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Monthly Report of Prospects for Japan's Economy

August 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.

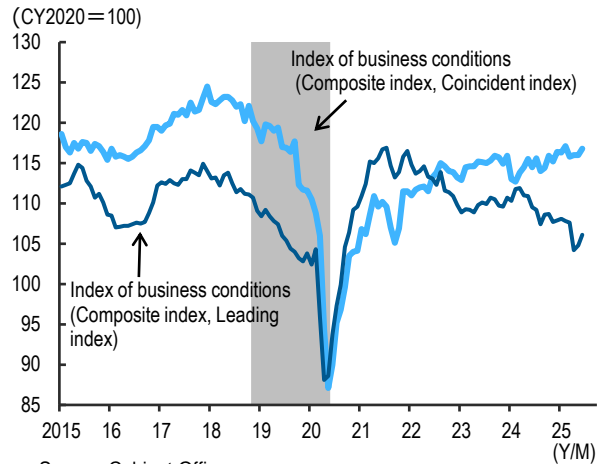


Figure 1-2 The Corporate Sector

Industrial production is weak but has begun to pick up. Economic activity in the service sector is recovering.

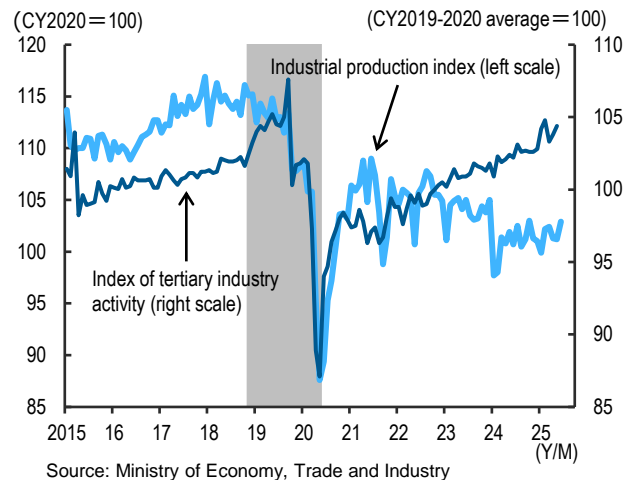


Figure 1-3 Overseas Demand

Exports have continued to rise in real terms even since the U.S. tariff hikes. Imports are also increasing.

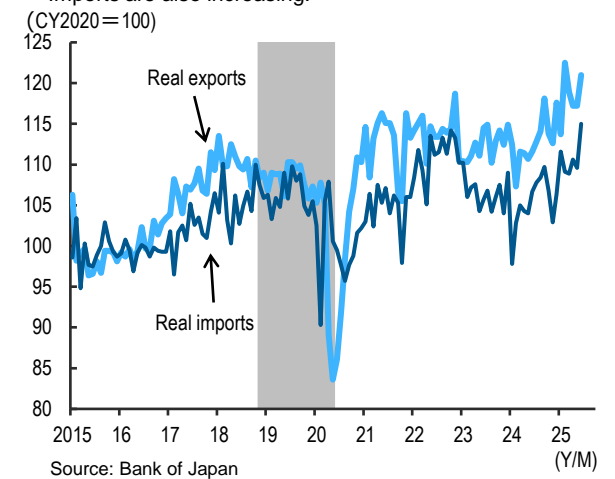


Figure 1-4 Employment and Income

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

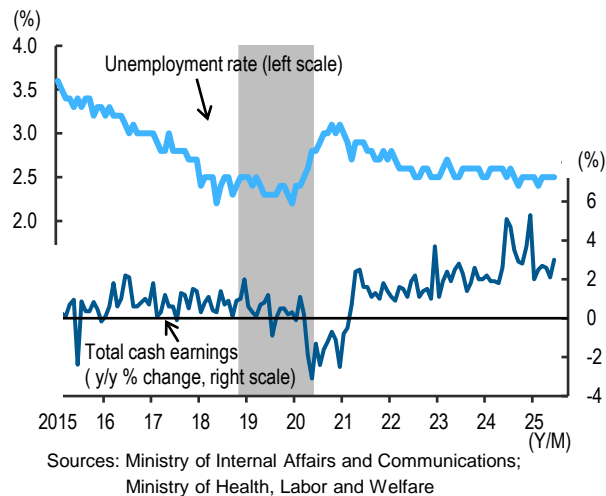


Figure 1-5 The Household Sector

Consumption is slowly picking up. Housing starts have rebounded slightly but remain at a low level.

