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Monthly Report of Prospects for Japan's Economy

July 2025

Macro-economics Research Center
Economics Department



The Japan Research Institute, Limited

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The General Situation – The economy is gradually recovering, though activity has slowed in some areas

Figure 1-1 Economic Activity

The coincident index of business conditions is weak, and the leading index remains at low levels despite rebounding slightly.

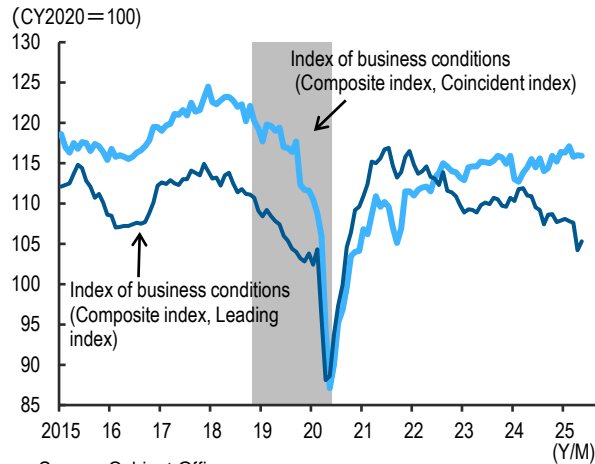


Figure 1-2 The Corporate Sector

Industrial production is weak. Economic activity in the service sector is recovering.

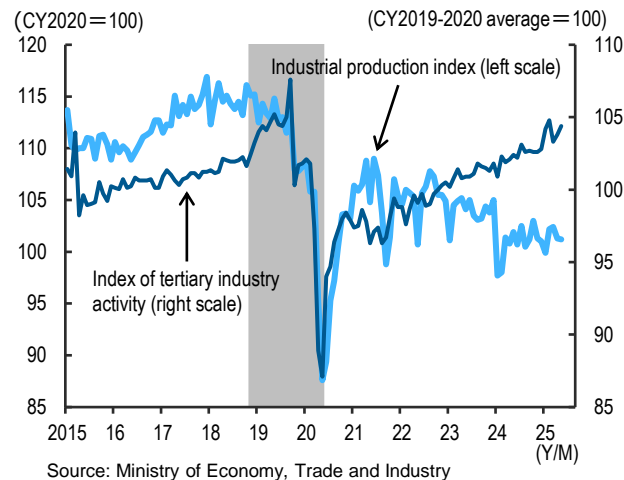


Figure 1-3 Overseas Demand

Exports are flat overall and exports to the U.S. are declining. Imports, especially energy-related, are falling.

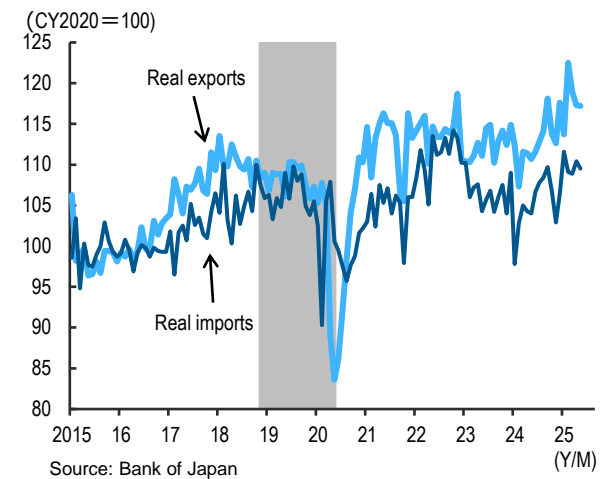


Figure 1-4 Employment and Income

The unemployment rate is low, hovering around 2.5%. Nominal wage growth is solid, averaging just above 2%.

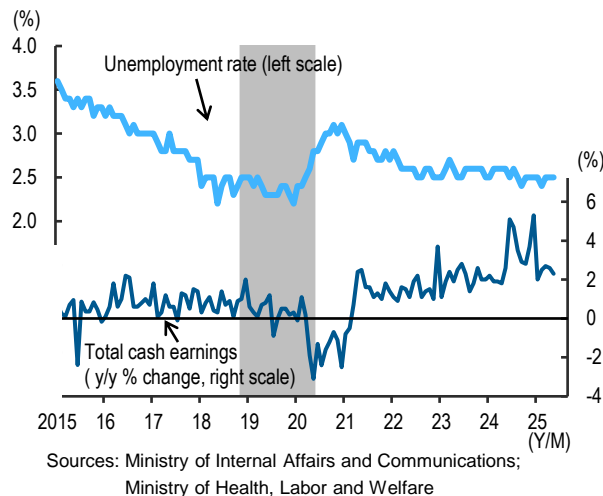


Figure 1-5 The Household Sector

Consumption is slowly picking up. Housing starts have fallen back significantly.

