Daiichi Life Research Institute

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Commentary on the Council on Economic and Fiscal Policy (July 30, 2026)

~Cabinet Office Mid-Year Projections, Long-Term Economic and Fiscal Projections, Overview of the Budget, and Guidelines for FY2027 Budget Requests~

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(Executive Summary)

○ According to the Cabinet Office Mid-Year Projections, real GDP growth is expected to expand to around 0.9% in FY2026 and around 1.1% in FY2027, driven by wage increases, policy effects, and a recovery in domestic demand. Regarding prices, wages, and consumption, the GDP gap will shift to excess demand, and real wages will remain positive as nominal wage growth outpaces inflation, continuing to drive steady increases in private consumption. Capital expenditure and exports will maintain an upward trajectory, supported by government investment promotion measures and the recovery of the global economy.

○ According to the Long-Term Economic and Fiscal Projections, under Case ① of the Growth Strategy Realization Scenario, potential growth rises to the upper 1% range, with nominal GDP expanding to around 1,100 trillion yen by FY2040. In the Baseline Projection Case, potential growth slows to the lower 0% range, leaving nominal GDP at around 930 trillion yen. As for fiscal indicators, under Growth Strategy Realization Case ①, the debt-to-GDP ratio declines steadily, and the primary balance (PB) turns positive in FY2027 and expands thereafter. Under the Baseline Projection Case, the PB falls back into a deficit in the late 2030s.

○ Regarding the Overview of the FY2027 Budget and the Budget Request Guidelines (Draft), macro-economic and fiscal management will shift the core fiscal management target from the PB target to a "stable reduction of the debt-to-GDP ratio" under "responsible proactive fiscal policy." Budgetary reforms and request rules will establish an uncapped "Strong and Prosperous Japan Investment Facility" and promote a departure from reliance on supplementary budgets. Social security expenses will be requested within the scope of natural increases, while permanent measures previously funded via supplementary budgets will be incorporated into the initial budget.

○ As the author's recommendations, regarding the shift in targets and market communication, it is necessary to carefully explain to the market that lowering the debt-to-GDP ratio is a stricter target than achieving a PB surplus, and does not represent a loosening of fiscal discipline. Regarding information disclosure and comparison standards for the budget, to prevent misunderstandings arising from the exit from supplementary budget reliance, information should be presented using comparisons like "the previous year's supplementary budget + the prior year's initial budget" or

"as a ratio to nominal GDP," rather than simple comparisons with the previous year's initial budget. Finally, regarding the evaluation of the social security burden ratio, structural distortions mean that numerical reductions can occur due to the composition of national income without providing actual burden relief; thus, strict verification and management including the "quality of growth and distribution" are essential.

1. Introduction

At the Council on Economic and Fiscal Policy held on July 30, 2026, discussions took place regarding the Cabinet Office Mid-Year Projections, the Long-Term Economic and Fiscal Projections, the Overview of the Budget, and the Guidelines for FY2027 Budget Requests. Based on the meeting materials, this paper presents the details discussed at the council along with the author's opinions.

2. Cabinet Office FY2026 Mid-Year Projections

(1) Economic Growth Outlook In FY2026 (FYR8), despite downward pressures such as rising crude oil prices, real GDP growth is projected to reach around 0.9% (nominal GDP growth around 3.0%), supported by income growth from wage hikes and policy effects. In FY2027 (FYR9), real GDP growth is expected to accelerate to around 1.1% (nominal GDP growth around 3.9%), driven by strengthened crisis management and growth investments as well as a continued recovery in domestic demand.

(2) Prices, Wages, and Supply-Demand Balance The GDP gap is expected to remain positive (excess demand) through FY2027. Consumer price inflation (headline) is projected to be around 2.2% in FY2026 and around 2.1% in FY2027.

Driven by tight labor market conditions, nominal wage growth will continue (around 3.1% in both fiscal years), maintaining positive real wage growth above inflation and sustaining a gradual increase in private consumption.

(3) Capital Expenditure and Exports Capital expenditure will maintain an upward trend supported by government investment promotion measures, despite being influenced by conditions in the Middle East. Exports are also expected to remain on an increasing trend in tandem with the global economic recovery.

3. Long-Term Economic and Fiscal Projections

Long-term economic and fiscal projections through FY2040 were modeled across three cases depending on the degree to which growth strategy effects materialize. Note that from FY2027 onward, an additional fiscal expenditure of a real 10 trillion yen per fiscal year is mechanically assumed.

(1) Economic Scenarios and Growth Outlook

- **Growth Strategy Realization Case ①** (where effects of innovation and resource allocation efficiency fully materialize): Potential growth rises to the upper 1% range. By FY2040, nominal GDP reaches approximately 1,100 trillion yen, and domestic private capital expenditure expands to around 240 trillion yen.
- **Growth Strategy Realization Case ②** (centered on public-private investment effects): Potential growth trends in the mid-1% range. Nominal GDP exceeds 1,040 trillion yen in FY2040.
- **Baseline Projection Case** (reflecting only the demand effects of additional fiscal spending): Potential growth slows to the lower 0% range. Nominal GDP in FY2040 remains around 930 trillion yen.

