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Economic Policy under the Takaichi Administration and Fiscal Sustainability

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Government Debt-to-GDP Ratio Shows Signs of Improvement

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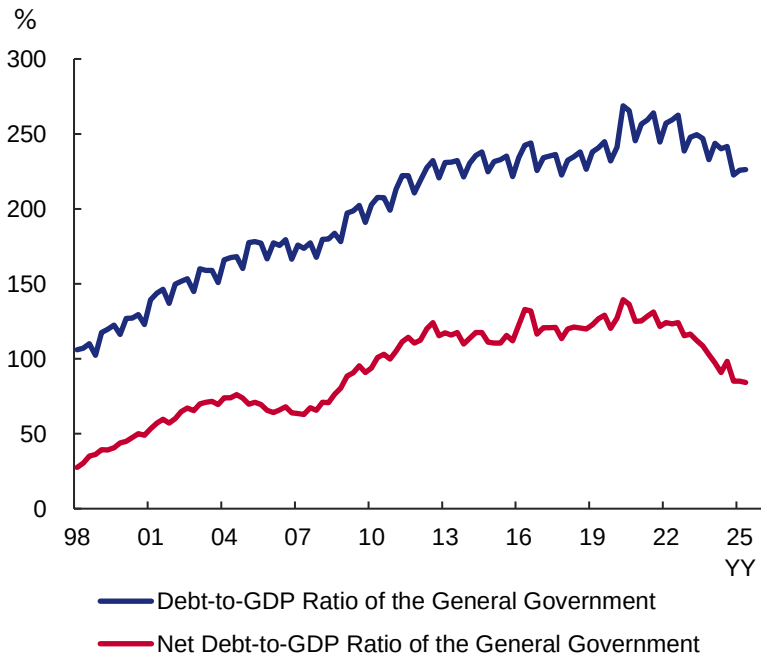
Prime Minister Takaichi has taken office with a policy approach that is considered by market participants to reflect elements of Abenomics, particularly a supportive stance on fiscal spending and monetary easing. As the Bank of Japan (BoJ) moves toward normalising its monetary policy, the prospect of fiscal expansion has prompted concerns in some quarters regarding the long-term sustainability of Japan's public finances.

Japan's government debt has surpassed 1,400 trillion yen. According to the Ministry of Finance, the outstanding balance of general government bonds is projected to reach 1,129 trillion yen by the end of fiscal year 2025, with annual interest payments exceeding 10 trillion yen. The debt-to-GDP ratio remains above 200%.

On the other hand, general account tax revenues have exceeded 70 trillion yen since fiscal year 2022, reflecting an improving fiscal position. According to the BoJ's Flow of Funds statistics, the debt-to-GDP ratio has declined to pre-pandemic levels. Moreover, the net debt-to-GDP ratio—which deducts government-held financial assets from gross debt—has fallen below 100%, a metric that Prime Minister Takaichi has highlighted as particularly important (Figure 1).

Figure 1: Historical Trends in the Government Debt-to-GDP Ratio



Source: INDB, Asset Management One Co., Ltd.
Note: Quarterly Data from March 1998 to June 2025

