Fiscal framework in Japan

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

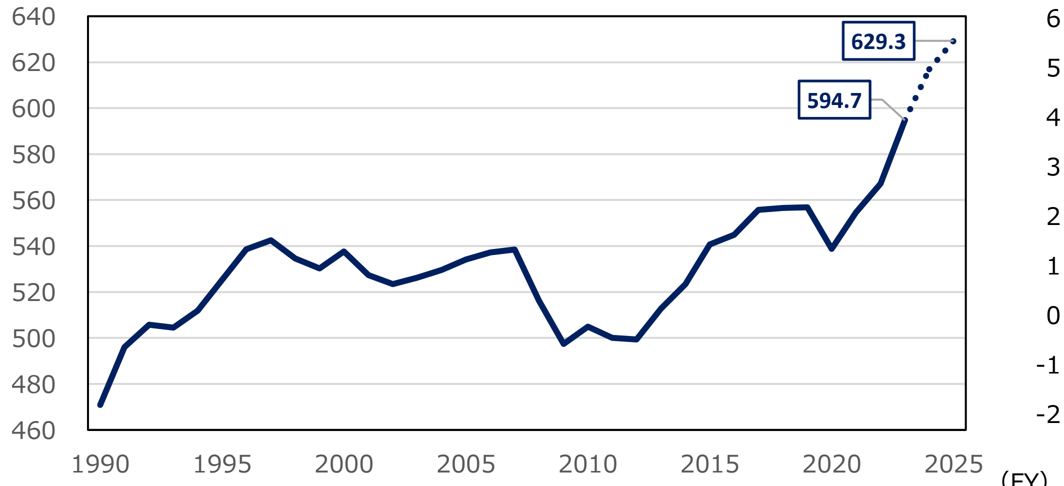
The 10th Tokyo Fiscal Forum

June 11, 2025

Ueda Junji

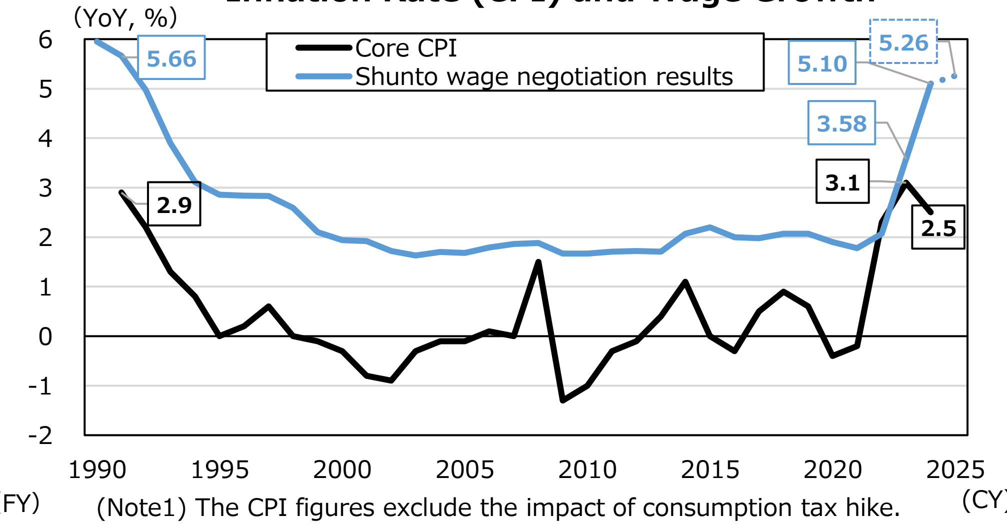
Major economic indicators

Nominal GDP (level)



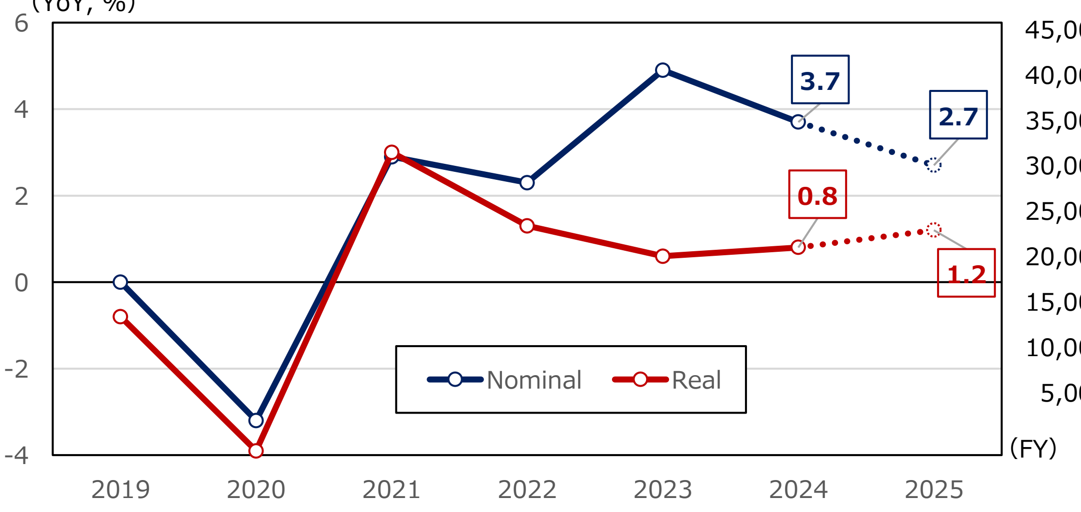
(Note) Figures for FY2024 and FY2025 are from “Fiscal 2025 Economic Outlook”.

Inflation Rate (CPI) and Wage Growth



(Note1) The CPI figures exclude the impact of consumption tax hike.
(Note2) Core CPI covers all items less fresh foods.
(Note3) The figures for wage growth in 2025 are the first set of results as of June 5th, 2025.

GDP Growth Rate



Share Price (Nikkei 225 Index)

(Note) Figures for FY2024 and FY2025 are from “Fiscal 2025 Economic Outlook”.
(Source) Cabinet Office, Ministry of Internal Affairs and Communications, Rengo (Japanese Trade Union Confederation), Bloomberg

Fiscal management: fiscal targets

Existing fiscal targets

- **Achieve primary balance surplus of the central and local governments in FY2025**
- **Reduce the public debt-to-GDP ratio steadily**

(*) Primary balance: Net lending/borrowing (revenue minus expenditure, total financing) excluding net interest expense

ref: Basic Policy 2024 (June 2024, cabinet decision)

The government will resolutely pursue fiscal consolidation and work on its existing targets and, in a world with interest rates in the future, will pay attention to trend of the international financial markets and make the tone of these targets sure to secure the sustainability of the economy, public finances and social security in the future.
To this end, **the government aims to achieve a combined national and local PB surplus in FY2025, and throughout the period of the plan (*), without going backwards in the progress and results of this effort, aiming for a stable reduction in the debt-to-GDP ratio,** making further progress in achieving both economic recovery and fiscal consolidation.

(*) In the new basic policy, the period of the plan is from 2025-2030.

Fiscal management: fiscal targets

Allowing flexibility

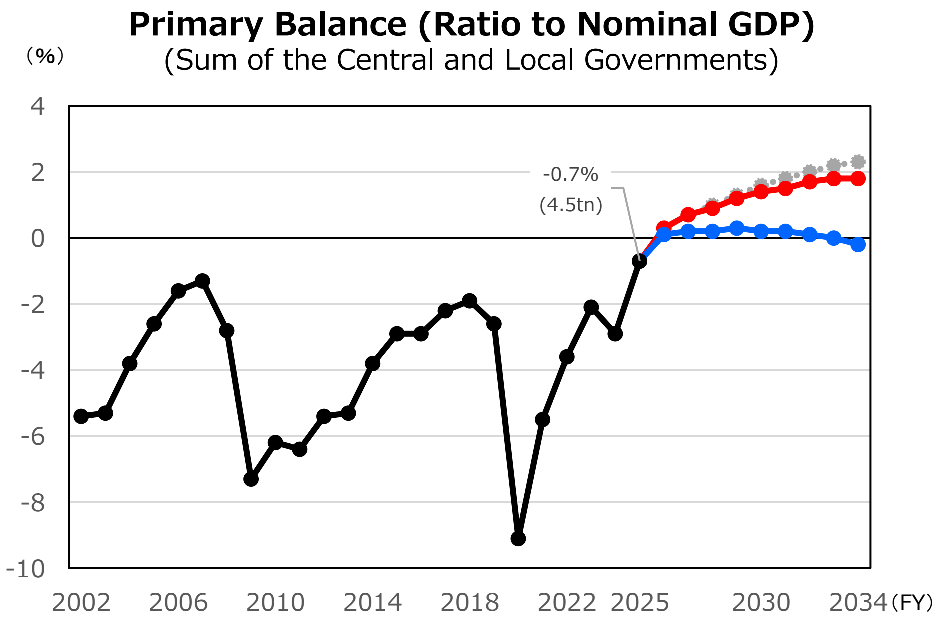
- **Macroeconomic policy options in line with the circumstances should not be distorted by giving a greater priority to meeting the above-mentioned target, including the current target year.**

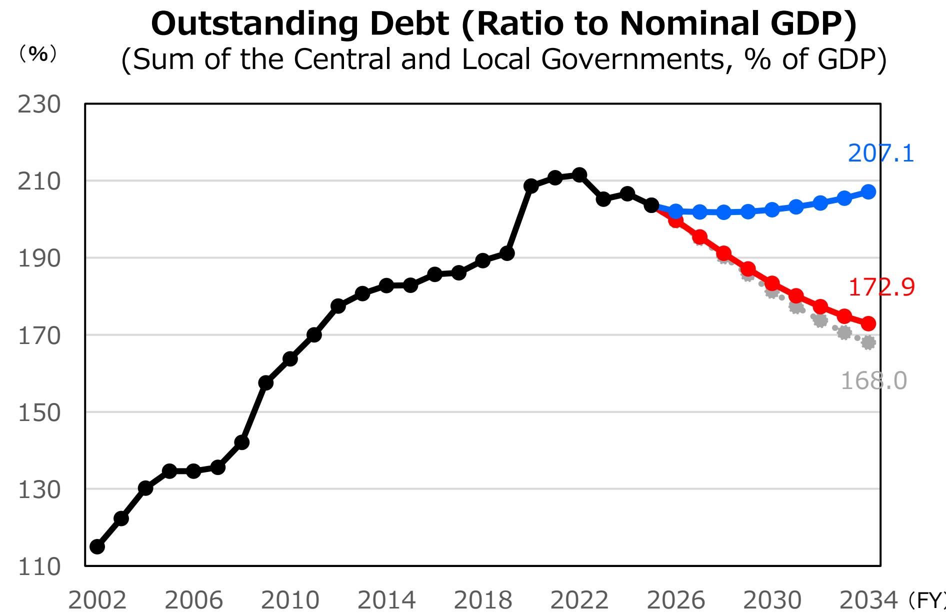
ref: Basic Policy 2024 (June 2024, cabinet decision)

The economy is the basis for public finances, and **these targets, including the current target year, should not distort macroeconomic policy options** in response to the situation.
There is no contradiction between necessary policy responses and addressing fiscal consolidation targets.
We will work to grow the economy and then work towards fiscal consolidation.
However, it is necessary to constantly monitor the domestic and international economic situation and other factors. For this reason, necessary reviews will be carried out according to the situation.

