English translation published in November 2025

Monthly Report of Prospects for Japan's Economy

October 2025

Macro-economics Research Center
Economics Department

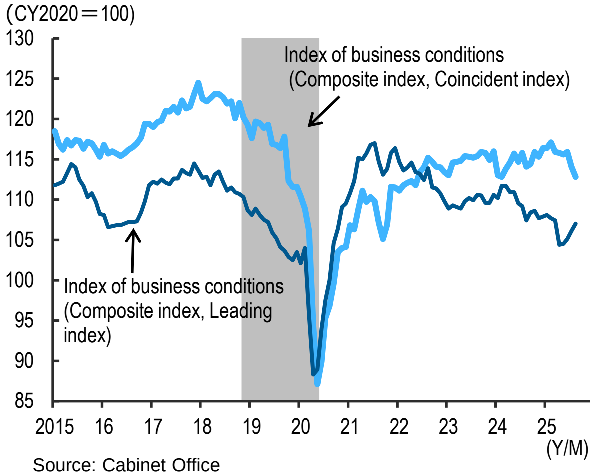
The Japan Research Institute, Limited

https://www.jri.co.jp/en/reports/reports/

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

Figure 1-1 Economic Activity

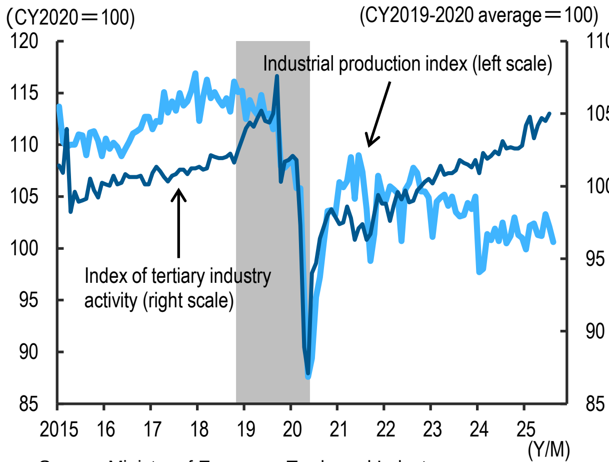
The coincident index of business conditions is exhibiting weakness.
The leading index is picking up in response to rising stock prices.



Source: Cabinet Office

Figure 1-2 The Corporate Sector

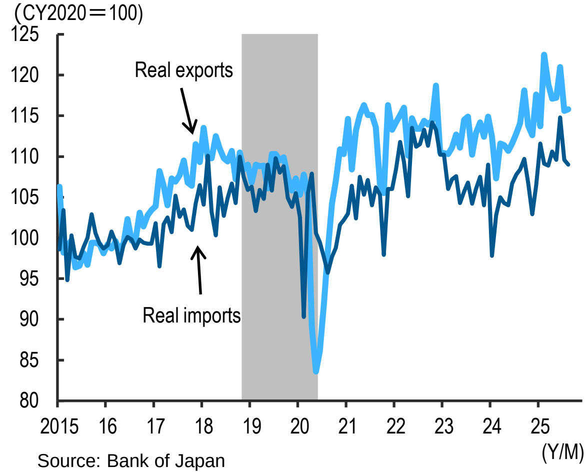
Industrial production is fluctuating.
Economic activity in the service sector is recovering.



Source: Ministry of Economy, Trade and Industry

Figure 1-3 External Demand

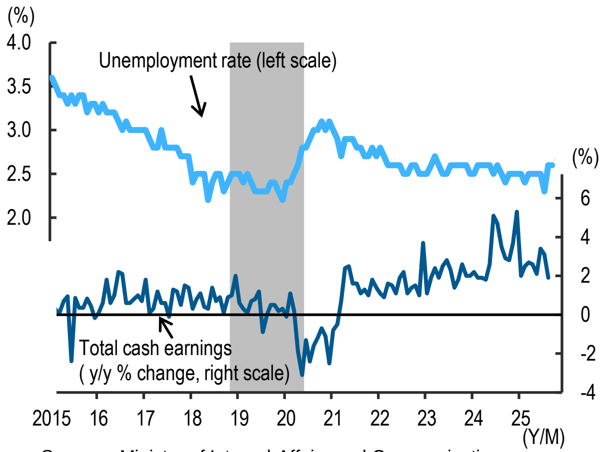
Exports are rebounding slightly, but remain weak.
Imports are falling.



