Daiwa's Economic View

Tax revenue overshoot not enough to cover LDP/Komeito cash handout promise

- Ruling parties planning cash handouts to curry favor ahead of Upper House election, but expected FY24 tax revenue surplus not enough to cover those costs; Upper House election looking increasingly unfavorable for ruling parties
- Tax revenue increase positive for nation's finances, but if increase driven by cost-push inflation, portion of measures to address high prices could be cancelled out

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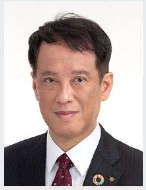

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The higher-than-expected FY24 tax revenue, which was expected to serve as a source of funding for the ruling parties' promise to provide cash handouts ahead of the Upper House election this month, only came to about Y1.8tn. Indeed, this amount was significantly lower than the required amount of roughly Y3.5tn. There are concerns that criticism of the cash handout plan will increase.

Increased tax revenue is a positive for the nation's finances, but if the increase is driven by cost-push inflation, a portion of the measures to address high prices could be cancelled out. Increased tax revenue due to a virtuous cycle of higher wages leading to higher prices is eagerly anticipated.

Higher-than-expected FY24 tax revenue falls short of roughly Y3.5tn target

The Liberal Democratic Party (LDP)/Komeito ruling coalition has included cash handouts in its campaign pledges ahead of the Upper House election. The coalition plans to use the higher-than-expected FY24 tax revenue to fund the cash handouts. However, in reality, this excess is not enough to cover the amount needed for the cash handouts. Also, such cash handouts are usually met with strong opposition from the public. There are concerns that such criticism will intensify during the Upper House election campaign.

The cash handouts will come to Y20,000 per person. An additional Y20,000 will be provided to children, as well as people exempt from resident tax. The necessary financial resources to fulfill that campaign promise is roughly Y3.5tn. However, it has been explained that the issuance of deficit-financing bonds is not needed because the higher-than-expected FY24 tax revenue can be used to cover the cash handouts.

Chart 1: Overview of FY24 General Account Settlement (Y bn)

〔Revenue〕			〔Expenditure〕		
Tax revenue	**1,797.0**	①	Unused funds	4,310.9	④
Non-tax revenue	1,605.5	②			
New bond issuance	**-5,000.0**	③			
Total	-1,597.5		Total	4,310.9	

Total	2,713.6	(A)
Increase in financial resources such as local allocation tax grants	**449.0**	(B)
Net surplus under Article 6 of Public Finance Act (A-B)	**2,264.5**	(C)

Source: MOF; compiled by Daiwa.

However, the higher-than-expected tax revenue amount in the final settlement was roughly Y1.8tn (① in Chart 1), which was only about half of the amount needed to fund the cash handouts. According to media reports, the ruling parties are considering using the overshoot of FY25 tax revenue estimate in the supplementary budget vs. the initial budget. However, the US-Japan tariff issue persists and so the exact extent of this surplus is unknown.

From the start, even if tax revenue exceeds expectations in the final settlement of accounts, a mechanism is in place so that any excess cannot be used as a source of funding for economic stimulus measures. The specific details are as follows. There is no need to read over all the details, but please refer to them if interested.

- As for the settlement of revenue, in addition to tax revenue, non-tax revenue also exceeded expectations (② in Chart 1: Y1.6tn).
- As for expenditures, unused funds that were not spent within the fiscal year and not carried over to the following fiscal year resulted in unused funds ④ in Chart 1: Y4.3tn).
- Higher-than-expected revenue and lower-than-expected expenditures seemed likely, so the government decided to cancel part of the planned issuance of new JGBs (③ in Chart 1: -Y5.0tn).
- As such, the total amount of higher-than-expected revenue and unspent expenditures ((A) in Chart 1: Y2.7tn) is being reduced by the same amount as the reduction in new JGB issuance.
- Certain percentage of five tax revenue items is automatically transferred to local governments as local allocation tax, so part of the higher-than-expected tax revenue will be allocated to local allocation taxes ((B) in Chart 1: Y0.4tn).
- Difference between expenditures and revenues ((A) in Chart 1: Y2.7tn) minus the amount allocated to local allocation taxes ((B) in Chart 1: Y0.4tn) is the net surplus ((C) in Chart 1: Y2.3tn) in the final account settlement.
- Under law, more than half of the net surplus must be transferred to the Government Debt Consolidation Fund.
- The Kishida administration increased defense spending. The remaining net surplus shall be accumulated as a source of funds for national defense.