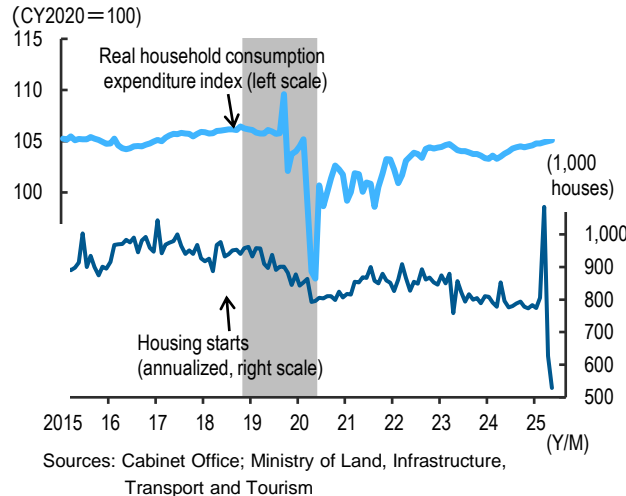
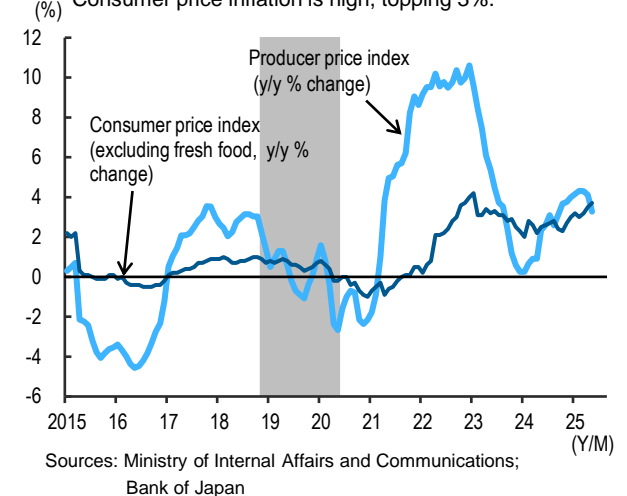


Figure 1-6 Prices

Producer price inflation is slowing, particularly in petroleum products. Consumer price inflation is high, topping 3%.



* The shaded area represents the period during which the Japanese economy was in recession.

Business confidence is favorable overall

◆ Business confidence is generally improving

In the June Tankan survey from the Bank of Japan (BOJ), the diffusion index (DI) for business conditions for large enterprises in all industries was up one percentage point from the previous survey. The DI for large manufacturing enterprises also rose by one percentage point. Although the machinery sector DI fell due to the U.S. tariff hikes, business conditions in the materials sector were boosted by lower prices of raw materials.

The DI for large non-manufacturing enterprises dipped by one percentage point, but remained at a high level. While consumption-related factors stemming from high inflation pushed the overall DI down slightly, orders held firm in the construction and logistics sectors, supporting business confidence.

◆ Production in the manufacturing sector is fluctuating

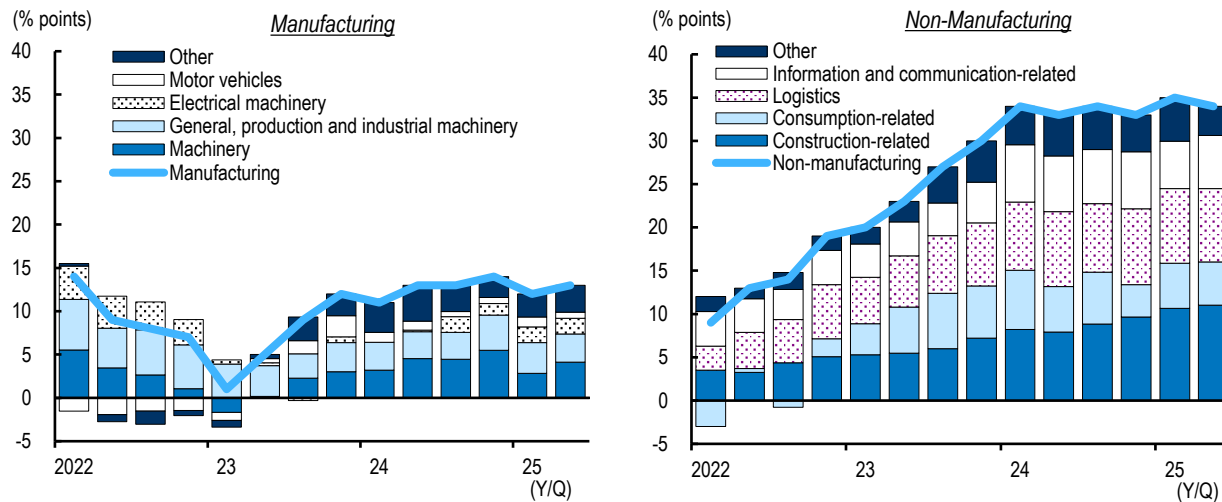
In May, the Industrial Production Index dropped by 0.1% month over month (MoM). By industry, higher output in the production machinery and chemicals sectors

provided a boost, but the electronic parts and devices sector dragged down the overall figure, with lower semiconductor-related output the primary factor. Near-future production plans indicate higher output in June, centered on electrical machinery and information/communications equipment. However, output looks set to slump in July because of lower production of transportation machinery. Tariffs may continue to adversely impact production plans going forward.