Source: Bank of Japan

Figure 1-4 Employment and Income

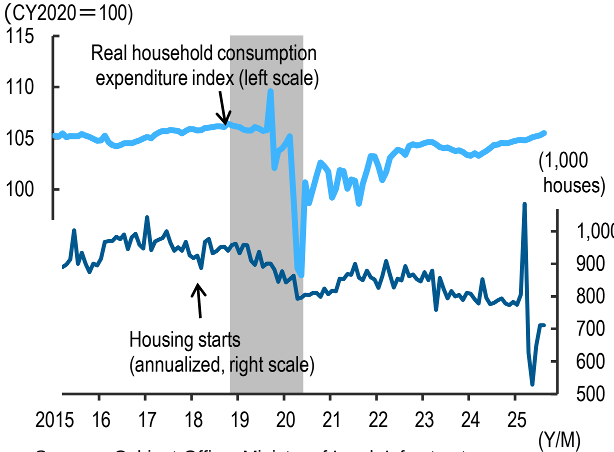
The unemployment rate is low, hovering around 2.5%.
Nominal wage growth is solid on average.



Sources: Ministry of Internal Affairs and Communications; Ministry of Health, Labor and Welfare

Figure 1-5 The Household Sector

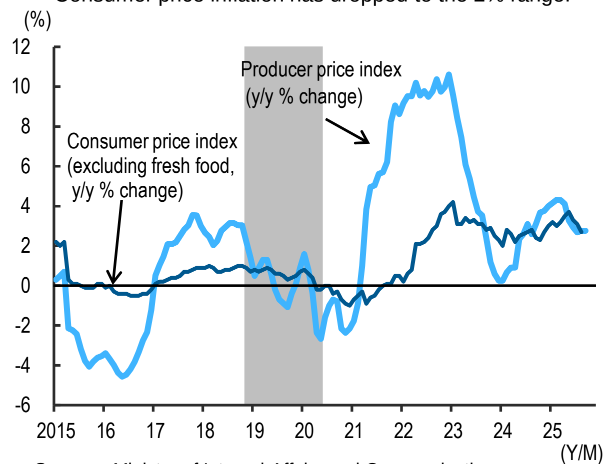
Consumption is slowly picking up.
Housing starts are at a low level.



Sources: Cabinet Office; Ministry of Land, Infrastructure, Transport and Tourism

Figure 1-6 Prices

Producer price inflation is slowing, particularly in energy.
Consumer price inflation has dropped to the 2% range.



Sources: Ministry of Internal Affairs and Communications; Bank of Japan

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

Business confidence among companies is favorable overall

◆ Business confidence is generally improving

In the September Tankan survey from the Bank of Japan (BOJ), the diffusion index (DI) for business conditions for large manufacturing enterprises was up one percentage point from the previous survey. In response to the conclusion of a tariff agreement with the U.S, overly pessimistic views receded, and business confidence in machinery-related sectors, particularly production machinery and electrical machinery, improved.

The DI for large non-manufacturing enterprises was unchanged from the previous survey. Business confidence in consumption/ logistics-related sectors deteriorated slightly due to labor shortages and rising prices, but construction-related sectors supported the overall DI thanks to strong performance in areas such as urban redevelopment projects.

