

Daiwa's Economic View

FY26 budget and JGB issuance plan: Tempering Takaichi's agenda

- Calendar-based market issuance falling below market expectations in FY26 JGB issuance plan; total issuance curtailed in response to market concerns
- Takaichi administration prioritizing measures to combat rising prices, fulfill requests from the DPP and JIP; consequently, crisis management/growth investments curtailed, tempering previous expansionary fiscal stance
- June "Basic Policy" likely next key test for fiscal policy stance

FICC Research Dept.

Koji Hamada

81-3-5555-8791

kouji.hamada@daiwa.co.jp

**Kenji Yamamoto**

81-3-5555-8784

kenji.yamamoto@daiwa.co.jp



Daiwa Securities Co. Ltd.

The calendar-based market issuance for the FY26 JGB issuance plan fell below market expectations, with reductions for T-bills and three super-long JGB maturities, while medium/long-term JGB issuance remained unchanged. The administration of prime minister Sanae Takaichi and fiscal authorities curbed the total JGB issuance, primarily for new JGBs and refunding bonds, in response to market concerns about fiscal expansion.

New JGB issuance has fallen below ¥30tn for two straight years. In terms of policy, priority was given to (1) wage increases to offset rising prices and (2) policy requests from the Democratic Party for the People (DPP) and the Japan Innovation Party (JIP). Crisis management investments and growth investments were scaled back. Both the general JGBs outstanding and the long-term debt balances of the national and local governments are projected to decrease as of end-FY26 compared to the end-FY25. At least at the initial budget stage, this represents responsible expansionary fiscal policy.

The next key test for the government's fiscal policy stance will likely come with the "Basic Policies for Economic and Fiscal Management and Structural Reform ("Basic Policy")," which is an important benchmark.

Surprised by lower-than-expected calendar-based market issuance

On 26 December, the government approved the FY26 initial budget during a Cabinet meeting and announced its JGB issuance plan. The JGB issuance plan, as previously reported, surprised the market with lower-than-expected calendar-based issuance. Indeed, the issuance of super-long JGBs with maturities of 20, 30, and 40 years were all reduced by ¥100bn/auction. The issuance amounts for 2-, 5-, and 10-year medium/long-term JGBs were unchanged, despite expectations for increased issuance as substitutes. The issuance of T-bills was increased in the FY25 supplementary budget, but returned to the same issuance level as that in the FY25 initial budget.

The calendar-based market issuance fell short of market expectations because the issuance of new JGBs and refunding bonds were smaller than anticipated, resulting in lower total JGB issuance. It seems like the Takaichi administration and fiscal authorities are mindful of market concerns about fiscal expansion. As for refunding bonds, T-bill issuance increased ¥6.3tn in the FY25 supplementary budget, but the increase compared to the FY26 budget request was only about ¥1.6tn. The fiscal authorities apparently devised a way to manage financing for the Government Debt Consolidation Fund.

FY26 initial budget to restrain expansionary fiscal policy within responsible limits

The FY26 initial budget appears to prioritize measures to address rising prices, policies addressing foreign nationals, and policies requested by DPP and JIP. The crisis management investments and growth investments being pushed forward by the Takaichi administration are more modest than expected, as was the case for the FY25 extra budget (Chart 1).

Chart 1: Key Policies / Expenditure Reforms in FY26 Initial Budget and Tax Revisions vs FY25 Initial Budget (Y bn)

Comparison with FY25 initial budget	
Reflection of economic and price trends	
Social security expenditures (e.g., revisions to medical service fees, long-term care fees, and welfare services for disabilities)	290.0
Non-social security expenditures (e.g., significant improvement in salaries for teachers and staff at public elementary and junior high schools)	510.0
Measures for foreign nationals, etc.	
Measures to address overtourism, congestion at airports, and secondary transportation, etc.	130.0
Tuition-free education	370.0
Crisis management investments	
Diversification of supply sources, domestic development, and recycling of critical minerals, etc.	28.0
Diplomacy and security	
OSA (Official Security Assistance)	10.1
Enhancement of basic research	
Significant increase in grants for operating expenses of national universities	18.8
Significant increase in scientific research expenses	10.1
GX and semiconductors ※Special account for energy measures	
GX	115.0
AI, semiconductors	906.2
Expenditure reform	
Social security expenditures (e.g., institutional reforms, efficiency improvements)	-150.0
Non-social security expenditures	-310.0
Tax system revisions	
Increase in International Tourist Tax (Portion for the first fiscal year; a negative figure indicates a tax increase)	-90.0

Source: MOF; compiled by Daiwa.

Social security is one item with increased expenditures compared to the previous fiscal year. Specifically, expenditures increased for medical fees, long-term care fees, and service fees for persons with disabilities. These funds will be used to finance wage increases for workers in these sectors. Teachers and staff at public elementary and junior high schools will also receive pay increases.