◆ The number of foreign visitors to Japan is recovering

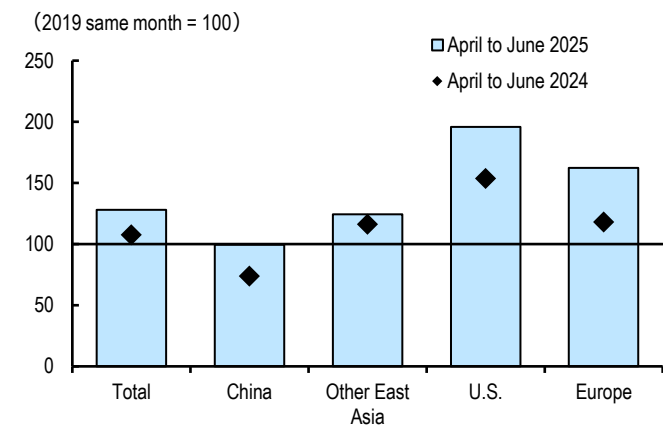
The number of foreign visitors to Japan in April-June continued to exceed pre-pandemic levels, standing at 28% higher than in the same quarter in 2019. By country/territory, the number of visitors from China, who had been slow to return, has recovered to the pandemic level. The number of travelers from Western countries is also holding firm, so the overall figure for tourist numbers is up.

Figure 2-1 DI for Business Conditions of Large Companies



Source: Japan Research Institute, Ltd. based on data from the Bank of Japan
Note: The December 2023 survey used a new baseline after the company sample was revised.

Figure 2-2 Number of Foreign Visitors to Japan (by country/region)



Source: Japan Research Institute, Ltd. based on data from the Japan National Tourism Organization

Note: Other East Asia consists of South Korea, Taiwan, and Hong Kong, and Europe consists of Germany, France, Spain, and the United Kingdom.

Exports and capital investment are now clearly feeling the impact of tariffs

◆ Higher U.S. tariffs are pushing down goods exports

Goods exports are weak. The rush of exports of products such as automobiles and semiconductors ahead of the U.S. tariff hikes has run its course. By country, exports to Asia are holding steady, but exports to the U.S. have fallen. In May, the Export Price Index for passenger cars bound for North America was down 19.4% year over year (YoY), with Japanese automakers bearing a considerable portion of the additional tariff of 25%. Exports to the U.S. suffered in terms of both volume and price.

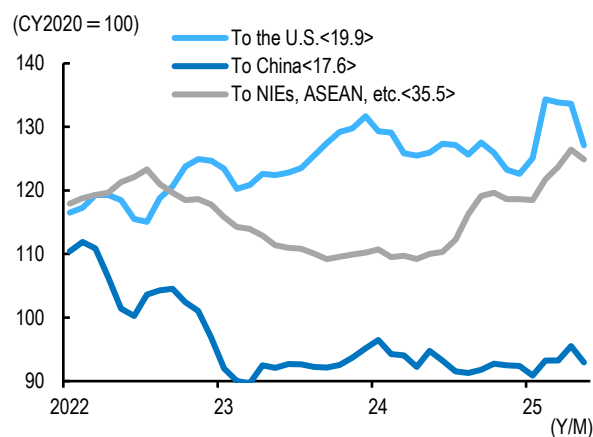
Going forward, U.S. tariff policy will continue to weigh on goods exports. Compounding the decline in Japan's exports to the U.S., a global economic slowdown resulting from lower exports from countries worldwide will also put downward pressure on external demand. The economic pressure will be especially severe for Asian countries, which are Japan's main export destinations, since exports to the U.S. make up a large share of their total exports. If the U.S. raises tariffs on more countries further, global demand may decline more than expected, dealing an additional blow to already sluggish external demand.

◆ Capital investment is weak

Capital investment is also sluggish. Levels of software investment remain high, albeit with some fluctuation, but machinery investment is decreasing. This reflects the fact that the uplift effect of equipment deliveries to newly built semiconductor factories has petered out, and that uncertainty surrounding U.S. tariff policy has risen.

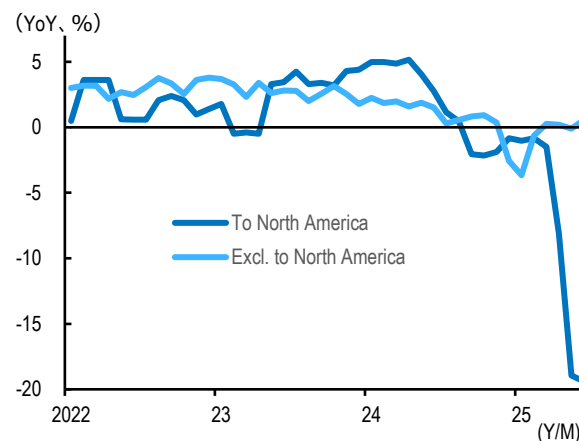
Capital investment, particularly machinery investment, will remain weak going forward. According to the BOJ Tankan, planned capital investments (including software but excluding land) for FY2025 are up 10.1% (YoY), so the rate of growth is high when compared with typical years, but this could be because rising uncertainty is causing companies to delay even rethinking their plans. But going forward, lower corporate earnings will begin to act as a drag, making a heavy scaling back of investment plans likely.