◆ Production in the manufacturing sector is fluctuating

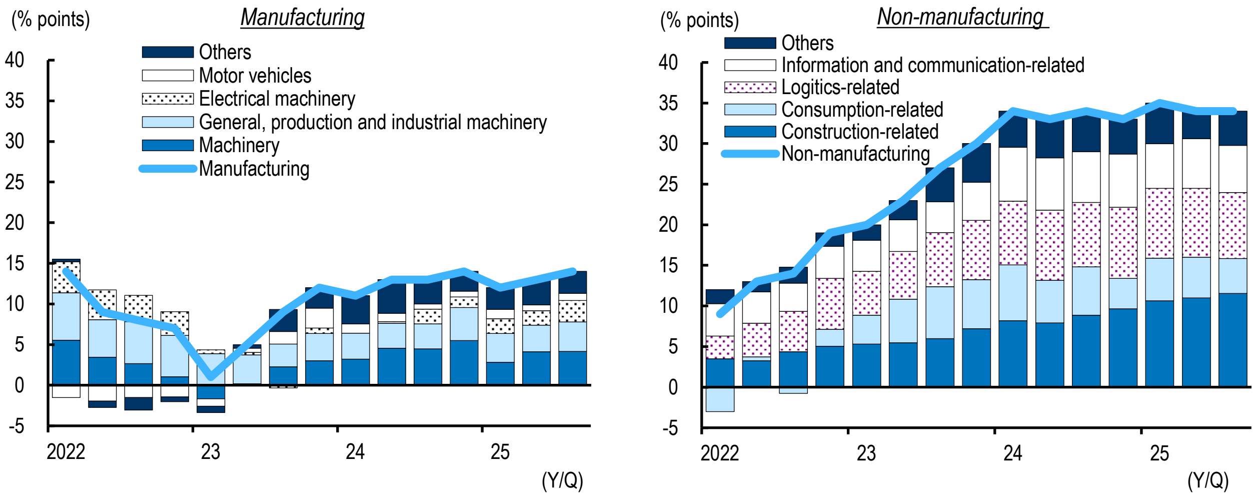
In August, the Industrial Production Index dropped by 1.6% month over month (MoM). The chief reason was lower output of electrical machinery and information/communications equipment, particularly goods such as PCs.

According to the Industrial Production Index Forecast (adjusted based on past forecasting errors), near-future production plans indicate an increase in output in September of 2.3% MoM). Rebounds are expected in the electrical machinery, information and communications equipment, and fabricated metals sectors, as given production dropped significantly in August.

◆ The number of foreign visitors to Japan remains high

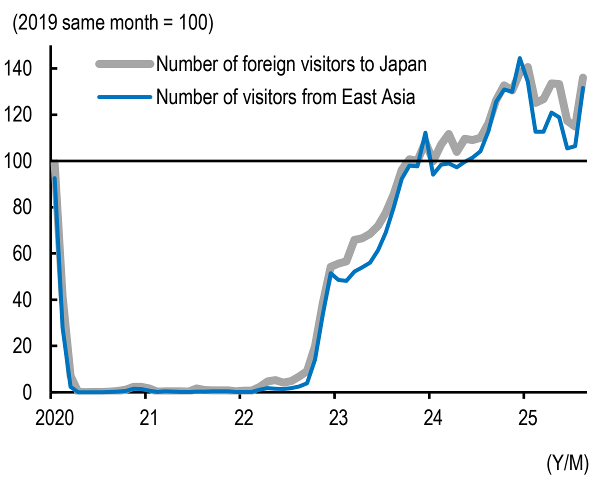
The number of foreign visitors to Japan in August continued to exceed pre-pandemic levels, being 36% higher than in the same month in 2019. The number of visitors from China and other East Asian countries fell in June and July due to unfounded rumors of an impending natural disaster, but the impact of this faded in August and tourist numbers picked back up.

Figure 2-1 DI for Business Conditions of Large Companies



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

Figure 2-2 Number of Foreign Visitors to Japan



Source: Japan Research Institute, Ltd. based on data from the Japan National Tourism Organization
Note: East Asia consists of China, South Korea, Taiwan and Hong Kong.

Goods exports are weak, but capital investment remains firm

◆ Exports are now clearly feeling the impact of tariffs

Goods exports are weak. By country/territory, real exports to the U.S. have plummeted. Japan-U.S. tariff negotiations resulted in an agreement at the end of July, and with the tariff rates decided, companies seem to have begun passing on the duties to sales prices in the U.S. As a result, demand within the U.S. may be weakening.