Fisch management

- The primary balance (PB) is currently expected to be in deficit in FY2025 due to additional expenditure plan decided in late 2024, while turning to be in surplus in FY2026.
- Recently the debt-to-GDP ratio gradually declines.





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

Higher Economic Growth Case: Assuming that potential growth rate steady rises, achieving around real 2% and nominal 3% GDP growth.

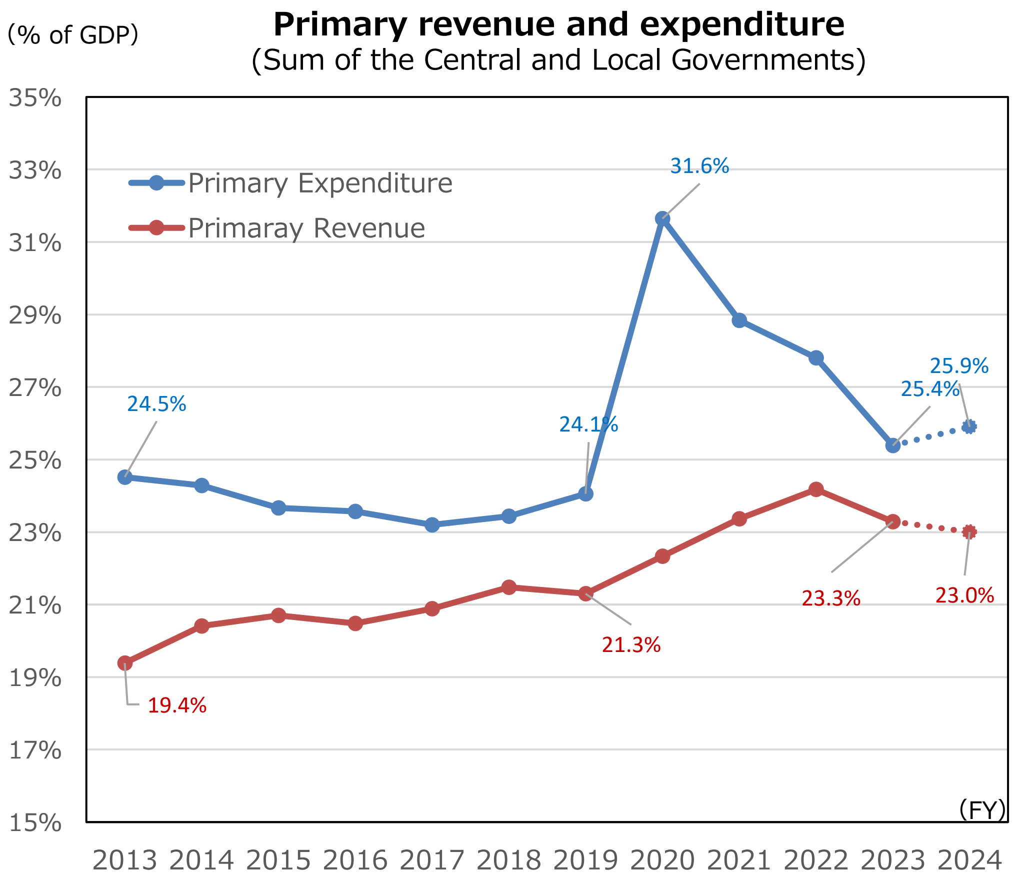
Transferring to a New Economic Stage Case: Assuming that potential growth rate steady rises, achieving around real 1% and nominal 2.5-3% GDP growth.

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

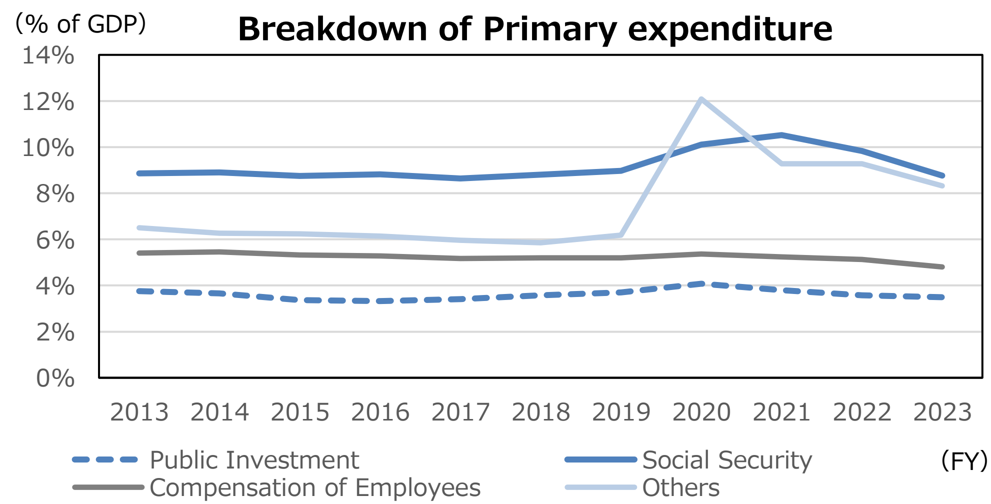
(Source) Cabinet Office, Economic and Fiscal Projections for Medium to Long Term Analysis, January 2025

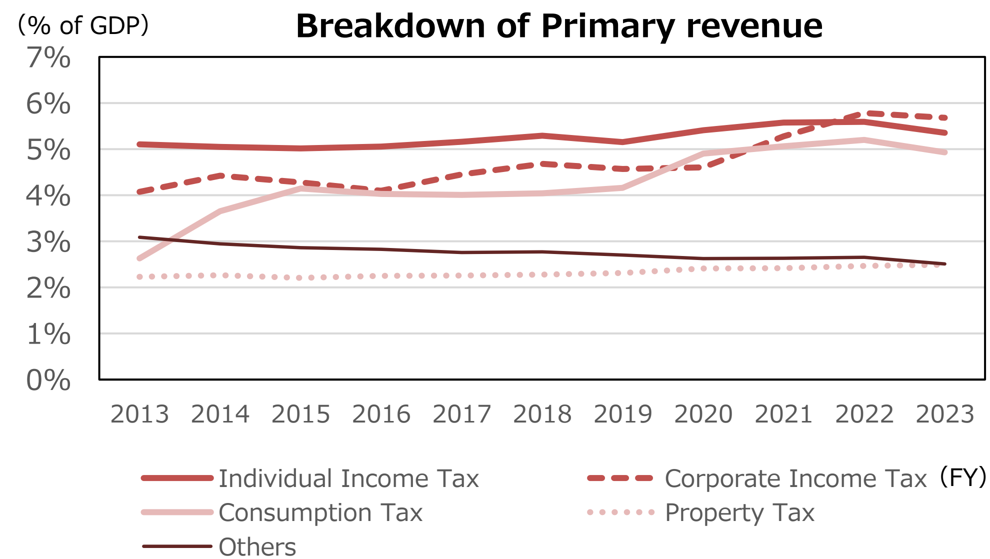
Fiscal policy: primary revenue and expenditure

■ **The level of expenditure-to-GDP is getting back to the pri-COVID19 level by normalizing extraordinary spending, while the revenue-to-GDP ratio becomes higher than before.**



(Note) The figures for FY2024 are from the Cabinet Office's Economic and Fiscal Projections for Medium to Long Term Analysis, January 2025





(Source) Cabinet Office

Fiscal management: expenditure reform

Expenditure reform

- **Continuing current expenditure reform efforts (FY2025–2027) for social security expenditures, expenditures other than social security, and of local government expenditures**

ref: Basic Policy 2024 (June 2024, cabinet decision)

In budgeting, the government will continue its expenditure reform efforts to date(*) under the above basic approach for the three-year period from 2025 to 2027. The specific details of the expenditure reform will be considered in the budgeting process for each fiscal year, taking into account economic and price trends and other factors as the Japanese economy enters a new stage.

(*) The government has continued expenditure reform since FY2013 and **continue the effort of expenditure reform for FY2022-FY2024 which was stated in the Basic Policy 2021**.

Defense buildup and children-related policy, which will be systematically expanded over multiple years, are to be financed by expenditure reforms through FY2027 or FY2028, respectively.

With regard to the expenditure reform for the social security system, efforts are to be made based on “the roadmap for reform aiming to build a social security system for all generations” (decided by the cabinet on Dec 22nd, 2023, “the roadmap for reform”).

