

**(Box 1) Effects of the Second Postponement of the Consumption Tax Hike on Real GDP**

The July 2016 Outlook Report factors in the Cabinet decision on June 2 to postpone the consumption tax hike to 10 percent by two and a half years, to October 2019, which is described in the Basic Policy on Economic and Fiscal Management and Reform 2016.

The effects of this second postponement of the consumption tax hike on real GDP growth rate can be estimated as follows (Box Chart 1 [1]). Compared to the estimation made in the previous Outlook Report, the real GDP growth rate for fiscal 2016 will decrease by 0.4 percentage point mainly in household expenditure, given that the front-loaded increase in demand that was expected to arise prior to the consumption tax hike will no longer be seen. That for fiscal 2017, on the other hand, will increase by 0.6 percentage point as a subsequent decline in demand will not be observed and a decline in real income, which would have been seen if the consumption tax hike were to be conducted, will not take place. In fiscal 2018, the positive effects on the real GDP growth rate -- which were presumed to be brought about by the dissipation of the subsequent decline in demand -- will not materialize; rather, the front-loaded increase in demand prior to the consumption tax hike scheduled to take place in October 2019 will likely be seen in part. Thus, it is projected that the effects of the consumption tax hike on the real GDP growth rate for fiscal 2018 will be unchanged from the previous projection. Estimations of both real GDP and the level of the output gap for the middle of the projection period and onward are to be higher than those made in the previous Outlook Report because, while a disappearance of the front-loaded increase and subsequent decline in demand will only smooth out fluctuations of real GDP, a disappearance of the negative effects on real income will raise the level of real GDP.

In the April Outlook Report, assuming the possibility that the front-loaded increase in demand prior to the April 2014 consumption tax hike would have included demand in some durable goods in expectation of the hike to 10 percent, it was estimated that the scale of the front-loaded increase in demand prior to the hike to 10 percent will be somewhat smaller than that implied by the degree of the increase in the tax rate -- i.e., the front-loaded increase in demand prior to the hike to 10 percent is expected to be one half instead of two

thirds of that observed prior to the hike in April 2014 (Box Chart 1 [2]).<sup>28</sup> However, it is likely that stock adjustments of durable goods that had been accumulated due to the April 2014 consumption tax hike will progress to a certain extent by 2019, given that the postponement of the hike means that there will be an interval of more than five years between the hikes. Therefore, in this Outlook Report, it is estimated that the scale of the front-loaded increase in demand prior to the October 2019 consumption tax hike will be about two thirds of the one seen last time, in proportion to the change in tax rate.

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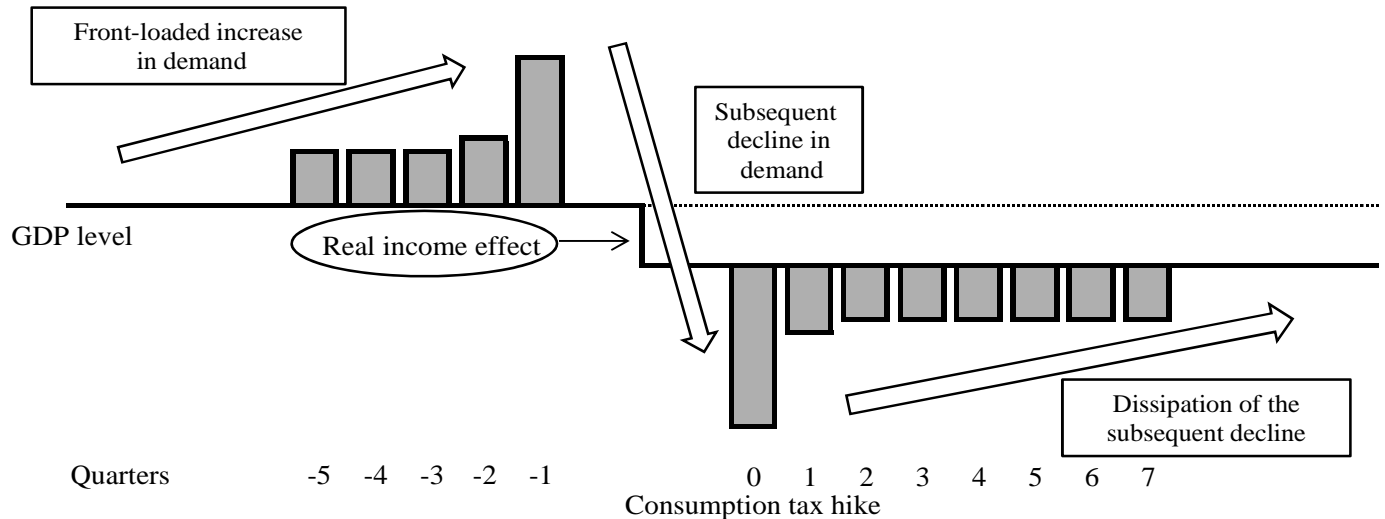
<sup>28</sup> See Box 1 in the April 2016 Outlook Report.

