

Daiwa's Economic View

Future trends for government's interest payments, primary balance according to projected impacts on later years

- Automatic projections for interest payments, primary balance, and new financial resource bond issuance
- Implications for responsible proactive fiscal policy

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.

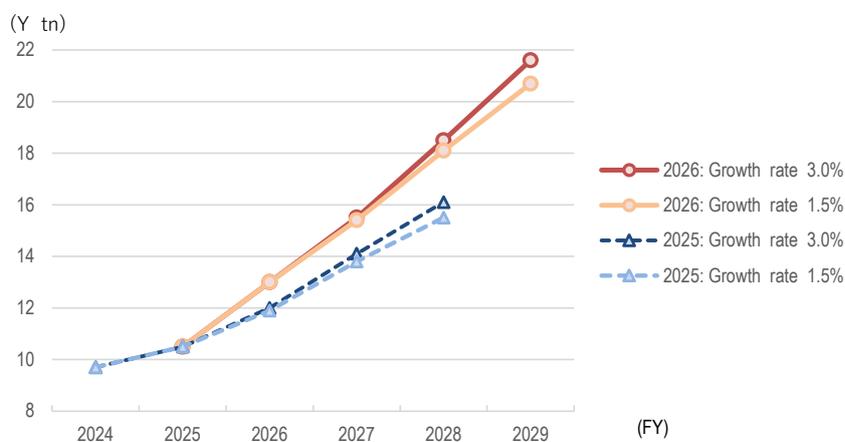
On 26 February, the government released its projections of the FY26 budget's impact on expenditures and revenues in later fiscal years (hereafter referred to as "projected impacts on later years"). Compared to the FY25 budget, the most noticeable factor is that interest payments on JGBs are higher-than-expected due to rising yields. However, the fiscal situation cannot be assessed based on that alone. Tax revenues are also higher-than-expected and, based on the initial budget, the primary balance calculations point to a sustained surplus.

However, even if nominal growth remains at 3%, the surplus amount will remain below Y5.0tn even in FY29. Deficits could return, depending on the scale of fiscal stimulus. Moreover, if the "difference" (shortfall) is covered by new financial resource bonds, the trend of increasing issuance amounts would also continue. The key to achieving responsible proactive fiscal policy lies in restraining the amount of fiscal stimulus and improving cost-effectiveness.

Interest payments on JGBs: Higher-than-expected due to rising yields

The projected impacts on later years automatically estimates the figures for the general account initial budget over the next three years, based on the policies and systems determined in the initial budget for that fiscal year. Comparing the FY25 budget with the FY26 budget, the higher-than-expected interest payments on JGBs are the first thing that grabs our attention. Interest payments on JGBs as of FY28 increased from around Y16tn for FY25 and to a low Y18tn level for FY26. The latter showed for the first time that interest payments on JGBs as of FY29 are around Y21tn, calculated to increase by around Y8.0tn over three years from FY26 (Chart 1).

Chart 1: Interest Payments on JGBs Based on Projected Impacts on Later Years (FY25 vs. FY26)



Source: MOF, compiled by Daiwa.

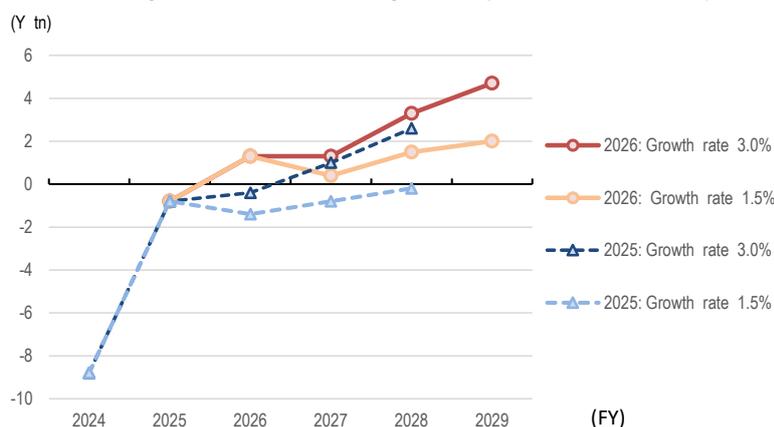
The overshoot of assumed yield levels significantly contributed to the higher-than-expected interest payments on JGBs. When comparing 10-year JGB yields, the FY25 budget assumed a rise from a 2% yield in FY25 to a 2.5% yield in FY28 under the 3% nominal growth rate scenario (yield is assumed to remain unchanged at 2% under the 1.5% nominal growth rate scenario). However, the FY26 budget assumes a rise from 3% in FY26 to 3.6% in FY29 under the 3% nominal growth rate scenario (yield is assumed to remain unchanged at 2% under the 1.5% nominal growth rate scenario).

