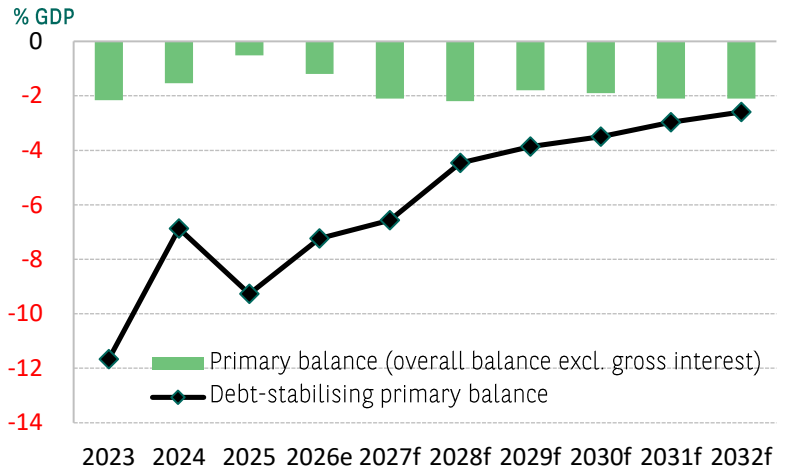
Japan: A moderately expansionary fiscal stance (1/2)

A persistent but sustainable primary deficit

Primary balance and debt-stabilising primary balance



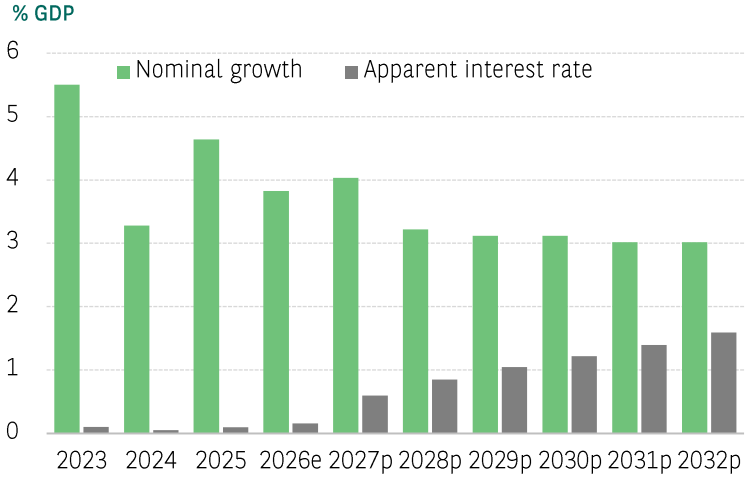
Source: IMF, BNP Paribas

Japan's primary balance deteriorated in 2026 to -1.2% of GDP, ending five consecutive years of improvement. The deficit is projected to widen further in 2027 to more than 2% of GDP, reflecting in particular the suspension of the consumption tax on food.

The government has shifted its fiscal anchor from a consolidation target (primary surpluses) to a sustainability target (no increase in the debt-to-GDP ratio). Beyond 2028, the primary deficit is projected to settle around -2% of GDP. It would remain below the debt-stabilising level, but by an increasingly narrow margin.

A favourable interest rate-growth differential

Apparent interest rate vs. nominal growth

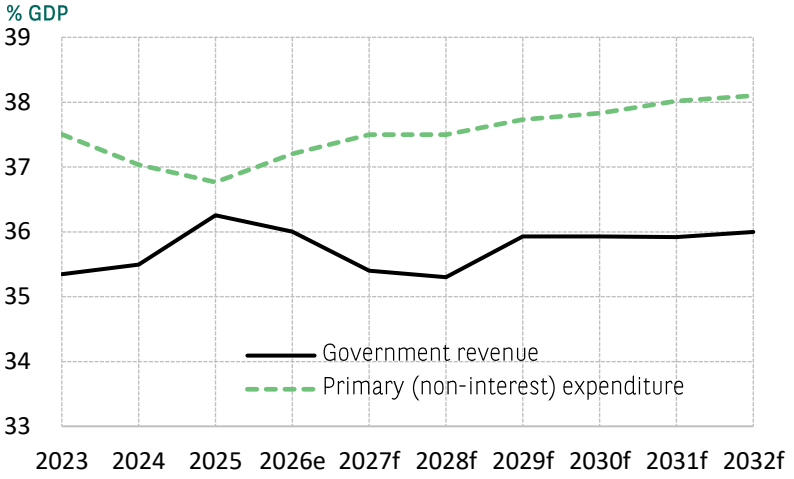


Source: IMF, BNP Paribas

Nominal growth would continue to exceed the apparent interest rate on Japan's debt, but this advantage would erode gradually. The apparent rate, close to zero through 2026, is projected to approach 1.6% by 2023 as debt is refinanced at higher rates amid monetary normalisation. Nominal growth is expected to remain robust, at around 3%, underpinned by the new growth and inflation regime. The r-g differential would therefore remain favourable, albeit to an increasing extent, narrowing the margin between the primary balance and its debt-stabilising level.

