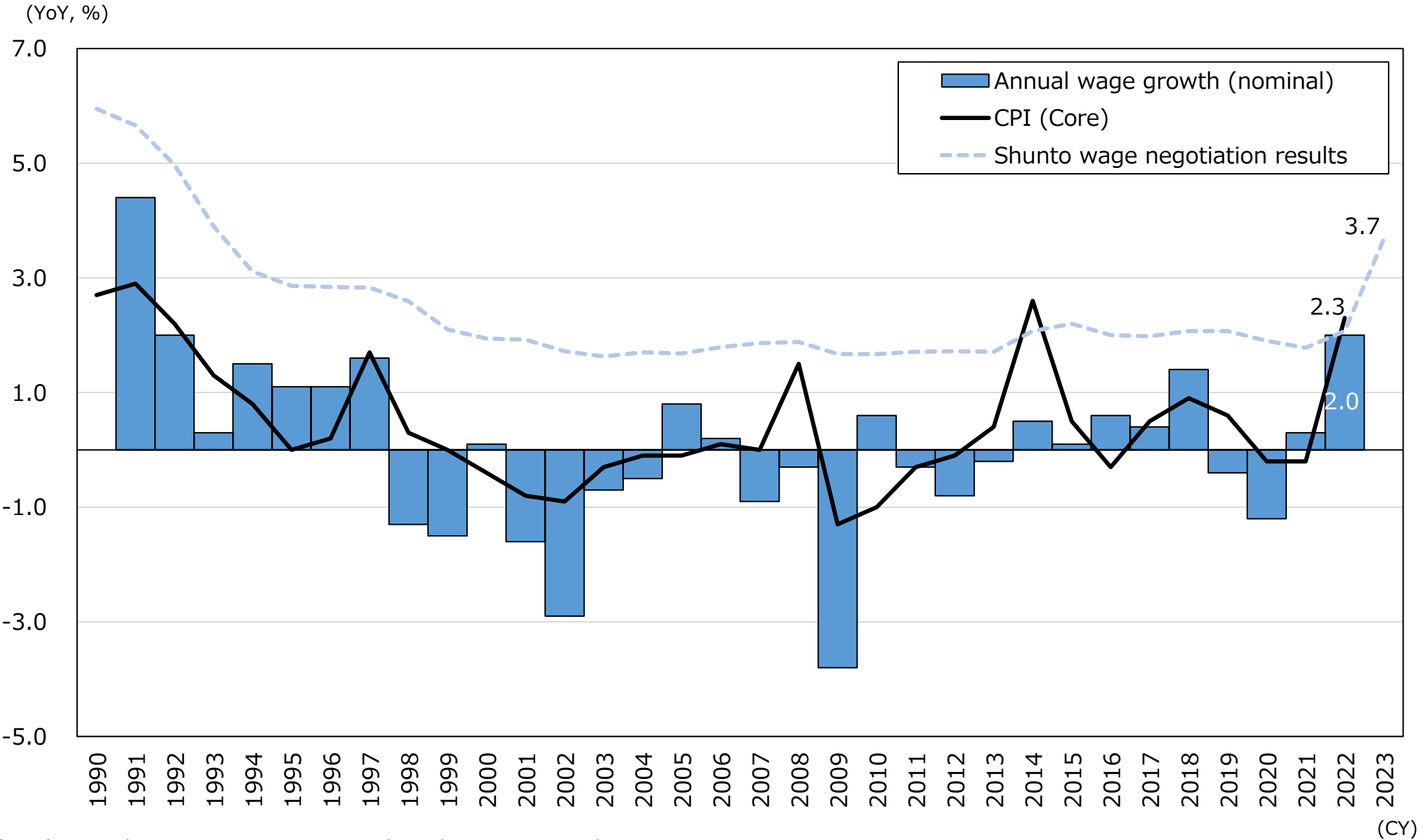
April 28, 2023

Statement on Monetary Policy (excerpt)

2. With extremely high uncertainties surrounding economies and financial markets at home and abroad, **the Bank will patiently continue with monetary easing** while nimbly responding to developments in economic activity and prices as well as financial conditions. **By doing so, it will aim to achieve the price stability target of 2 percent in a sustainable and stable manner, accompanied by wage increases.**

The Bank will continue with Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control, aiming to achieve the price stability target, as long as it is necessary for maintaining that target in a stable manner. It will continue expanding the monetary base until the year-on-year rate of increase in the observed consumer price index (CPI, all items less fresh food) exceeds 2 percent and stays above the target in a stable manner. The Bank will continue to maintain stability of financing, mainly of firms, and financial markets, and will not hesitate to take additional easing measures if necessary.

