

Daiwa's Economic View

Upside risks to Japanese economy—Effects of fiscal package could mitigate downward impact from tariffs

- Our estimates of economic effects of cuts to gasoline tax, diesel fuel tax, and consumption tax, and stimulus payments
- Fiscal programs currently under discussion could be large enough to substantially mitigate downward impact from tariffs
- Attention should be paid to both downside risks from tariffs and upside risks from fiscal policies at home and abroad

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Summary

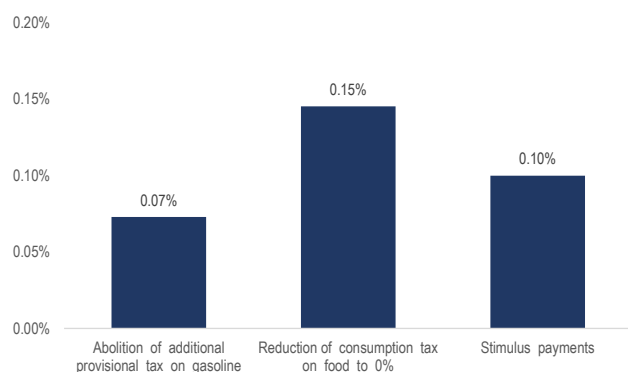
Following the ruling parties' failure to win a majority in both the lower and upper houses, we are seeing an increase in the likelihood of fiscal spending, such as cuts to the gasoline tax and consumption tax, and stimulus payments. On 4 August, in response to Yoshihiko Noda, the leader of the Constitutional Democratic Party of Japan (CDP), stating that his party wanted to earnestly discuss stimulus payments, tax cuts, and subsequent tax breaks with stimulus payments, Prime Minister Shigeru Ishiba replied that he also wanted to do so. Since August, the ruling and opposition parties have been negotiating about the abolition of the additional provisional tax on gasoline.

Our trial calculations suggest that real GDP is estimated to be pushed up by roughly 0.3–0.4ppt in the case of implementation of an economic package consisting of (1) the abolition of the additional provisional tax on gasoline, (2) reduction of the consumption tax on food to 0%, and (3) a uniform Y20,000 stimulus payment to the entire public plus an additional provision of Y20,000 to children (those under 18) and households exempt from resident tax.

At present, we estimate that [the Trump tariffs will push down real GDP by about 0.6ppt](#). Given the tariff-driven drag, we forecast real GDP growth of +0.8% for FY25.

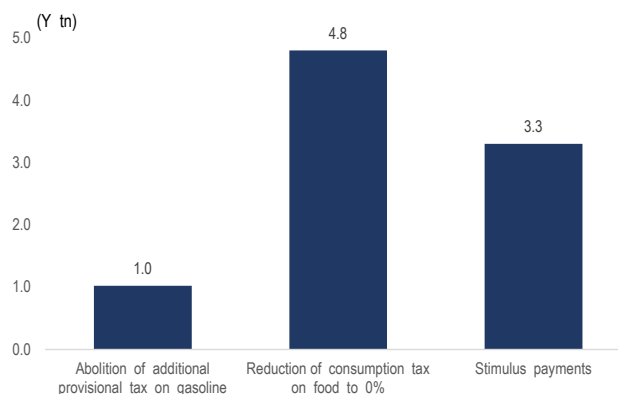
However, if gasoline tax cuts and/or stimulus payments were implemented early, the growth rate forecasts could be revised upwards. We need to carefully watch both the downside risks from tariffs and upside risks from fiscal policies at home and abroad.

Positive Effects on Real GDP



Source: Compiled by Daiwa.

Scale of One Year's Worth of Tax Cuts and Stimulus Payments



Source: Compiled by Daiwa.

Prior studies of marginal propensity to consume (MPC)

When estimating the impact of gasoline and consumption tax cuts and stimulus payments, the household marginal propensity to consume (MPC)—the ratio of increased consumption to increased income—is an important parameter.

According to prior studies of the 2020 special one-off stimulus payments, household MPC is estimated at 0.22 by the Cabinet Office (in 2023) and 0.10 by the RIETI (in 2021). In 2017, the Cabinet Office's study on premium vouchers and other measures (conducted in 2015) estimated that MPC was 0.36.

The programs currently under discussion (cuts to gasoline tax and consumption tax on food) are likely to have the effect of improving real disposable income via reductions in the price of necessities. However, necessities tend to have low price elasticity and the immediate consumption response is generally small, so we assume that the MPC of these programs will not be high. Based on this, in our trial calculations, we adopted a conservative MPC of 0.20 for each—the gasoline tax cut, the consumption tax cut on food, and stimulus payments.

