

Economic Commentary

FICC Research Dept.

High crude oil prices may lead to early supplementary budget compilation

- Funds for measures to address high crude oil prices are running out; talks within LDP on compiling early supplementary budget
- In FY22, first supplementary budget compiled in May due to surging crude oil prices; total expenditures, including use of reserves, came to roughly Y4.1tn
- Supplementary budget discussions may intensify after initial budget for FY26 is passed



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The *Nikkei* reported on 2 April that the Liberal Democratic Party (LDP) is discussing the formulation of an early supplementary budget for FY26, as funding for measures to address surging crude oil prices is running out. While a supplementary budget at the start of the fiscal year is unusual, the first supplementary budget for FY22 was also approved by the Cabinet in May of that year as a measure to address surging crude oil prices. Total expenditures at that time, including the use of contingency reserves, came to roughly Y4.1tn. In FY26 as well, discussions regarding supplementary budgets may intensify once the initial budget is enacted. Catalysts for fiscal deterioration concerns could come into focus sooner than expected. The JGB market will likely view that as a cause for concern.

Similarities with first supplementary budget for FY22: Crude oil price spike over \$100

In the past there have been cases of supplementary budgets being passed early in the fiscal year. Here, the first supplementary budget for FY22, in particular, can serve as a useful reference this time when considering a supplementary budget for FY26. In FY22, crude oil prices rose sharply, surpassing \$100/bbl and the government introduced measures to address both surging crude oil prices and inflation.

We should note that at that time the Kishida Cabinet was in power and current Prime Minister Sanae Takaichi, in her capacity as LDP Policy Research Council chairperson, was responsible for coordinating the party's policies at that time.

Differences with first supplementary budget for FY22: Amount of contingency reserves very different

The biggest difference between FY22 and FY26 lies in the amount of contingency reserves on hand. In FY22, in addition to the general contingency reserves of Y0.5tn, special contingency reserves of Y5.0tn were set aside to address both the COVID-19 pandemic and rising prices. Funding for measures to address both inflation and rising crude oil prices should come not only from the first supplementary budget, but also from the drawing down of contingency reserves.

For FY26, general contingency reserves will amount to only Y1.0tn. Funds allocated to the first supplementary budget for measures to address rising crude oil prices and inflation must be sufficient enough to cover expenses until the second supplementary budget is enacted.

First supplementary budget for FY22 and JGB issuance plan: Calendar-based market issuance unchanged

The first supplementary budget for FY22 included expenditures of approximately Y2.7tn along with revenue of Y2.7tn from deficit-financing bonds. The JGB issuance plan utilized front-loading issuance of refunding bonds and the calendar-based market issuance amount was unchanged.

The total cost of measures to address inflation and high crude oil prices, including the drawdown of contingency reserves, was estimated at roughly ¥4.1tn (see final paragraph of this report). If expenditures in the first supplementary budget for FY26 amount to approximately ¥4.0tn and are funded entirely by deficit-financing bonds, the government's JGB issuance plan will also attract attention. It is still too early to make definitive projections, but at this point, we can envision either the use of front-loading issuance of refunding bonds or an increase in T-bill issuance. If crude oil prices fall in the future, there will be unspent funds in the budget. That would make it easier to adjust to actual expenses.

Supplementary budget compilation timing: Talks permitted after passing initial budget; Cabinet decision as early as May possible

The government generally does not publicly comment on the preparation of an early supplementary budget until the initial budget has been enacted. This is because, if the government speaks out, opposition parties might demand initial budget revisions. Until the initial budget is passed, remarks from the ruling parties will come first.

The initial budget for FY26 has already been passed by the Lower House. If the Lower House passes the budget bill and the Upper House then fails to vote on the bill within 30 days, the Lower House's vote will be deemed the decision of the Diet overall. The budget is expected to be passed by 11 April, after which the government will also be free to discuss the supplementary budget.

The initial budget for FY22 was enacted on 22 March. On 21 April of that year, the LDP and Komeito reached an agreement to compile a supplementary budget. The Cabinet approved the first supplementary budget proposal on 17 May. Komeito, which was one of the ruling parties at that time, strongly advocated for the early compilation of a supplementary budget, but negotiations with the LDP, which opposed that idea, took time.

Takaichi has so far allocated a larger portion of the budget to measures combating rising prices rather than that for growth and crisis management investments. Many believe that policy decisions and implementation are quick, such as deciding to release oil reserves before other countries to offset rising crude oil prices. Even though the passage of the initial budget for FY26 is expected to be delayed compared to that for FY22, if a supplementary budget is compiled at an early stage, we could expect a Cabinet decision by as early as May.

Market impact: Fiscal deterioration concerns are likely to take shape sooner than anticipated

Concerns about proactive fiscal policy remain in focus on the JGB market. The key points of interest are the amounts allocated to growth and crisis management investments, as well as defense spending, starting from FY27, which remain unclear at this juncture. However, deliberations on the first supplementary budget for FY26 should provide concrete catalysts for fiscal deterioration. In the JGB market, this will likely attract attention as new catalysts impacting fiscal management.

[Ref.] Costs to combat oil prices/inflation and their funding sources until enacting second supplementary budget for FY22

The complicated trends for contingency reserves and budgets in FY22 are as shown below (approximate amounts).

Initial budget	General contingency reserves	Y0.5tn
	Contingency reserves to address COVID-19 pandemic	Y5.0tn
28 Apr	Drawdown of COVID-19 contingency reserves (COVID-19 response)	Y1.1tn
	Drawdown of general contingency reserves (response to inflation)	Y0.4tn
First supplementary budget	Measures to address surging crude oil prices	Y1.2tn
	Replenishment of COVID-19 contingency reserves	Y1.1tn
	※Expansion of eligible uses of COVID-19 contingency reserves to include measures to address inflation	
	Replenishment of general contingency reserves	Y0.4tn
29 Jul	Drawdown of contingency reserves to address COVID-19 and inflation (response to inflation)	Y0.2tn
20 Sep	Drawdown of contingency reserves to address COVID-19 and inflation (response to inflation)	Y2.3tn

By the time the second supplementary budget for FY22 was enacted, the total amount the government allocated to measures addressing rising crude oil prices and inflation came to roughly Y4.1tn.

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