Fiscal management: expenditure reform

ref: Basic Policy 2021 (June 2021, cabinet decision)

- For three years from FY2022 to FY2024, the Government will continue existing efforts to reform government expenditures and will compile a budget **in accordance with the following benchmarks(*).**

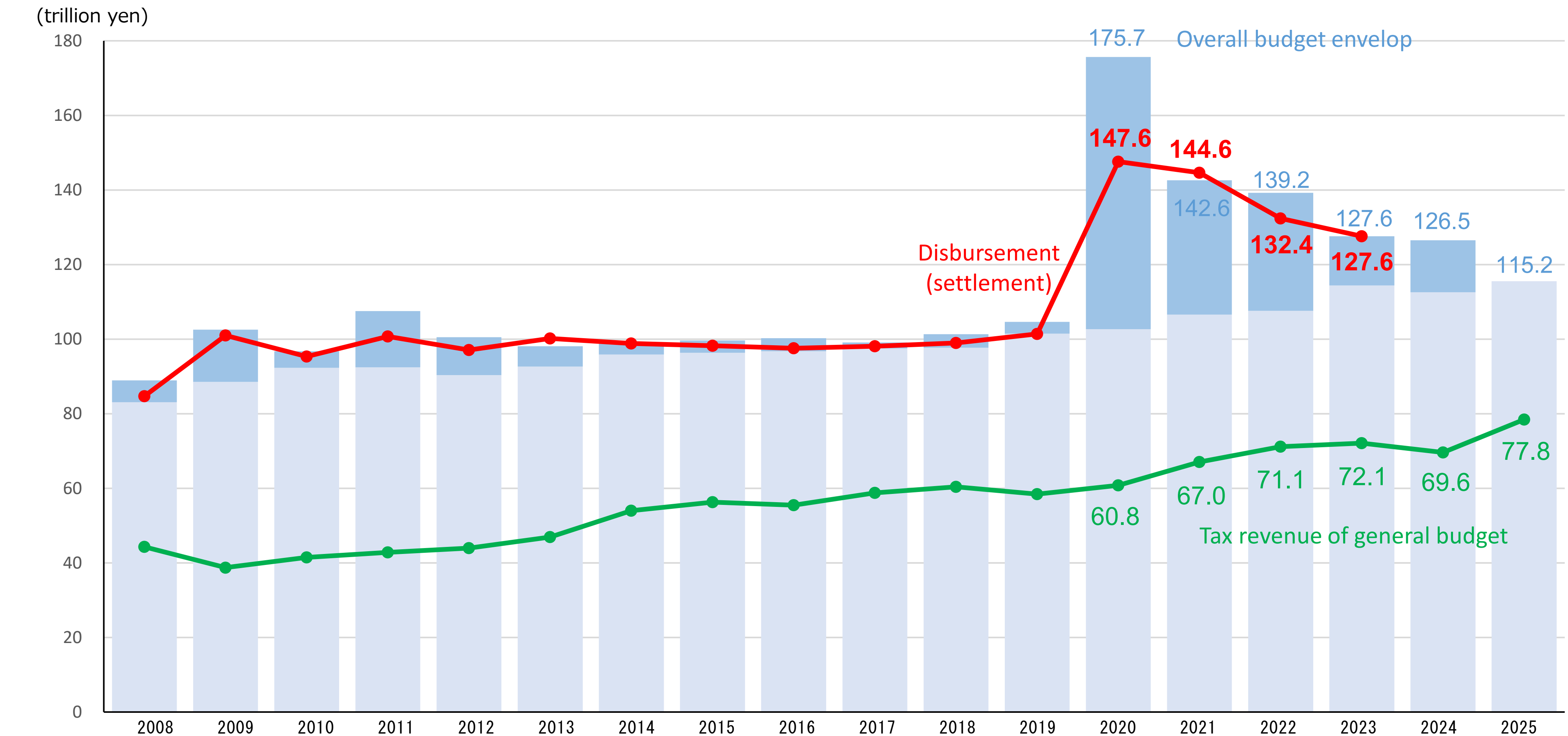
① With regard to **social security expenditures,** the policy is to aim to keep the essential increase **within the levels equivalent to the expected increase due to population aging** during the foundation-reinforcement period, and the policy will be continued based on the future economic situation and price movements and the like.

② With regard to **general expenditures other than social security expenditures**, the Government will **continue existing efforts** to reform government expenditures, with consideration of the future economic situation and price fluctuation and other such factors.

③ With regard to the level of **local government expenditures**, while keeping in line with the efforts of the national government's general expenditures, the Government will ensure that **the total amount of general revenue sources** necessary for stable fiscal management of local governments, including those receiving local allocation tax grants, **shall be maintained substantially at the same level** as that of the FY2021 Fiscal Plan of Local Governments, and not below.

Fiscal management: supplementary budgets

■ **Supplementary budgets and extra-budgetary funds have been flexibly used to cope with economic shocks.**

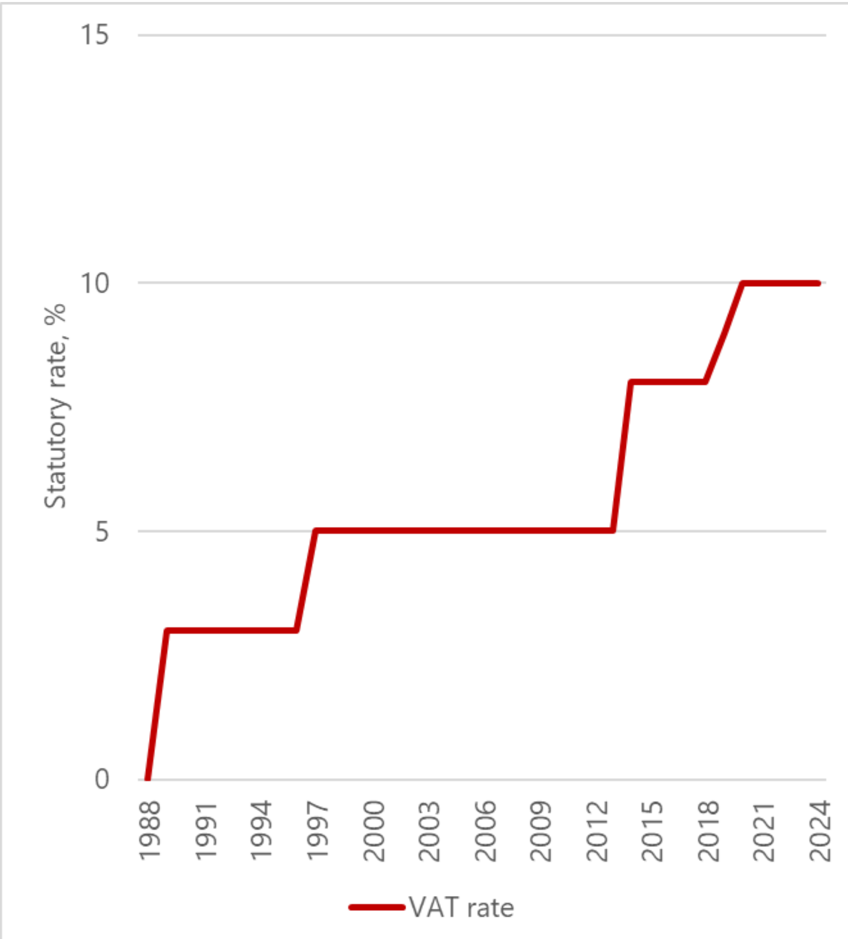


	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Additions by supplementary budgets	5.8	14.0	4.4	15.1	10.2	5.5	3.1	3.3	3.5	1.7	3.6	3.2	73.0	36.0	31.6	13.2	13.9

(FY)

Fiscal management: revenue reform

- Consumption tax (Value-Added Tax) was first introduced in 1989 with 3% rate, and the rate was raised to 5% in 1997, 8% in 2014, and 10% in October 2019.
- Consumption tax revenue has been earmarked to social spending since 2000.



Value added tax (VAT) fits better to economic globalization and aging

- VAT does not accumulate at the production stages, assuring the production efficiency
- VAT does not undermine international competitiveness
- ✓ In contrast, CIT (corporate income tax) and SSC (social security contribution) distorts both (i) production efficiency and (ii) international competitiveness.

Sato (2019), 'The impact of demography on financing social expenditure', presented at G20 Symposium, January 2019.

Fiscal management: special issues

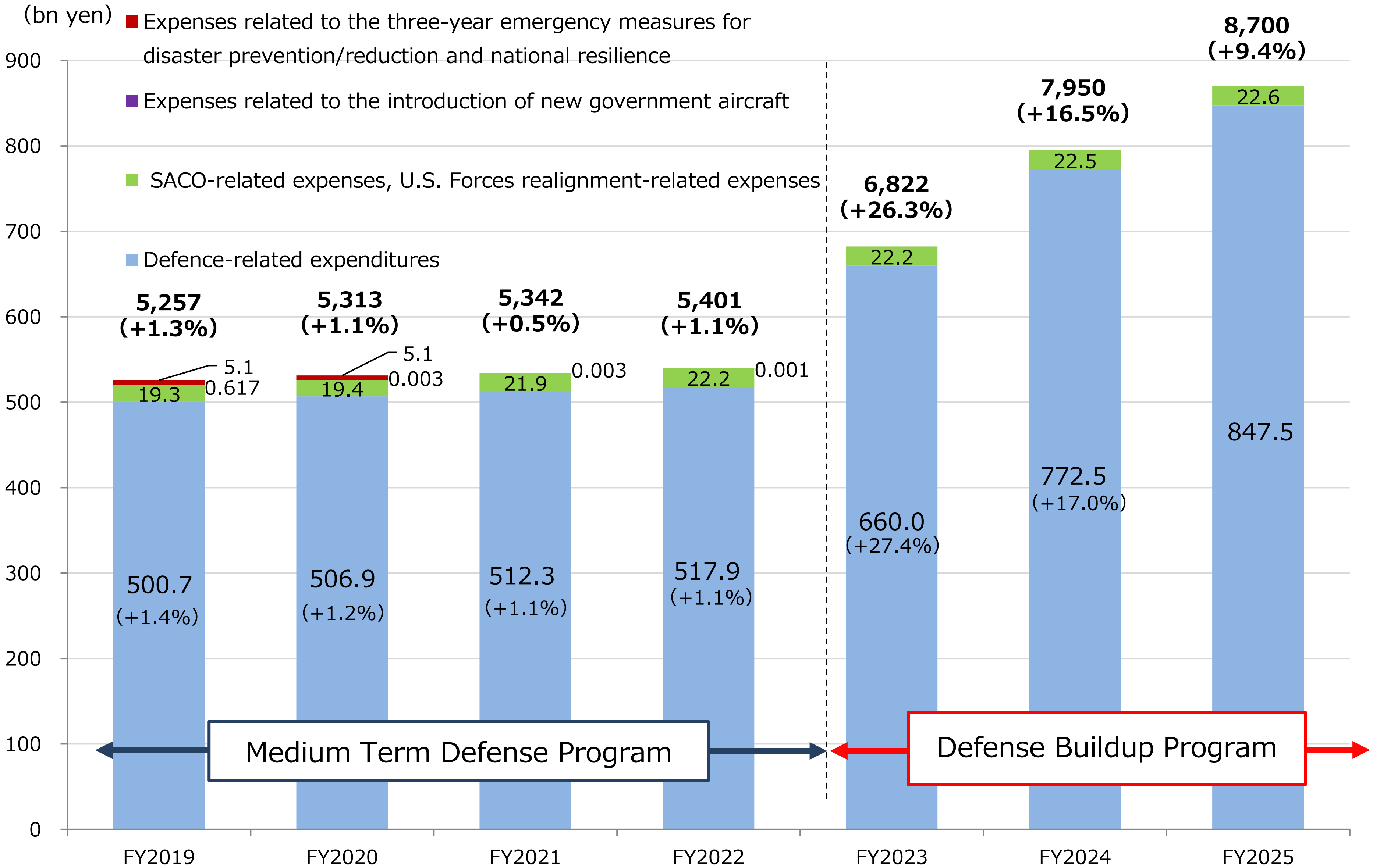
Defense spending

- **Defense buildup program for FY2023-2027** sets defense expenses at **43 trillion yen in 5 years**.
- **Additional expenses** (15 out of 43 trillion yen) from the previous defense buildup program for FY2019-2023 **is planned to be fully secured** through expenditure reform, utilization of settlement surplus, non-tax revenue including creating Defense buildup funds, and tax measures.
- **Tax measures** to secure financial resources for strengthening defense capabilities will be implemented from **FY 2026**. (Introduction of **special defense corporation tax** and revision of tobacco tax)

