Economic Commentary (supplementary budget)

Considering early supplementary budget scale and funding

- Cabinet decision on supplementary budget likely around mid-June
- Expect small scale of around Y4.0tn
- Most funding from deficit-financing bonds; JGB issuance plan may avoid increased issuance of coupon-bearing JGBs
- Fiscal deterioration concerns may temporarily intensify, but could later subside

Koji Hamada
81-3-5555-8791
kouji.hamada@daiwa.co.jp

Daiwa Securities Co. Ltd.

On 14 May, several news outlets reported that the government was considering a draft supplementary budget for FY26. Here, we expect the cabinet to approve a supplementary budget proposal around mid-June.

We anticipate a relatively small supplementary budget, specifically around Y4.0tn.

The funding will likely come almost entirely from deficit-financing bonds. That said, the JGB issuance plan includes increased issuance of T-bills and the utilization of front-loading issuance of refunding bonds. As such, an increase in the issuance of coupon-bearing JGBs could be avoided.

Concerns on the JGB market about fiscal deterioration are likely to intensify temporarily. However, depending on the size of the budget, the JGB issuance plans, and the level of interest regarding Prime Minister Sanae Takaichi's fiscal policy, such intensity may ease for the time being.

When will cabinet approve supplementary budget?

14 May marked the first time multiple media reports indicated that the government was considering compiling a supplementary budget for FY26. Apparently, these discussions have been proceeding behind the scenes.

The cabinet is likely to approve a supplementary budget around mid-June. Keep in mind that the Diet session will end on 17 July. If the opposition parties demand sufficient time to deliberate on the supplementary budget in the Diet, a cabinet decision made around the end of June would not allow for enough time. If the goal is to have the cabinet approve the budget around mid-June, the government would need to start the formal compilation process sometime between May and early June (please refer to our 13 May 2026 report *Considering deadline for compiling early supplementary budget*).

What is the size of the supplementary budget?

Based on a review of the various media reports, the supplementary budget is likely to include the continuation of gasoline price subsidies, subsidies for electricity and gas bills over the summer, and an increase in the contingency reserves. These all fall within our expectations. In response to demands from the opposition parties, measures such as financial support for small and medium-sized enterprises and assistance for low-income individuals and families with children could be added. There are reports that only the contingency reserves will be booked.

In the case of these particulars, our view that the supplementary budget will come to around Y4.0tn remains unchanged. This figure is based on the amounts allocated in the first supplementary budget for FY22 and the utilization of contingency reserves. At that time, crude oil prices were well above $100/bbl and an early supplementary budget had been compiled (please refer to our 9 Apr 2026 report *High crude oil prices may lead to early supplementary budget compilation*).

Important disclosures, including any required research certifications, are provided on the last page of this report.

Following this supplementary budget, another supplementary budget is likely to be compiled sometime between this autumn and December. The Diet will likely pass the budget in December, which has been the case in recent years. The purpose of this supplementary budget is to secure funding through December for the government's measures to address high prices. It is safe to assume that the budget will not swell to the Y10tn range seen for those supplementary budgets compiled between autumn and December (FY23 to FY25).

Outlooks for supplementary budget funding and JGB issuance plans

In the case of a supplementary budget at the very start of the fiscal year, it is difficult to secure funding through measures such as revising tax revenue estimates, reducing existing expenditures, or adding non-tax revenue. It is highly likely that the entire funding will come from deficit-financing bonds.

Still, JGB issuance plan revisions should ideally be addressed through increased issuance of T-bills and the utilization of front-loading issuance of refunding bonds, while avoiding an increase in the issuance of coupon-bearing JGBs.

The reason is that even if the supplementary budget increases spending to offset rising prices, it is unclear whether the full amount will actually be spent, particularly in the case of contingency reserves and gasoline subsidies. Indeed, the crude oil price, which is now hovering around $100/bbl, could drop significantly depending on the situation in Iran.

If funds in the budget are left over, the government can simply cancel the front-loading issuance of refunding bonds. In the case of T-bills, the government can simply halt additional issuance. That would have less of an impact on the JGB market than temporarily increasing the issuance of coupon-bearing JGBs and then again reducing the amount.

Will fiscal deterioration concerns intensify?

Once discussions on the supplementary budget get underway in earnest, concerns about the deterioration of public finances are likely to intensify on the JGB market.

However, as mentioned earlier, if the budget is around Y4.0tn and there is no increase in the issuance of coupon-bearing JGBs, the intensity of concerns about fiscal deterioration may ease for the time being.

Takaichi's stance on the supplementary budget is also attracting attention. The administration's top priority is investing in growth and crisis management, but the FY25 supplementary budget allocated a significant amount of funds for measures to address high prices (please refer to our 2 Dec 2025 report *FY25 supplementary budget announcement: Key points for FY26 initial budget, JGB issuance plan*). We had assumed that a supplementary budget for FY26 would be considered shortly after the passage of the initial budget. The government's cautious stance up until now is somewhat surprising.

It remains to be seen whether Takaichi's comments on the supplementary budget will change the market's perception of proactive fiscal policy. That said, we should keep in mind that the level of interest in fiscal policy initiatives appears to have cooled somewhat.

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.

<u>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.</u>

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, Investment Management Association of Japan, Type II Financial Instruments Firms Association, Japan Security Token Offering Association