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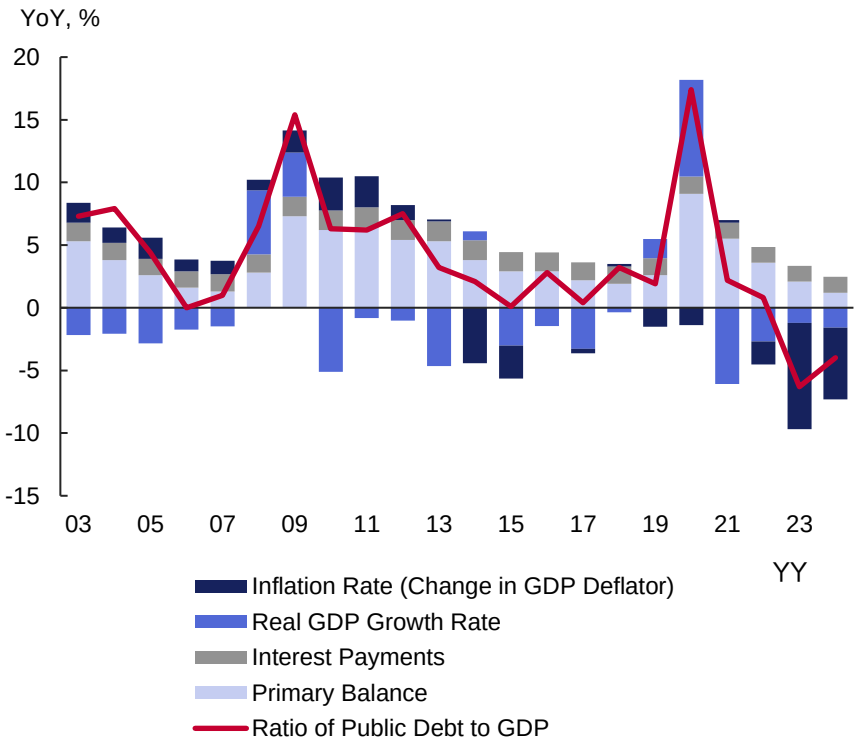
Inflation Contributes to Lower Debt-to-GDP Ratio

An analysis of the year-on-year changes in Japan's government debt-to-GDP ratio (Figure 2) reveals that price fluctuations, which had previously contributed to an increase in the ratio until the early 2010s, began to exert downward pressure from fiscal year 2014 onward, as Japan started to emerge from deflation. Since fiscal year 2022, with inflation becoming more entrenched, it has played a significant role in reducing the ratio.

During the post-pandemic recovery, real GDP growth has also contributed to lowering the debt burden. In parallel, rising tax revenues have brought the primary balance—defined as the fiscal balance excluding interest payments—closer to surplus, further easing upward pressure on the debt-to-GDP ratio.

Interest payments, meanwhile, have consistently added to the ratio. However, the weighted average interest rate on general government bonds has remained near zero since fiscal year 2017. Despite the growing stock of government debt, persistently low interest rates have helped contain the increase in debt servicing costs.

Figure 2: Decomposition of the Public Debt-to-GDP Ratio



Source: Asset Management One Co., Ltd., Japan Cabinet Office
Note: 1. Annual data from FY 2003 to FY 2024,
2. The public debt balance (including ordinary government bonds, local government bonds, general account borrowings, tax allocation special account borrowings, etc., representing long-term liabilities arising from general policy expenditures) is used. Interest payments are based on the general account.,
3. Figures up to FY 2023 are actual results; FY2024 is an estimate.
4. Due to the use of simplified estimation methods, numerical values may contain errors.

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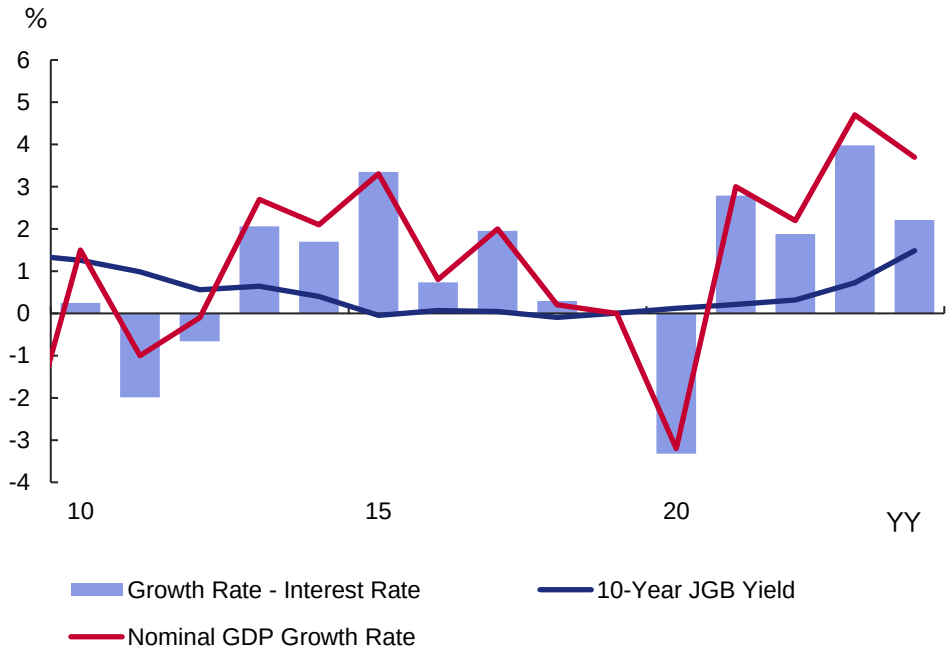
The Importance of Nominal GDP Growth