Green Transformation(GX)

- **20 trillion-scale fiscal support** for up-front investments will be provided **over the next 10 years** funded by issuing **GX economy transition bonds**.
- This support will target investments in fields for which decisions are inevitably difficult only by the private sector and contribute to strengthen industrial competitiveness and to achieve economic growth as well as reducing CO2 emissions.
- **The GX Economy Transition Bonds will be redeemed by Pro-Growth Carbon Pricing (carbon surcharges starting from FY2028, emissions quotas starting from FY2033).**

Fiscal management: defense budgets



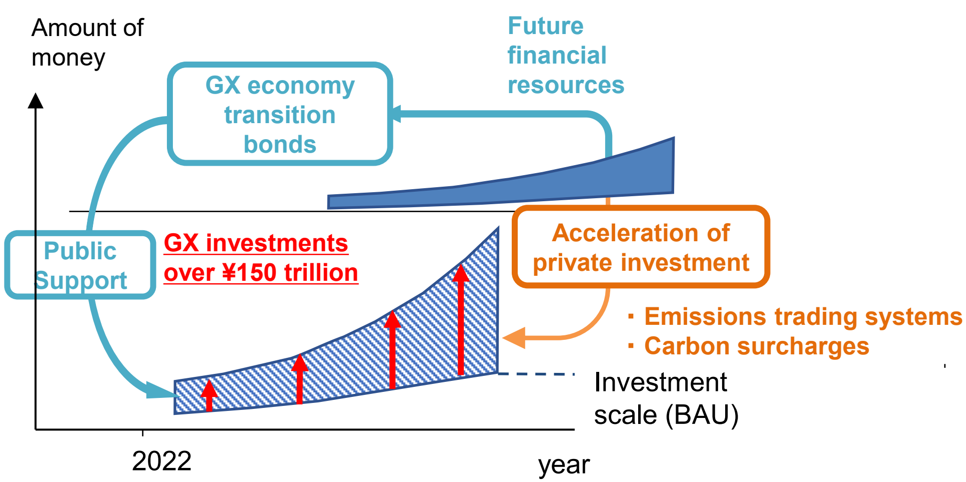
(Source) Ministry of Finance

Fiscal management: green transformation

Provisional translation on the document in Fiscal System Council

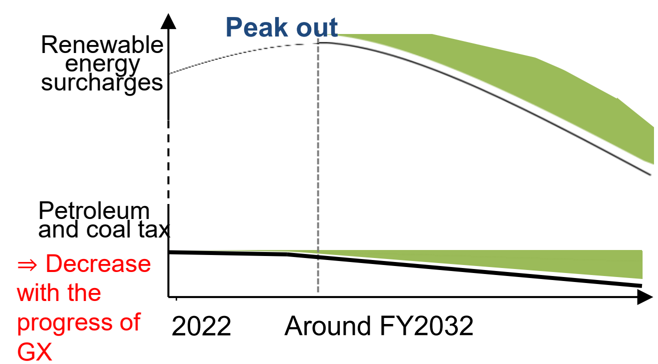
○ **The Basic Policy for the Realization of GX** mentions that in order to realize Over ¥150 trillion investment by public and private over the next 10 years, the government has to enable private companies to make prospects by the support measure during long term. Therefore, "GX economy transition bonds (tentative name)" will be issued for ensuring financial resource so that ¥20 trillion-scale support for up-front investments will be provided.

○ One of the concepts in the Basic Policy for the Realization of GX is **"Government support integrated with regulation for GX investment"**, which **means that not only promoting investment but also introducing regulations and reforms are important** for transformation through whole society and economy.



* BAU: Business As Usual

< Trend of citizens' financial burden in the medium to long term>
(for illustrative purposes)



* Introducing the following within the extent of the future decrease of citizens' energy-related financial burden (renewable energy surcharges / petroleum and coal tax)
(i) Requiring electricity generation utilities to pay for emissions quotas (starting FY2033)
(ii) Carbon surcharges (starting FY2028)

Government support integrated with regulation for GX investment

Creating demands for decarbonization and innovative industries by the strengthening regulation and other measures

+

promoting public and private investment by the government

→ Realizing Green Transformation

Fiscal management: special issues

Policies related to children

- The Children's Future Strategy provides a framework for enhanced measures worth **3.6 trillion yen** and securing stable financial resources up to **FY2028**.
- In FY2024, 1.3 trillion yen of policies will be implemented, and in FY2025, the government will implement more than 80% of the planned measures.
- The government will secure financial resources by expenditure reforms and making maximum use of existing budget and creating a system for contributions through the social insurance system.

AI and semiconductor industry

- **Over the seven years to FY2030**, the government will provide over **10 trillion yen** of public support (including financial support) for AI and semiconductor sectors.
- Securing the necessary financial resources by following measures:
  (1) issuing special session bonds which will be redeemed by transferring funds from the FILP special account
  (2) using the return of government funds previously budgeted for semiconductor support
  (3) the use of GX economy transition bonds and the inspection and review of government funds

Fiscal management: child-related policies

- While making the maximum use of existing budget, the government will carry out thorough expenditure reforms by FY2028 and utilize the effects of public expenditure savings and social insurance contribution cuts through the reforms.
- Expenditure reforms and wage increases are designed to bring about substantial social insurance contribution cuts and within that range the government will develop a financial support system without any substantial contribution hike.

[Expenditures] As of acceleration plan completion: 3.6 trillion yen

Enhancing financial support	Enhancing support for all children and child-rearing households	Promoting co-working and co-parenting
1.7 trillion yen	1.3 trillion yen	0.6 trillion yen

[Revenues] Financial resources for acceleration plan: thorough expenditure reforms, etc.

Making maximum use of existing budget, etc.	Thorough expenditure reforms, etc.	
1.5 trillion yen	1.1 trillion yen	1.0 trillion yen
	Public expenditure savings	Financial support system※

Financial support system： Creating a system for contributions through the social insurance system.

By implementing expenditure reforms and promoting wage increases, the government will effectively reduce the burden of social insurance contributions. A subsidy scheme will be established within the scope of this reduction, thereby ensuring that no material burden is imposed.

Fiscal management: lessons from Japan’s experience

Trade-offs between fiscal control and flexible policy

- Japan's fiscal framework has been based on **a combination of strict initial budget controls and flexible supplementary budget formulation**, which allow for necessary policy responses while expecting to return to a strictly controlled initial state in the medium term.

- Recently, **for policy issues requiring expenditures over multiple fiscal years, separate framework has been established to secure the necessary financial resources** based on a pay-as-you-go approach.

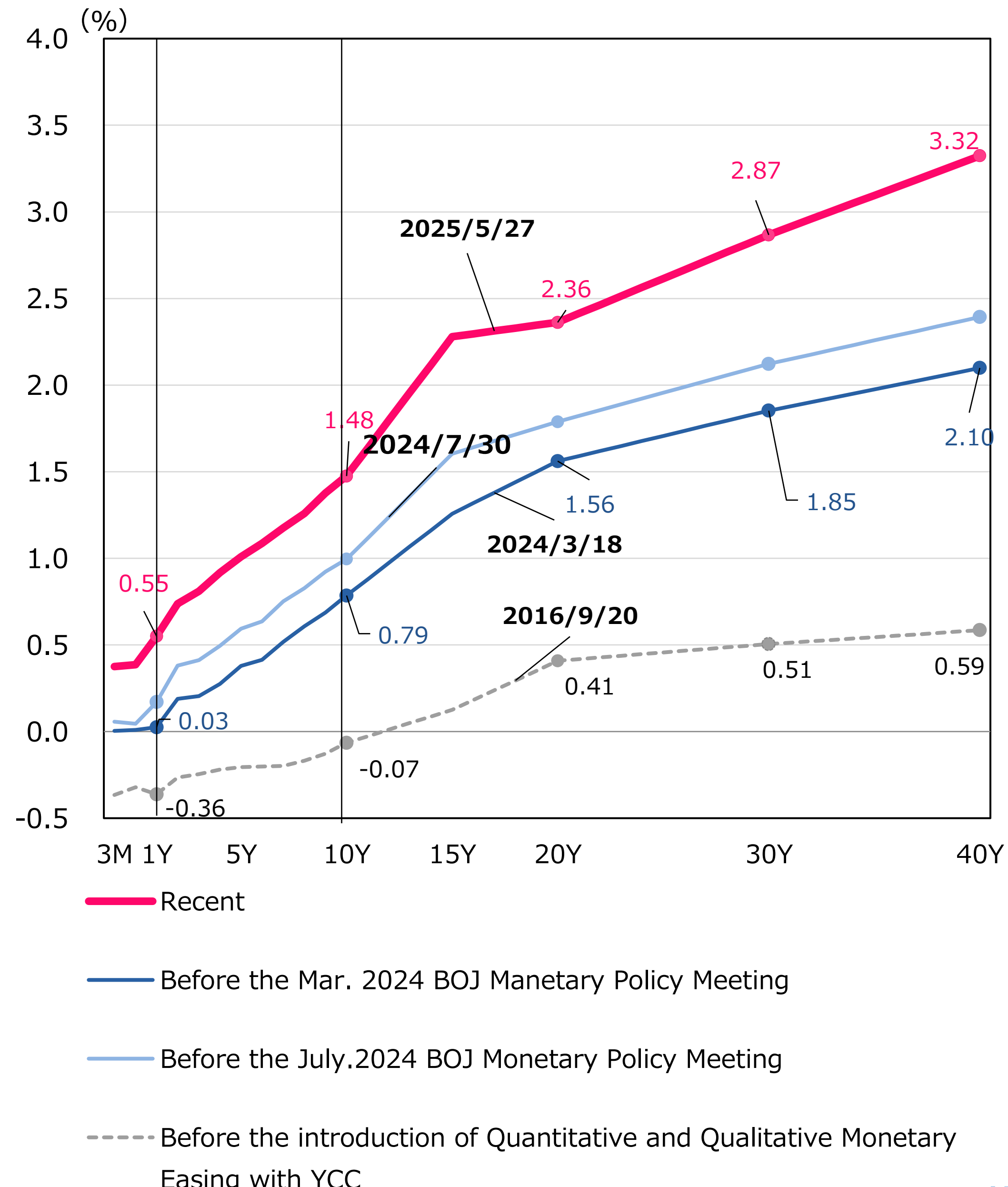
→ These separate frameworks do not necessarily require balancing revenues and expenditures on a single-year basis, enabling expenditures to be planned from a medium- to long-term perspective.

