

Daiwa's Economic View

Cabinet's budget formulation authority threatened by opposition parties' bill to cut gasoline tax

- Opposition parties' bill to cut gasoline tax is likely to pass as ruling parties lack a majority in both upper and lower houses
- If passed, the tax cuts would preempt the budget formulation authority inherently held by cabinet, undermining the foundation of parliamentary cabinet system
- This would result in fiscal expansion without clear accountability, adding a new risk factor to the JGB market

FICC Research Dept.

Koji Hamada

81-3-5555-8791

kouji.hamada@daiwa.co.jp

**Kenji Yamamoto**

81-3-5555-8784

kenji.yamamoto@daiwa.co.jp



Daiwa Securities Co. Ltd.

The ruling parties have lost their majorities in both the lower and upper houses, making it increasingly likely that a gasoline tax cut bill submitted by opposition parties will be enacted. If it passes, we would see an unusual case of a tax cut being decided ahead of the budget, preempting the budget formulation authority that should be inherently held by the cabinet. This could undermine the foundation of Japan's parliamentary cabinet system, leading to fiscal expansion without clear accountability and representing new risk factors for the JGB market.

Opposition parties' bill to cut gasoline tax likely to pass — Content and three key challenges

At an extraordinary Diet session in August, opposition parties jointly submitted a bill to cut gasoline tax. The bill did not pass during the five-day session, but it will continue to be debated during an extraordinary Diet session in autumn. As the ruling parties currently lack a majority in both houses, the bill is highly likely to be passed.

The statutory gasoline tax is Y28.7 per liter, on top of which an additional (provisional) tax of Y25.1 per liter is currently being levied for the time being. The opposition parties' bill would abolish this additional Y25.1. If enacted, gasoline prices including consumption tax would fall by roughly Y27–28 per liter.

The opposition parties' bill includes practical measures to address industry concerns. If retailers purchase gasoline inventories at high prices including the additional provisional tax and the tax is removed before those stocks are sold, they would incur losses when the gasoline is sold. The bill therefore provides a mechanism in which the nation compensates for such inventory losses.

Meanwhile, there are three major challenges. First, the schedule to implement the change is very tight. In the bill, 1 November 2025 is set as the day to abolish the additional provisional tax. However, an extraordinary Diet session is unlikely to convene before late September or October, and system changes and industry notifications are expected to take several weeks or months. Thus, there may not be enough time to prepare for the change.

Second, the bill does not specify how to finance the tax cuts. The tax cut would reduce national tax revenue by about Y1tn per fiscal year. This hole may be filled by upward revisions to tax revenue forecasts, but we cannot deny the possibility of additional issuance of JGBs.

Third, a passage of the bill substantially changes the sequence for deciding the national budget, creating ambiguity over who is responsible for budgets. The details of this issue are explained in the next section.

Legislator-initiated bills preceding the budget undermine the cabinet's budget formulation authority

The biggest problem posed by the opposition parties' gasoline tax cut bill is that it threatens the cabinet's budget formulation authority and signals a serious dysfunction in Japan's parliamentary cabinet system.

Only the cabinet has the authority to compile budgets and submit them to the Diet. The cabinet makes budget bills and submits them together with budget-related bills (changes necessary to implement the budget) such as tax reform bills and bills to issue deficit-financing bonds.

As Japan uses the parliamentary cabinet system, the cabinet and the ruling parties function as a single unit. While the majority parties in the Diet form the cabinet, the ruling parties support passage of the cabinet's budget proposals and other bills.

Bills approved by cabinet at a cabinet meeting and submitted to the Diet are called "cabinet bills." Budget-related bills fall into this category.

In contrast, bills drafted and submitted to the Diet by lawmakers are called "legislator-initiated bills." The gasoline tax cut bill jointly submitted by the opposition parties falls into this category.

Normally, tax cut bills are submitted as cabinet bills in the process of budget compilation. However, with the ruling parties now lacking a majority in both houses, it is now possible that the gasoline tax cut bill, a legislator-initiated bill submitted by the opposition parties, will pass before the budget is decided. That would force the cabinet to compile a budget (after the passage of the gasoline tax cut bill) implementing the bill enacted by opposition parties, reversing the usual sequence.

This could threaten the cabinet's budget formulation authority and erode the principle of the parliamentary cabinet system, in which the government and ruling parties are jointly responsible for the budget. This also entails risks of losing policy consistency and fiscal discipline.

Political situation and fiscal risk: Fiscal expansion without accountability

The Liberal Democratic Party (LDP) plans to decide on whether it will hold an extraordinary party leadership election. If a new prime minister/party leader were chosen and formed a coalition with the Democratic Party for the People (DPP), a scenario of aggressive fiscal expansion jointly led by the government and the ruling parties could emerge.

On the other hand, if the Ishiba administration continues, the ruling parties are highly likely to cooperate with the Constitutional Democratic Party of Japan (CDP) on budget issues, without forming a coalition. Among pledges of opposition parties in the Upper House election, the CDP was relatively cautious about fiscal expansion: the party called for a consumption tax cut only for food items, limited to a one-year period (at most two years), and pledged not to rely on deficit-financing bonds for financial resources.

That said, even if the Ishiba administration continues, there is no guarantee that fiscal discipline will be maintained. Unless the CDP joins the coalition, there is no guarantee that it will align with the ruling parties. The details of the consumption tax cut, a key concern in the JGB market, vary among opposition parties, but there remain concerns about a start of a small-size and time-limited measure. Public pressure could then lead to permanency or larger-scale measures.

Thus far, opposition parties have tended to shift their policies to realistic ones once they gained political power. However, the present situation allows them to enact expansionary fiscal bills from a position of opposition. This poses a different kind of risk to the JGB market than fiscal expansion led by the government and ruling parties.

IMPORTANT DISCLOSURES

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Securities Co. Ltd. retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.

Ratings

Issues are rated 1, 2, 3, 4, or 5 as follows:

- 1: Outperform TOPIX/benchmark index by more than 15% over the next 12 months.
- 2: Outperform TOPIX/benchmark index by 5-15% over the next 12 months.
- 3: Out/underperform TOPIX/benchmark index by less than 5% over the next 12 months.
- 4: Underperform TOPIX/benchmark index by 5-15% over the next 12 months.
- 5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

Benchmark index: TOPIX for Japan, S&P 500 for US, STOXX Europe 600 for Europe, HSI for Hong Kong, STI for Singapore, KOSPI for Korea, TWII for Taiwan, and S&P/ASX 200 for Australia.

Target Prices

Daiwa Securities Co. Ltd. sets target prices based on its analysts' earnings estimates for subject companies. Risks to target prices include, but are not limited to, unexpected significant changes in subject companies' earnings trends and the macroeconomic environment.

Disclosures related to Daiwa Securities

Please refer to https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/e_disclaimer.pdf for information on conflicts of interest for Daiwa Securities, securities held by Daiwa Securities, companies for which Daiwa Securities or foreign affiliates of Daiwa Securities Group have acted as a lead underwriter, and other disclosures concerning individual companies. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/credit_ratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)

If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.

Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108

Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association, Japan Security Token Offering Association