Inflation: wage growth and CPI in Japan

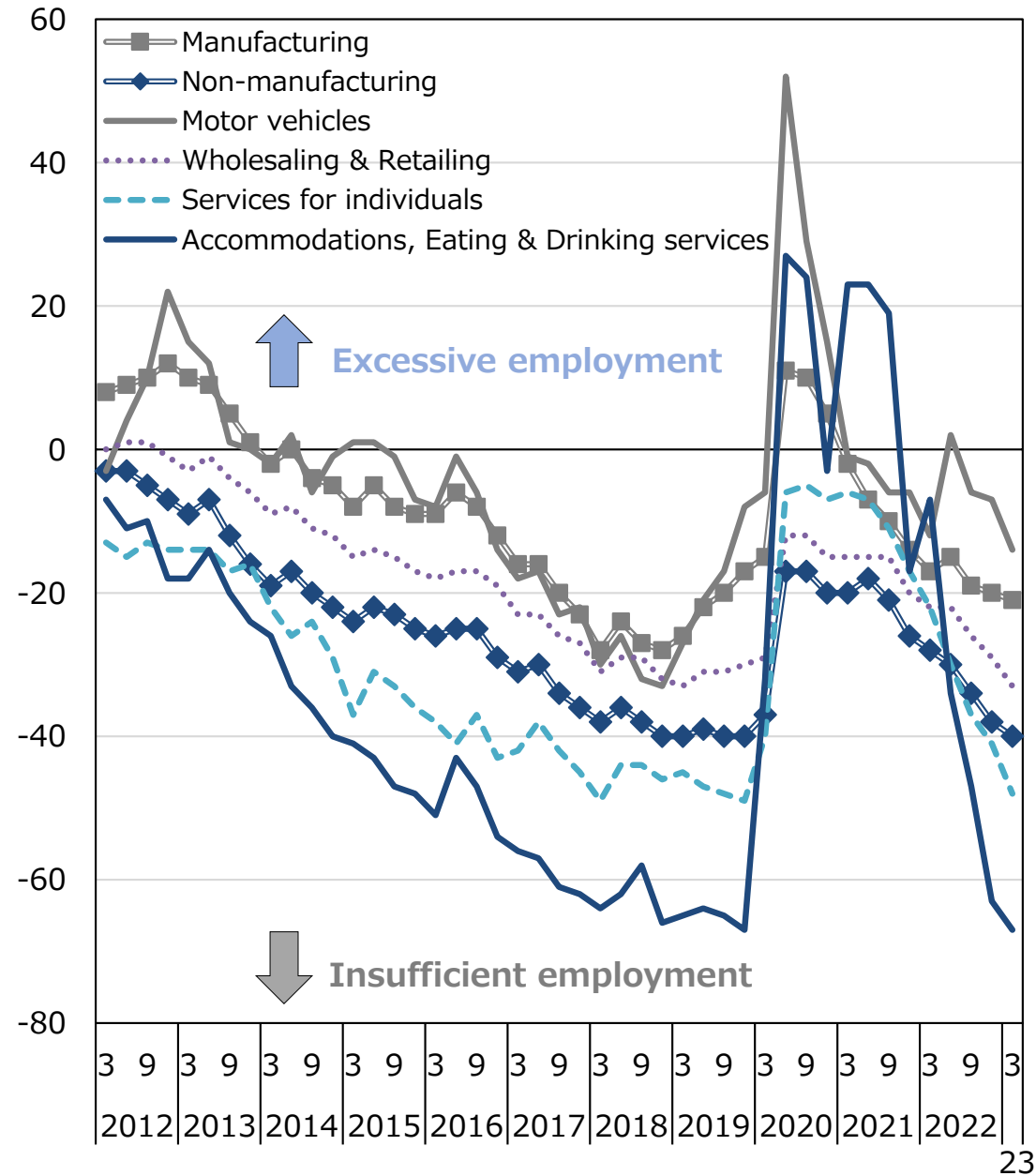


(Note) 2023 Shunto wage negotiation results: 5th aggregate results

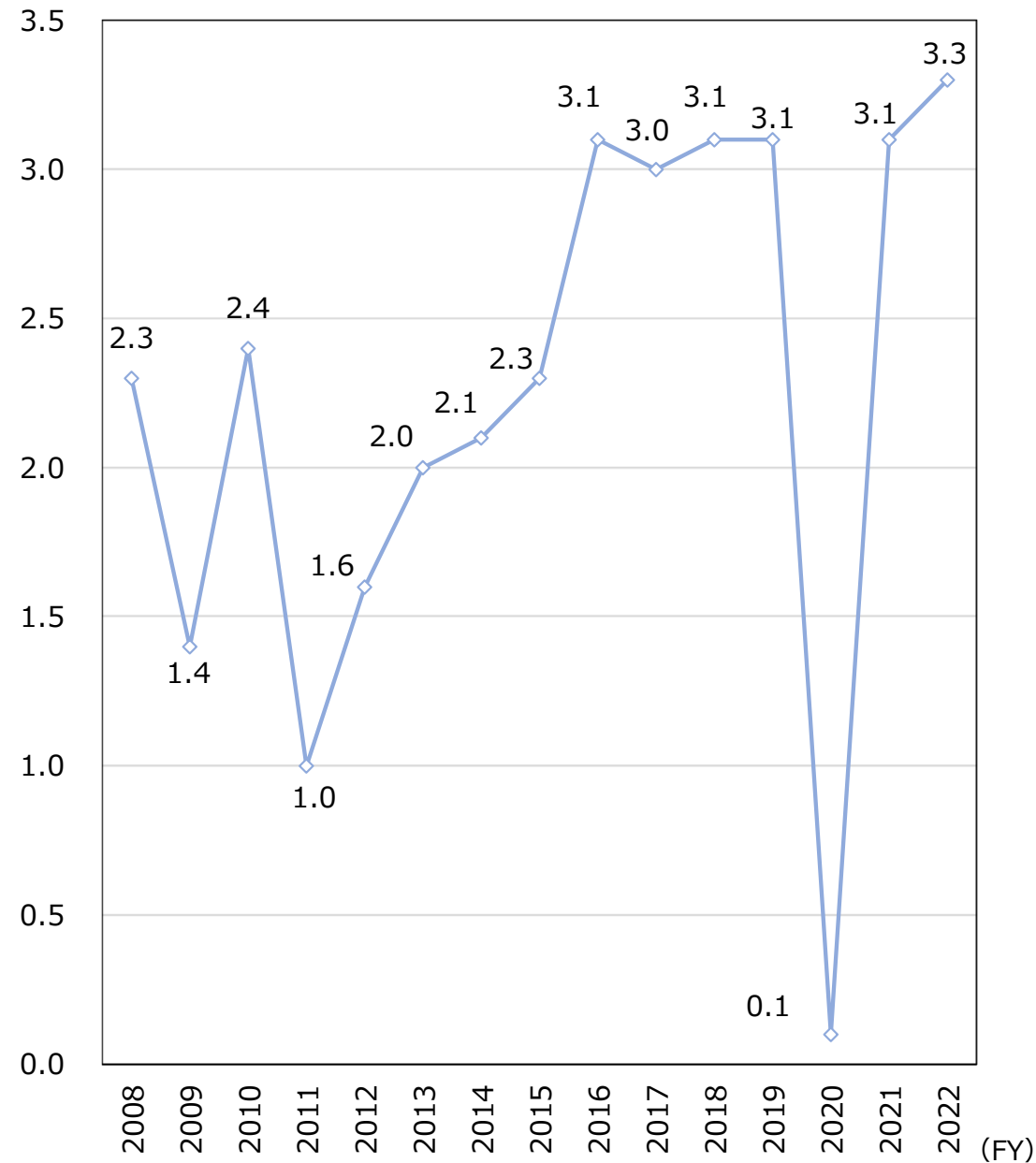
(Source) Ministry of Health, Labour and Welfare, Ministry of Internal Affairs and Communications, Rengo (Japanese Trade Union Confederation)