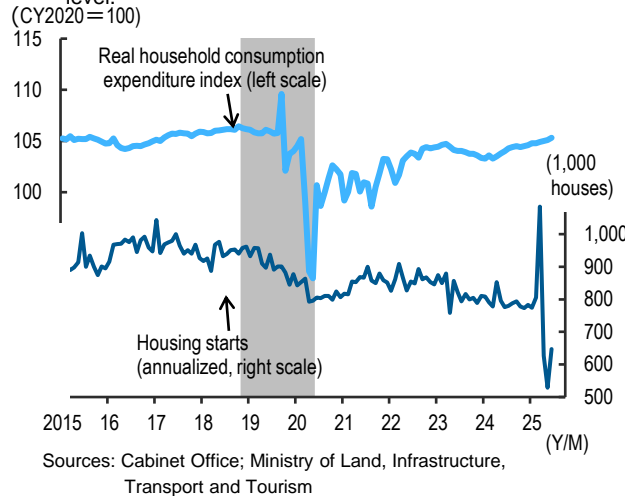
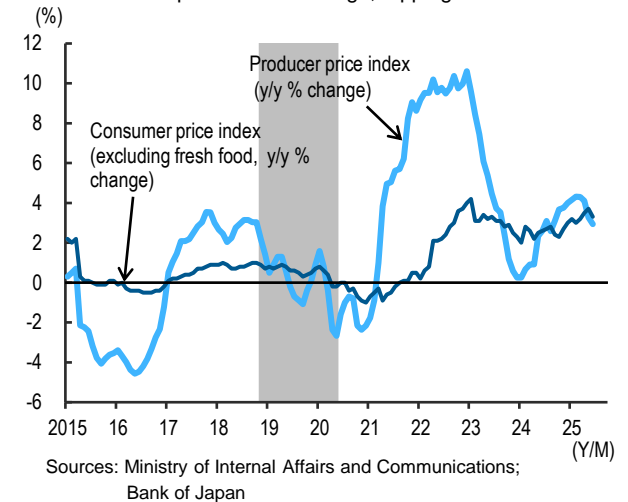


Figure 1-6 Prices

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



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

Annualized real GDP growth was 1.0% quarter over quarter (QoQ) in Q2 2025

◆ GDP has grown for five consecutive quarters

Annualized QoQ real GDP growth in the second quarter was 1.0%, with growth staying in positive territory for five straight quarters. Capital investment continued to rise, supporting domestic demand, and overall growth was lifted by foreign demand. Demand from foreign tourists remained firm, and exports to the U.S. held steady in real terms, as Japanese exporters lowered the prices of goods sold to the U.S.

◆ Manufacturing activity is picking up

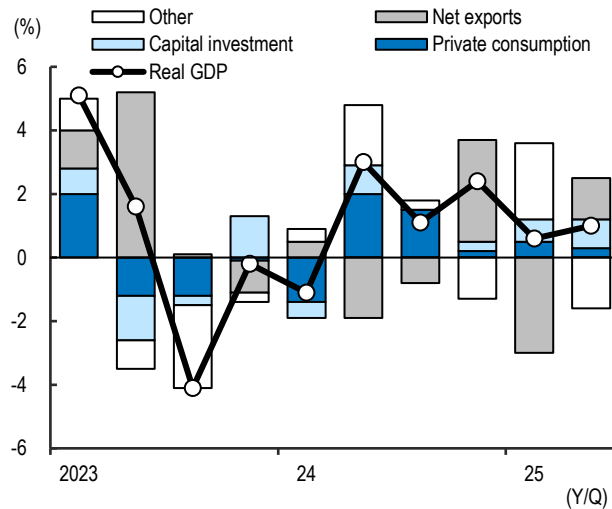
Production activity in the manufacturing sector is recovering. In June, the Industrial Production Index increased by 1.7% month over month (MoM). The main reason was higher output of transportation machinery, particularly aircraft components. Near-future production plans indicate increases in output in both July (1.8% MoM) and August (0.8% MoM), with the increase to be centered on electronics parts/devices and production machinery. However, production plans tend to be set higher than actual output turns out to be. As U.S. tariffs hit Japanese exports, production

may end up lower than the plans indicate. This is particularly the case for machinery-related sectors as these are mostly export-oriented.

◆ Consumer confidence is weak

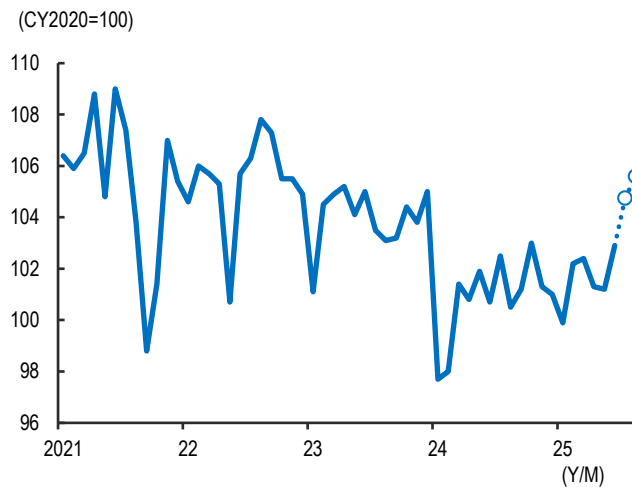
The Consumer Confidence Index is showing signs of weakness. Factors including food prices continuing to rise and growing economic anxiety in response to U.S. tariffs and other policies may be weighing on consumer sentiment.

