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

~ Agenda for the New Cabinet to Address by the End of the Year, and Macroeconomic Management ~

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(Executive Summary)

- Proposals from Private-Sector Members: A proposal was made to break away from chronic reliance on supplementary budgets and the harmful effects of single-year budgeting, establishing FY2027 as the "First Year of Responsible Active Fiscal Policy." The proposal emphasizes setting up a priority investment framework, reviewing expenditure, implementing living assistance, and securing fiscal trust through measures such as the "stable reduction of the debt-to-GDP ratio" looking toward 2040.
- Report from Bank of Japan (BOJ): Following the raise of the policy interest rate to around 1.25% in September 2026, BOJ Governor Ueda reported that the economy is moderately recovering supported by growing AI demand and employment improvements. As underlying inflation approaches the 2% target, the BOJ plans to adjust the degree of monetary accommodation step by step while monitoring upside risks to prices.
- Proposals regarding Interest Rates & Prices: Private-sector members noted that while rising long-term interest rates and surging food prices burden low- and middle-income earners, interest rate hikes also bring positive aspects—such as increased interest income on deposits and increased purchases of Japanese Government Bonds (JGBs) by overseas investors—despite increasing mortgage burdens. They proposed that the government and BOJ coordinate to promote tax relief awareness for mortgages and consider new retail JGB products.
- Author's Recommendations: Reducing the consumption tax on food items is a highly tangible price-mitigation policy that directly eases the burden on households, mitigates regressivity, and helps establish institutional infrastructure for flexible tax rate adjustments during crises. From the perspective of accurate tax revenue realities and communication, the FY2026 tax revenue estimate is an underestimate; assuming 3% nominal growth, actual revenue is expected to reach around 90 trillion yen, requiring data-driven, balanced dialogue with markets and the media. Regarding interest rate impacts, household financial assets exceed liabilities overall, yielding significant benefits from interest income, while rising yields attract top global institutional investors back to JGBs. Finally, regarding spillover effects, the rise in Japan's long-term interest rates is primarily driven by spillovers from the U.S., refuting concerns that Japanese fiscal risk is the cause; however, attention must be paid to rising interest payment costs, balancing growth acceleration with fiscal sustainability.

1. Introduction

At the Council on Economic and Fiscal Policy held on September 30, 2026, discussions centered on the agenda for the new cabinet to address by the end of the year and macroeconomic management.

This paper introduces the contents discussed at the meeting along with the author's commentary, based on the meeting materials.

2. Execution and Establishment of "Responsible Active Fiscal Policy"

As a touchstone for the FY2027 budget, private-sector members proposed designating FY2027 as the "First Year of Responsible Active Fiscal Policy," striving to break away from constant dependence on supplementary budgets and establishing a framework to rectify the drawbacks of single-year budgeting.

From the perspective of establishing a priority investment framework titled "Strong and Wealthy Japan," focus should be placed on key areas contributing to growth capacity, supply capabilities, and economic security, with reviews based on PDCA/EBPM and multi-year funding arrangements.

Regarding integrated revenue and expenditure reform:

Expenditure Review: Re-examine special tax measures and subsidies, return/utilize surpluses from special accounts and funds, and conduct zero-based reviews of past price-mitigation measures in supplementary budgets.

Household Burden Relief: Temporary reduction of the consumption tax rate on food and beverages (for 2 years), support funds to reduce worker burdens, and reductions in social insurance premiums through social security reform.

Furthermore, from the viewpoint of fiscal sustainability toward 2040, market trust must be secured through core targets such as "stably lowering the debt-to-GDP ratio" and achieving multi-year improvements in the primary balance (PB).

3. Monetary Policy and Economic/Price Outlook

BOJ Governor Ueda reported the monetary policy decision (September 2026) to raise the uncollateralized overnight call rate target from around 1.0% to around 1.25%.

Economic and Price Conditions & Outlook: The economy continues a moderate recovery, supported by medium- to long-term increases in AI demand and improvements in employment and income environments.

Price Trends: Underlying inflation is approaching the 2% price stability target. As inflation may exceed 2% in the second half of FY2026 and beyond, the BOJ intends to adjust the degree of monetary accommodation incrementally while closely monitoring upside risks.

4. Changes in Price/Interest Rate Environment and Macroeconomic Management

Private-sector members highlighted current economic, price, and interest rate conditions: while final demand remains firm and economic recovery continues, Japan's 10-year JGB yield has risen to around 3% due to Middle East tensions, high crude oil prices, and rising global long-term interest rates. Although real wages have turned positive, food price increases since the COVID-19 pandemic have outpaced other goods and wages, burdening low- and middle-income households.

Regarding the impacts of interest rate hikes and countermeasures:

Households: While interest income on deposits (1,018 trillion yen) increases, mortgage burdens grow—especially for households in their 30s and 40s. Measures such as interest rate reduction support (e.g., Flat 35 fixed-rate refinancing) and publicizing mortgage tax deductions should be promoted.

Corporations: Financing conditions are generally favorable, but variations in impact depending on business scale and debt structure need careful monitoring.

JGB Market: Designing attractive new retail JGB products should be considered to build a stable JGB holding structure.

Government-BOJ Coordination: The government and the BOJ must coordinate closely to stabilize expected inflation rates and reconcile economic growth with price stability.

5. Author's Recommendations

Based on the above, the author presented recommendations during the meeting regarding the new cabinet's agenda and macroeconomic/fiscal management:

Effects of Consumption Tax Cuts on Food & Beverages:

Immediate Impact: Previous measures (gasoline subsidies, electricity/gas relief, tuition/school lunch relief, which lowered inflation by ~1% point) lacked tangible visibility for citizens. Cutting tax rates on high-frequency food purchases provides an immediate, tangible benefit.

Institutional Infrastructure: It is crucial to build institutional infrastructure in Japan—similar to European nations—allowing flexible VAT rate adjustments during crises.

Price Competition & Regressivity: Inducing retail price competition is expected to push inflation down by over 1 percentage point while directly alleviating the tax burden on low- and middle-income groups with high food expenditure ratios, thereby mitigating consumption tax regressivity.

Tax Revenue Realities and Dialogue with Markets/Media:

Underestimation: The FY2026 tax revenue estimate is overly conservative compared to the previous year's actual results. Assuming 3% nominal growth, actual tax revenue is projected to reach around 90 trillion yen.

Balanced Communication: Some market participants and media outlets ignore rising tax revenues and primary balance improvements, focusing solely on spending expansion. Balanced dialogue based on verified data is essential.

Interest Rate Trends and Impact on Households, Corporations, and Markets:

Households: While mortgage-holding generations face higher burdens, household financial assets exceed liabilities overall, meaning the positive impact of increased deposit interest income is significant.

Return of Global Investors: Higher yields restore market functionality and attract premier global institutional investors (such as Norway's sovereign wealth fund) back to JGBs and yen assets, contributing to stable debt ownership and curbing yen depreciation.

Corporate & Policy Coordination: Corporate financing remains generally sound, but close monitoring and tight government-BOJ coordination remain vital to ensure sustainable growth and price stability.

Spillover Effects of U.S. Long-Term Interest Rates (Term Premium):

Causality Analysis: Empirical testing (Granger causality analysis using post-2024 data) clearly demonstrates that long-term rate increases and term premium expansions spill over from the U.S. to Japan.

Implications for Fiscal Sustainability: Concerns that Japanese fiscal risks are driving up U.S. rates are statistically refuted. However, attention must be paid to rising debt servicing costs due to U.S.-led rate increases, making it imperative to boost growth rates while maintaining fiscal sustainability and market confidence.