Measures for addressing foreign nationals, which has attracted high public interest, will also be strengthened. This funding will come from increases in the international tourist tax, visa fees, and residency-related fees.

The increase in funding for free education, combined at the national and local levels, was relatively large at Y0.6tn compared to the previous fiscal year. JIP strongly advocated for this policy. Furthermore, the FY26 tax reforms include raising the tax-free annual income threshold in line with DPP's request. In each case, it appears that consideration was given to the passage of the initial budget proposal and budget-related bills

Meanwhile, as for the crisis management investment and growth investment initiatives (focus of the Takaichi administration), we were left with the impression that fields were narrowed down and the financial amounts were small. The most notable items in the FY26 initial budget are capex tax breaks within the tax reforms (cuts of Y410bn on a full-year basis) along with increased spending on AI/semiconductors and GX (increase of approximately Y1.0tn y/y). Increases for other items were limited to around Y10bn in scope.

As a result, the amount of new JGBs issued in the FY26 initial budget will fall below Y30tn for the second straight year. The ratio of general JGBs outstanding to GDP is projected to increase by 2ppt y/y in FY25, but is expected to decrease by 4ppt in FY26. The ratio of long-term debt outstanding to GDP for national and local governments is projected to decrease by 1ppt in FY25

and by 5ppt in FY26. The FY25 supplementary budget and the FY26 initial budget maintain a “responsible expansionary fiscal policy” by restraining “Takaichi’s agenda” (preferences).

Chart 2: Outstanding Amount of General JGBs and % of GDP, Outstanding Amount of National and Local Governments’ Long-term Debt and % of GDP (actuals and projections)

	FY24	FY25	FY26
Outstanding amount of general JGBs (Y tn)	1,080	1,136	1,145
% of GDP	168%	170%	166%
Outstanding amount of national and local governments’ long-term debt* (Y tn)	1,286	1,335	1,344
% of GDP	200%	199%	194%

Source: MOF; compiled by Daiwa.

Notes: (1) GDP for FY24 is based on actual results; figures for FY25 and FY26 are based on the government’s economic projections.

(2) The outstanding balance of general JGBs for FY25 indicates the total of initial and extra budgets, while the figure for FY26 is an estimate based on initial budget.

*National figure for FY25 indicates the total of initial and extra budgets, while the figure for FY26 is an estimate based on initial budget. Local governments’ figures for FY25 and FY26 are estimates based on municipal bond issuance plans.

June “Basic Policy” could be next key opportunity to debate fiscal policy

JIP and DPP have indicated their intention to support the FY26 initial budget proposal and budget-related bills. Amendments during Diet deliberations seem unlikely, as was the case with the FY25 initial budget.

The next time budget and fiscal expansion concerns become a topic of discussion (barring a snap election) will likely be the “Basic Policy” (decided each year in June) for the FY27 budget. The medium/long-term fiscal consolidation targets are expected to be revisited for discussion. Specific measures for crisis management investment and growth investment compiled by Japan’s Growth Strategy Headquarters may be incorporated into the “Basic Policy.” JIP is now consulting with the LDP and, as a result, social security system reforms could potentially be finalized sooner rather than later.

The FY25 supplementary budget and the FY26 initial budget were compiled shortly after the Takaichi administration took office. The specific details of the policy measures will be finalized in 2026, while subject to factors such as prices and the economy. It is also conceivable that the reflection of Takaichi’s agenda (preferences) within the budget could change.

IMPORTANT DISCLOSURES

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Securities Co. Ltd. retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.

Ratings

Issues are rated 1, 2, 3, 4, or 5 as follows:

- 1: Outperform TOPIX/benchmark index by more than 15% over the next 12 months.
- 2: Outperform TOPIX/benchmark index by 5-15% over the next 12 months.
- 3: Out/underperform TOPIX/benchmark index by less than 5% over the next 12 months.
- 4: Underperform TOPIX/benchmark index by 5-15% over the next 12 months.
- 5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

Benchmark index: TOPIX for Japan, S&P 500 for US, STOXX Europe 600 for Europe, HSI for Hong Kong, STI for Singapore, KOSPI for Korea, TWII for Taiwan, and S&P/ASX 200 for Australia.

Target Prices

Daiwa Securities Co. Ltd. sets target prices based on its analysts' earnings estimates for subject companies. Risks to target prices include, but are not limited to, unexpected significant changes in subject companies' earnings trends and the macroeconomic environment.

Disclosures related to Daiwa Securities

Please refer to https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/e_disclaimer.pdf for information on conflicts of interest for Daiwa Securities, securities held by Daiwa Securities, companies for which Daiwa Securities or foreign affiliates of Daiwa Securities Group have acted as a lead underwriter, and other disclosures concerning individual companies. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/credit_ratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)

If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.

Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108

Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association, Japan Security Token Offering Association