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Monthly Report of Prospects for Japan's Economy

September 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 exhibiting weakness. The leading index has rebounded slightly but remains at a low level.

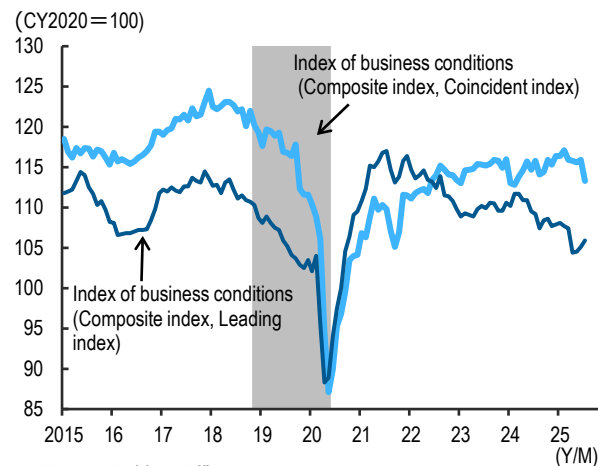


Figure 1-2 The Corporate Sector

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

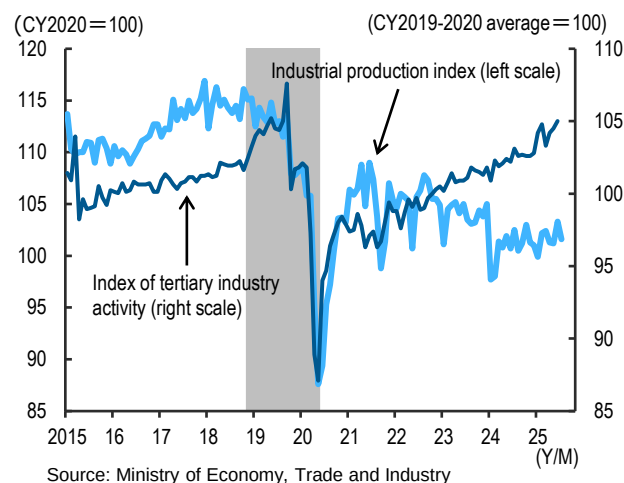


Figure 1-3 Overseas Demand

Exports, particularly of automobile-related products, are falling. Imports are also down.



Figure 1-4 Employment and Income

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

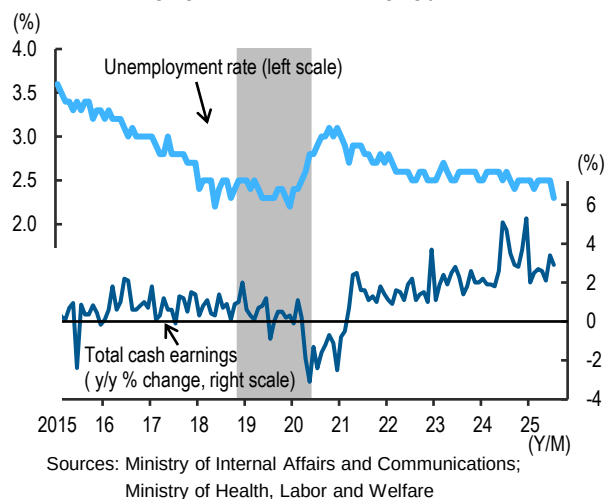


Figure 1-5 The Household Sector

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

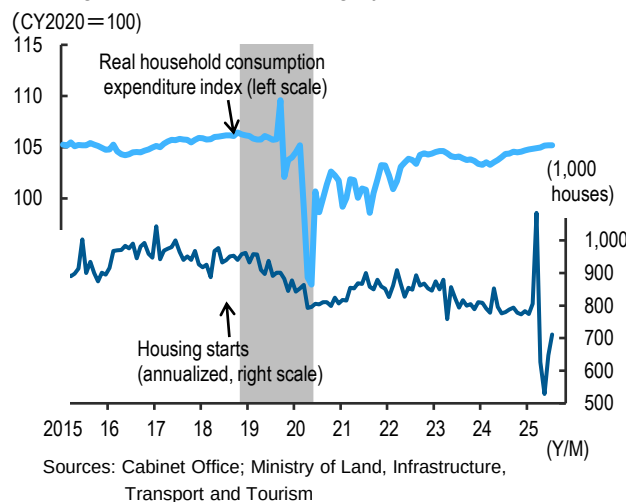
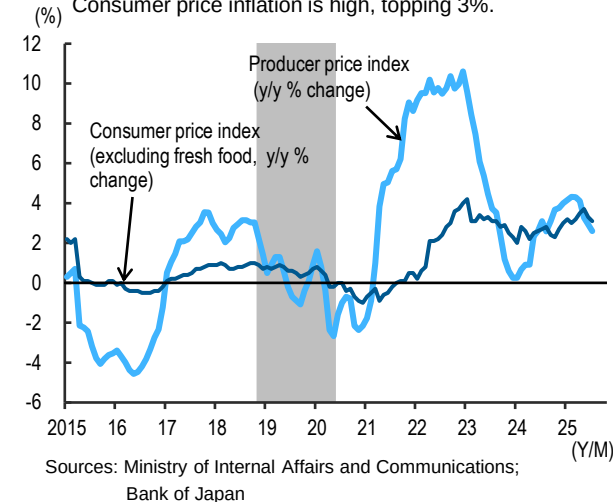