✓ Making it difficult to understand the overall framework of fiscal management

✓ Tempting spending-first decisions deferring burdens in the future

Fiscal risk: interest rate (JGB yield curve)

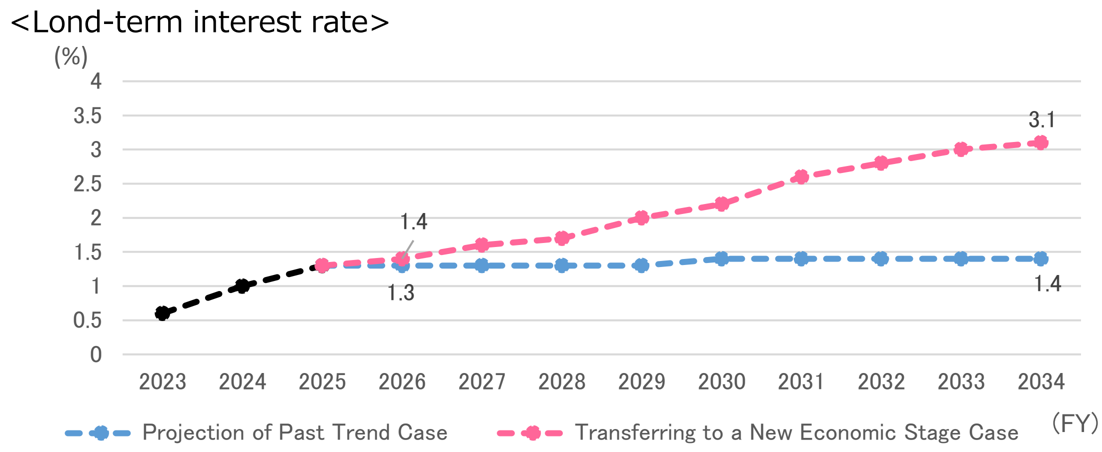
Date	Monetary Policy	Policy interest rate
2016, Jan.	Introduction of "Quantitative and Qualitative Monetary Easing with a Negative Interest Rate"	-0.1
2016, Sep.	New Framework for Strengthening Monetary Easing: "Quantitative and Qualitative Monetary Easing with Yield Curve Control"	–
2024, Mar.	Changes in the Monetary Policy Framework	0~0.1
2024, Jul.	Change in the Guideline for Money Market Operations and Decision on the Plan for the Reduction of the Purchase Amount of Japanese Government Bonds	0.25
2025, Jam.	Change in the Guideline for Money Market Operations	0.5



(Source) Bloomberg

Fiscal risk: interest payment

CAO: Economic and Fiscal Projections for Medium to Long Term Analysis



Transferring to a New Economic Stage Case :
Assuming that potential growth rate steady rises, achieving around real 1% and nominal 2.5-3% GDP growth.

	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030	FY2031	FY2032	FY2033	FY2034
Government bonds	28.2tn	29.0tn	30.7tn	32.3tn	34.1tn	36.1tn	38.4tn	41.0tn	43.8tn	46.5tn
Interest payment	10.5tn	10.3tn	11.6tn	12.9tn	14.3tn	16.0tn	17.9tn	20.1tn	22.3tn	24.6tn

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

	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030	FY2031	FY2032	FY2033	FY2034
Government bonds	28.2tn	28.9tn	30.4tn	31.6tn	32.8tn	33.8tn	34.9tn	36.0tn	37.0tn	37.9tn
Interest payment	10.5tn	10.2tn	11.3tn	12.2tn	13.1tn	13.8tn	14.6tn	15.3tn	16.0tn	16.6tn

(Source) Cabinet Office, Economic and Fiscal Projections for Medium to Long Term Analysis, Jan,2025

Fiscal risk: interest payment

MOF: The estimate on the impact on expenditures and revenues

(Case-1) Economic Growth:3%

	FY2024	FY2025	FY2026	FY2027	FY2028
Government bonds	27.0tn	28.2tn	30.6tn	33.1tn	35.3tn
Interest payment	9.7tn	(+8.6%) 10.5tn	(+13.7%) 12.0tn	(+17.5%) 14.1tn	(+14.6%) 16.1tn

(note1) Interest rate FY2025:2.0% FY2026 onward: implied forward rate

(note2) ( ) is the ratio of the previous year

(Case-２) Economic Growth:1.5%

	FY2024	FY2025	FY2026	FY2027	FY2028
Government bonds	27.0tn	28.2tn	30.5tn	32.8tn	34.8tn
Interest payment	9.7tn	(+8.6%) 10.5tn	(+13.3%) 11.9tn	(+16.0%) 13.8tn	(+12.3%) 15.5tn

(note1) Interest rate :constant at 2.0%

(note2) ( ) is the ratio of the previous year

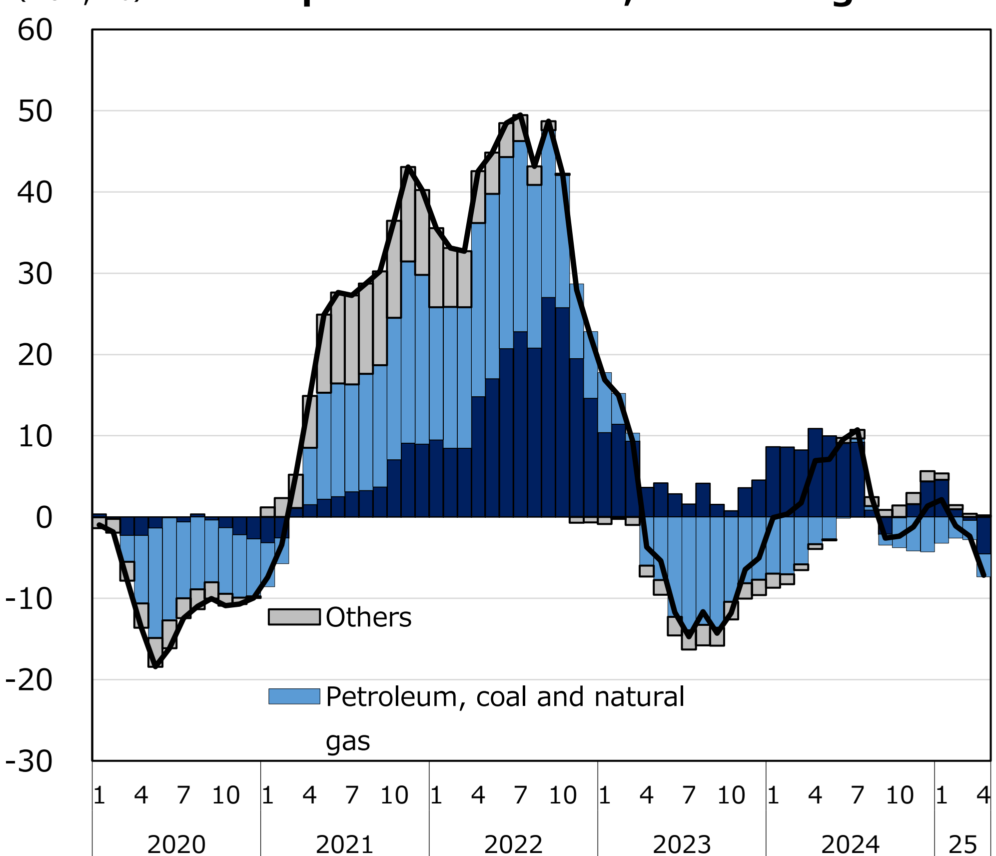
<Impact on the national debt service cost if interest rates rise from 2025 onwards>

Interest rates	FY2026	FY2027	FY2028
+1%	+0.9 tn	+2.1 tn	+3.7 tn
+2%	+1.8 tn	+4.3 tn	+7.4 tn

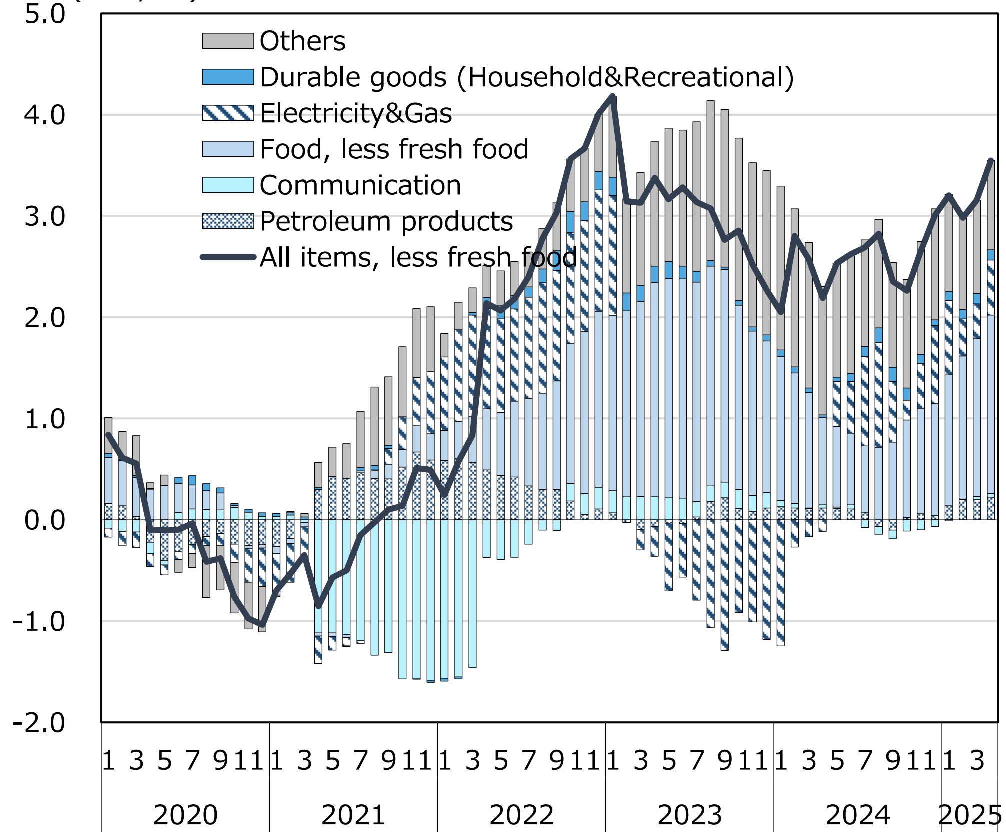
(Source) Ministry Of Finance, The estimate on the impact on expenditures and revenues, Jan,2025