Inflation: employment conditions and minimum wage growth

(% points) **Employment Conditions**



(YoY, %) **Growth of Minimum Wage**

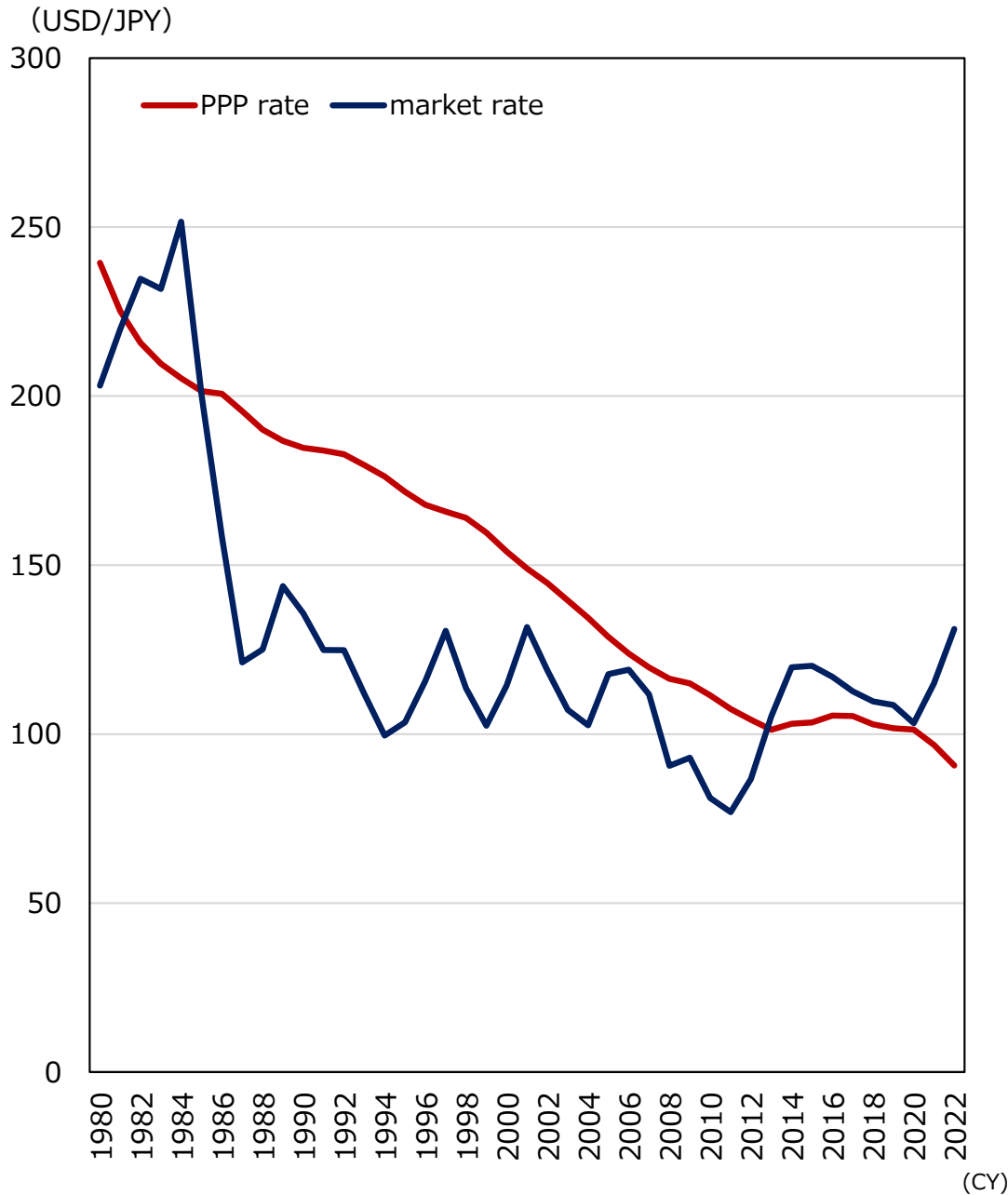


(Note) Employment Conditions: diffusion index of "Excessive employment" minus "Insufficient employment"

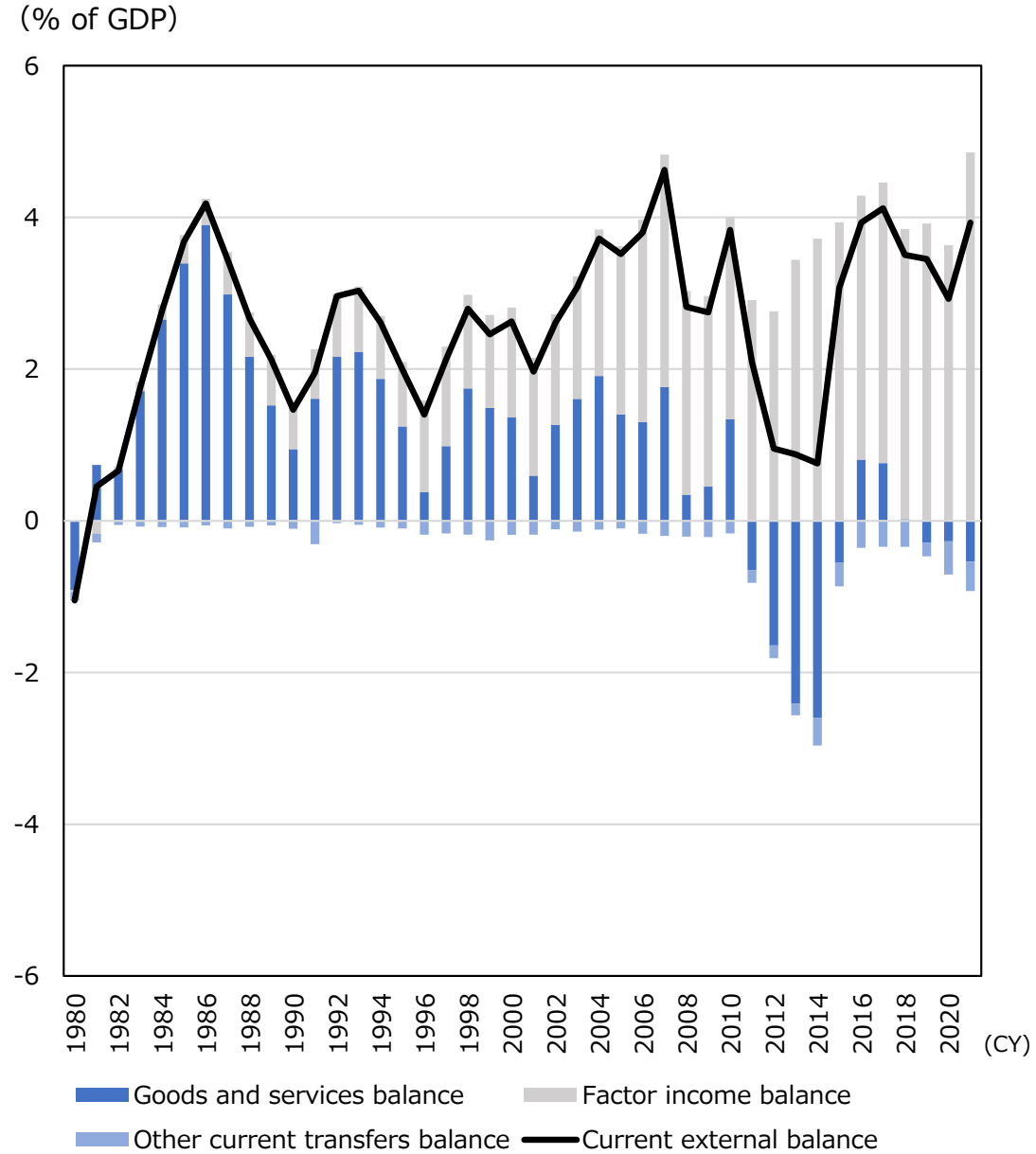
(Source) Bank of Japan, Ministry of Health, Labour and Welfare