Figure 2-1 Real GDP Growth Rate
<QoQ % Change, Annualized>



Source: Japan Research Institute, Ltd. based on data from the Cabinet Office

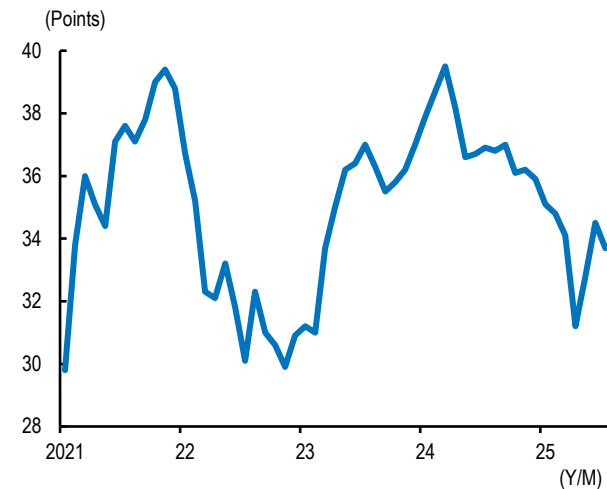
Figure 2-2 Industrial Production Index
<seasonally adjusted>



Source: Ministry of Economy, Trade and Industry

Note: The dotted line is an extension based on the manufacturing production forecast index for July and August.

Figure 2-3 Consumer Confidence Index



Source: Cabinet Office

Goods exports are weak, but capital investment is starting to pick up

◆ Goods exports will weaken going forward

Goods exports are rising in real terms. By country or territory, exports to the NIEs, ASEAN countries, etc. are solid, lifting goods exports overall. Exports of semiconductor-related products may have increased ahead of the imposition of tariffs specifically targeting the chip sector. Exports to the U.S. have fluctuated because of the demand surge ahead of tariff application and the subsequent drop, but have held firm on average. This reflects the fact that companies are absorbing the tariff burden by lowering export prices to avert a decline in the volume of their exports to the U.S.

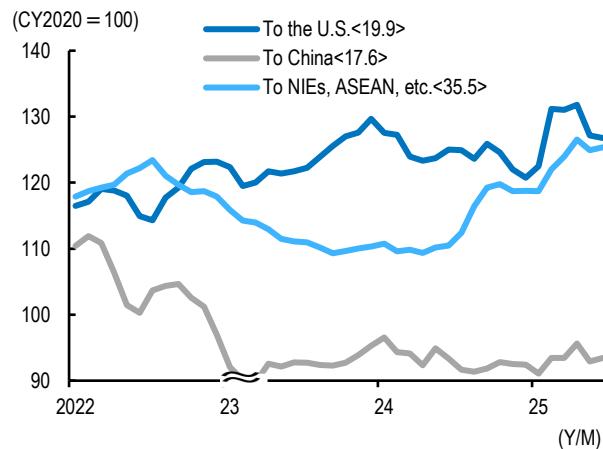
However, goods exports are projected to weaken going forward. The reductions in the prices of goods exported to the U.S. have put pressure on corporate earnings, so going forward, companies are expected to step up moves to pass through tariff costs to selling prices in the U.S. As a result, exports to the U.S. look set to start declining in real terms. In addition, signs of a global economic slowdown are expected to become more pronounced in the second half of the year, which will also push down Japan's exports across the board.

◆ Downward pressure on capital investment will ease

Capital investment is slowing. While software investment to improve efficiency and save on labor remains at a high level, machinery investment, for example, is weak due to increasing uncertainty surrounding U.S. tariffs. According to a survey conducted in June by the Development Bank of Japan, planned capital investments by large companies in FY2025 are up 10.5% from the previous fiscal year, representing a significantly lower rate of increase than that of last fiscal year.

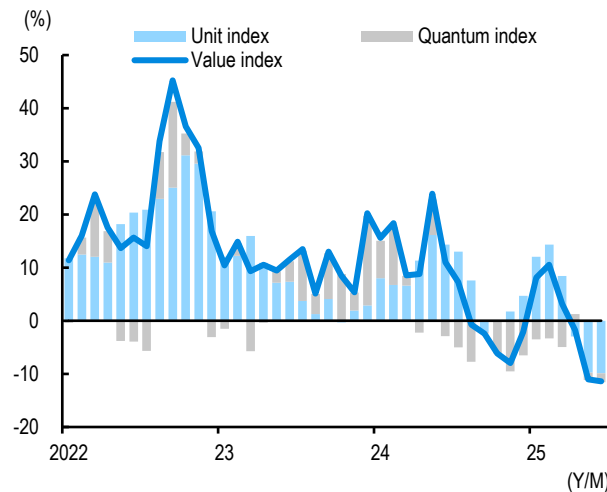
However, with the conclusion of the Japan-U.S. tariff negotiations in July, uncertainty has receded. Downward pressure on capital investment, particularly in machinery, is expected to ease.