Structural changes: inflation

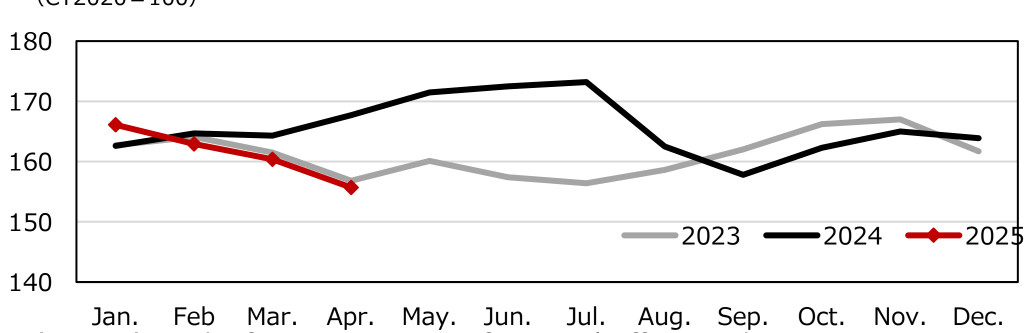
Import Price Index, YoY change



CPI



Level



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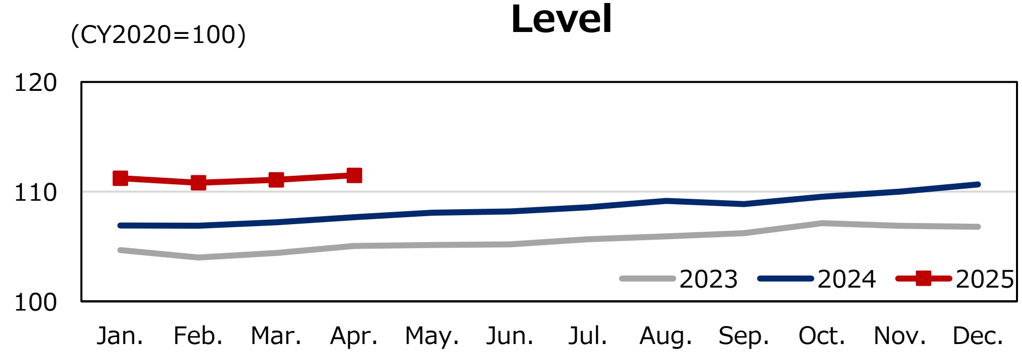
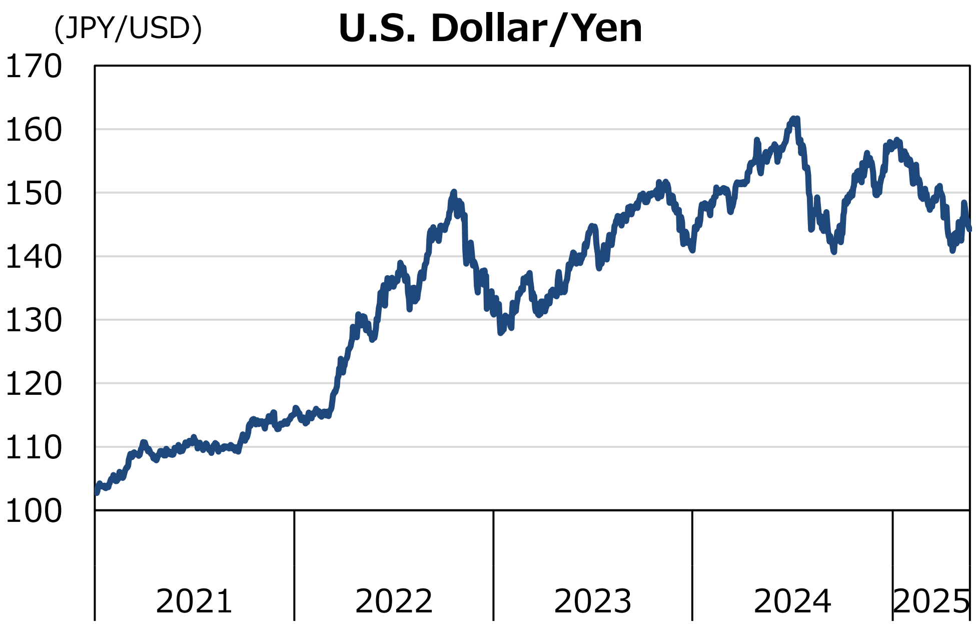
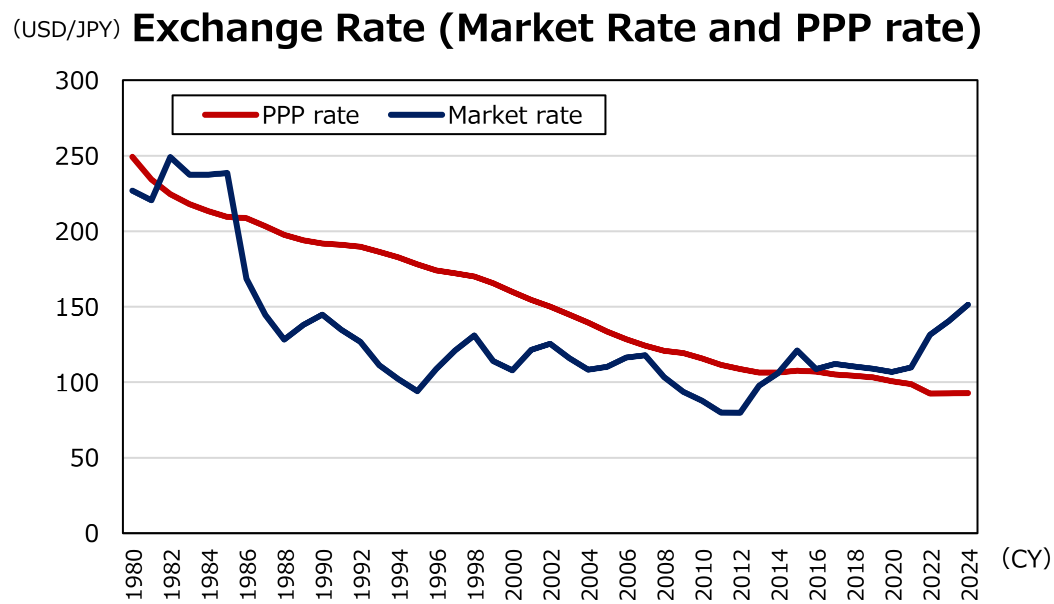
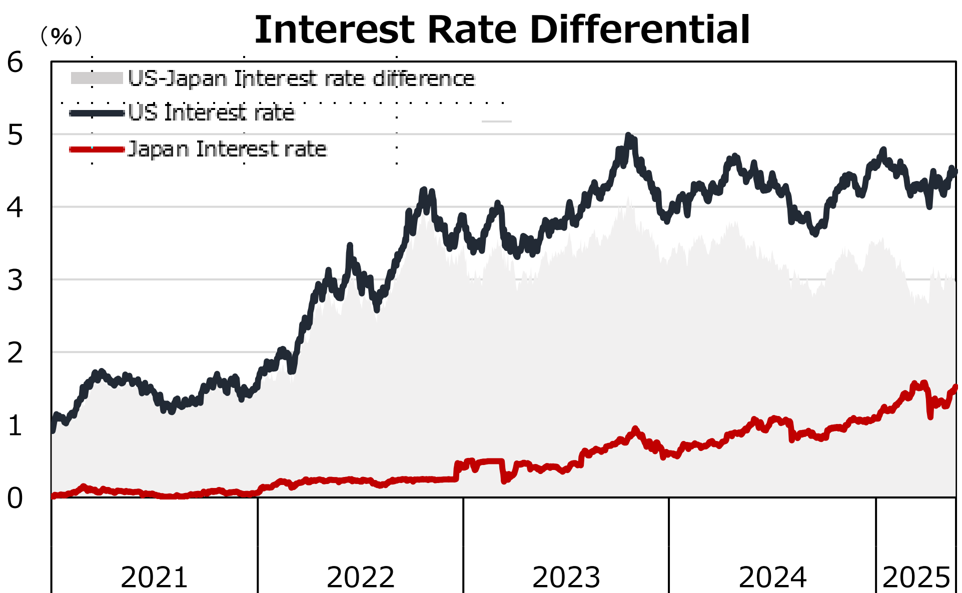


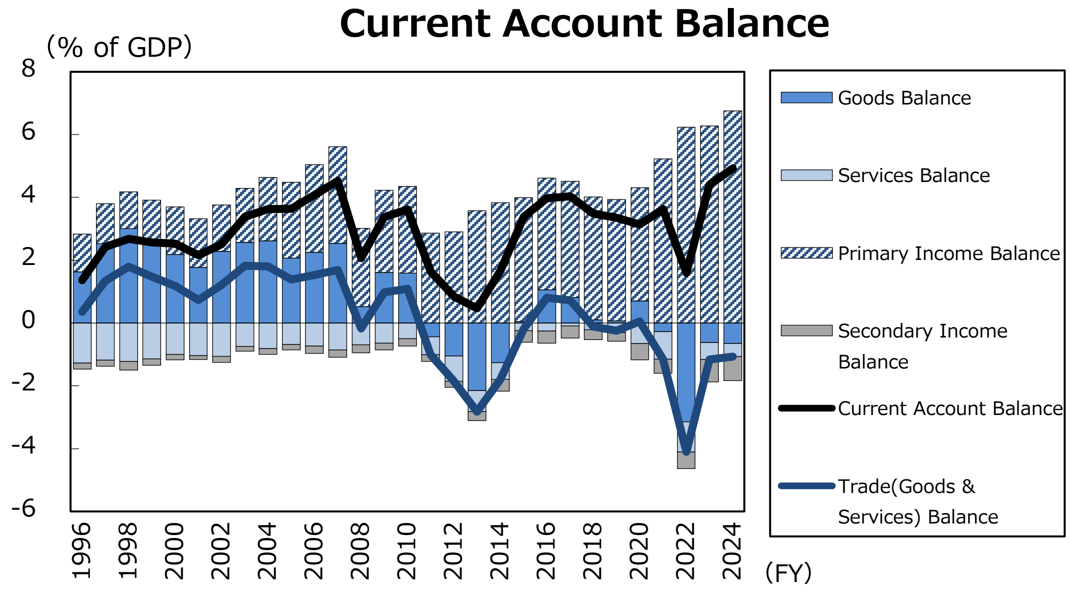
(Source) Bank of Japan, Ministry of Internal Affairs and Communications