Figure 3-1 Real Exports by Partner Country
<seasonally adjusted>



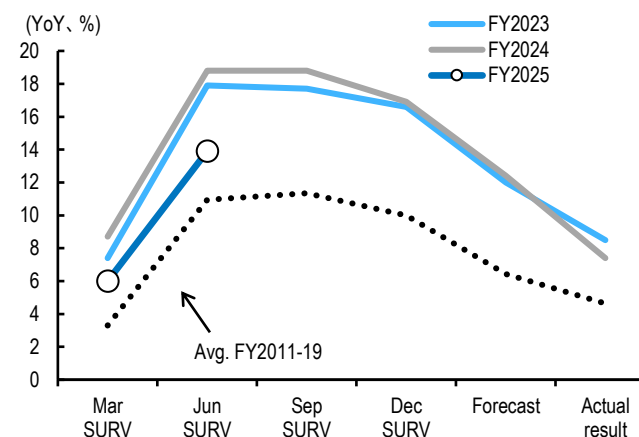
Source: Japan Research Institute, Ltd based on data from the Bank of Japan
Note: Figures in angle brackets represent the overall percentage of total nominal exports in 2024.

Figure 3-2 Export Price Index for Automobiles



Source: Japan Research Institute, Ltd based on data from the Bank of Japan

Figure 3-3 Capital Investment Plan
<all sizes, all industries>



Source: Japan Research Institute, Ltd based on data from the Bank of Japan
Note: Capital investment includes software investment and excludes land purchasing expenses.

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The income environment is improving and personal consumption remains firm

◆ Wages are continuing to grow rapidly

In May, basic salaries of ordinary workers increased by 3.0% YoY, and the pay of part-time workers also climbed 3.7% YoY, so both measures maintained rapid growth.

Wage growth is also expected to hold firm going forward, thanks to strong upward wage pressure caused by factors such as labor shortages. Rates of wage increases agreed at the 2025 shunto (spring wage negotiations) were high, averaging 5.25% and surpassing last year's figure. In the near term, high rates of wage increase are expected to be applied at more and more enterprises. Part-time workers, whose wages are less affected by shunto trends, will also benefit from the tailwind of a planned increase in minimum wages in the autumn.

In addition, government support for wage increases is also expected to spur companies to raise pay. The government has launched a five-year plan to promote wage hikes, and adopted a policy of supporting firms in increasing wages sustainably. This includes measures to help companies, particularly SMEs, improve productivity.

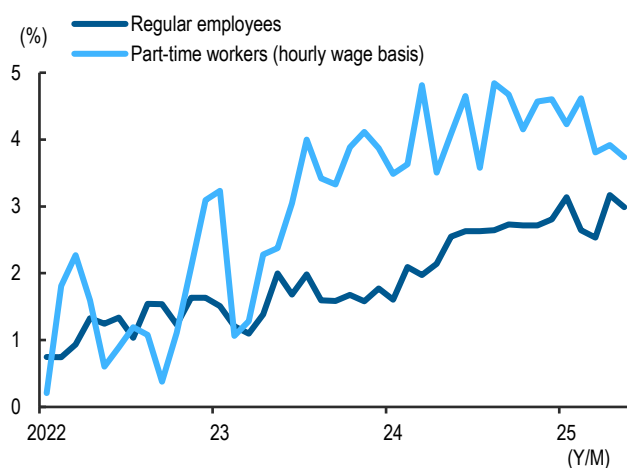
◆ Consumer confidence is bottoming out

Personal consumption is picking up. Consumption of non-durable goods is weak in

the face of rising prices, particularly food prices. However, services consumption, especially people eating meals outside the home, is robust, and automobile sales, which saw a temporary slump in March due to the suspension of plant operations, have also recovered.

Personal consumption is also expected to remain resilient going forward. With nominal wage growth staying solid, and inflation slowing, real wages look set to rise moderately from this summer onwards. Consumer confidence is bottoming out as alarm over inflation eases, and a recovery in real wages should give personal consumption a boost.

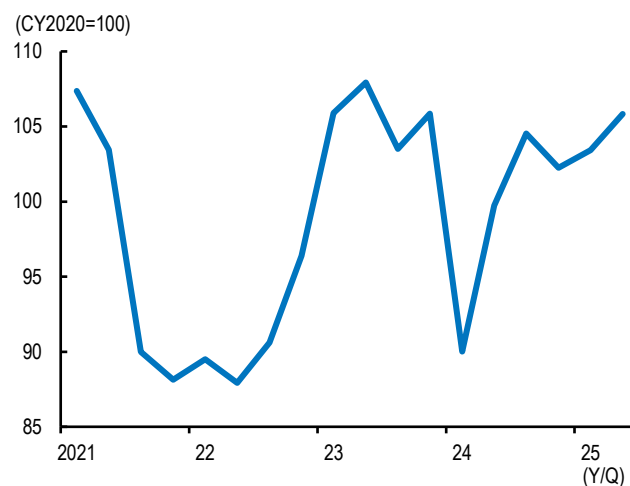
Figure 4-1 Basic Salaries <YoY>



Source: Japan Research Institute, Ltd. based on data from the Ministry of Health, Labour and Welfare

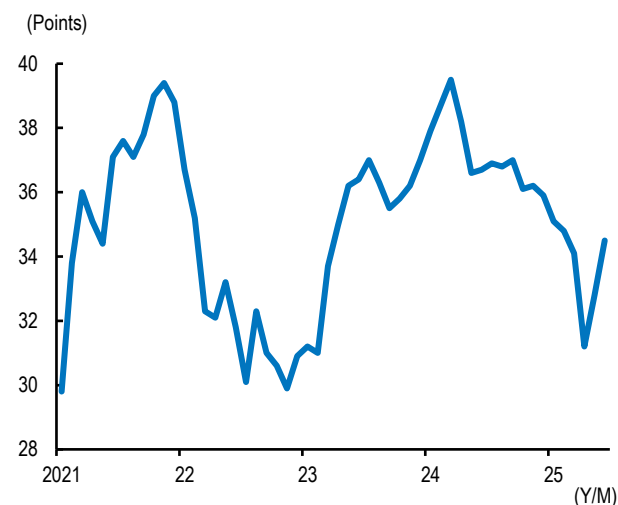
Note: Adjusted for data faults caused by the replacement of surveyed companies.