Figure 1-6 Prices

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



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

Real GDP for Q2 2025 has been revised upward

◆ Real GDP has been revised upward

In the second QE (quarterly estimate) for Q2 2025, real GDP growth was put at 2.2% year over year (YoY) (0.5% quarter over quarter (QoQ)), an upward revision from the +1.0% in the first QE. Capital investment was revised downward, while personal consumption and inventory investment saw upward revisions.

◆ Manufacturing activity is weak

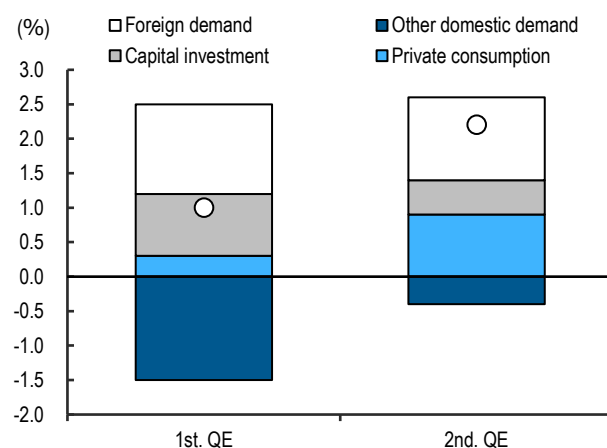
Production in the manufacturing sector is fluctuating. In July, the Industrial Production Index decreased by 1.6% month over month (MoM). This reflected a slump in output of production machinery, particularly in the automobile and semiconductor manufacturing equipment sectors.

According to the Industrial Production Index Forecast (adjusted based on past forecasting errors), near-future production plans indicate a decrease in output in August of 1.7% MoM. As U.S. tariffs hit Japanese exports, production may weaken. This is particularly the case in machinery-related sectors, many of which are export-oriented.

◆ Personal consumption is providing support

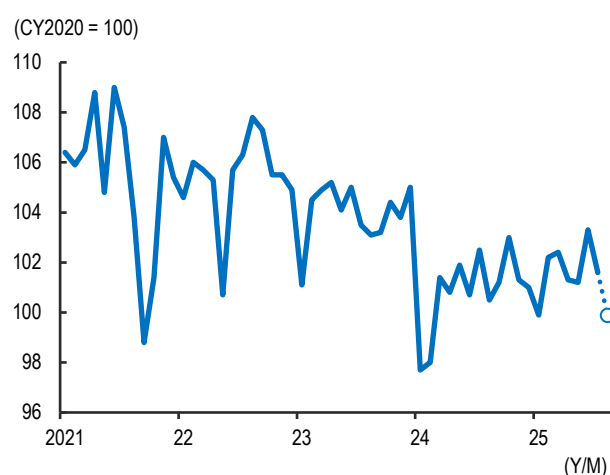
Personal consumption is gradually recovering. The Consumption Activity Index (Real) is being supported by service-related consumption, particularly of face-to-face services, and this is outweighing the heavy burden of soaring food prices and weak demand for non-durable goods. Among face-to-face services, the number of restaurant customers has continued to recover since 2022. Higher prices of agricultural produce could be giving a boost to the food service sector by causing a shift in consumption from eating at home to meals outside the home.

Figure 2-1 Real GDP Growth Rate for Q2 2025 <YoY annual growth rate>



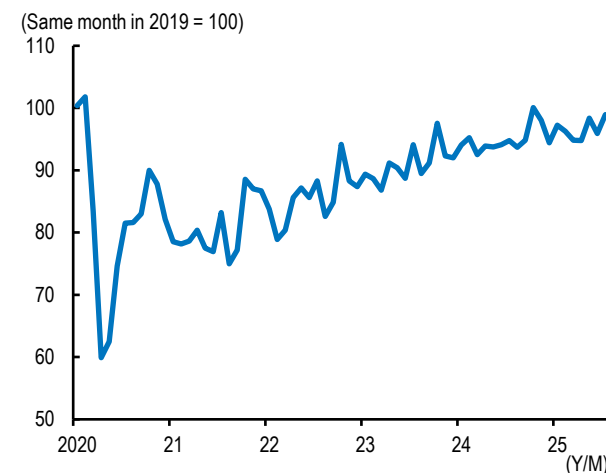
Source: Japan Research Institute, Ltd. based on data from the Cabinet Office

Figure 2-2 Industrial Production Index <seasonally adjusted>



Source: Ministry of Economy, Trade and Industry
Note: The dotted line shows the adjustment value (Aug) calculated by the Ministry of Economy, Trade and Industry based on past adjustment patterns, with the adjustment postponed.

