23 January 2013 (No. of pages: 3)

Japanese report: 21 Jan 13

FY12 Supplementary Budget Will Boost FY13 GDP by 0.7 Points

Reactionary plunge likely in FY14

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Summary

- The cabinet approved the draft of the FY12 supplementary budget on 15 January in order to carry out the Abe administration's economic measures, Emergency Economic Measures for the Revitalization of the Japanese Economy, approved 11 Jan by the cabinet.

- The FY12 supplementary budget amounts to Y10.2 trillion, the largest figure following that for FY09 in the wake of the Lehman crisis, of which we expect Y4.7 trillion to go to actual public works spending, boosting FY13 GDP by 0.7-percentage points.

- Fiscal policy management plays a role in economic stability. However, budgets enabling large-scale public works spending have often been followed by reactionary plunges. This, combined with a situation where budget execution for reconstruction projects for 2011 quake/tsunami affected areas is expected to play out gradually in FY13, will likely result in a plunge in public works spending, dragging down real GDP growth by 0.9-percentage points in FY14. At the same time, personal consumption is likely to see a reactionary plunge following front-loaded consumption in advance of the expected consumption tax hike in April 2014. As such, repercussions from policy measures are expected to substantially depress GDP growth in FY14. Thus, we expect the FY13 principal budget, which is likely to be approved by the cabinet shortly, to take into account factors impacting following years.

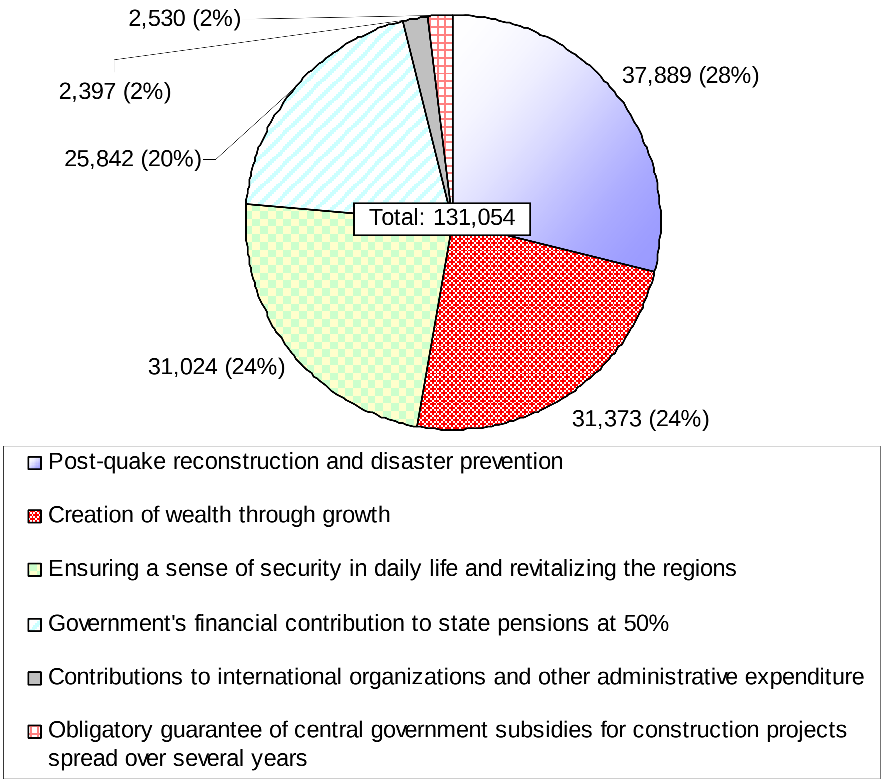
FY12 supplementary budget draft approved 15 Jan by cabinet

The cabinet approved the draft of the FY12 supplementary budget on 15 January in order to carry out the Abe administration's economic measures, Emergency Economic Measures for the Revitalization of the Japanese Economy, approved 11 Jan by the cabinet. In this report, we analyze the impact of the supplementary budget on the economy.

Framework of supplementary budget

The FY12 supplementary budget amounts to Y10.2 trillion, the largest figure following that for FY09 in the wake of the Lehman crisis (including expenditures earmarked in the regular budget but not executed yet, the total supplementary budget amount will be Y13.1 trillion). The supplementary budget include (1) post-quake reconstruction and disaster prevention, (2) creation of wealth through growth, and (3) ensuring a sense of security in daily life and revitalizing the regions, for which Y3.8 trillion, Y3.2 trillion, and Y3.1 trillion have respectively been allocated, all exceeding Y3 trillion (Chart 1).[1]

Framework of FY12 Supplementary Budget (Y00 mil, % share) **Chart 1**



Source: Ministry of Finance; compiled by DIR.