Structural and political pressures on expenditure

Revenue and primary (non-interest) expenditure



Source: IMF, BNP Paribas

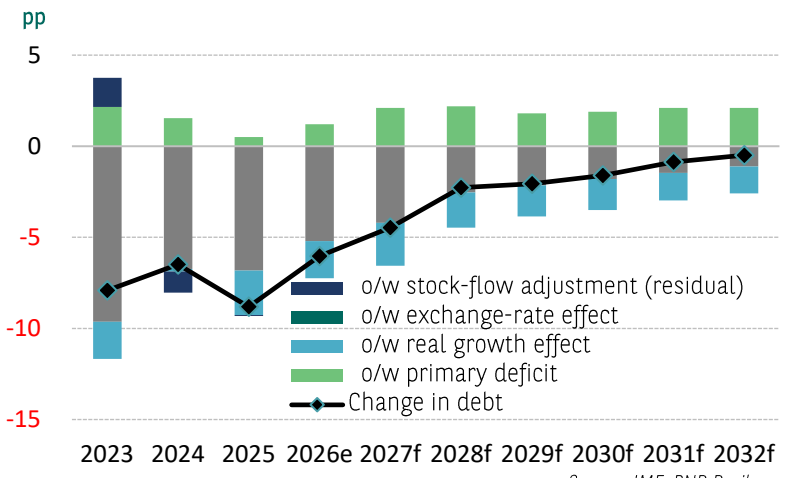
Revenue is projected to fall in 2027–2028 as a result of tax cuts (suspension of the tax on food products) before recovering thanks to nominal growth.

Revenue is projected to fall in 2027-2028 owing to the suspension of the consumption tax on food, before recovering on the back of nominal growth. Primary spending would rise steadily, driven by demographic pressure (healthcare, pensions), defence needs and an expansionary fiscal stance, with a particular emphasis on public investment.

Japan: A moderately expansionary fiscal stance (2/2)

Low interest rates drive the decline in the debt-to-GDP ratio

Contributions to the change in debt, baseline scenario

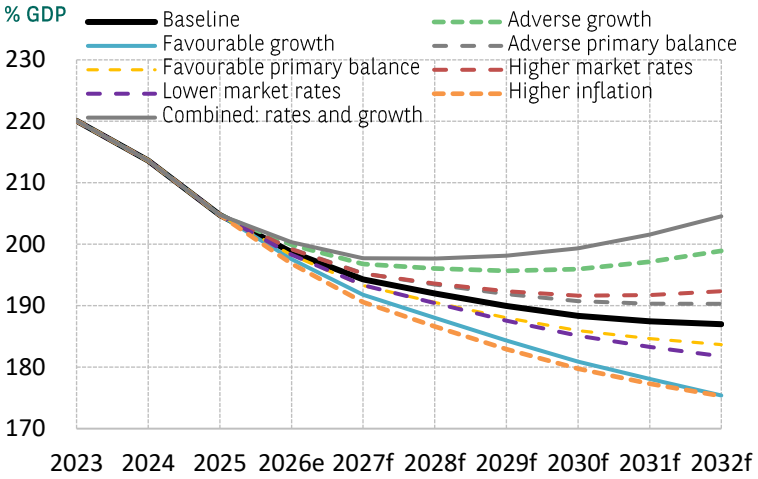


Source: IMF, BNP Paribas

Japan's public debt is projected to keep declining, from 205% of GDP in 2025 to 187% in 2032. The pace of decline is, however, set to slow markedly (from 6pp in 2026 to less than 1pp from 2030 onwards). This slowdown mainly reflects the fading of the favourable r-g differential – the main driver of debt reduction – and, to a lesser extent, persistent primary deficits.

The debt reduction trajectory relies on growth

Public debt: scenarios



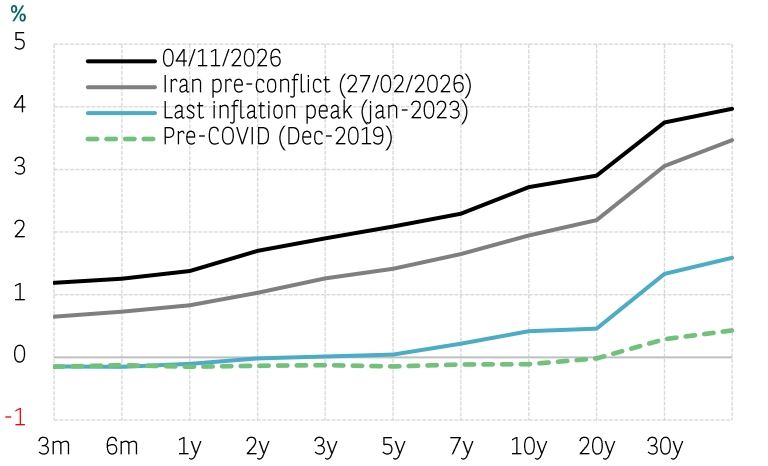
Source: IMF, BNP Paribas

Note: the 'growth' and 'primary balance' scenarios incorporate, respectively, a negative shock to growth and to the deficit of 0.5 percentage points of GDP per year compared with the baseline scenario; the 'interest rate' scenario incorporates a 1 percentage point rise in the apparent interest rate.

The reduction in Japan's debt-to-GDP ratio rests primarily on the favourable gap between nominal growth and the apparent interest rate. This leaves the debt path exposed to growth and interest rate shocks. A combination of weaker growth and higher interest rates would be enough to jeopardize the government's objective of reducing the ratio. Inflation, for its part, supports public finances through its effect on nominal growth. The potential for a fall in the debt-to-GDP ratio is similar in scenarios involving either strong growth or additional inflation.

A sharp rise in interest rates

Japan yield curve



Source: IMF, BNP Paribas

Japan's yield curve has shifted significantly upwards in recent years. Following years of ultra-accommodative monetary policy, the Bank of Japan has initiated a cycle of adjustment, including the end of negative interest rates, which is evident at the short end of the yield curve. The long end of the curve is influenced by a number of converging factors: reduced BoJ purchases of JGBs, concerns over fiscal sustainability, and rising inflation and growth expectations. However, the pass-through to interest expense is gradual due to an average maturity exceeding 8 years.