Figure 2-3 Number of Customers in the Restaurant Industry



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

Corporate earnings vary depending on the industry, and the surge in capital investment is slowing

◆ Non-manufacturing earnings are strong, but profits in the manufacturing sector are worsening

According to the Financial Statements Statistics of Corporations, ordinary profit (all industries) for the April-June quarter increased 0.2% YoY, but performance was varied across industries. Due to the U.S. tariff hikes, the manufacturing sector saw its earnings decline, with transportation machinery bearing the brunt. Earnings in the non-manufacturing sector, meanwhile, continued to rise on the back of factors including resilience in services consumption and lower energy prices.

Increased polarization of corporate earnings is expected to continue going forward. Non-manufacturing profits are expected to keep rising as energy prices look set to stay at low levels over the near term, and because personal consumption will remain solid due to real wage growth turning positive. In contrast, earnings in the manufacturing sector are expected to keep declining. During the second half of the year, a clear global economic slowdown should become apparent, which will lead to further pressure on exports. In their earnings announcements, major automakers are

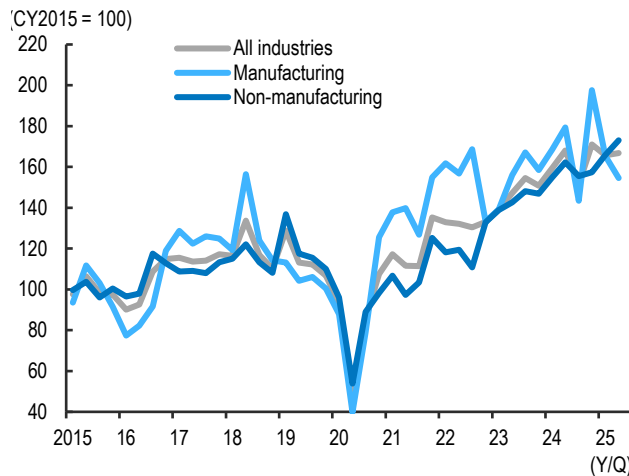
forecasting a drop in profits of 36% YoY in FY2025.

◆ Capital investment is set to slow

Capital investment (including software investment) was up 1.6% QoQ, climbing for the fifth successive quarter. Amid worsening worker shortages, companies are accelerating investment in software for labor-saving.

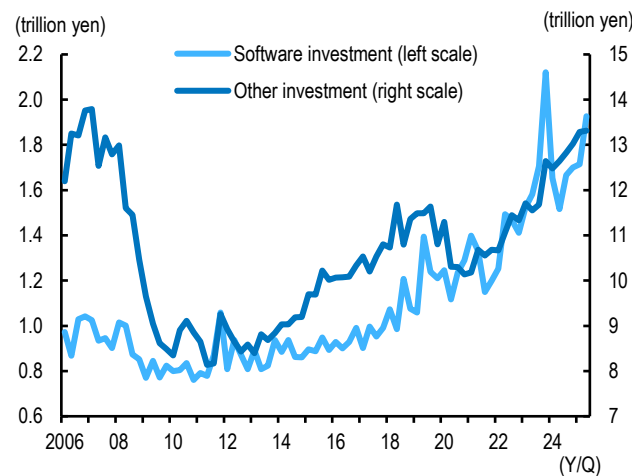
Regarding the outlook for capital investment, investment in software should hold firm due to structural labor shortages, but machinery investment is predicted to weaken as companies book lower profits. According to a survey conducted in June by the Development Bank of Japan, the rate of increase in capital investments in FY2025 is expected to be lower than in the previous fiscal year.

Figure 3-1 Ordinary Profit
<all sizes, seasonally adjusted>



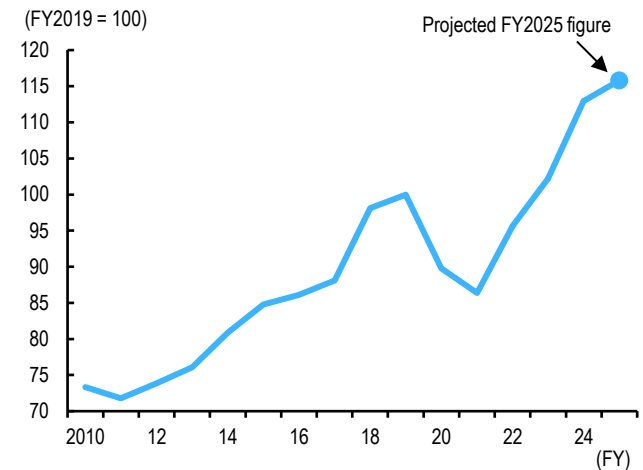
Source: Japan Research Institute, Ltd based on data from the Ministry of Finance
Note: Non-manufacturing industries exclude financial and insurance industries.