Structural changes: external positions





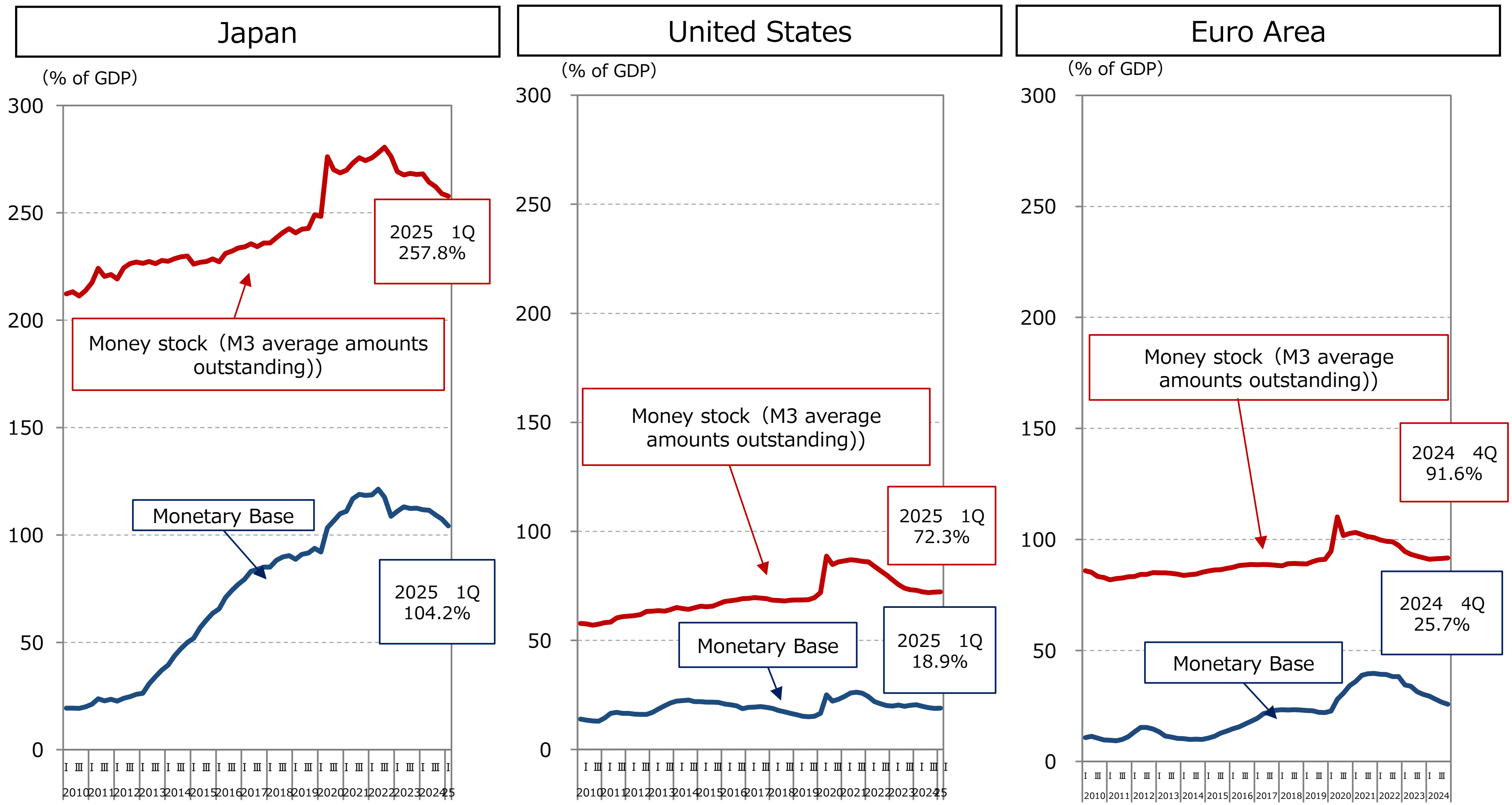




(Note) The interest rates for both Japan and the U.S. represent the yields on 10-year current bonds in both countries.
(Source) Bloomberg, Bank of Japan

Structural changes: domestic money stock

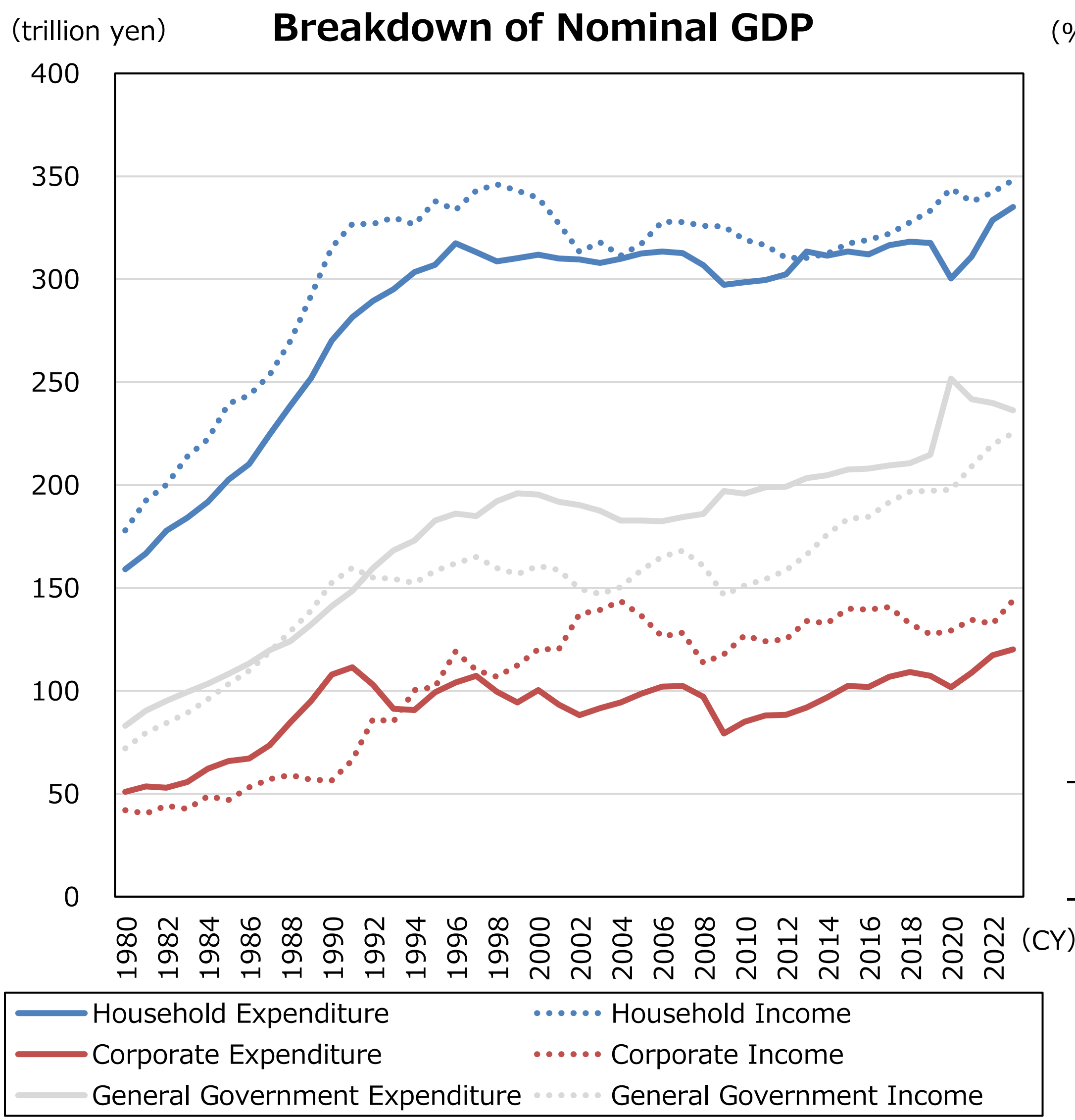
Money stock and monetary base, relative size to GDP