In other words, even if tax revenue exceeds its target by around Y3.0-4.0tn when settling accounts, mechanisms are in place that prevent the use of those financial resources for cash payments.

When explaining this to the public, it is probably more accurate to say, “The issuance of Y5.0tn in new JGBs for FY24 has been canceled. This portion will be reissued in the FY25 supplementary budget and used as a source of funds to cover benefits.”

If this is reissued in the supplementary budget for FY25, it will result in an increase in new JGBs. However, there is the assumption that the Y5.0tn in new JGBs not issued in FY24 will result in an increase in the issuance of front-loaded refunding bonds. The increase in new JGB issuance will be absorbed by the front-loaded issuance of refunding bonds and calendar-based market issuance (of JGBs) will remain unchanged.

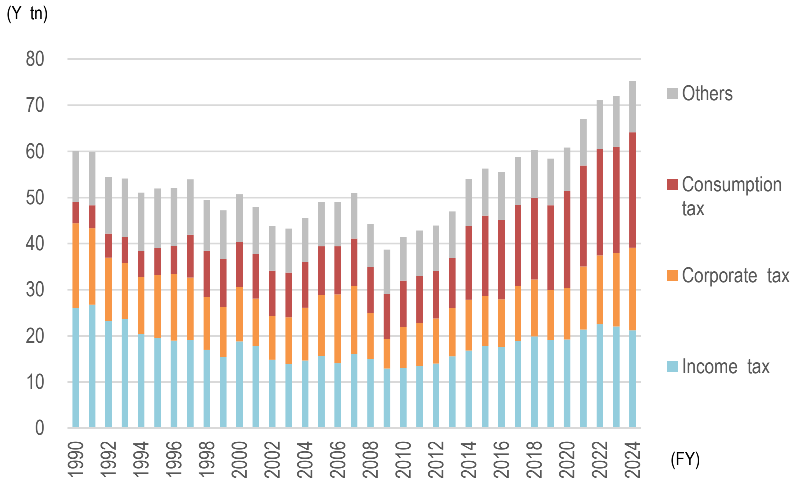
Continued national tax revenue growth; cost-push inflation as one factor in 2020s

National tax revenue began to increase in the 2010s. However, one reason for such growth in the 2020s has cost-push inflation. A portion of the tax revenue increase is being effectively offset by government measures to address high prices. A virtuous cycle of higher wages leading to higher prices is likely required for further fiscal consolidation.

National tax revenue continued to decline from the 1990s to the 2000s. However, this decline bottomed out in the 2010s and has since been steadily increasing. The increase in the 2010s was due to the economic recovery brought about by Abenomics, increased corporate earnings due to the economic recovery and the effect of yen depreciation, and two consumption tax hikes.

That said, the increase in the 2020s has been due to yen depreciation and the sharp rise in global fuel and material costs being passed to consumer prices, leading to increases in consumption tax and other taxes (Chart 2).

Chart 2: Tax Category Trends for Japan's General Account Tax Revenue Settlement



Source: MOF; compiled by Daiwa.

Thanks to efforts by the government and the BOJ, a virtuous cycle of higher wages leading to higher prices has started turning. However, cost-push inflation is reducing real incomes and making life difficult for the people. The ruling parties aim to support people's livelihoods by providing subsidies to offset high gasoline, electricity, and gas prices. In other words, part of the increased tax revenue is being effectually offset by increased spending on measures to address high prices. The full-scale realization of a virtuous cycle of higher wages leading to higher prices will result in further fiscal consolidation.

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