Figure 3-2 Capital Investment by Corporate Enterprises <seasonally adjusted>



Source: Japan Research Institute, Ltd based on data from the Ministry of Finance
Note: All sizes and all industries (excluding finance and insurance).

Figure 3-3 Actual and Projected Capital Investment



Source: Japan Research Institute, Ltd based on data from the Development Bank of Japan
Note: Large enterprises, all industries. FY2025 projected actuals calculated based on initial plans as of June and the average of the revision rates for FY2023 and FY2024.

The household income environment is improving

◆ Increases in employment and wages are pushing up incomes

The household income environment is favorable. In June, the real incomes of employees increased by 2.4% YoY, the fourteenth consecutive monthly rise.

This can be attributed to the following two factors:

The first is overall favorable labor market conditions. As companies consolidate and reorganize their production facilities, the number of people employed in manufacturing is falling, but robustness in non-manufacturing employment is driving the improvement. The increase in the number of employed persons is pushing up incomes overall.

The second is that nominal wages are rising. Against the backdrop of intensifying labor shortages, the rates of wage increases agreed at the 2025 shunto (spring wage negotiations) were high, averaging 5.25%, which was up on last year. As a result, nominal wages are climbing relatively rapidly.

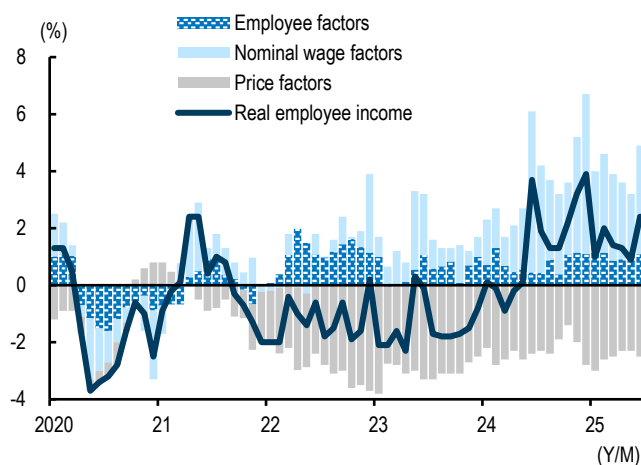
◆ Nominal wage growth could slow going forward

The income situation for households is expected to continue to improve in the near term. While the number of employees should continue to rise moderately for the time being, centered on the non-manufacturing sector, slower inflation will serve to lift real

incomes. Companies, facing serious labor shortages and high levels of inflation, are also under heavy pressure to increase pay, so nominal wages are expected to continue rising rapidly.

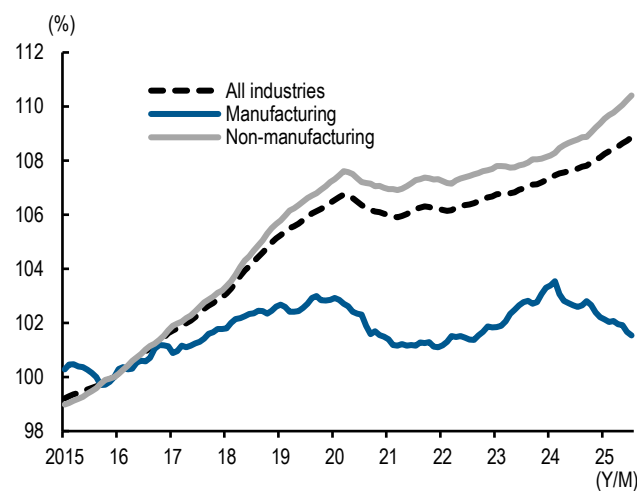
However, nominal wage growth next fiscal year is likely to be somewhat lower than it has been this fiscal year. This will reflect lower corporate earnings due to the U.S. tariff hikes. In the FY2025 edition of a survey concerning wage increases conducted by Tokyo Shoko Research, around 20% of companies said that due to the impact of U.S. tariffs, they would hold off on base pay hikes, or at least reduce the margin of increase, in FY2026.

Figure 4-1 Real Employee Income <YoY>



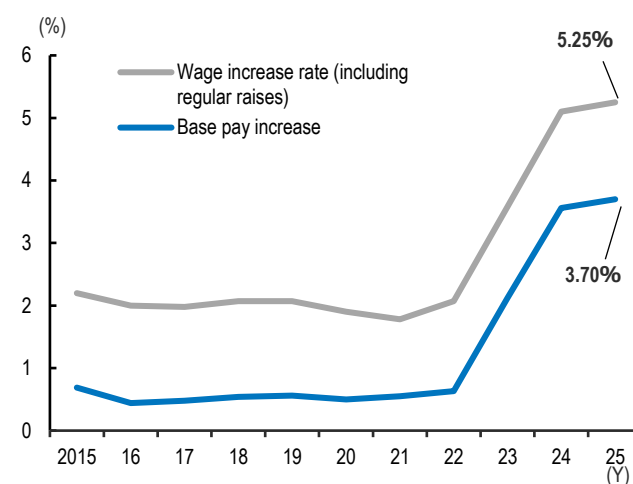
Source: Japan Research Institute, Ltd. based on data from the Cabinet Office, Ministry of Health, Labour and Welfare, and Ministry of Internal Affairs and Communications
Note: Price factor is the household final consumption expenditure deflator. Total employee income is estimated by multiplying nominal wages (total cash compensation) by the number of employees (non-agricultural and non-forestry only).