## Effects of the Delayed Consumption Tax Hike on Real Economy

(1) Effects on Real GDP

(a) Illustration of the Expected Effect of the Consumption Tax Hike on Real GDP

(Effects on the Level of Real GDP; Arrows Represent Effects on Growth Rates)



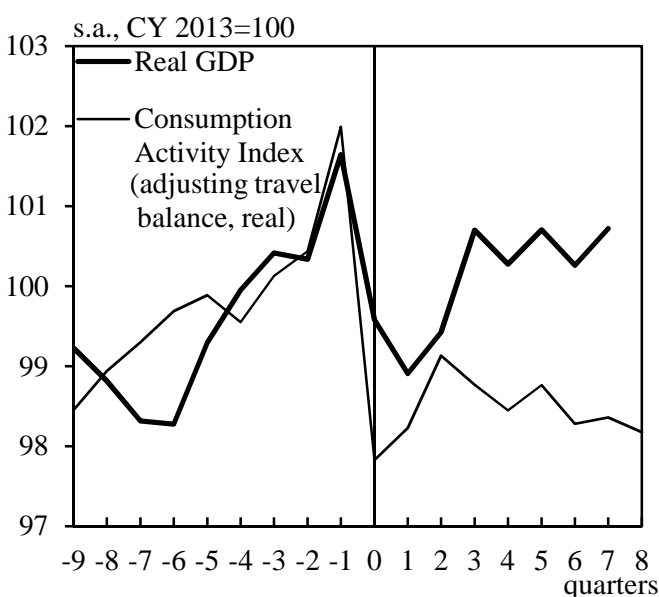
(b) Estimated Effects of the Consumption Tax Hikes on GDP Growth Rate

contribution to the real GDP growth rate, % points

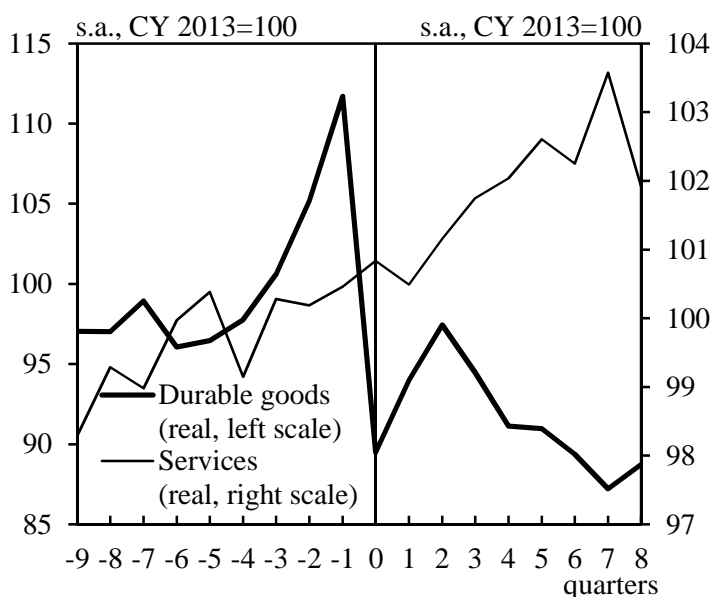
|                         | FY 2013 | FY 2014 | FY 2015 | FY 2016 | FY 2017 | FY 2018 |
|-------------------------|---------|---------|---------|---------|---------|---------|
| This Outlook Report     | 0.8     | -1.3    | 0.0     | 0.0     | 0.0     | 0.1     |
| Previous Outlook Report | 0.8     | -1.3    | 0.0     | 0.4     | -0.6    | 0.1     |
| Change                  | 0.0     | 0.0     | 0.0     | -0.4    | 0.6     | 0.0     |

(2) Prior to and after the Consumption Tax Hike in Fiscal 2014

(a) GDP and Private Consumption



(b) Durable Goods and Services (Consumption Activity Index)



Notes: 1. Quarter 0 is the quarter (2014/Q2) that includes April 2014, the month in which the consumption tax rate was raised. Figures for quarter 8 (2016/Q2) are April-May averages.

2. Figures for the Consumption Activity Index (adjusting travel balance) exclude inbound tourism consumption and include outbound tourism consumption. Figures are as of July 28.

Sources: Cabinet Office; Bank of Japan; Ministry of Economy, Trade and Industry; Ministry of Internal Affairs and Communications, etc.