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



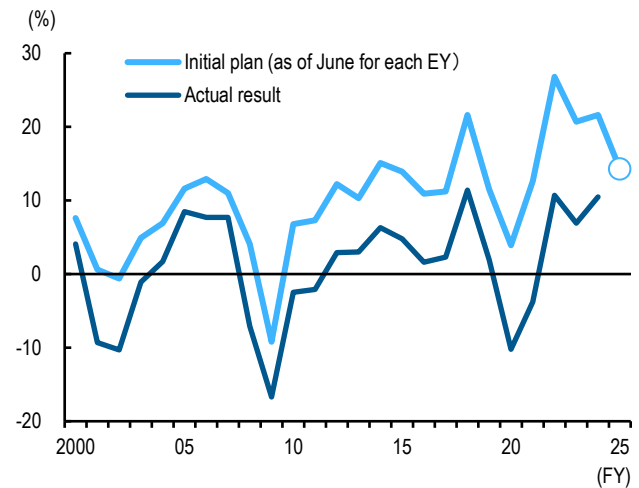
Source: Japan Research Institute, Ltd based on data from the Bank of Japan
Note: Backward 3-month average. Figures in angle brackets represent the overall percentage of total nominal exports in 2024.

Figure 3-2 Factor Analysis of export value to the U.S. <YoY>



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

Figure 3-3 Capital Investment Plan
<large companies, YoY>



Source: Japan Research Institute, Ltd based on data from the Development Bank of Japan
Note: The 2025 response was prior to the conclusion of the U.S.-Japan tariff negotiations.

The household income environment is beginning to improve

◆ Wages continue to grow rapidly

Total cash earnings in June (adjusted to reflect data discrepancies arising from a change in the companies surveyed) rose 3.4% year over year (YoY), a notable increase. Basic salaries continued to climb, and significant rises in special payments such as regular and one-time bonuses lifted the overall increase. While special payments rose less than last year because of growing concern about U.S. tariff policy, they nonetheless grew at a high pace. This was especially true at SMEs, reflecting an entrenched determination to improve the treatment of employees by boosting their bonuses as labor shortages intensify.

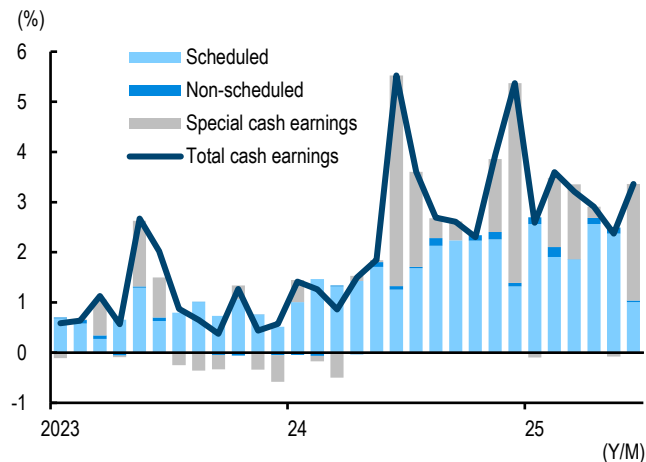
◆ Minimum wage increases will also provide a tailwind

Looking ahead, more companies will be implementing the wage hikes agreed during the shunto (spring wage negotiations), resulting in even higher increases in the basic salaries of ordinary workers. And with inflation also set to slow, real wage growth (calculated based on the CPI composite) should turn positive in the autumn.

In addition, the planned increases in minimum wages in the autumn are also expected to contribute to improving the income environment, especially for part-time

workers. The national government's Central Minimum Wages Council has asked prefectural labor bureaus to increase minimum wages by 63 yen per hour. If every prefecture raises its minimum wage in line with this guidance, the national average will rise to 1,118 yen. With the significant increases seen in recent years, the number of workers earning around the minimum wage has risen. So, minimum wage hikes are set to have an increasingly large impact on the wages of workers overall.

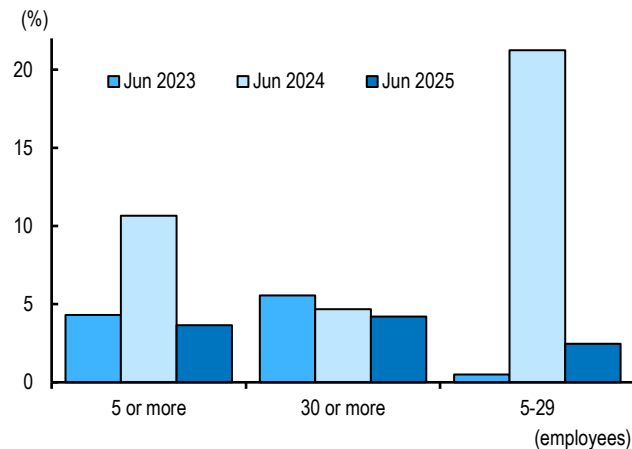
Figure 4-1 Total Cash Earnings <YoY>



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

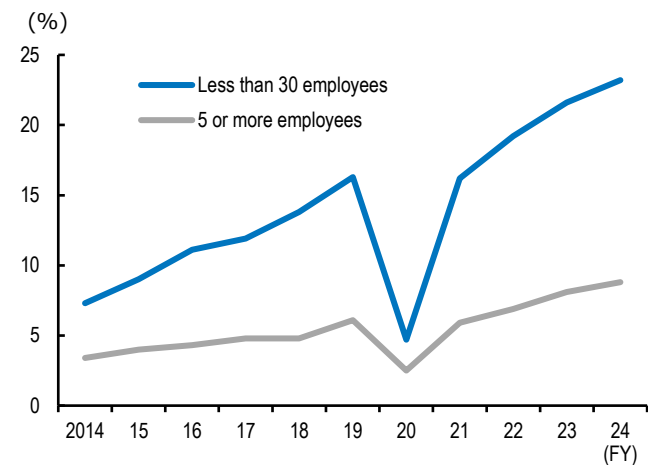
Note: Adjusted for data faults caused by the replacement of surveyed companies.