Figure 4-2 Number of Employed Persons <backward 12-month average>



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

Figure 4-3 Rate of Wage Increases from Spring Negotiations



Source: Japan Research Institute, Ltd. based on data from the Japanese Trade Union Confederation

Note: Base pay increase is the weighted average for unions where the wage increase amount is clearly identifiable.

Inflation is slowing

◆ Energy prices are pushing down inflation

In July, core inflation (all items, less fresh food) slowed for the second straight month, dropping to 3.1%. Energy prices were lower than they were a year earlier, which pushed down the overall inflation rate. However, the pace of increase in food prices, mainly meals outside the home and processed foods, remained high. This pushed the Bank of Japan's measure of core inflation (which excludes fresh food and energy) up to 3.4%, accelerating for the 12th consecutive month.

Price growth 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 peak. Slower rises in the prices of agricultural produce, including rice, are expected to have a ripple effect on processed foods. In addition, a deceleration in the ascent of import prices due to a lull in the yen's depreciation is highly likely to ease the upward pressure on food prices.

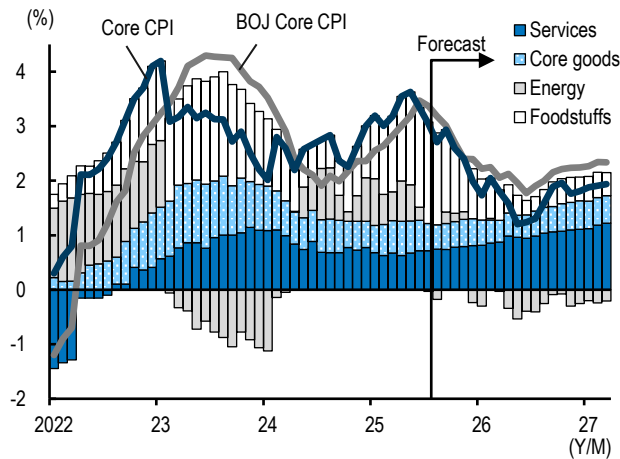
◆ The Bank of Japan (BOJ) will keep its policy rate unchanged

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

Long-term interest rates rose in September. Rates were driven higher due to rising long-term interest rates worldwide, growing expectations of an interest rate hike by the BOJ, and mounting concerns about fiscal expansion by the minority LDP government as it seeks to placate other parties.

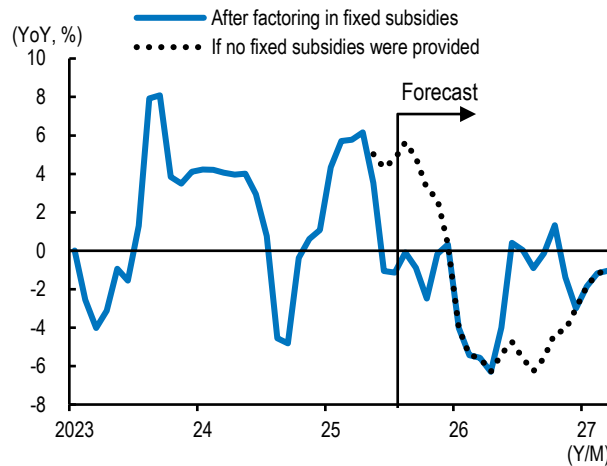
Amid lingering uncertainty surrounding U.S. tariff policy, the BOJ is expected to leave its policy rate unchanged in the near term. The next rate hike is expected to be in March 2026. For the time being, long-term interest rates also look likely to remain more or less flat, after which they should rise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

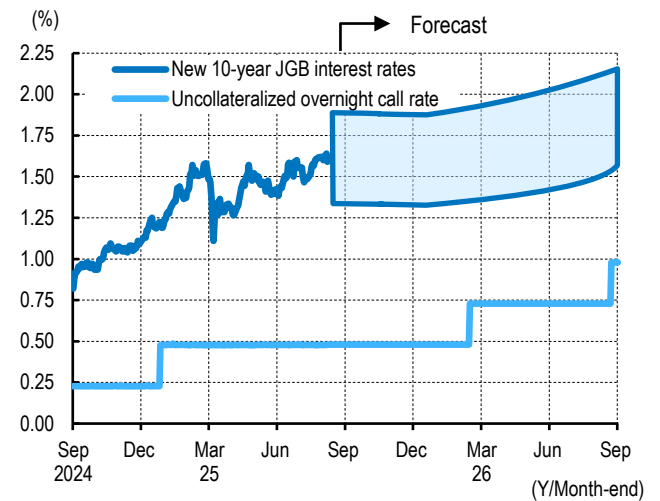
Figure 5-2 Gasoline Price Forecast Factoring in Fixed Subsidies



Source: Japan Research Institute, Ltd. based on data from the Ministry of Economy, Trade and Industry

Note: Calculated based on our crude oil price forecast. Fixed subsidies are expected to be gradually reduced starting around fall 2025.