Primary balance: Surplus continues based on initial budget, but amount is modest

Comparing the FY25 budget with the FY26 budget, tax revenues are also higher-than-expected.

The government's primary balance in the general account has also included upward revisions in terms of the surplus periods and amounts on an initial budget basis. The primary balance surplus in the FY25 budget will only occur for two years, specifically Y1.0tn in FY27 and Y2.6tn in FY28, under the 3% growth rate scenario. However, the FY26 budget projects a surplus of Y1.3tn in FY26, followed by an increase to Y4.7tn in FY29 with a 3% growth rate. Even with a growth rate of 1.5%, this figure remains flat at Y2.0tn, but a surplus is maintained (Chart 2).

Chart 2: Primary Balance Based on Projected Impacts on Later Years (FY25 vs. FY26)



Source: MOF; compiled by Daiwa.

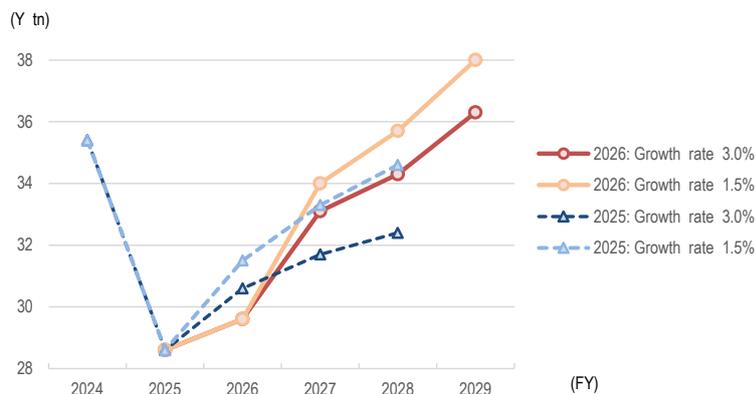
Note: This graph depicts the initial budget for the national general account. The government has so far aimed to achieve surpluses in the primary balances of national and local government accounts. Local governments have already achieved surpluses.

Issuance of new financial resource bonds: Sustained upward trend

The gap between total expenditures and total revenue from taxes and other sources is shown as the “difference” in projected impacts on later years. If the projected expenditures and revenues remain unchanged, the “difference” will be close to the amount of new financial resource bonds issued.

When comparing the FY25 budget “difference” and the FY26 budget “difference,” both show an increasing trend with FY25 serving as the low point. Moreover, at the time of the FY26 budget compilation, the FY26 budget was held below Y30tn at Y28.6tn and calculations show it will increase beyond the FY25 budget starting in FY27. Even as nominal GDP increases and the economy grows, the issuance of new JGBs shows no sign of slowing down despite sustained 3% economic growth (Chart 3). Even if the primary balance remains in surplus at the initial budget stage for FY26, that may not necessarily reassure the market.

Chart 3: Difference in Projected Impacts on Later Years (approximately equal to amount of newly issued financial resource bonds, FY25 vs. FY26).



Source: MOF; compiled by Daiwa.

Responsible proactive fiscal policy: Fiscal stimulus must restrain spending, improve quality

The projected impacts on later years are automatically estimated based on the initial budget's systems and policies for that fiscal year. Future policy additions are not factored in. For example, growth and crisis management investments, additional measures to counter rising prices, further increases in defense spending, and consumption tax cuts are also not included as prerequisites.

If the administration of Prime Minister Sanae Takaichi pursues even greater proactive fiscal policy going forward, the amount of newly issued financial resource bonds could be higher-than-expected, even if a nominal growth rate of 3% is secured. Also, the primary balance surplus based on the initial budget is only Y4.7tn even in the 3% growth scenario for FY29, which is not necessarily substantial. Unless fiscal stimulus is significantly curtailed or new revenue sources are secured, the primary balance is likely to slip back into a deficit.

Moreover, there is no guarantee that fiscal stimulus will necessarily lead to 3% growth.

In order for the market to have confidence in "responsible proactive fiscal policy," the administration will need to set fixed limits to restrict the scale of fiscal stimulus. It must strive to secure revenue sources through expenditure reforms and other measures. It must also strictly adhere to the so-called "wise spending" approach, selecting those fiscal stimulus measures most likely to lead to economic growth. The formulation of growth strategies that do not rely solely on fiscal stimulus measures, such as deregulation, will be required.

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