Gasoline tax cut would push up real GDP by 0.07ppt, or 0.13ppt if combined with tax cut on diesel fuel

The gasoline tax comprises the national gasoline excise tax and local gasoline excise tax. The statutory tax rates are ¥24.3 per liter (national) and ¥4.4 per liter (local). The measures under consideration would abolish the additional provisional tax rate introduced in 2008—¥24.3 (national) plus ¥0.8 (local) per liter, for a total of ¥25.1 per liter. Based on the tax revenue forecasts in the initial FY25 budget, revenue from gasoline excise tax is approximately ¥1.98tn and that from local gasoline excise tax is about ¥0.21tn. Therefore, the abolishment of the additional provisional tax rate is estimated to reduce related tax revenue by around ¥1tn.

For diesel fuel, the statutory diesel fuel tax is ¥15.0 per liter and the provisional tax is ¥17.1 per liter. If the provisional portion is abolished for diesel fuel (similar to gasoline), tax revenue is estimated to be reduced by around ¥0.48tn based on the FY25 tax revenue forecast of ¥0.9tn.

A gasoline tax cut would have an impact on households and companies via lower prices. Particularly among households, the major transmission paths would be substitution effects in line with lower prices (an increase in demand for gasoline) and an increase in real income due to a decline in gasoline spending. Prior studies show that short-term price elasticities are small, so the substitution effects are limited in the short run. Therefore, the direct impact on overall household finances would likely be mainly to boost consumption via an increase in real income.

Based on input-output tables, approximately 60% of gasoline use is final household consumption and roughly 40% is intermediate input by firms. Therefore, we estimate that the gasoline tax cut would bring a benefit of around ¥0.6tn to households and about ¥0.4tn to companies. Regarding diesel fuel, intermediate input by companies accounts for more than 90%, while household use accounts for less than 10%. Therefore, a cut to diesel fuel tax would mainly produce a cost-cutting effect for companies. We estimate that a diesel fuel tax cut would bring a benefit of about ¥0.04tn to households and about ¥0.44tn to companies.

We estimated what the scale of the tax cuts would be for one year based on the above, as well as household MPC and secondary spillover effects. The cuts to the gasoline tax and diesel fuel tax are expected to boost real GDP by roughly 0.07ppt and 0.06ppt, respectively. The total effect on real GDP is estimated to be about +0.13ppt.

If the additional provisional tax (about ¥25.1 per liter) were removed from the retail price of gasoline, we estimate headline CPI would be pushed down by roughly 0.25ppt. Because the government already has a measure for a flat-rate reduction in fuel oil prices in place that reduces headline CPI by around 0.1ppt, if that measure were to end when the gasoline tax cut took effect, these changes would lower CPI by about 0.15ppt on a net basis.

Breakdown of Taxes on Gasoline and Diesel Fuel (¥)

	Statutory tax	Provisional tax	Total
Gasoline taxes (total)	28.7	25.1	53.8
Gasoline excise tax (national)	24.3	24.3	48.6
Gasoline excise tax (local)	4.4	0.8	5.2
Diesel fuel tax	15	17.1	32.1

Source: MOF, Ministry of Internal Affairs and Communications; compiled by Daiwa.

Cutting food consumption tax to 0% would boost real GDP by 0.15ppt

Some of the pledges made during July's Upper House election included the CDP and the Japan Innovation Party (JIP) proposing a temporary cut to the consumption tax on food to 0% and the Democratic Party for the People (DPP) proposing a cut to the consumption tax to 5% across the board. According to estimates by the MOF, annual tax revenue is expected to be reduced by around ¥4.8tn if the consumption tax on food were cut to 0%.

Because food is a necessity with low price elasticity, as with a gasoline tax cut, the direct impact on households of a cut to the consumption tax for food is expected to be mainly seen via the income effect (higher consumption in line with a rise in real income), rather than the substitution effects (stronger demand due to price changes). Based on this, as well as household MPC and secondary spillover effects, we estimate that a ¥4.8tn annual tax cut due to a cut to the consumption tax on food would boost real GDP by approximately +0.15ppt.

However, if the consumption tax were cut to 5% across the board¹, annual tax revenue is expected to decline by ¥15.3tn based on the MOF's estimates. In this case, real GDP is estimated to be boosted by about 0.69ppt.

A simple estimate of the impact on CPI indicates that cutting the consumption tax on food to 0% would lower headline CPI by about 1.6ppt, while an across-the-board consumption tax cut to 5% would lower headline CPI by about 2.7ppt.