Figure 4-2 Special Cash Earnings of Ordinary Workers <YoY>



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

Figure 4-3 Impact Rate from Minimum Wage Increase



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

Note: The impact rate refers to the proportion of workers whose wages would fall below the revised minimum wage after the adjustment..

Inflation is slowing

◆ Energy prices are pushing down inflation

In June, core inflation (all items, less fresh food) dropped to 3.3%, slowing for the first time in four months. While food prices remain persistently high, particularly in the restaurant and processed food sectors, the inflation rate was pushed down by moderating energy prices, driven by government subsidies and weakening global market conditions.

Inflation is expected to slow until early next year and then remain around 2%. Energy prices will rise more slowly, albeit with fluctuation, and food prices will also top out. The price of agricultural produce, including rice, will rise more slowly. This will have a ripple effect on processed foods, so upward price pressures are expected to ease.

However, depending on the degree of the ripple effect, there is also a risk that prices of processed foods and meals outside the home will remain high. According to a survey by Teikoku Databank, food manufacturers now tend to implement price increases with more of an emphasis on logistics and labor costs than they have over the past two years. So even if the agricultural produce prices rise more slowly, it is possible that food manufacturers will keep raising prices

based on other cost increases.

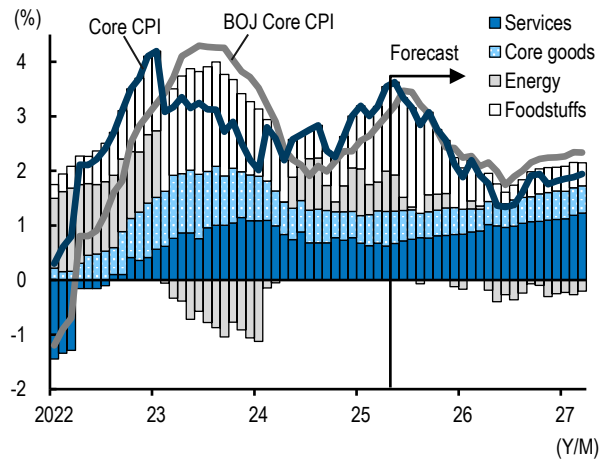
◆ The Bank of Japan (BOJ) will keep its policy rate unchanged

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

Long-term interest rates remained high in August. While growing fears of a U.S. recession pushed them down, they were supported by expectations of a BOJ rate hike that emerged in the wake of the U.S.-Japan tariff agreement.

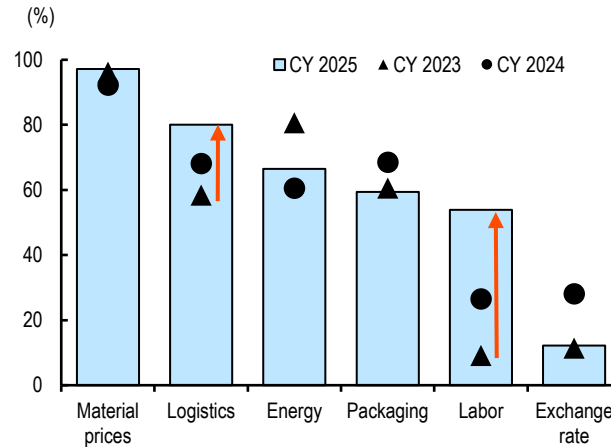
Amid lingering uncertainty surrounding U.S. tariff policy, the BOJ is expected to leave its policy rate unchanged in the near term. The next rate hike is expected to be in March 2026. Long-term interest rates look likely to remain more or less flat for the time being, after which they should rise gradually,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

Figure 5-1 Consumer Price Index <YoY>



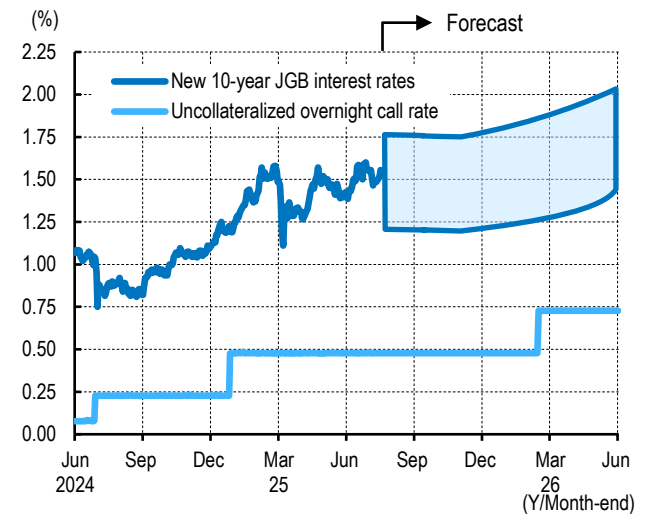
Source: Japan Research Institute, Ltd. based on data from the Ministry of Internal Affairs and Communications

Figure 5-2 Factors Contributing to Food Price Increases (Based on Number of Items)



Source: Japan Research Institute, Ltd. based on data from Teikoku Databank, Ltd.
Note: For 2025, the data covers food and beverage items for which 195 major food companies raised prices or planned to raise prices from January to November 2025 (as of July 31, 2025, based on available information). Some overlap exists among the price increase factors.