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



Source: NEEDS-FinancialQUEST

Topic ①: Consumption by foreign tourists shifting from goods to experiences

◆ Visitors now favor services over souvenirs

The share of shopping expenditures in total inbound tourist spending has declined in recent years. In 2015, when the term bakugai (explosive buying) was crowned buzzword of the year, shopping accounted for over 40% of total spending by foreign visitors, but by 2024, that figure had slumped into the 20% range. By nationality, the drop is most pronounced among Chinese tourists, who once formed the backbone of Japan's shopping-driven inbound market.

In the past few years, consumption has shifted from tangible goods to intangible experiences. This trend is partly attributable to repeat visitors, who tend to be more eager to engage in experiential spending. Tourists from East Asia and the ASEAN6 countries, who together account for over 80% of inbound arrivals, are especially likely to be repeaters. This is helping to push up services consumption as a proportion of total expenditures.

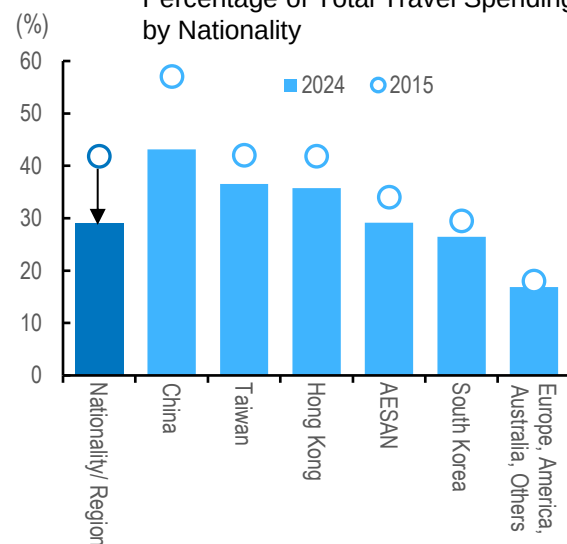
Moreover, the growing number of tourists from distant countries and territories has also buoyed services consumption. Visitors from the U.S. and Europe, for instance, tend to stay longer, resulting in higher outlays on accommodation, transportation,

and other services. In recent years, the government has been taking steps to make travel to Japan easier, waiving or relaxing visa requirements, for example. These moves have provided a tailwind for inbound consumption by people from faraway places.

◆ Enhancing value-added in experiential spending is key

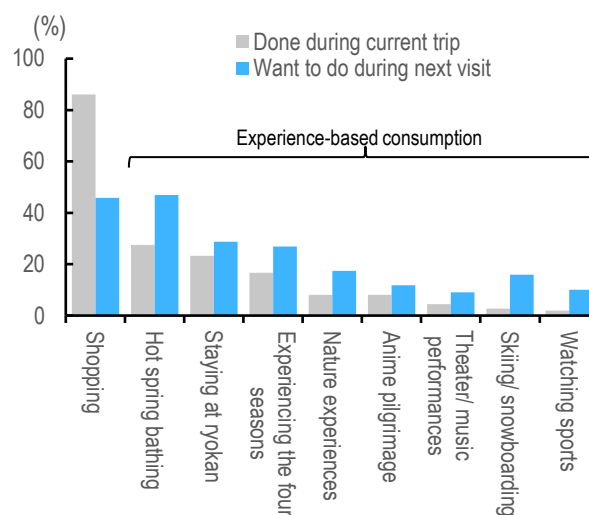
Looking ahead, inbound consumption may face downward pressure from a stronger yen caused by narrowing interest rate differentials between Japan and the U.S. However, services consumption, which is less sensitive to currency fluctuations, is likely to provide a stabilizing cushion. With continued growth expected in the number of repeat visitors from Asia and long-haul tourists from the West, enhancing the value-added appeal of experiential offerings will become increasingly important.