Figure 4-2 New Vehicle Sales



Source: Japan Research Institute, Ltd. based on data from the Japan Automobile Dealers Association

Figure 4-3 Consumer Confidence Index



Source: Cabinet Office

Inflation is slowing

◆ Rice prices are showing signs of having peaked

In May, core inflation (all items, less fresh food) accelerated for the third straight month to hit 3.7%. This was because rice prices have remained high, and increases in prices of agricultural produce have spilled over into meals outside the home and processed foods.

Price growth is expected to slow until early next year and then remain around 2%. Also, falling energy prices due to a worldwide drop in energy demand and the effect of government energy subsidies should serve to bring down inflation. In addition, the ascent of rice prices is likely to slow due to the release of stockpiled rice and an increase in rice imports.

However, rising prices of services are expected to increase prices overall. Pass-through of higher wages to selling prices, particularly prices of general services, will continue. Prices of public services, which had been left unchanged for many years, could also start rising. In its Basic Policy on Economic and Fiscal Management and Reform 2025, the government declared that it would raise standard prices for public services such as medical treatment and childcare.

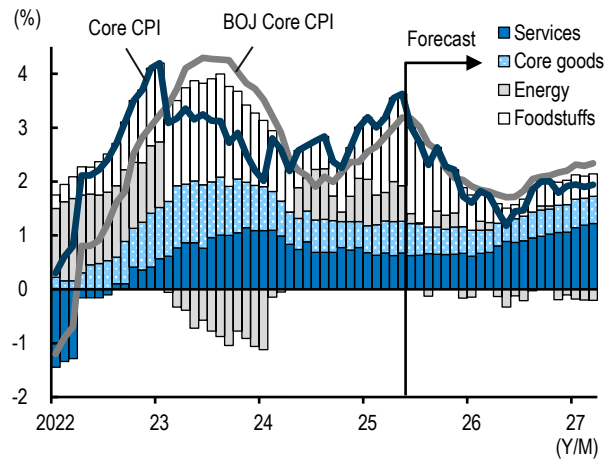
◆ The Bank of Japan (BOJ) will keep its policy rate unchanged

At its June monetary policy meeting, the BOJ decided to keep its policy rate unchanged.

Long-term interest rates rose in July. Even as concerns about the possibility of a U.S. economic slowdown ease, U.S. long-term interest rates have risen, with long-term interest rates in Japan being pulled up alongside them.

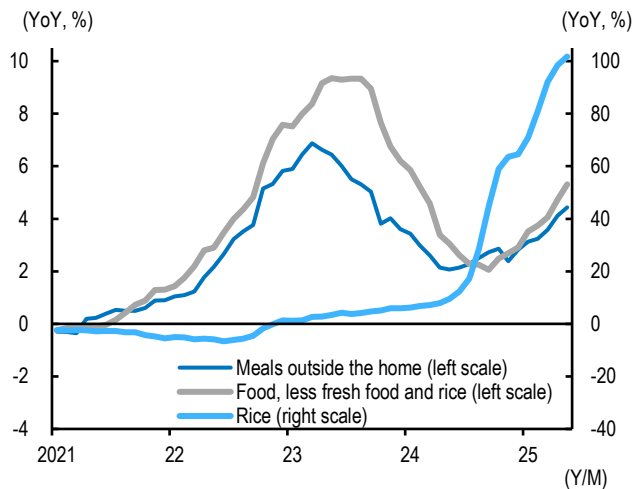
Amid lingering uncertainty surrounding U.S. tariff policy, the BOJ is expected to leave its policy rate unchanged in the near term. The next rate hike is expected to be in March 2026. For the time being, long-term interest rates also look likely to remain more or less flat, after which they should rise gradually, reflecting heightened anticipation of a rate hike by the BOJ and increased fiscal spending by the government.