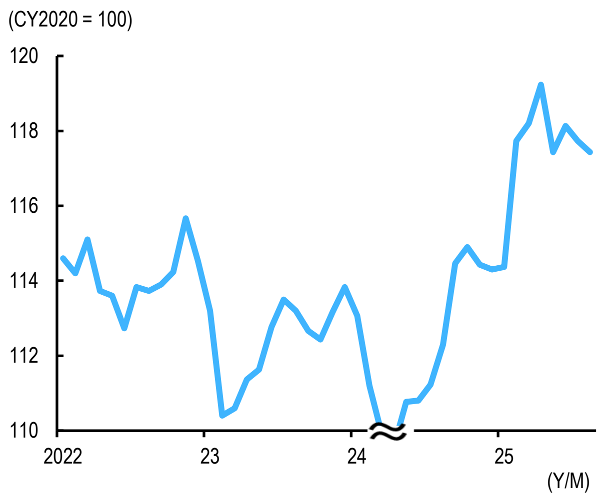
Goods exports will remain weak for the time being given the world economy's lack of momentum as the year-end approaches. Various countries are expected to implement loose fiscal and monetary policies next year. As a result, the world economy should recover, and Japan's exports should bottom out..

◆ The appetite for capital investment is strong

Capital investment remains robust, even as corporate earnings weaken due to the U.S. tariff hikes. Looking at capital investment by type, software investment is still high, and investment in machinery and construction is holding firm as companies replace or upgrade existing equipment.

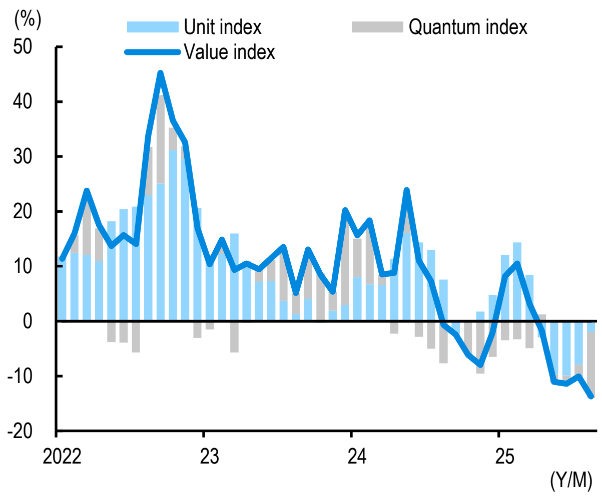
In the near term, capital investment is expected to remain solid, though growth will slow somewhat from the previous fiscal year due to lower corporate earnings. According to the BOJ Tankan, planned capital investments (including software but excluding land) for FY2025 are up 11% year over year (YoY), so the rate of growth is still high when compared with typical years. Companies remain eager to invest in software to address medium- to long-term challenges such as labor shortages and digital transformation. In addition, structural investment demand, such as that driven by the aging of equipment, is expected to support overall investment.

Figure 3-1 Real Exports <seasonally adjusted>



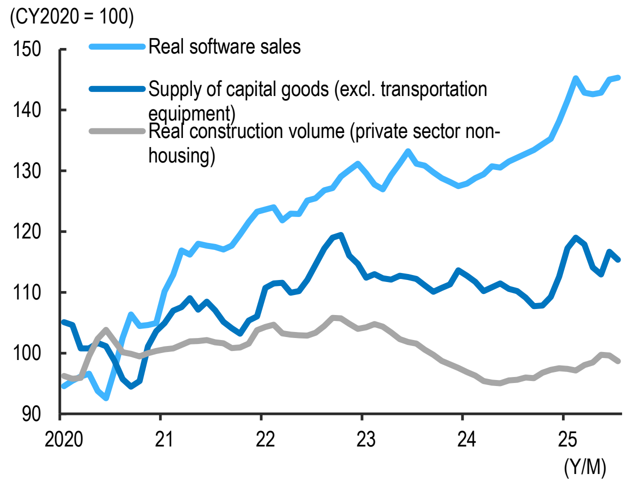
Source: Japan Research Institute, Ltd. based on data from the Bank of Japan
Note: Backward 3-month average.