Figure 6-1 Shopping Expenditures as a Percentage of Total Travel Spending by Nationality



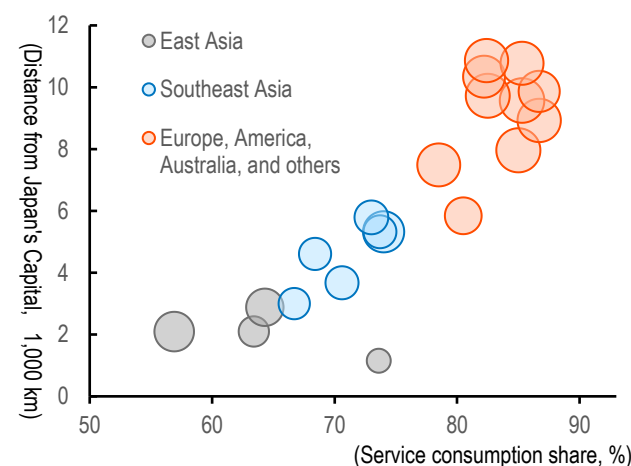
Source: Japan Research Institute, Ltd. based on data from the Japan Tourism Agency

Figure 6-2 Activities that Visitors Did/ Want to Do in Japan



Source: Japan Research Institute, Ltd. based on data from the Japan Tourism Agency
Note: CY2024. Multiple responses allowed.

Figure 6-3 Distance Between Capitals and Share of Service Consumption



Source: Japan Research Institute, Ltd. based on data from the Japan Tourism Agency
Note: CY2024. Larger circles indicate higher per capita spending in Japan.

Topic②: Price of meals outside the home sensitive to rising personnel expenses

◆ Higher labor costs are also fueling food price inflation

Since the summer of last year, food prices have surged. While the rise in rice prices appears to be peaking, increases in prices of processed foods and meals outside the home have been accelerating recently.

Behind this trend lies not only the spike in costs of raw ingredients such as rice, but also the growing tendency of companies to pass on higher personnel expenses to consumers. According to a survey by Teikoku Databank, food manufacturers now tend to implement price increases with more of an emphasis on labor costs than they have over the past two years.

◆ Restaurants are still struggling to pass on costs

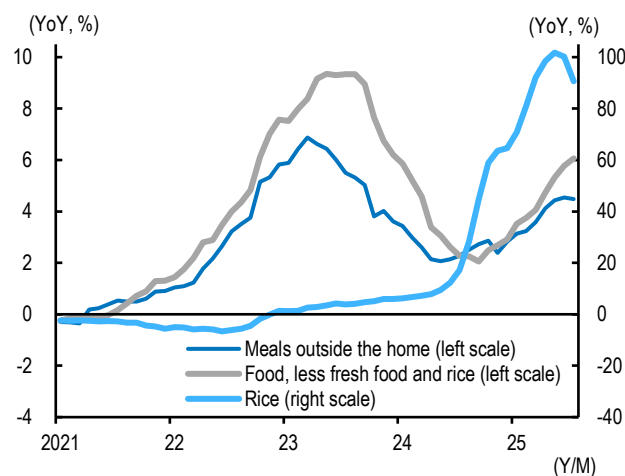
Among food prices, the prices of meals outside the home may continue rising. Two factors underlie this:

The first is the intensity of labor cost pressures. Compared to other sectors, food service is suffering from a particularly acute shortage of workers, making it essential to improve employee compensation to attract new hires and retain existing staff.

Moreover, the sector has a high proportion of part-time workers, making it especially sensitive to minimum wage hikes and pressure from policymakers to increase remuneration.

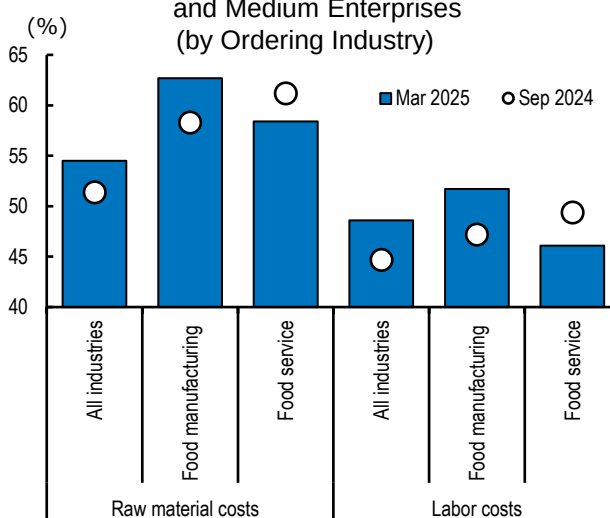
The second is the ample room to pass on labor costs to prices. According to a March 2025 survey by the Small and Medium Enterprise Agency, the rate of labor cost price pass-through in the food service sector has declined since the previous survey in September 2024. This stands in stark contrast to the situation in food manufacturing, where pass-through rates have risen sharply. The underlying reason is the cost structure of the restaurant sector. Labor costs account for roughly 30% of total output in the food service sector, which is far higher than in food manufacturing. This leaves restaurants squeezed by rises in both food costs and personnel expenses. Going forward, food service providers may increasingly seek to pass on these higher costs, though they will also need to carefully gauge consumers' capacity to pay.