(2) 「Fiscal Indicators (Debt-to-GDP Ratio & Primary Balance)

- **Public Debt-to-GDP Ratio**: Under Growth Strategy Realization Case ①, high economic growth rates and PB surpluses outweigh interest expense increases (interest rate factors), resulting in a steady decline throughout the projection period. Under the Baseline Projection Case, it turns upward around FY2030.
- **Primary Balance (PB)**: After achieving near-balance in FY2025 (-0.2 trillion yen, -0.0% of GDP), the PB turns positive in FY2027 (+1.4 trillion yen, +0.2% of GDP) under Growth Strategy Realization Cases ① and ②, with the surplus widening through the mid-2030s. Under the Baseline Projection Case, the surplus gradually shrinks and falls back into deficit in the late 2030s.

4. Overview of the FY2027 Budget (Draft) – Private-Sector Members' Proposal

Basic Principles of Macroeconomic and Fiscal Management Aiming to achieve both a "strong economy" and "fiscal sustainability" based on "responsible proactive fiscal policy." Moving a step beyond the traditional PB target (in place since the Basic Policy 2001), the core fiscal management target will be centered on "stable reduction of the debt-to-GDP ratio" in line with Basic Policy 2026. The PB will be improved and managed over a multi-year framework.

Key Points of Budgetary Reform

- Establish the "Strong and Prosperous Japan Investment Facility" to execute a budget allocation suitable for the "First Year of Responsible Proactive Fiscal Policy."
- Shift toward initial budget structures that depart from reliance on supplementary budgets, appropriately reflect price and wage increases, and align with growth enhancement and nominal economic expansion.
- Advance concrete issues such as social security reform (refundable tax credits, review of co-payment rates), prioritized investment in education and research, and reform of public works evaluations.

5. Guidelines for FY2027 Budget Requests (Draft)

Establishment of the "Strong and Prosperous Japan Investment Facility"

- Create this investment facility separately from general expenditure, establishing an uncapped framework for requests (allowing item requests).
- Consider separate management under special accounts with multi-year secured funding for key areas such as economic security.

Request Rules for Each Expenditure Category

- **Social Security Expenses** (pensions, medical care, etc.): Request within the range of natural growth (+390 billion yen), adding price/wage trends and aging factors during the budget formulation process.
- **Expenses for Defense Capability Enhancement Plan**: Request based on the Defense Capability Enhancement Plan.

- **Discretionary Expenditure** (other expenses): Request within the same amount as the previous year's initial budget, allowing an additional request facility of up to +20%.

Operational and Reform Guidelines

- Transition permanent measures previously addressed via supplementary budgets into the initial budget.
- Reflect self-review results of subsidies and funds to enforce expenditure prioritization and thorough PDCA cycles.

6. Author's Recommendations

Based on the above, the author presented recommendations at the Council meeting focusing on three aspects: "Shift in fiscal management targets and market understanding," "Clear communication and comparison standards for budget formulation," and "Evaluation and management of the social security burden ratio (KPI)."

First, regarding the **shift in fiscal management targets and market understanding**, the author noted that the near-balancing of the PB in the previous fiscal year was an advanced outcome driven by higher-than-expected baseline tax revenue growth, making it logical to anchor "debt-to-GDP ratio reduction" as the core target. Furthermore, assuming a scenario where government bond yields exceed nominal growth rates, lowering the debt-to-GDP ratio is a stricter target than achieving a PB surplus; thus, it is necessary to convey to the market that this does not represent a relaxation of fiscal discipline. Additionally, it should be carefully explained that the term "fiscal consolidation" was removed because it often implies fiscal tightening or austerity, which could cause misunderstandings.

Regarding **clear communication and comparison standards for budget formulation**, because the departure from supplementary budget reliance will significantly alter initial budget structures, simple comparisons with the previous year's initial budget would be misleading. It is crucial to disclose information using comparisons such as "the year before last's supplementary + previous year's initial" as well as comparisons as a "ratio to nominal GDP," rather than just absolute amounts. Furthermore, budget request comparisons should be presented on a standard that includes special accounts.

Regarding the **evaluation and management of the social security burden ratio (KPI)**, the author pointed out a structural distortion: because the denominator, "national income," includes corporate profits and primary income from overseas investment, corporate wage suppression or overseas profit retention can expand the denominator, causing an apparent decline in the burden ratio even if household burdens remain unchanged. Therefore, rather than solely pursuing numerical targets, it is essential to rigorously verify and manage the "quality of growth and distribution," including domestic investment feedback and labor distribution.