

# **The Long-term Outlook for Japan's Economy and Public Finance amidst Population Decline**

## **- Envisioning Household Conditions in 2060 -**

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While Japan continues to experience low economic growth, social security benefits are expanding due to the aging population, and the cumulative increase in government debt casts uncertainty over the future of the Japanese economy. This paper lays out a “baseline scenario” (projection), assuming that both the government and the Bank of Japan will maintain their current policies. Based on a realistic economic outlook, the estimates in this paper indicate that the baseline scenario leads to a divergence of net central and local government debt as the primary balance deficit persists.

Although public opinion tends to be pessimistic in this situation, this paper demonstrates that if a moderate interest rate environment can be expected, a combination of reasonable tax increases and institutional reforms that lead to economic growth can adequately address these challenges. Assuming an annual tax increase equaling 0.12% of GDP to bring the primary balance to zero by FY2060, the net debt-to-GDP ratio would stabilize at 184%. If the burden of this tax increase is shared equally across all households, the increase in burden per household in FY2060 is estimated to be 28,000 yen per month for working households and 20,000 yen per month for elderly households.

This report also considers the following risk scenarios: (1) a continuation of the primary balance deficit, (2) a lower than expected inflation rate or a return to deflation and (3) the long-term interest rate exceeding the GDP growth rate. Furthermore, there

is also a risk that a government bond downgrade could occur at some point due to an unforeseeable event. On the other hand, the prospects for the Japanese economy will improve if Japan can achieve a 0.5% increase in annual total factor productivity (TFP) growth, which would reduce the total debt-to-GDP ratio by 19.3 percentage points by FY2060.

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