Daiwa Institute of Research

16 June 2025 (No. of pages:2)

Japanese report: 29 May 2025

Japan's Long-Term Outlook Toward FY2040 No.1 (of 3)

Growth Rate of Over +1% Can Be Maintained Despite Declining Population

Addressing social security and fiscal issues in addition to strengthening growth potential is essential

Economic Research Dept.
Keiji Kanda
Munehisa Tamura
Akane Yamaguchi
Kazuma Kishikawa
Koki Akimoto
Yoshiya Kikuchi

Summary

- While the Japanese economy is gradually overcoming deflationary problems, structural challenges are piling up. Looking to the future from a demographic perspective, it is necessary to take into consideration the year 2040, when the pace of increase in the "elderly population index" (the ratio of the population 65 years or older to the working-age population) will peak. For this reason, we have compiled a three-part series report entitled "Japan's Long-Term Outlook Toward FY2040." This report, the first in the series, focuses on economic growth. Additionally, the second, published on the same day as this report, will examine social security system reform, and the third will examine fiscal consolidation.

- With its ongoing population decline, Japan must significantly strengthen its supply capacity in terms of labor and capital. If labor-related policies, such as promoting the active participation of older workers through health and continued employment, and accepting foreign workers, are implemented to the maximum degree, GDP could increase by approximately 86 tril yen by FY2040. Capital stock is estimated to be approximately 250 tril yen short, leaving significant room for increased investment in IT equipment, software, and human capital, withal of which have high marginal productivity. Increasing the capital equipment ratio in industries such as accommodation and food services, and nursing care is also necessary. Strengthening support for entrepreneurship and R&D investment, diversifying the workforce, promoting trade, and attracting foreign capital are all measures that can contribute to improving total factor productivity (TFP).

- Based on the above analytical results, we formulated three economic scenarios. The real GDP growth rate through FY2040 is projected to be -0.5% annually in the "decline scenario," +0.3%

in the “status quo scenario,” and +1.5% in the “high-growth scenario.” The decline scenario must be avoided at all costs, but even under the status quo scenario, it will not be possible to escape long-term stagnation. As shown in the second and third reports in this series, due to the rapid rise in social insurance premiums and the deterioration of fiscal conditions, there is also a possibility that the economy could eventually transition to the decline scenario.

- If the high-growth scenario is realized, disposable income for the working-age population will increase sustainably. This will make it easier to have and raise children, thereby supporting an increase in the birthrate. However, even if the high-growth scenario is realized, social insurance rates and the ratio of public debt to GDP are expected to continue rising. A three-pronged reform of the economy, social security, and fiscal policy is necessary.