Figure 5-1 Consumer Price Index <YoY>



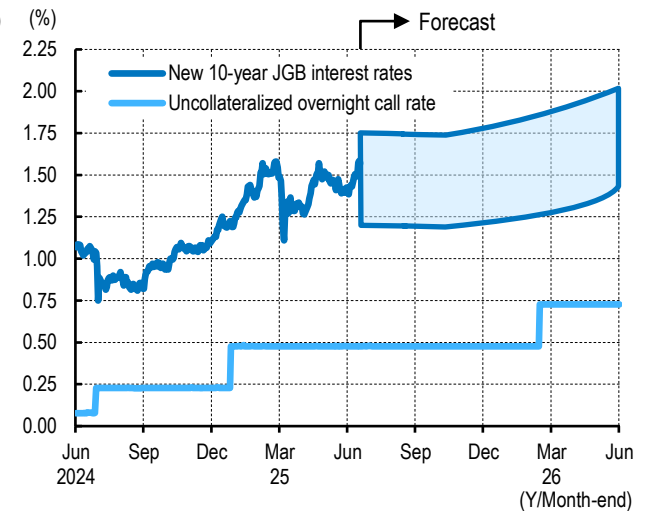
Source: Japan Research Institute, Ltd. based on data from the Ministry of Internal Affairs and Communications

Figure 5-2 Consumer Price of Rice, Meals Outside the Home and Processed Food



Source: Japan Research Institute, Ltd. based on data from the Ministry of Internal Affairs and Communications

Figure 5-3 Outlook for Japan's Main Interest Rates



Source: NEEDS-FinancialQUEST

Topic ①: Numbers of Japanese domestic travelers are weak

◆ Domestic travel by Japanese citizens is stagnant

Demand for hotel accommodation in Japan is polarized between Japanese citizens and foreign nationals. While the number of foreign hotel guests is well above the pre-pandemic levels, the number of Japanese guests has stagnated at the same level as before the pandemic.

One explanation is that domestic travel demand has receded due to soaring accommodation costs. Prices have risen because the expansion in demand from inbound tourists has pushed occupancy rates back to pre-pandemic levels, and because of a worsening shortage of workers in the hospitality industry. Room rates are now close to 1.3 times the pre-pandemic level. As accommodation costs have gone from being lower than they were a year ago to higher, the number of Japanese guests at hotels in Japan has stalled, and the rising prices may be driving down demand.

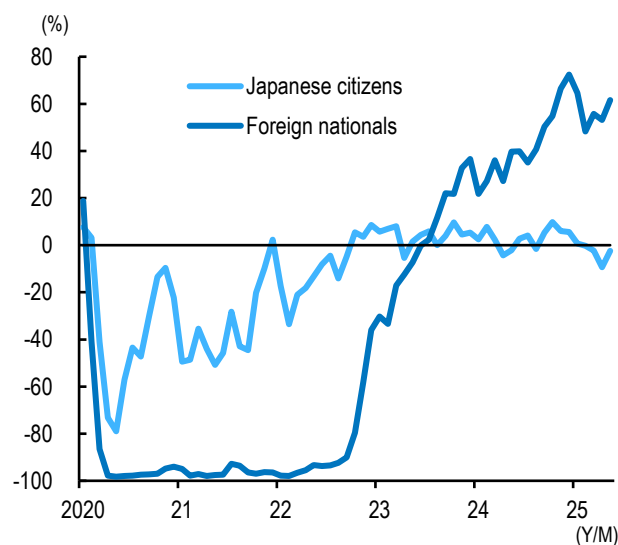
◆ Regional disparities in tourism revenues are also being exacerbated

The number of Japanese guests is also expected to remain weak going forward.

Although the income environment for households in Japan is forecast to gradually improve, higher lodging costs due to worker shortages in the hotel sector and increasing demand from inbound tourists will continue to weigh on the numbers.

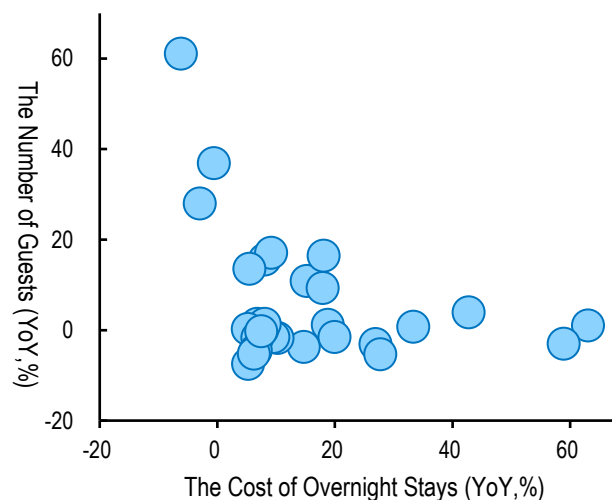
This sluggishness in Japanese hotel guest numbers could push down tourism revenues in sightseeing spots away from the major cities, where the proportion of Japanese guests is high, thereby magnifying regional disparities between these areas and the major urban centers. To revitalize regional economies and address the problem of overtourism in cities, it will be important to pursue a range of initiatives, such as developing wide-area tourism plans, in order to expand demand from inbound tourists to encompass rural areas.

Figure 6-1 Total Number of Overnight Stays (compared to the same month in 2019)



Source: Japan Research Institute, Ltd. based on data from the Japan Tourism Agency

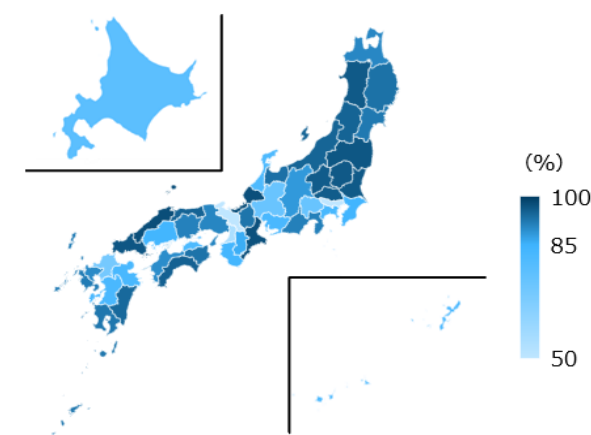
Figure 6-2 Relationship between the Number of Guests and the Cost of Overnight Stays



Source: Japan Research Institute, Ltd. based on data from the Japan Tourism Agency and the Ministry of Internal Affairs and Communications

Note: From Jan 2023 until May 2025.