Inflation: exchange rate and external balance

Exchange rate (market rate and PPP rate)



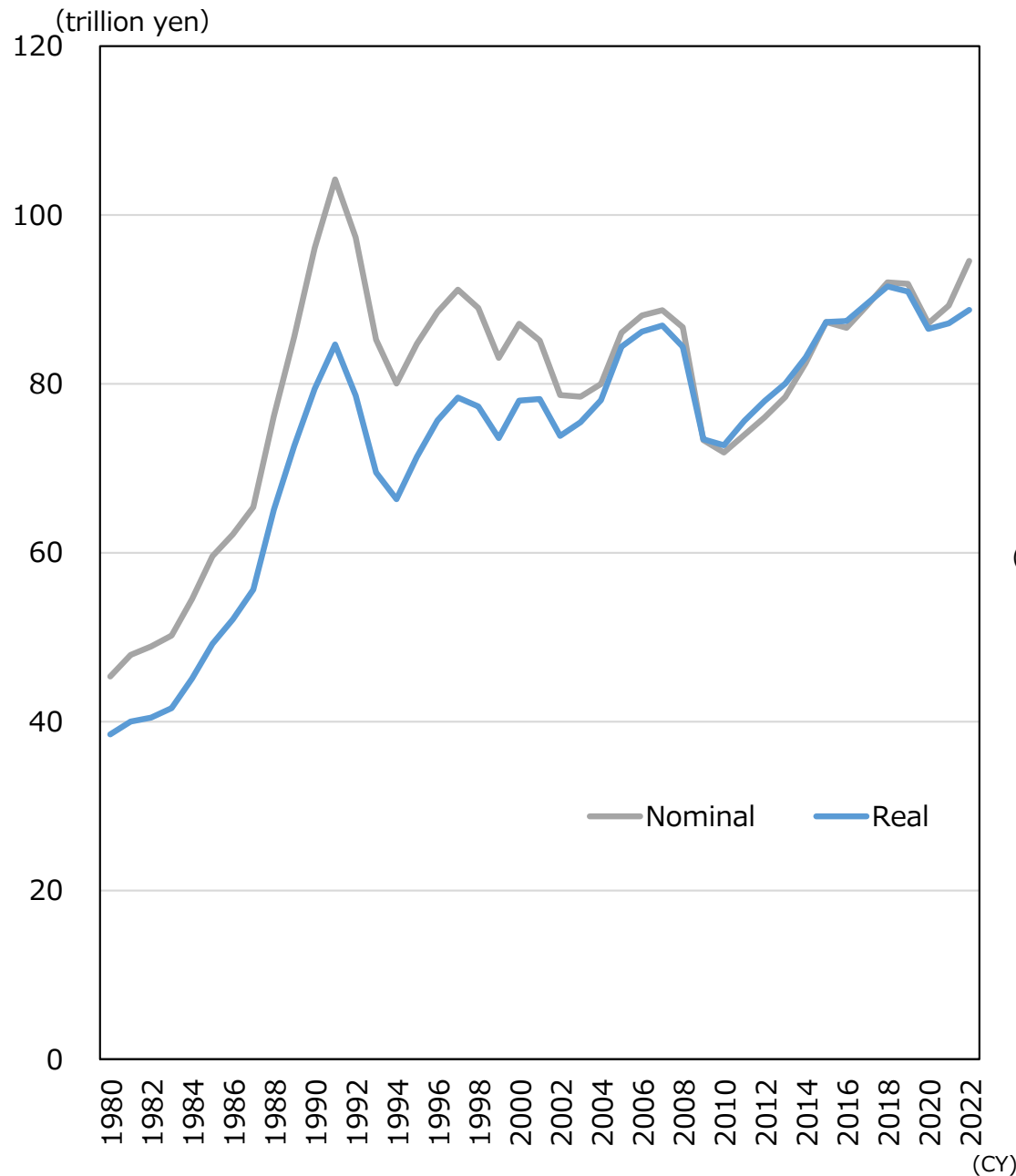
External balance (SNA)



(Source) IMF, Bloomberg, Cabinet Office

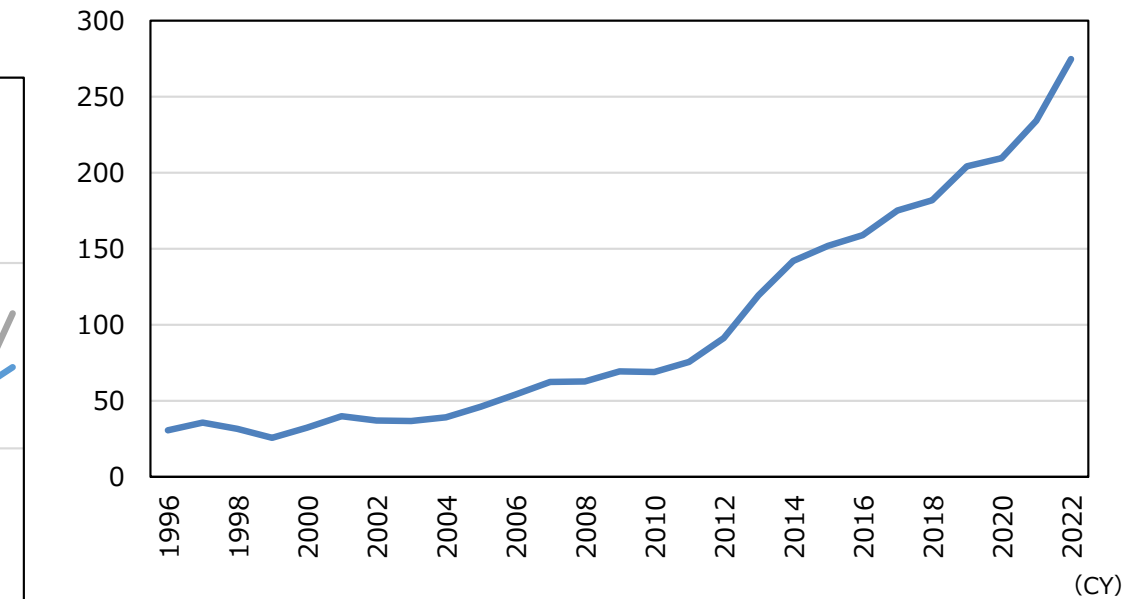
Inflation: firm's domestic capital spending and FDI