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



Source: NEEDS-FinancialQUEST

Topic ①: Legal changes are hampering a recovery in housing starts

◆ Housing starts have plummeted

After surging to 1.08 million in March, the number of housing starts (in seasonally adjusted annualized terms) plunged to 0.62 million in April and 0.52 million in May, the lowest figure ever. In June, the number of starts was just 0.64 million, a weak rebound.

A background factor behind the sharp decline was the revision of the Building Energy Efficiency Act and the Building Standards Act. Under the Building Energy Efficiency Act, it is now mandatory to conform with standards for newly-built homes, whereas previously it was only necessary for the architect to explain the home's energy conservation performance to the builder (small homes) or for the builder to notify the authorities of the construction plan (larger homes). Furthermore, the Building Standards Act amendments made many homes that were previously partially exempt from review or outside the scope of buildings requiring confirmation subject to both full review and building confirmation. This raised concerns about increased costs related to the completion of procedures and other tasks, leading to front-loaded starts before the revisions took effect and a subsequent fall-back after

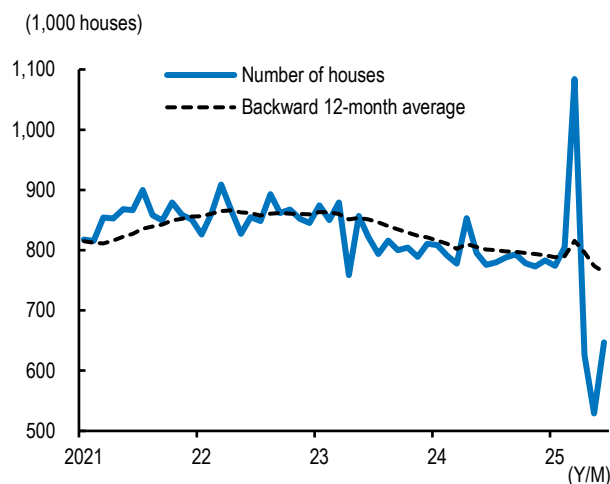
they took effect.

◆ The administrative burden and higher costs associated with the rule changes are weighing on recovery

Looking ahead, the pace of recovery in housing starts is expected to remain slow. While the government has been working to mitigate the burden caused by the expansion of the range of homes subject to review and building confirmation, it is currently unable to process applications fast enough, with the backlog swelling to nearly 20,000. The increased burden on the companies that build and sell homes could also put pressure on the number of housing starts.

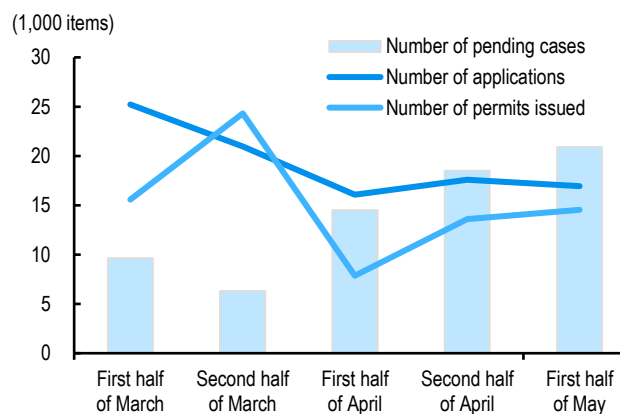
Higher costs associated with home purchases are another factor weighing on recovery. Construction costs have skyrocketed in recent years, mainly due to soaring prices of building materials and labor shortages. A return to the levels seen before the demand rush (780,000 units per year) may be considerably far off.

Figure 6-1 Housing Starts
<annualized, seasonally adjusted>



Source: Japan Research Institute, Ltd. based on data from the Ministry of Land, Infrastructure, Transport and Tourism

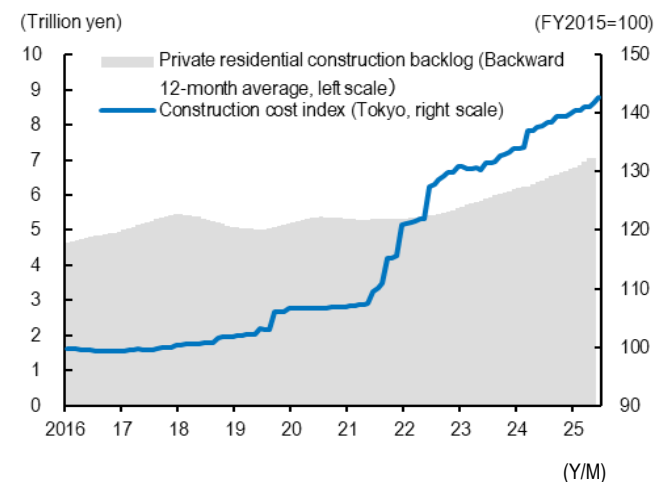
Figure 6-2 Building Confirmation Trends in 2025



Source: Ministry of Land, Infrastructure, Transport and Tourism

Note: The number of applications and permits issued is estimated by aggregating cases received since March and adjusting for the response rate. The number of pending cases is calculated by subtracting the cumulative number of permits issued from the cumulative number of applications received since March.

