Fiscal stimulus won’t boost growth much

- The fiscal stimulus package unveiled today will include much less fresh spending than the headline suggests. And the bulk of the spending will merely offset the unwinding of previous stimulus measures rather than result in a major fiscal expansion. Even so, the measures reduce the pressure on the Bank of Japan to ease policy and we reiterate our long-held view that the Bank will keep interest rates unchanged.

- Two weeks ago, the government indicated that it will compile a fiscal stimulus package worth ¥10tn. The headline figure has ballooned since then, with press reports today suggesting it will be as large as ¥26tn (5% of GDP). However, the Japanese government has a long history of presenting vastly inflated stimulus figures. (See our Update, “Stimulus package doesn’t let the BoJ off the hook”, 2nd Aug. 2016.) Today is no different.

- According to a draft seen by Bloomberg, around ¥13tn constitutes spending by the private sector, which shouldn’t be included in the headline figure. ¥3.8tn will be devoted to loans. Given that bank lending rates are near record lows and banks are the most willing to lend since the early 1990s, credit shouldn’t be too difficult to obtain for creditworthy borrowers. Fresh public spending will amount to a much smaller ¥9.4tn. That’s still equivalent to a sizeable 1.7% of GDP though and explains why the government is projecting a 1.4% boost to real GDP from the measures announced today.

- By contrast, we believe that the impact on growth will be much smaller. The ¥9.4tn includes around ¥1.5tn in spending by local governments, with the remainder spread out across the customary supplementary budget due at the end of the year and the regular budget for the fiscal year that starts in April. The supplementary budget will reportedly include spending of around ¥4.3tn, which wouldn’t be much larger than the ¥3.9tn in spending included in the two supplementary budgets of the previous fiscal year. And the regular budget for this year included ¥2.0tn in extraordinary spending to offset the impact of the sales tax hike. The net boost to public spending from the measures announced today will therefore be only ¥3.5tn, or 0.7% of GDP.

- However, it remains to be seen whether the budget for the coming fiscal year will foresee such a large increase in spending. After announcing a ¥7.5tn fiscal stimulus package in August 2016, the government raised spending in the following supplementary and regular budgets by less than ¥2tn combined, which explains why public demand didn’t rise much in the year after the stimulus package was announced. (See Chart 1.) What’s more, budgeted expenditure doesn’t always provide reliable indications about actual changes in public spending. (See Chart 2.)

- For now, we’re sticking to our forecast of a ¥1.5tn rise in public demand in 2020 and reiterate our forecast of a 0.2% drop in GDP next year. Even if budgeted spending rises by as much as the government has pledged, we estimate that GDP would merely stagnate rather than expand. That said, the fiscal stimulus measures announced today reduce the pressure on the Bank of Japan to provide additional stimulus even if the economy slows more sharply than we currently anticipate after the sales tax hike.

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**Chart 1: Public Demand (Value, Yen Tn)**

- 2016 fiscal stimulus package

**Chart 2: Annual Change in Public Spending (Yen Tn)**

- Actual
- Regular & Supplementary Budget

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