Capital spending by corporations

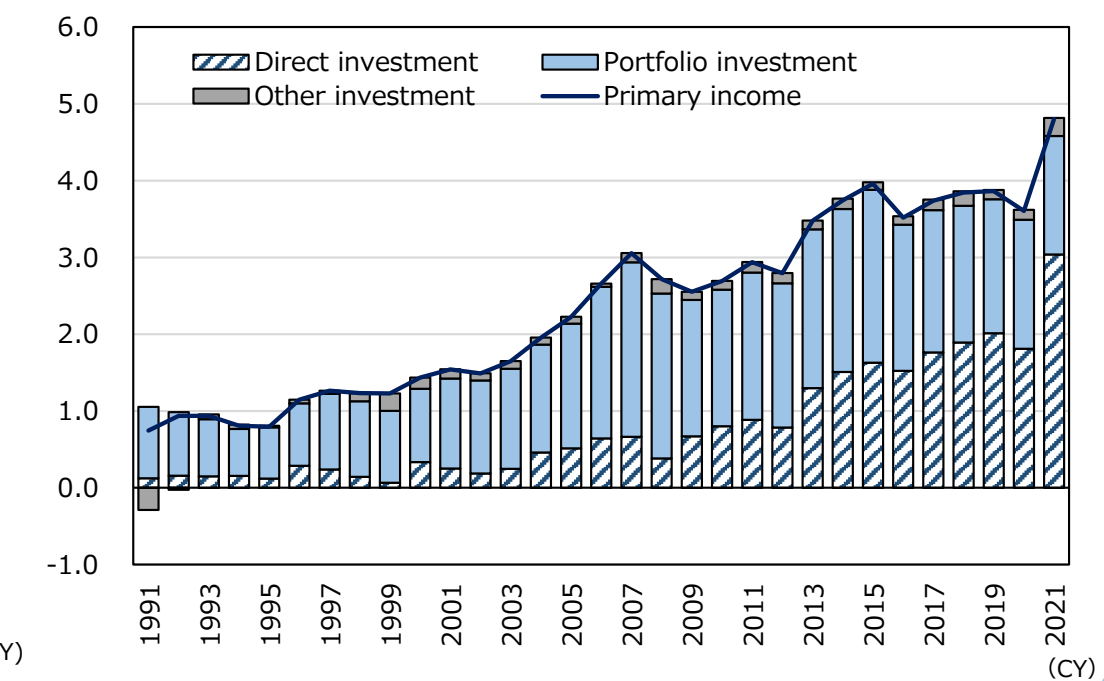


(Source) Cabinet Office, Bank of Japan, Ministry of Finance

Outward Direct Investment Position

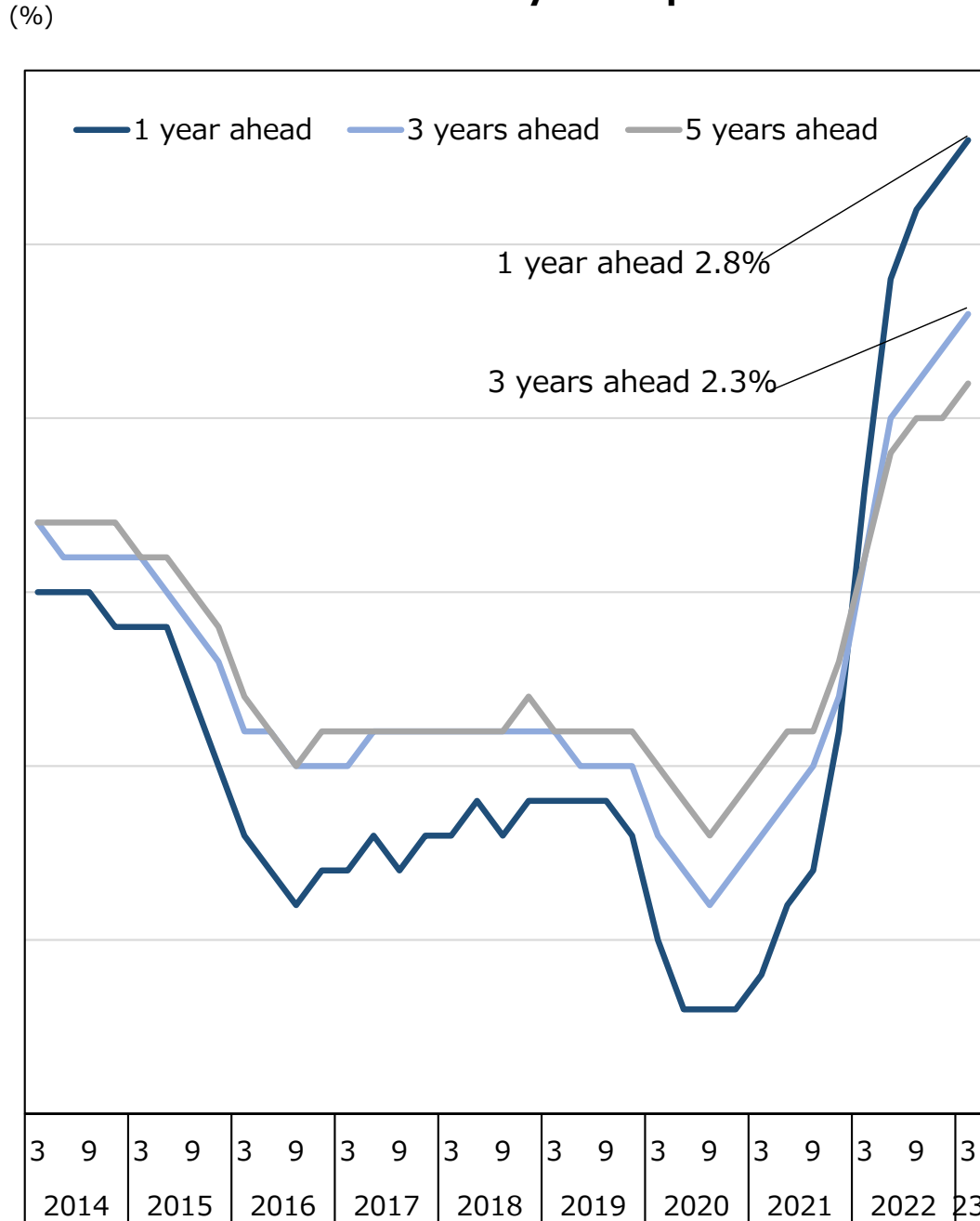


Primary income component (net)