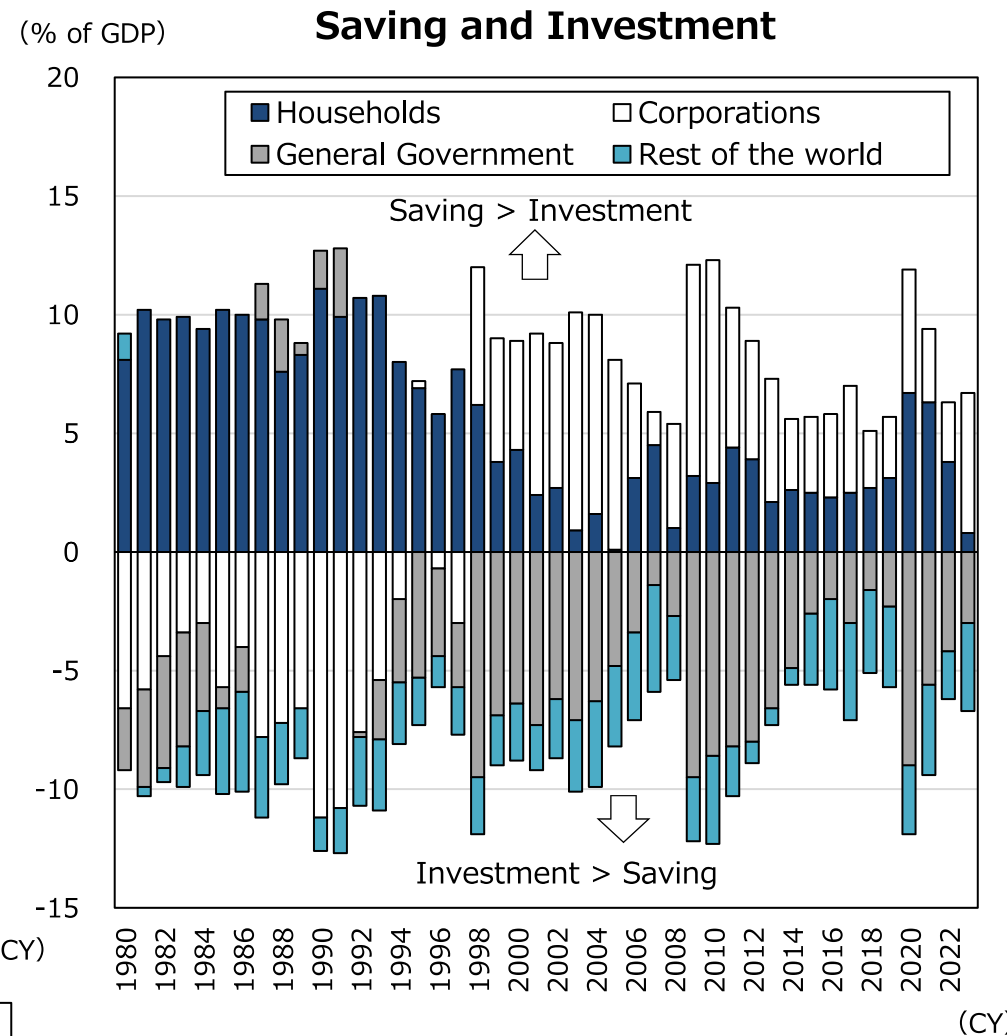


(Note 1) Japan's money supply (M3) consists of currency in circulation, all deposits issued by deposit-taking institutions, quasi-money, and CDs.
(Note 2) The Federal Reserve defines M2 as: M1 (currency in circulation, traveler's checks, demand deposits, and other demand deposits) + savings deposits + small-denomination time deposits + money market funds (MMFs) held by non-institutional investors.
(Note 3) The ECB defines M3 as: M2 (M1, which includes currency in circulation, traveler's checks, and demand and other deposits; and M2, which includes savings deposits, small-denomination time deposits, and money market funds held by non-institutional investors).
(Note 4) The money supply and monetary base are average values for each quarter.

(Source) BOJ, FRB, ECB

Structural changes: saving and investment of institutional sectors



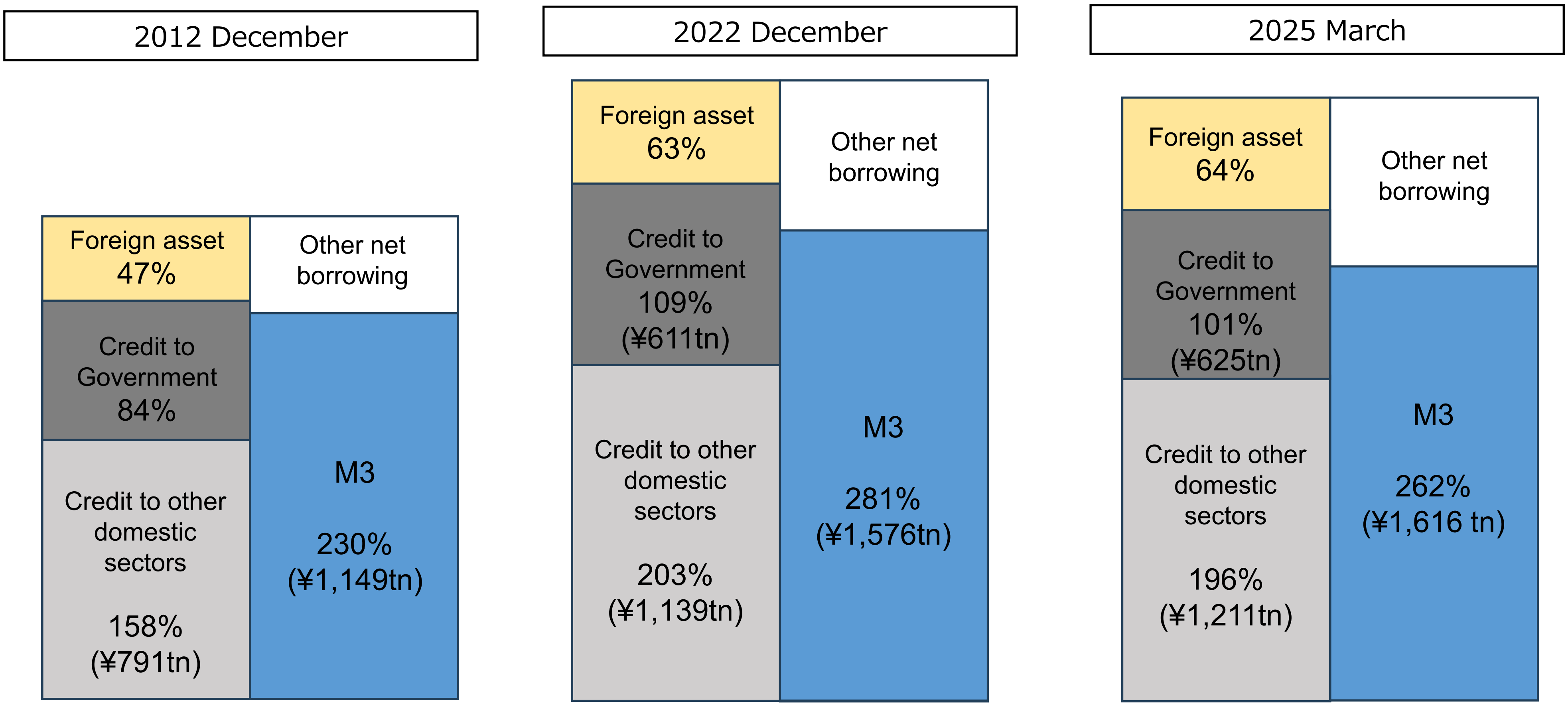


(Source) Cabinet Office

Structural changes: domestic money stock

■ **Recently, monetary stock (M3 held by domestic non-financial sectors) is not growing as much as the growth of credit to domestic sectors by banks.**

Consolidated balance sheet of central bank and domestic banks



(Source) Bank of Japan, Monetary Survey

Structural changes: domestic money stock

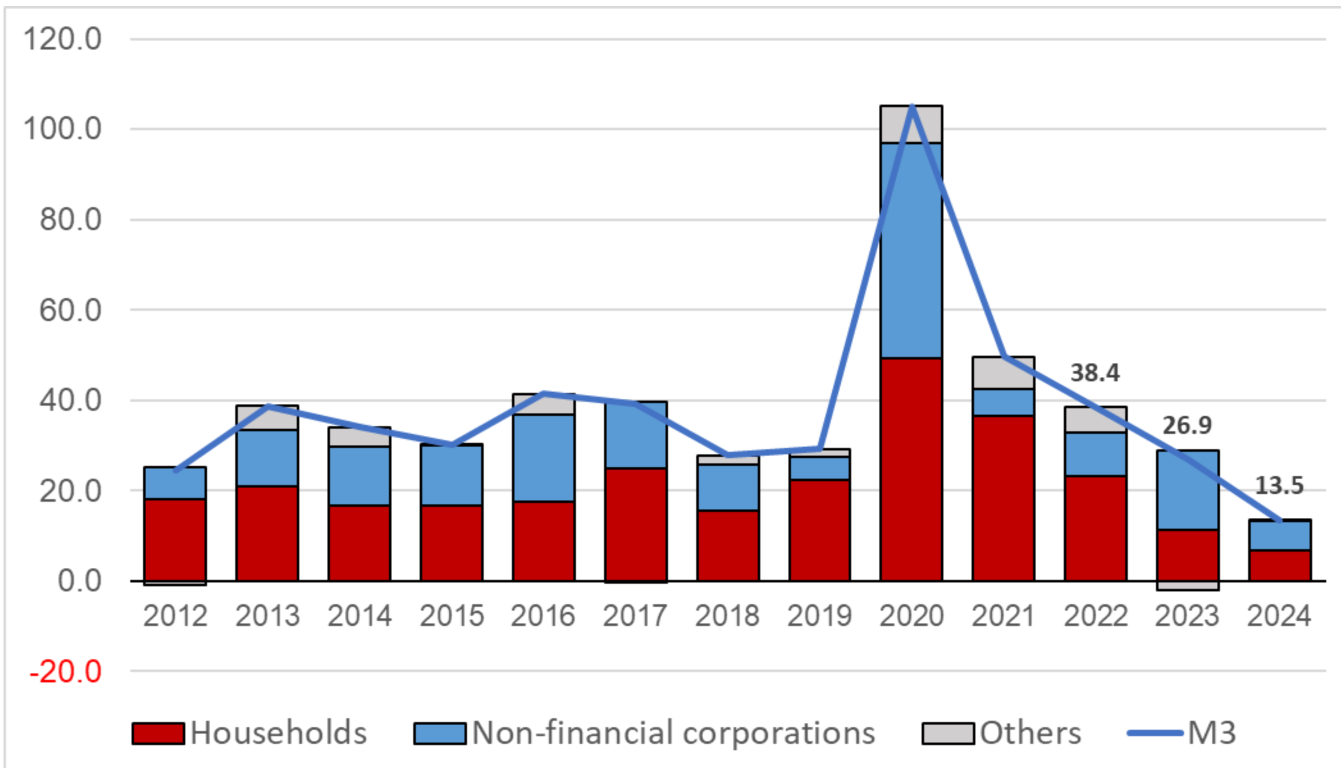
■ **M3 held by domestic households are not growing compared to the pre-COVID periods.**

ΔM3 = ΔM3 held by households

+ ΔM3 held by non-financial corporations

+ ΔM3 by local governments and others

(trillion-yen, year on year difference)



Fiscal risk: lessons from Japan’s experience

Lagged impacts of eased fiscal and monetary policies

- Under the deflationary situations with low interest rate, the potential risks for future inflation and currency depreciation have not been recognized while the domestic money stock has been significantly increased.
- When expectation for domestic inflation and currency fluctuation changes, volatility of relative prices of “substitutes for money” can be getting higher – including real asset, foreign exchange. Inflation is not limited to domestic goods and services.