Figure 6-3 Prefectures with a High Percentage of Overnight Stays by Japanese Citizens



Source: Japan Research Institute, Ltd. based on data from the Japan Tourism Agency

Topic②: Fears of regional economic deterioration due to worsening of operating performance in manufacturing

◆ U.S. tariffs will also put downward pressure on domestic demand

Due to the U.S. tariff hikes, the earnings of Japanese manufacturing companies are expected to deteriorate. Export volumes are likely to drop due to a slowdown in the U.S. economy and a decrease in manufacturers' price competitiveness in the U.S. market. Even if Japanese companies reduce export prices to maintain price competitiveness, a decline in corporate earnings is inevitable as margins will be squeezed.

Should manufacturing profits fall, there is a danger that the wage-hiking trend will weaken. According to estimates, if reciprocal tariffs are increased to 25%, the pace of wage rises would plummet to 2.0-2.4% per year.

◆ Regional economic deterioration could also lead to population outflows

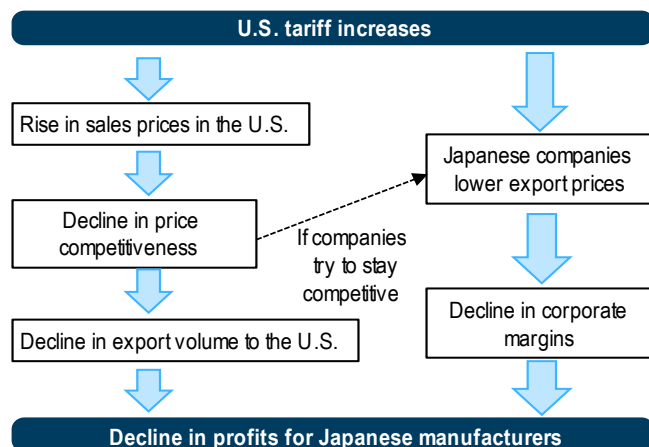
There is a danger that slower wage increases in the manufacturing sector could also have a negative impact on wage levels in provincial regions. In areas with large numbers of manufacturing workers, such as the North Kanto and Tokai regions, there tends to be a strong correlation between non-manufacturing and manufacturing wages. Lower wages in manufacturing could spill over into non-manufacturing sectors for two reasons.

The first is structural linkages across industries. In areas with a heavy manufacturing presence, there are numerous companies that do business with the manufacturers. Thus, a deterioration in operating performance in the manufacturing sector tends to affect the performance of these companies.

The second is that lower manufacturing wages could reduce consumption within the regions. In areas with a high concentration of manufacturers, the incomes of their employees exert a powerful impact on local consumption. If manufacturing workers see their incomes worsen, the operating performance of service providers and retailers will also be depressed.

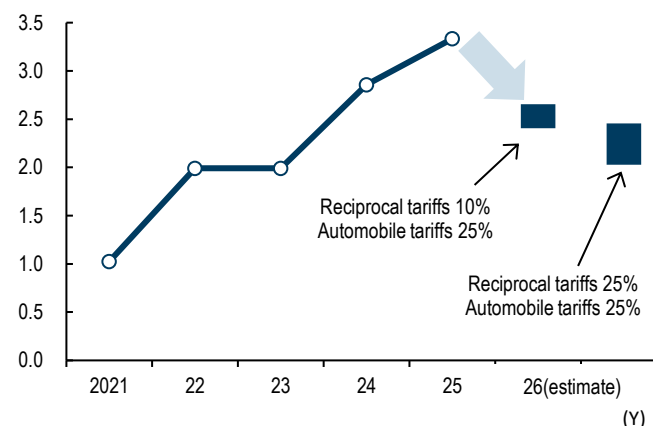
Additionally, should regional wage levels fall, it could also accelerate the exodus of young people seeking the more favorable employment environment of urban areas. Regional economic decline thus threatens to shake the growth foundations of the Japanese economy as a whole.

Figure 7-1 Decline in Corporate Profits due to Tariff Increases



Source: Japan Research Institute, Ltd

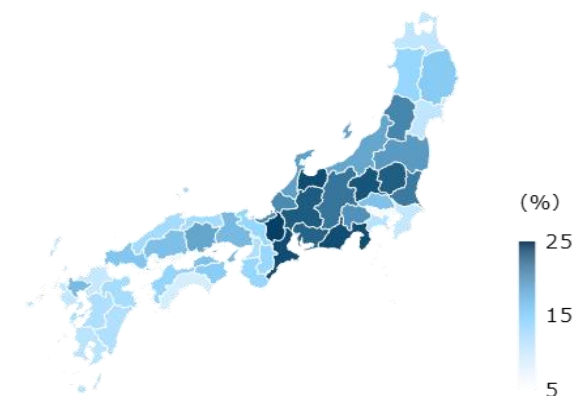
Figure 7-2 Wages in the Manufacturing Sector <YoY>



Source: Japan Research Institute, Ltd. based on data from the Ministry of Health, Labor and Welfare and the Ministry of Finance

Note: For the method of estimation, see Fujimoto and Nishioka [2025], "Trump Tariffs Hinder Wage Hike Momentum," Japan Research Institute, Research Focus, No. 2025-015.