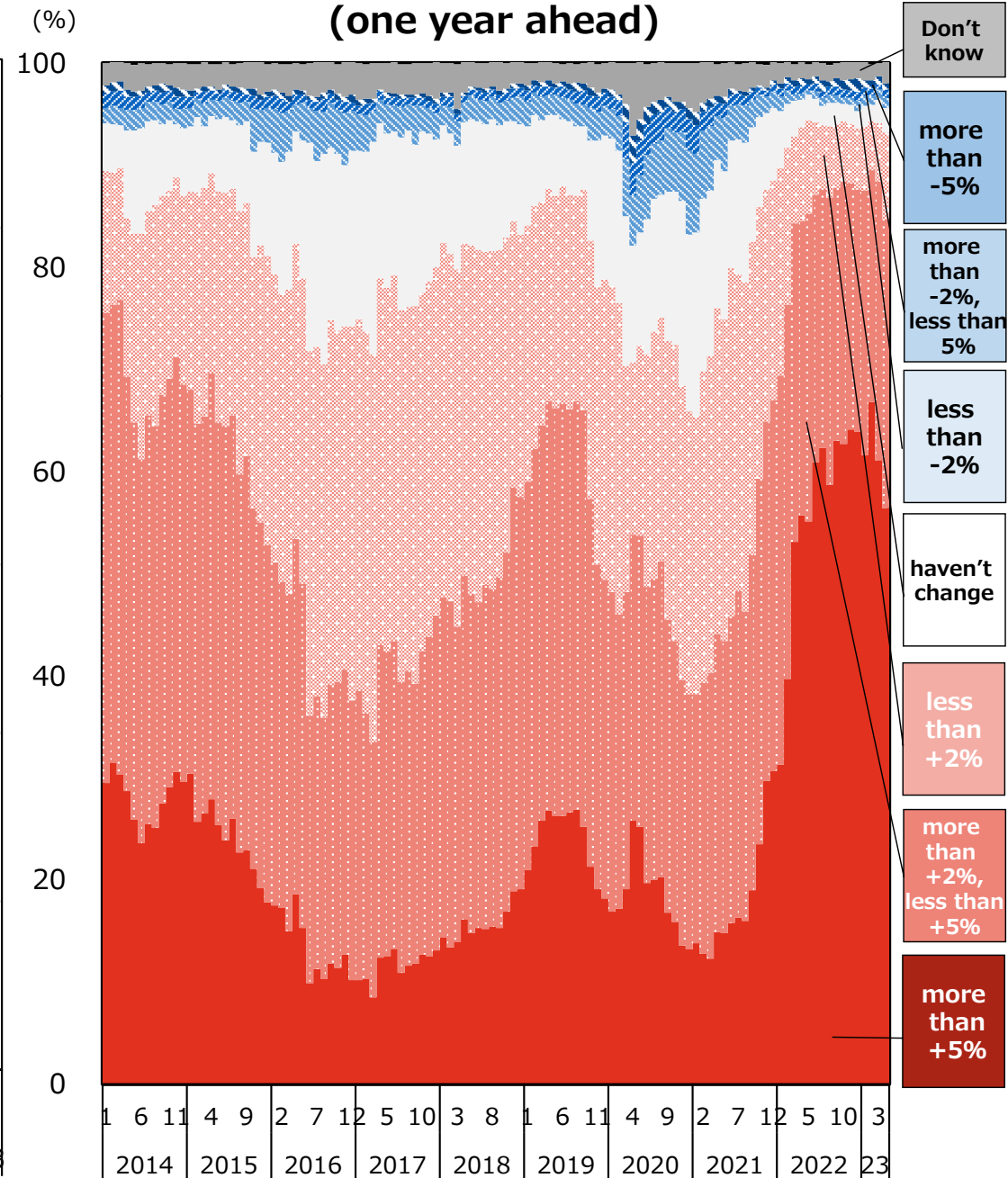


Inflation: outlook by enterprises and consumers in Japan

Inflation outlook by enterprises



Inflation outlook by consumers (one year ahead)



(Source) Bank of Japan, Cabinet Office

Fiscal management: commitments for fiscal consolidation

IV. Medium- to Long-term Economic and Fiscal Management

Fiscal consolidation target set in Basic Policy 2018

Achieve a primary surplus of the national and local governments By FY2025

At the same time, steadily reduce the public debt-to-GDP ratio

Basic Policy 2022

- The government will resolutely pursue fiscal consolidation and work on achieving the current target.
- However, the economy is the foundation of public finance, and macroeconomic policy options in line with the circumstances should not be distorted by giving a greater priority to meeting the current target year.
- Adopting a policy as needed to deal with the circumstances is not traded off against working to achieve the fiscal consolidation target.
- The government will faithfully rebuild the economy.
- The government will also work to put public finances on a sound footing.
- But there is also a need to keep a close eye on economic situations at home and abroad, etc., at all times, such as the impact of the infection and the most recent price hike.
- The government will therefore undertake the necessary verification depending on the situations.

Fiscal management: highlights of the FY2023 budget

National Security

- **Defense buildup program for FY2023-2027** sets the level of defense force development expenses at around **43 trillion yen** (1.6 times the amount in the previous program for FY2019-2023)
- The revenue will be secured for maintaining stable defense capabilities.

Green Transformation (GX)

- **GX Economy Transition Bonds** will be established to provide upfront investment support in the amount of **20 trillion yen** over the next 10 years.
- The GX Economy Transition Bonds are going to be redeemed by future fiscal resources through embodying the vision of **Pro-Growth Carbon Pricing**.
- FY2023 budget includes 0.5 trillion yen, in addition to 1.1 trillion yen in FY2022 supplementary budget.

Policies related to children

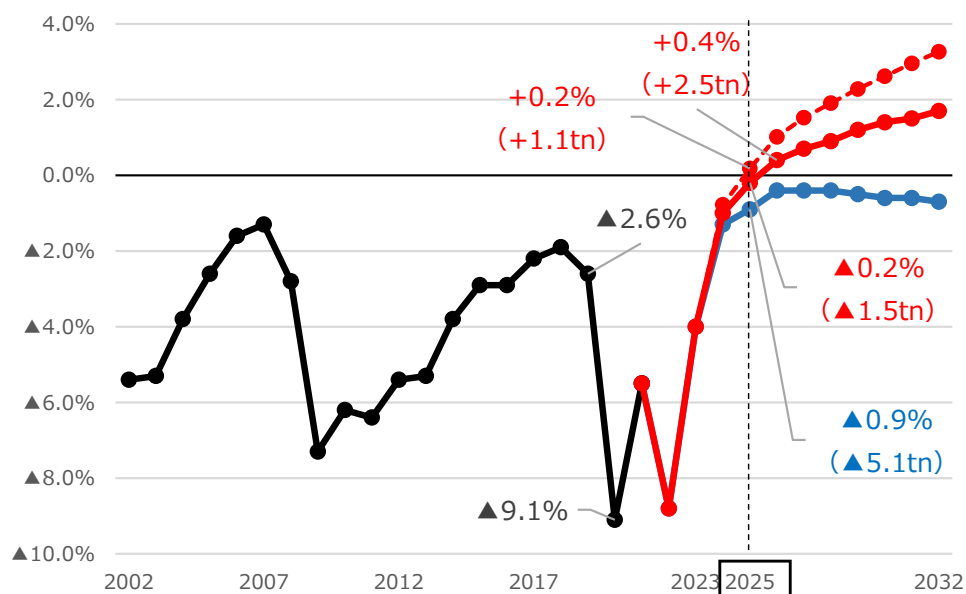
- **“The Children and Family Agency”** was established in April 2023.
- **“The Children’s Future Strategy”** is currently discussed, including acceleration measures for strengthening economic support for child-rearing throughout the life stages and efforts to raise incomes of young generations, and fiscal resources.