Figure 7-1 Consumer Prices 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

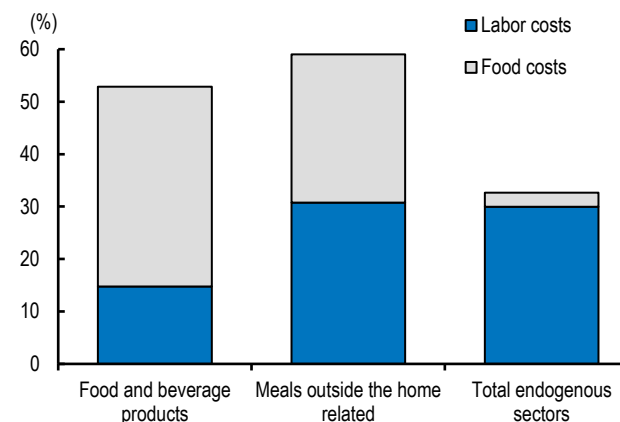
Figure 7-2 Price Pass-through Rates for Small and Medium Enterprises (by Ordering Industry)



Source: Japan Research Institute, Ltd. based on data from the Small and Medium Enterprise Agency

Note: Percentage of increased costs successfully passed on to prices.

Figure 7-3 Various Costs as a Share of Production Value



Source: Japan Research Institute, Ltd. based on data from the the Ministry of Internal Affairs and Communications "2020 Extended Input-Output Tables"

Note: "Labor costs" are inputs to employee compensation; "Food costs" are inputs to agriculture, forestry, fisheries, and food and beverage products. "Meals outside the home related" = Restaurants + Takeout/ delivery food services.

U.S. tariffs to create downward economic pressure

◆ Economic growth to slow

Looking ahead, Japan's economy is expected to slow down. Exports are predicted to begin declining during the second half of the year as the adverse impact of higher tariffs spreads across the global economy.

Meanwhile, the inflation rate will fall early next year as the pace of increase in energy and food prices slows. Real wages will begin rising from the autumn, and this should support personal consumption. Furthermore, with labor shortages becoming more serious, continued investment in software will provide an economic tailwind.

Later, Japan's economy is expected to start picking up in FY2026. Although worsening corporate earnings will have a negative effect, next fiscal year's spring wage negotiations are expected to yield a relatively high increase of around 4.5% amid labor shortages and rising prices. 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 0.8%

Real GDP growth is projected to remain solid, registering 0.8% in FY2025 and 0.7% in FY2026. However, there are significant downside risks for both domestic and external demand. Domestic demand is exposed to risks such as 1) a slump in personal consumption due to prolonged food inflation and 2) capital investment and

wage downturns due to declining corporate earnings. Should these materialize, the economy will take a hit. As for external demand, if the continued trade surplus with the U.S. is viewed as a problem, there is a risk of the U.S. imposing additional tariffs.

Figure 8 Projections for Japan's GDP Growth and Main Indicators (as of September 8, 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	0.3	2.2	-0.8	0.3	0.8	1.0	1.0	1.0	1.0	0.7	0.8	0.7
Private Consumption Expenditure	0.1	1.6	0.3	0.6	0.9	0.9	0.8	0.8	0.8	0.7	0.8	0.7
Housing Investment	5.1	2.0	-7.5	0.2	0.1	0.0	0.0	-0.1	0.0	-0.4	0.1	-0.4
Business Fixed Investment	2.9	2.6	-0.9	0.5	0.8	1.3	1.5	1.7	1.7	2.1	1.4	1.1
Private Inventories (percentage points contribution)	(2.5)	(-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	0.1	0.8	1.0	1.1	1.4	1.5	1.5	1.5	1.3	0.1	1.3
Public Investment	0.9	-2.2	1.6	1.4	1.0	1.3	1.7	1.8	1.5	0.8	-0.1	1.5
Net Exports (percentage points contribution)	(-3.1)	(1.2)	(-0.9)	(-0.5)	(-0.1)	(-0.1)	(-0.1)	(-0.1)	(-0.0)	(-0.4)	(-0.2)	(-0.2)
Exports of Goods and Services	-1.2	8.0	-3.1	-1.0	0.8	0.8	0.9	0.9	1.2	1.7	2.3	0.4
Imports of Goods and Services	12.0	2.5	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	5.1	4.7	3.9	3.0	2.9	2.4	3.0	3.2	3.4	3.7	3.6	3.0
GDP deflator	3.3	3.0	3.0	2.7	2.2	2.1	2.2	2.3	2.3	2.9	2.7	2.2
Consumer Price Index (excluding fresh food)	3.1	3.5	2.9	2.3	1.9	1.3	1.6	1.8	1.9	2.7	2.7	1.7
Unemployment Rate (%)	2.5	2.5	2.4	2.5	2.5	2.5	2.4	2.4	2.4	2.5	2.5	2.4
Exchange Rates (JY/US\$)	153	145	146	144	142	140	140	140	141	153	144	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.