Figure 6-3 Building Cost Index (Housing),
Construction backlog



Source: Japan Research Institute, Ltd. based on data from the Ministry of Land, Infrastructure, Transport and Tourism and the Construction Research Institute

Topic②: Public service prices shifting to upward trend

◆ Main cause of price increases is partially regulated prices

Prices of public services in Japan are edging up. And a look at the underlying movement (the trimmed mean) reveals that prices have been rising faster recently. This development suggests that the trend of the past 30 years, where prices were largely kept unaltered except when consumption tax rates were changed, may have reached a turning point.

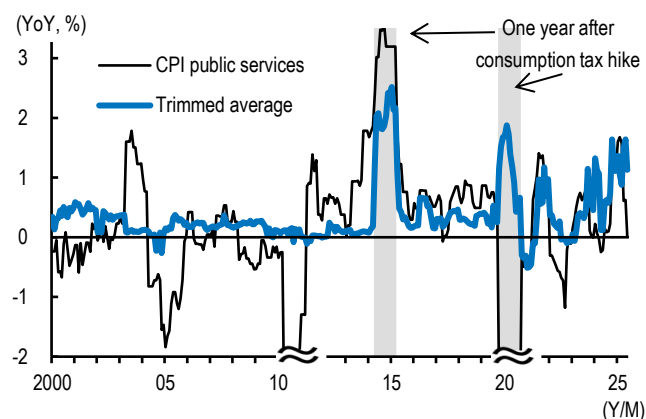
The main cause of rising public service prices is increases in "partially regulated prices," for which changes require government approval or notification. These "partially regulated prices" include fares and various insurance premiums, and the background to the price increases is that the government has been tolerating price pass-through by providers of the services. In contrast, "fully regulated prices," which are set by the national government or local authorities in accordance with laws, have not moved much. "Fully regulated prices" include medical fees and water charges, and the government and local authorities may be holding back on raising prices as consumers suffer in the face of the inflation gripping the economy as a whole.

◆ Impetus for BOJ interest rate hike could also grow

Looking ahead, public service prices could start increasing faster as the government and local authorities move to raise "fully regulated prices." The 2025 edition of the Basic Policy on Economic and Fiscal Management and Reform makes clear mention of "raising official prices (for medical care, nursing care, childcare, welfare, etc.)" as part of a review and revision of public systems to align them with inflation. The background to this policy shift is rising costs. In recent years, wage increases at public enterprises have been below the overall level, yet improving worker treatment is vital for retaining personnel. On the facilities side, securing funds for renovating infrastructure such as water pipes has also become an issue.

Since service prices are rarely revised, they tend to be regarded as indicative of the underlying level of inflation. Public service prices rising more rapidly could also encourage the BOJ to raise interest rates and continue raising them.

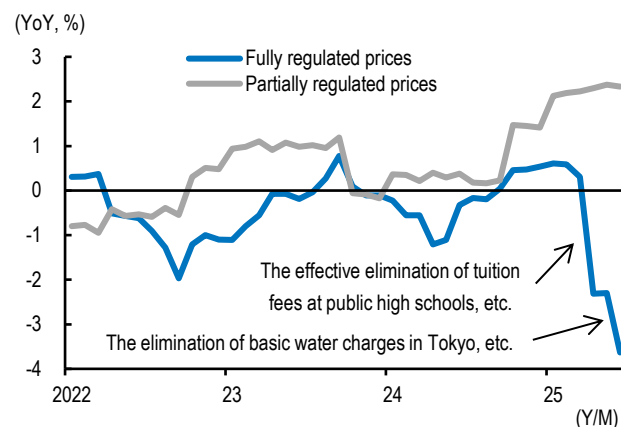
Figure 7-1 Public Service Prices
(Consumer Prices)



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

Note: Public services include water charges but exclude gas and electricity costs, which fluctuate significantly with energy market conditions. The trimmed average calculates inflation excluding extreme fluctuations by removing the top and bottom 10% of items (based on item count) with the most volatile prices.