Fiscal management: CAO's economic and fiscal projections

- **If the economic growth rate indicated in the Growth Achieved Case is realized, and efforts to improve expenditure efficiency continue as before, the Primary Balance for the central and local governments combined will turn into a surplus in FY2025**, as in the previous analysis in last July.
- The ratio of outstanding debt to Nominal GDP is projected to decline in the projection periods in the Economic Growth Achieved Case. In the Baseline Case, it rises in the latter half of the periods.

Primary Balance (Ratio to Nominal GDP)

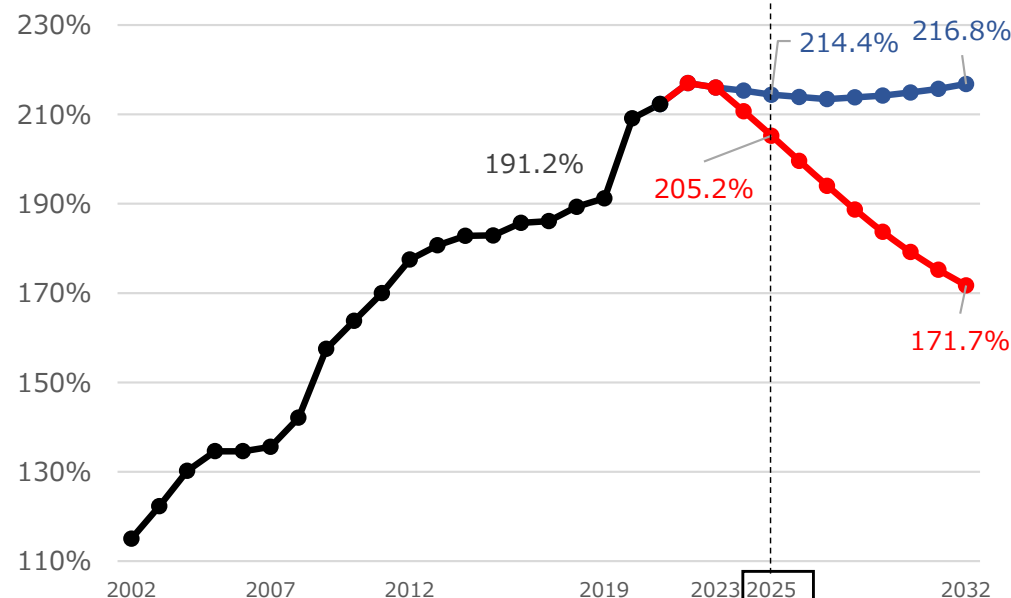
(Sum of the Central and Local Governments)



("tn" stands for "trillion yen.")

Outstanding Debt (Ratio to Nominal GDP)

(Sum of the Central and Local Governments, % of GDP)



—●— Economic Growth Achieved Case:

Assuming that potential growth rate steady rises, achieving around real 2% and nominal 3% GDP growth.

...●... Economic Growth Achieved Case (Considering the expenditure reform) :

Assuming that potential growth rate steady rises, achieving around real 2% and nominal 3% GDP growth. Also, assuming the effect on improvement in the primary balance by efforts for increasing spending efficiency to be about 1.3 trillion yen per year when its impact on the economy is taken into consideration.

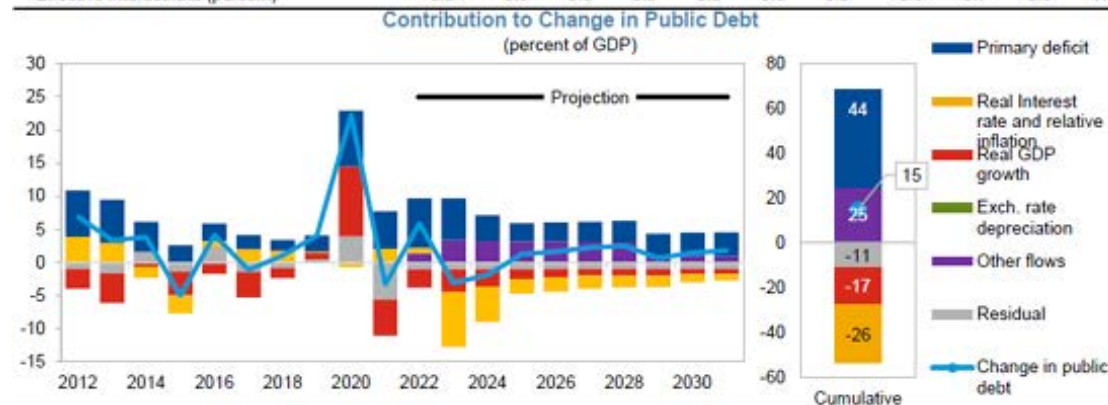
—●— Baseline Case :

Growth rates of GDP are assumed to be in the mid-0% range for both real and nominal GDP every year.

Fiscal management: IMF's economic and fiscal projections

Baseline projections by IMF (percent of GDP)