Figure 7-3 Share of Workers Employed in Manufacturing



Source: Japan Research Institute, Ltd. based on data from the the Ministry of Internal Affairs and Communications

Note: Hokkaido and Okinawa both have less than 10%.

U.S. tariffs will create downward economic pressure

◆ Economic growth will slow

Looking ahead, Japan's economy is expected to slow down. Regarding U.S. tariffs, most countries, including Japan, are likely to be spared the additional reciprocal tariffs that are supposed to come into force in August, and only have to cope with the flat 10% hike.

Exports will fall in the near term due to deteriorations in the U.S. and Chinese economies as a result of the U.S. tariff hikes. This will cause corporate earnings to drop and wage increases to be curbed, so private-sector demand will weaken over the next fiscal year. In response to the adverse economic impact of the U.S. tariffs, the government will likely take steps to support the economy.

Personal consumption will remain resilient going forward, though the pace of increase is expected to slow somewhat. Against a backdrop of worsening business performance, bonuses in the second half of this fiscal year will rise by a smaller margin. Basic salaries will continue to increase as a reflection of structural labor shortages, particularly in non-manufacturing, but the pace of increase is expected to slow.

Regarding capital investment, while software investment looks set to keep rising, there is a high degree of uncertainty about U.S. tariffs, and machinery investment in the manufacturing industry is weak.

◆ Japan's economic growth rate for FY2025 is expected to be 0.2%

Real GDP growth is projected to be 0.2% in FY2025 and 0.7% in FY2026. However, if negotiations with the U.S. end badly and additional tariffs are imposed, the growth rates will be lower. In addition, back-and-forth imposition of retaliatory tariffs by the U.S., China, the EU, etc. would exert downward pressure on Japan's economy.

Figure 8 Projections for Japan's GDP Growth and Main Indicators (as of July 16, 2025)

(seasonally adjusted, annualized % changes from the previous quarter)										(% changes from the previous fiscal year)		
	CY2025				CY2026				CY2027	FY2024	FY2025	FY2026
	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3			
	(Actual)	(Projection)								(Actual)	(Projection)	
Real GDP	-0.2	-0.3	0.3	0.7	0.7	0.8	0.8	0.8	0.9	0.8	0.2	0.7
Private Consumption Expenditure	0.6	0.2	0.4	0.7	0.8	0.5	0.5	0.5	0.5	0.8	0.6	0.5
Housing Investment	5.6	-6.2	-0.1	0.1	-0.0	0.0	0.0	-0.1	0.0	-1.0	-0.5	-0.0
Business Fixed Investment	4.4	-4.1	0.3	0.2	0.3	0.6	0.9	0.9	1.0	2.4	0.1	0.6
Private Inventories (percentage points contribution)	(2.1)	(0.1)	(0.0)	(0.0)	(0.0)	(-0.0)	(-0.0)	(-0.0)	(-0.0)	(0.1)	(0.3)	(-0.0)
Government Consumption Expenditure	-2.0	2.2	1.1	1.0	1.1	2.0	1.6	1.5	1.9	1.3	0.7	1.5
Public Investment	-2.5	3.0	1.6	1.4	1.0	1.3	1.7	1.8	1.5	1.3	0.3	1.4
Net Exports (percentage points contribution)	(-3.5)	(-0.2)	(-0.4)	(-0.1)	(-0.1)	(-0.1)	(-0.0)	(-0.0)	(-0.0)	(-0.4)	(-0.5)	(-0.1)
Exports of Goods and Services	-2.2	-4.8	-1.0	0.5	0.5	0.7	0.9	1.1	1.2	1.7	-0.6	0.7
Imports of Goods and Services	12.7	-3.6	0.9	1.0	1.0	1.1	1.2	1.2	1.3	3.5	1.5	1.1

(% changes from the same quarter of the previous year)										(% changes from the previous fiscal year)		
Nominal GDP	5.1	4.7	3.6	3.0	2.9	2.5	3.0	3.2	3.3	3.7	3.5	3.0
GDP deflator	3.3	4.1	3.1	3.2	2.7	2.0	2.3	2.4	2.4	2.9	3.3	2.3
Consumer Price Index (excluding fresh food)	3.1	3.5	2.9	2.5	2.0	1.6	1.8	1.9	1.9	2.7	2.7	1.8
Unemployment Rate (%)	2.5	2.5	2.5	2.4	2.4	2.4	2.4	2.4	2.4	2.5	2.4	2.4
Exchange Rates (JY/US\$)	153	145	145	143	141	138	136	136	136	153	143	137
Import Price of Crude Oil (US\$/barrel)	79	74	73	72	71	70	69	67	66	83	72	68

Sources: Cabinet Office; Ministry of Internal Affairs and Communications; Ministry of Economy, Trade and Industry; Ministry of Finance
The projection figures are based on those of the Japan Research Institute, Ltd.