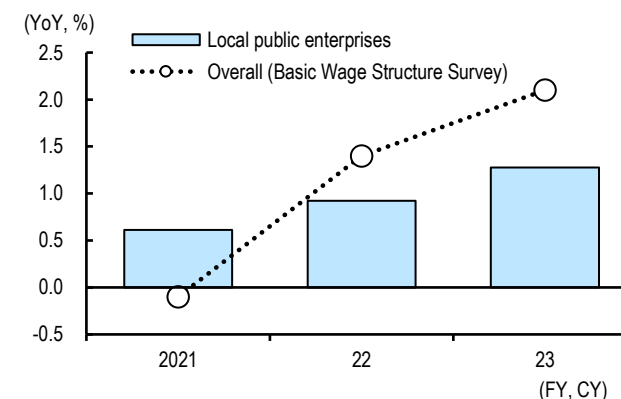
Figure 7-2 CPI Public Services
(by Administrative Involvement)



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

Note: Classified in reference to sources including Cabinet Office [2024], Economic White Paper 2024; Kohei Shintani, Yoshiyuki Kurachi, Shinichi Nishioka [2016], "Characteristics of Public Utility Charges in Japan," Bank of Japan, BOJ Review Series, 2016-J-12.

Figure 7-3 Wage Increase Rates for Local Public Enterprises



Source: Japan Research Institute, Ltd. based on data from the the Ministry of Internal Affairs and Communications and the Ministry of Health, Labour and Welfare
Note: "Local public enterprises" refers to the average monthly income per employee at enterprises applying public enterprise accounting for each fiscal year. "Overall" indicates the cash wages paid in June of each year based on the Basic Wage Structure Survey.

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U.S. tariffs will create downward economic pressure

◆ Economic growth will slow

In FY2025, Japan's economy is expected to slow down. The volume of exports is expected to begin declining sooner or later during the second half of the year as the damage to the American and Chinese economies from higher prices and lower earnings caused by the U.S. tariff hikes materializes. Meanwhile, the inflation rate will fall early next year as the pace of increase in energy and food prices slows. Real wages should begin rising from the autumn, and robust personal consumption is expected to support the economy. Furthermore, with labor shortages becoming more serious, continued investment in software will provide an economic tailwind.

Later, in FY2026, Japan's economy is expected to pick up. Although worsening corporate earnings will have a negative effect, labor shortages and rising prices should lift the wage increases agreed at next fiscal year's spring wage negotiations to around 4.5% range, a high level. Personal consumption is expected to keep rising. External demand will also bottom out. Fiscal stimulus in many countries, including the U.S., will lead to a pick-up in the global economy.

◆ The growth rate for FY2025 is expected to be 0.6%

Real GDP growth is projected to be 0.6% in FY2025 and 0.7% in FY2026. However, if the continued trade surplus with the U.S. is viewed as a problem and additional tariffs are imposed, the growth rates will be lower. In addition, Tit-for-tat

retaliatory tariff imposition by the U.S., China, the EU, etc. would also exert downward pressure on Japan's economy.

Figure 8 Projections for Japan's GDP Growth and Main Indicators (as of August 15, 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	0.6	1.0	-0.8	0.6	0.9	0.9	0.8	0.9	0.9	0.8	0.6	0.7
Private Consumption Expenditure	0.9	0.6	0.8	0.8	0.9	0.7	0.6	0.6	0.6	0.8	0.8	0.7
Housing Investment	5.6	3.2	-10.5	0.2	0.1	0.0	0.0	-0.1	0.0	-0.4	-0.1	-0.6
Business Fixed Investment	3.9	5.5	-2.1	0.6	0.8	0.9	1.0	1.1	1.1	2.0	2.0	0.7
Private Inventories (percentage points contribution)	(2.2)	(-1.2)	(0.0)	(0.0)	(0.0)	(-0.0)	(-0.0)	(-0.0)	(-0.0)	(0.1)	(-0.0)	(-0.0)
Government Consumption Expenditure	-2.1	0.0	0.8	1.0	1.1	1.4	1.5	1.5	1.5	1.3	0.1	1.3
Public Investment	0.6	-2.1	1.6	1.4	1.0	1.3	1.7	1.8	1.5	0.8	-0.2	1.4
Net Exports (percentage points contribution)	(-3.1)	(1.3)	(-0.9)	(-0.3)	(-0.1)	(-0.1)	(-0.0)	(-0.1)	(-0.0)	(-0.4)	(-0.1)	(-0.1)
Exports of Goods and Services	-1.2	8.4	-3.1	-0.2	0.8	0.8	0.9	0.9	1.2	1.7	2.5	0.5
Imports of Goods and Services	12.0	2.6	1.0	1.0	1.2	1.2	1.3	1.3	1.3	3.4	2.9	1.2

(% changes from the same quarter of the previous year)										(% changes from the previous fiscal year)		
Nominal GDP	5.2	5.2	4.0	3.0	2.9	3.0	3.0	3.1	3.2	3.7	4.1	3.2
GDP deflator	3.3	3.3	3.3	3.0	2.4	2.2	2.2	2.3	2.3	2.9	3.2	2.3
Consumer Price Index (excluding fresh food)	3.1	3.5	3.0	2.5	2.0	1.5	1.6	1.8	1.9	2.7	2.8	1.7
Unemployment Rate (%)	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.4	2.5	2.5	2.5
Exchange Rates (JY/US\$)	153	145	147	145	143	141	139	139	139	153	145	140
Import Price of Crude Oil (US\$/barrel)	79	75	72	69	64	64	63	62	62	83	70	63

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.