Stimulus payments estimated to boost real GDP by 0.10ppt

The pledges made by the ruling Liberal Democratic Party (LDP) and Komeito during July's Upper House election included proposing a stimulus payment of ¥20,000 per person as an inflation measure, with an additional ¥20,000 for children and for adults in households exempt from resident tax. On the other hand, the CDP proposed a ¥20,000 per-person "dining support" stimulus payment be made until the cut to the consumption tax on food was implemented.

Based on demographics and the Comprehensive Survey of Living Conditions, the necessary fiscal spending for the proposals by the LDP/Komeito and by the CDP are estimated at around ¥3.3tn and ¥2.5tn, respectively. The economic effects of these stimulus payments are estimated as follows—a uniform ¥20,000 per-person stimulus payment alone would boost real GDP by roughly 0.08ppt, while the addition of a ¥20,000 stimulus payment for children and resident-tax-exempt adults (on top of the uniform stimulus payment) would boost real GDP by about 0.10ppt.

On a net basis, the effects of economic measures would substantially ease downward pressure from tariffs

We estimate that real GDP would be boosted by about 0.3–0.4ppt in total if the government implemented (1) the abolition of the additional provisional tax on gasoline, (2) reduction of the consumption tax on food to 0%, and (3) a uniform ¥20,000 stimulus payment to the entire public, plus an additional provision of ¥20,000 to children (those under 18) and people exempt from resident tax. These estimates assume there are no "barter" measures such as future tax increases or spending cuts to finance the measures when these programs are implemented. We should also take particular note of the fact that we must keep in mind that the existing program for a flat-rate reduction in the price of fuel oil would likely be ended if a gasoline tax cut were implemented.

¹ Our trial calculation assumed MPC of 0.3.

We currently anticipate that [the Trump tariffs will push down the Japanese economy by about 0.6ppt](#). While we must keep in mind that the effect of these economic measures will emerge at different times, we estimate that the economic package described above will largely mitigate the tariff-driven drag.

[The Apr–Jun 2025 GDP \(published 15 Aug\)](#) posted a 0.3% q/q rise (+1.0% annualized), indicating solid economic conditions. Furthermore, retroactive revisions to base statistics raised the real GDP growth rate in the Jan–Mar 2025 quarter from –0.0% to +0.1% q/q, which lifted the FY25 growth baseline from +0.3% to +0.47%. We should keep in mind that, given these revisions, if assumptions remain unchanged, [the BOJ's July Outlook Report](#) projection of +0.6% for FY25 could be revised upwards to about +0.8%.

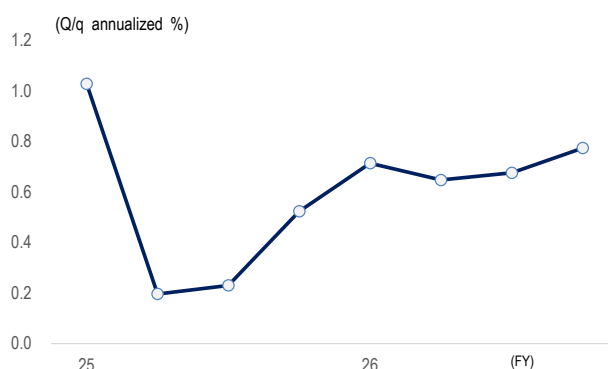
Assuming the impact from tariffs materializes going forward, we currently expect real GDP growth of +0.8% for FY25 and +0.7% for FY26. However, these forecasts could be revised upwards if gasoline tax cuts and/or stimulus payments are implemented early. It will be important to take note of economic developments as well as the timing and scale of these policies while also monitoring both the downside risks from tariffs and the upside risks from fiscal policies at home and abroad.

Scale and Effects of Each Measure

	Tax cuts/Stimulus payments (¥ tn)	Positive effects on real GDP (ppt)
Gasoline tax cuts	1.0	0.07
Diesel fuel tax cuts	0.5	0.06
Reduction of consumption tax on food to 0%	4.8	0.15
Reduction of consumption tax to 5% across the board	15.3	0.69
Uniform ¥20,000 stimulus payment to the entire public	2.5	0.08
Uniform ¥20,000 stimulus payment to the entire public + ¥20,000 stimulus payment for children and resident-tax-exempt adults	3.3	0.10

Source: Compiled by Daiwa.

Forecasts for Real GDP Growth Rate



Source: Cabinet Office; compiled by Daiwa.
 Note: Including our forecasts.

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