Looking closely at the supplementary budget, the proportion of public works spending is high in response to the "national land strengthening plan" proposed by the governing Liberal Democratic Party. Of an additional Y5.5 trillion from the issuance of construction bonds, Y4.7 trillion will go to actual public works spending (Y0.8 tril will go to equity investment in public corporations).[2]

Other expenditures include allowances for child rearing and increasing employment for younger generations, measures for small and medium-sized enterprises and small-scale businesses, measures inducing innovation, and measures facilitating the supply of risk money to national strategic areas.

1. The emergency measures also include those that do not require expenditures such as regulatory reform to fully harness potential, and measures for currency market stability.
2. Public works spending comprises Y2.4 trillion for public works by the central government, Y1.4 trillion in local allocation tax grants for public works by local governments, and Y0.9 trillion for facility expenses.

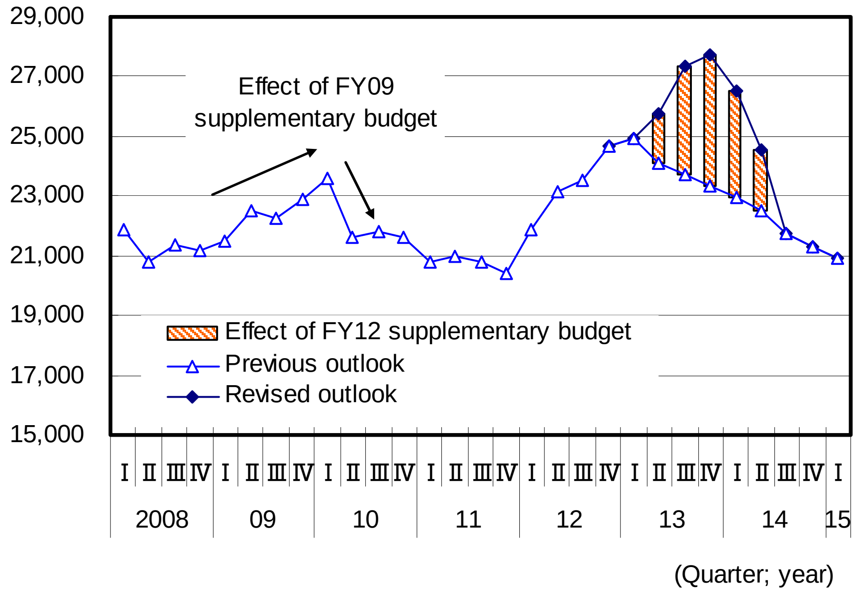
However, such measures do not have immediate effects in terms of economic growth. Thus, effects of the supplementary budget in stimulating the economy will come almost entirely through public works spending.

Impact of supplementary budget

Factoring in the positive effects ensuing from the emergency economic measures and supplementary budget, we have revised our assumption for public works spending substantially upward (Chart 2). Of Y4.7 trillion for public works spending in the supplementary budget, we assume Y4 trillion will go on spending that impacts GDP figures. Looking back, public spending impacting GDP growth has shown a tendency to be lower than budget figures because spending earmarked in budgets includes that for purchasing land, and also that not disbursed/carried over to the following fiscal year.

Based on our assumption, we expect public works spending will boost FY13 GDP by 0.7-percentage points. In the FY12 supplementary budget, public works spending is mainly allocated for projects that will have immediate effects rather than those that have strong cost efficiency. Therefore, the multiplier effect of public works spending in the supplementary budget will likely be limited to around 1.

Outlook for Public Works Spending (Y bil; annualized) **Chart 2**



Source: Cabinet Office; compiled by DIR.

Reactionary plunge likely

Fiscal policy management plays a role in economic stability. However, while economic measures may bring favorable results such as ending deflation and improving sentiment, budgets enabling large-scale public works spending have often been followed by reactionary plunges. This, combined with a situation where budget execution for reconstruction projects for 2011 quake/tsunami affected areas is expected to play out gradually in FY13, will likely result in a plunge in public works spending, dragging down real GDP growth by 0.9-percentage points in FY14. At the same time, personal consumption is likely to see a reactionary plunge following front-loaded consumption in advance of the expected consumption tax hike in April 2014. As such, repercussions from policy measures are expected to depress GDP growth substantially in FY14. Thus, we expect the FY13 principal budget, which is likely to be approved by the cabinet shortly, to take into account factors impacting following years.