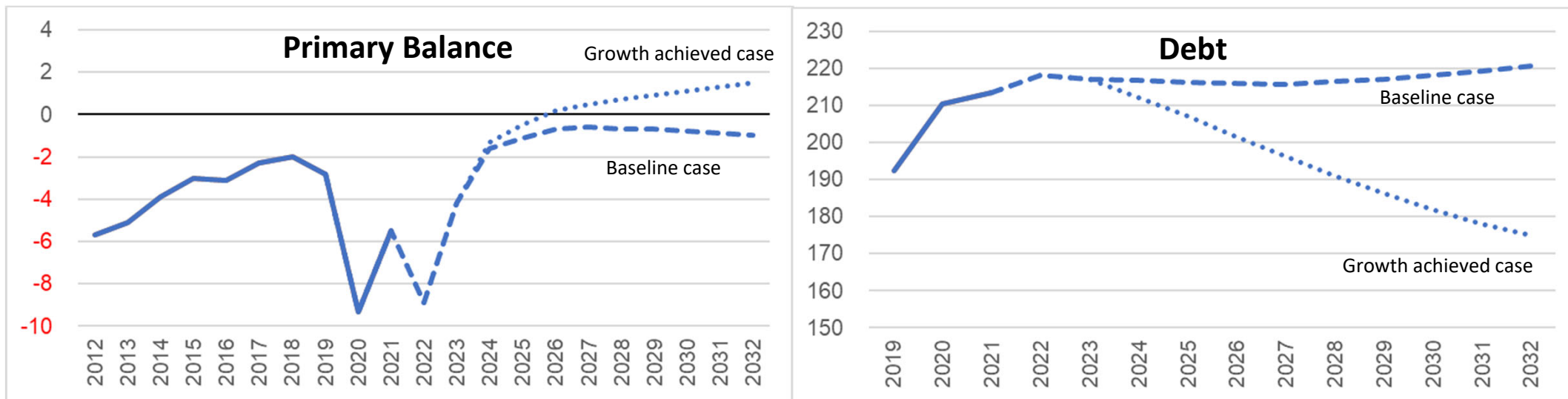
	Actual	Medium-Term projection						Extended Projection			
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Public debt	255.4	261.3	258.2	256.3	257.6	259.2	261.5	264.0	264.7	266.1	268.0
Change in public debt	-3.3	5.9	-3.1	-1.9	1.3	1.7	2.2	2.5	0.7	1.5	1.8
Contribution of identified flows											
Primary deficit	5.6	7.5	6.2	3.8	2.7	2.9	3.1	3.2	3.4	3.5	3.6
Noninterest revenues	35.6	35.1	34.6	34.4	34.4	34.4	34.4	34.4	34.4	34.4	34.4
Noninterest expenditures	41.2	42.6	40.9	38.3	37.1	37.3	37.5	37.7	37.8	37.9	38.0
Automatic debt dynamics	-3.3	-1.9	-11.7	-8.0	-3.7	-3.4	-3.0	-2.8	-2.7	-2.1	-1.8
Real interest rate and relative inflation	2.1	0.8	-8.3	-5.4	-2.2	-2.2	-2.0	-1.7	-1.7	-1.3	-1.0
Real growth rate	-5.4	-2.7	-3.4	-2.6	-1.5	-1.3	-1.0	-1.1	-1.1	-0.8	-0.8
Real exchange rate	0.0	...	...	...	...	...	...	...	...	...	...
Other identified flows	0.0	1.4	3.4	3.3	3.2	3.2	3.1	3.1	1.0	1.0	1.0
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	0.0	1.4	3.4	3.3	3.2	3.2	3.1	3.1	1.0	1.0	1.0
Contribution of residual	-5.6	-1.1	-1.1	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Gross financing needs	68.0	62.1	57.2	54.9	52.9	52.9	54.4	55.3	56.0	54.9	54.3
of which: debt service	63.4	55.7	52.0	52.1	51.2	51.0	52.3	53.0	53.6	52.3	51.7
Local currency	63.4	55.7	52.0	52.1	51.2	51.0	52.3	53.0	53.6	52.3	51.7
Foreign currency	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memo:											
Real GDP growth (percent)	2.1	1.1	1.3	1.0	0.6	0.5	0.4	0.4	0.4	0.3	0.3
Inflation (GDP deflator; percent)	-0.2	0.3	3.8	2.6	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Nominal GDP growth (percent)	1.9	1.3	5.2	3.7	1.9	1.8	1.7	1.7	1.7	1.6	1.6
Effective interest rate (percent)	0.6	0.6	0.5	0.5	0.5	0.5	0.5	0.6	0.7	0.8	1.0



Staff commentary: Public debt will rise over the forecast horizon, reflecting a primary deficit that remains about 3 ppts of GDP above its debt stabilizing level in 2031.

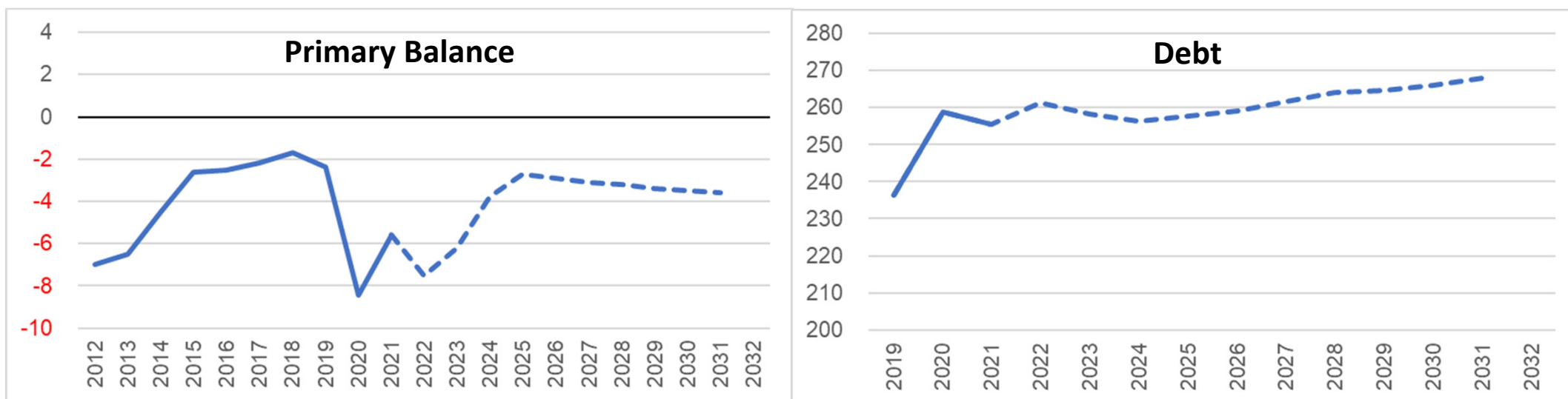
Fiscal management: projections by CAO and IMF

CAO projection: central and local governments



Note: Figures above include the expenditures and fiscal resources for the recovery and reconstruction measures and GX measures.

IMF projection: general government



(Source) CAO, 2023, Economic and Fiscal Projections for Medium to Long Term Analysis, January 24, 2023.

IMF, 2023, Japan: staff report for the 2023 article IV consultation, Annex VII. Sovereign Risk and Debt Sustainability Analysis Figure 4.

Fiscal management: revision of output gap estimation

■ Revision of the output gap estimation by IMF (2023 Article IV staff report)

- ✓ A new method was adopted to estimate the output gap in Japan to avoid issues with the HP filter and large GDP revisions.
- ✓ It relies on statistics on the utilization of labor and capital rather than on GDP statistics because factor utilization statistics are more timely and less prone to large revisions.

(Source) IMF, 2023, Japan: staff report for the 2023 article IV consultation, Annex III. The New Methodology for Estimating the Output Gap.

■ Revision of the output gap estimation by CAO (May 2023)

- ✓ Temporary estimation method assuming no changes in potential labor input during the COVID-19 shock period was revised to reflect downward trend of labor input.
- ✓ Potential GDP growth was revised downward, which resulted in smaller GDP gap in 2021 and 2022.

(Source) “Review of the tentative treatment of the GDP gap estimation in the COVID-19 shock”, May 12, 2023, Indicator of the Week, No.1310.