As illustrated in Figure 2 on the previous page, changes in Japan's government debt-to-GDP ratio are shaped by two key factors: (1) nominal GDP growth—comprising real GDP growth and the GDP deflator—and interest payments, and (2) the primary balance. While the primary balance is now trending toward surplus, the so-called Domar condition, in which nominal GDP growth exceeds the interest rate, is becoming increasingly relevant.

Over the past decade, Japan's low interest rate environment has frequently enabled nominal GDP growth to outpace interest rates (Figure 3). Looking ahead, with the BoJ expected to raise rates upon achieving its inflation target, and the Takaichi administration pursuing expansionary fiscal policy, concerns may emerge regarding rising interest payments and increased government spending.

Nonetheless, nominal GDP growth has recently played a significant role in improving the debt-to-GDP ratio. In the context of a shift toward a more inflationary environment, whether nominal GDP growth continues to exceed interest rates will be a critical determinant of the long-term sustainability of Japan's public finances.

Figure 3: Nominal GDP Growth Rate and 10-Year Government Bond Yield



Source: Asset Management One Co., Ltd. , INDB
Note: Annual data from FY2010 - FY2024

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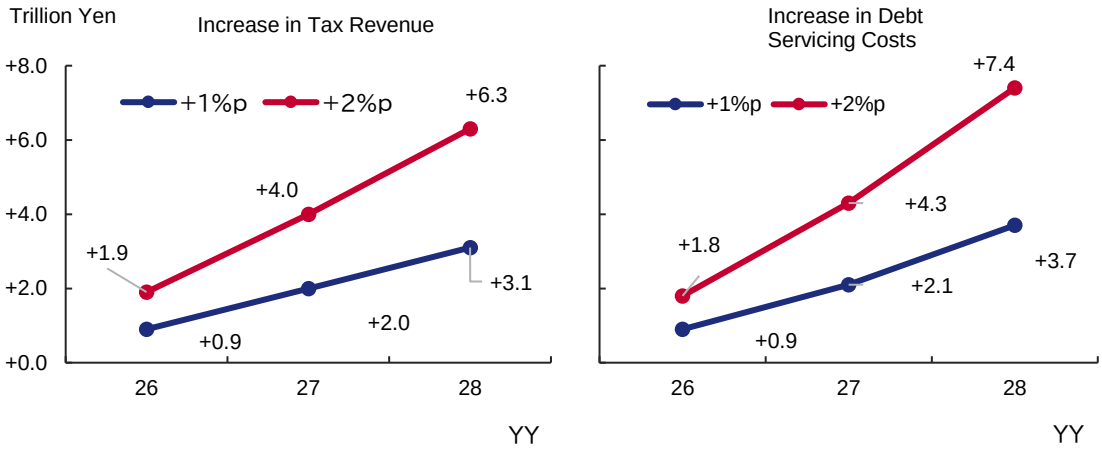
Responsible Expansionary Fiscal Policy under the Takaichi Administration

When evaluating Japan's fiscal outlook, it is essential to consider both government expenditures and revenue sources, particularly tax income, which tends to rise in tandem with nominal GDP growth. According to estimates from the Ministry of Finance, the potential increase in debt servicing costs e.g., interest payments, resulting from higher interest rates could be largely offset should nominal GDP expand concurrently, thereby boosting tax revenues (Figure 4).

