

2 June 2026

Takaichi prepares tax cut amidst economic and political headwinds

Key takeaways

- While the details are still pending, Prime Minister Takaichi Sanae will likely make a decision this month to cut the consumption tax on foodstuffs starting in April 2027.
- Among the details to be considered is whether to offset the cost of the tax or rely on higher tax revenues, but the latter option could be risky given ongoing uncertainty stemming from the Hormuz crisis.
- If she proceeds with the tax cut, Takaichi will show once again that her political priorities are paramount, though this decision could also spur greater mobilization against her government from her own party's fiscal hawks.

Prime Minister Takaichi Sanae has reportedly already decided to cut the consumption tax on foodstuffs, notwithstanding the still-ongoing deliberations of the National Conference on Social Security that she established to examine broader issues of social security funding and outlays. At this point, the prime minister is weighing whether to stick to her original idea – reducing the tax on foodstuffs to zero for two years, which comes with administrative challenges for businesses – or reducing the tax to 1% for the sake of easier adjustments to cash registers in time for implementation in April 2027. The prime minister will make a final decision this month, as a tax cut to zero might require extending the current Diet session to pass legislation sooner to enable businesses more time to adjust their systems. A Ministry of Economy, Trade, and Industry (METI) report delivered to the National Conference Tuesday said that businesses could be ready for a 1% tax rate in five or six months versus ten to twelve months for a 0% rate, suggesting that a tax cut to 1% is more likely.

Aside from mitigating the administrative burden on businesses, the one-percent plan could marginally ease some of the budgetary pressure on the government, insofar as reducing the tax to 1% could cost JPY 4.4tn in lost revenue instead of JPY 5tn in the case of zeroing out the tax. That said, even those marginal savings could prove illusory if the government needs to deliver subsidies to businesses to manage the costs of changing their systems, as seems likely. The prime minister and some of her advisers have downplayed the need to fund a temporary measure fully, though the run-up in long-term yields since the start of this year has prompted Takaichi to gesture more towards fiscal sustainability and the maintenance of market confidence, promising not to use deficit bonds for the tax cut. Nevertheless, although some members of the government have suggested that the tax cut could be funded out of the automatic increase in tax revenues – which have been roughly between JPY 4tn and 5tn in recent years – relying on these gains could be risky on multiple fronts.

While the state of the global economy next spring is unknowable, the government could be cutting the consumption tax in a stagflationary environment in which, due to the Hormuz crisis, higher prices have eroded household disposable incomes and sapped consumer confidence while reducing corporate profits. The tax revenues the government will be counting on to fund the tax cut could also be weaker than anticipated. Meanwhile, the government's ongoing fuel subsidies – which the prime minister has shown no sign of scaling back despite pressure from within the Liberal Democratic Party (LDP) – could mean that the government is implementing this tax cut amidst an ongoing open-ended spending commitment that has already prompted one deficit-funded supplemental budget. It will also be implementing this tax cut at the same time that its 2027 budget, which is expected to include higher defense spending and "bridge bond"-funded strategic investments as well as the natural increase in social security spending, takes effect. Cumulatively, this set of policies could make it difficult for the prime minister to make the case for "responsible fiscal expansion," creating conditions for higher borrowing costs.

The prime minister's determination to proceed with the tax cut – which she has described as her "long-cherished wish" – highlights the primacy of politics in understanding Takaichi's behavior. Takaichi campaigned on cutting the consumption tax, has been generally buoyed by the perception that she will tackle ongoing cost of living issues, and faces a public that has remained broadly supportive of the tax cut, whether to 0% or 1%. If she were to back away from cutting the tax now, she would pay a significant price and create an opportunity for challengers on the LDP's right to exploit. Meanwhile, her push to cut the consumption tax is also part of a broader right-wing campaign to curb the power of the Ministry of Finance (MOF), essentially demonstrating the ability of a determined prime minister to overrule MOF's preferences in pursuit of her priorities; winning a symbolic victory against MOF should not be overlooked as a factor in Takaichi's determination on this issue.

At the same time, however, by pressing for the tax cut over the advice of the council she created to study the issue – which has focused mainly on the refundable tax credit that could be introduced after the consumption tax cut instead of the tax cut – and gambling

on a sizable new tax expenditure at the same time that she intends to boost spending in other areas and in the face of already rising bond yields, she could encourage the mobilization of fiscal hawks within the LDP against her policies. The government's decision to introduce a supplemental budget to fund fuel subsidies has already [spurred](#) calls from senior LDP officials and the business community for an "exit strategy" from the costly and open-ended price cap. The prospect of a broader increase in spending, the prime minister's assurances about "responsibility" notwithstanding, could contribute to more organized opposition to the prime minister within the LDP, not least since the divide between the LDP's fiscal hawks and doves has been one of the party's most persistent cleavages. The decision by an LDP national security panel to not include a GDP-percentage target for defense spending in its recommendations to the government – citing the absence of an agreement on how to fund a higher target – could be an early indicator of fiscal hawk mobilization within the party against the prime minister's programs. A warning from LDP Secretary-General Suzuki Shunichi in a speech over the weekend about the need for fiscal sustainability suggests that the party's concerns about the financial consequences of the Takaichi government are unlikely to abate. Significantly, the consequences of the tax cut could unfold during the months leading up to the LDP's leadership election in September 2027, potentially complicating Takaichi's path towards reelection as LDP leader.

Tobias Harris

Founder and Principal
Japan Foresight LLC
tobias@japanforesight.com
+1.847.738.4048