The Japan Innovation Party, currently in coalition with the Liberal Democratic Party, has identified sustained nominal economic growth as a key objective of monetary policy. It advocates a balanced approach to fiscal and monetary policy that supports both economic recovery and price stability. Prime Minister Takaichi has emphasized that demand-pull inflation—driven by rising wages and stronger domestic demand—is the most desirable form of inflation. Rather than relying solely on growth derived from increases in the GDP deflator (Figure 5), the administration aims to foster expansion through real GDP growth.

The Takaichi administration's proposed measures—including household support and bold investment incentives—are designed to stimulate growth without triggering excessive inflation. If successful, these policies could lead to higher tax revenues, exemplifying a responsible and sustainable approach to expansionary fiscal policy. Such an outcome would be both economically sound and strategically necessary.

Figure 4: Estimation of the Impact of the Budget on Future Fiscal Expenditures and Revenues



Source: Asset Management One Co., Ltd., Ministry of Finance of Japan
Note: 1. From FY2026 to FY2028, the annual nominal economic growth rate is assumed to be +3.0%, the consumer price inflation rate +2.0%, and the 10-year government bond yield is assumed to be 2.2% in FY2026, 2.4% in FY2027, and 2.5% in FY2028.
2. Assumptions:
Scenario 1: deviation of +1% in both nominal economic growth rate and interest rate from the above assumptions.
Scenario 2: A deviation of +2% in both nominal economic growth rate and interest rate from the above assumptions.

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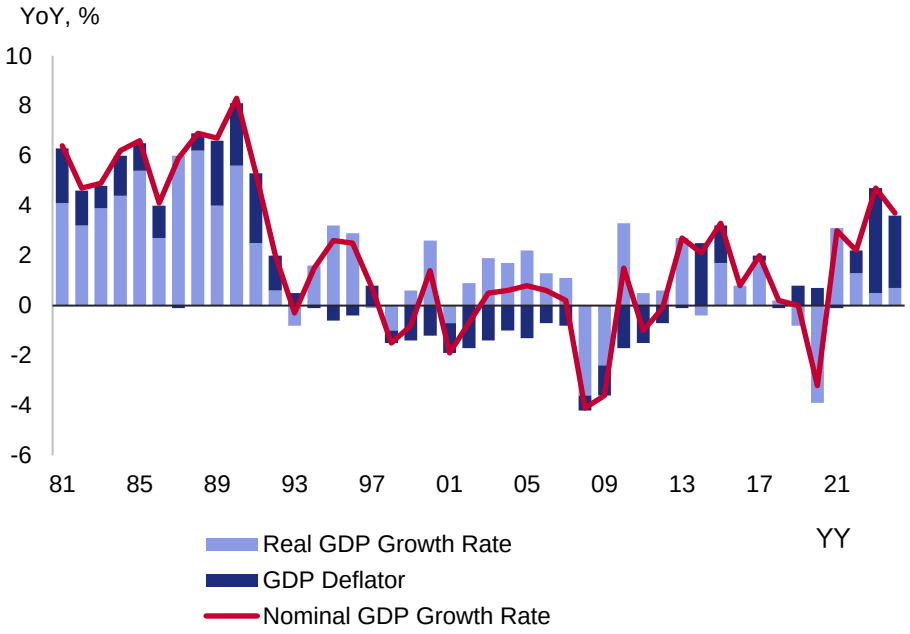
Figure 5: Breakdown of Nominal GDP Growth Rate



Source: Asset Management One Co., Ltd., INDB
Note: Annual data from FY1981 to FY2024

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