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 Private Capital Investment Related Indicators <seasonally adjusted>



Source: Japan Research Institute, Ltd. based on data from the Ministry of Economy, Trade and Industry
Note: Backward 3-month average.

The income situation for households is improving

◆ Strong wage growth is expected to continue

In August, basic salaries of ordinary workers (adjusted to reflect data discrepancies arising from a change in the companies surveyed) saw a relatively strong increase of 3.1%. Although the official (unadjusted) figure of 2.5% suggests some degree of weakness, as the rates of increase agreed at the shunto (spring wage negotiations) are applied, the actual wage situation appears healthy.

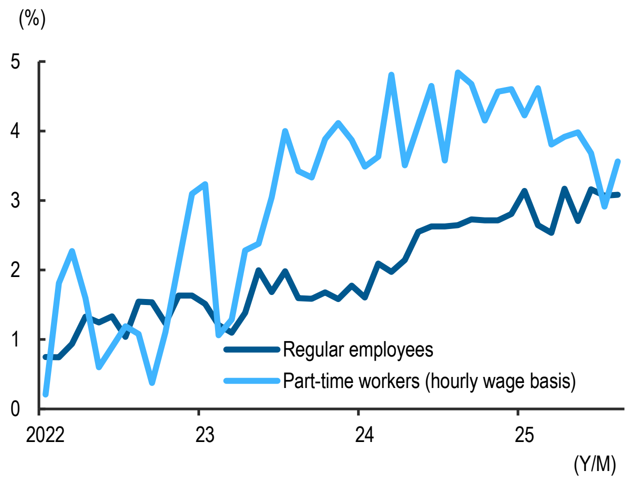
Wage growth is expected to continue at a similar level to now throughout this fiscal year, and next fiscal year, wage growth should remain high. Although worsening corporate earnings caused by U.S. tariff policy will have a negative effect, labor shortages and rising prices will continue to exert heavy upward pressure for wage increases, and companies are likely to increase labor's share of income and improve the treatment of employees.

◆ Improved confidence is providing a tailwind for consumption

Personal consumption is gradually recovering. Looking at broad-ranging personal services in the Indices of Tertiary Industrial Activity, while there is weakness in consumer goods-related retail trade due to high prices, services consumption-related activity, in areas such as entertainment, remains on the recovery track.

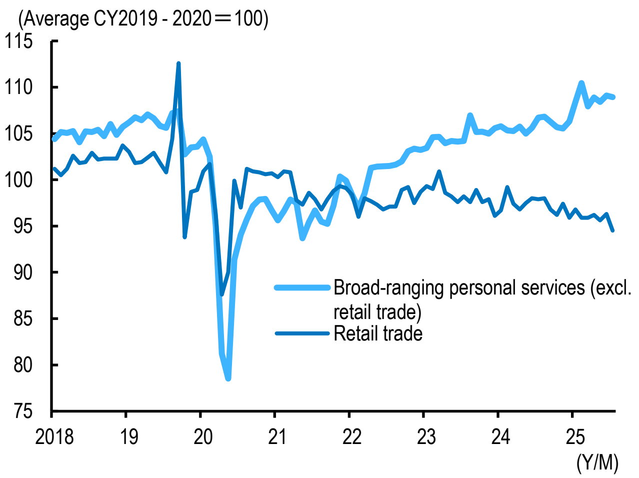
Personal consumption is also expected to keep rising in the near term. With nominal wage growth staying solid and inflation slowing, real wages look set to start increasing moderately from this autumn onwards. Improved consumer confidence will also provide a tailwind for consumption. As the inflation rate has fallen, the Consumer Confidence Index is up, and perceptions concerning asset value have improved markedly. Rising stock prices are also giving consumption a lift.

Figure 4-1 Basic Salaries <YoY>



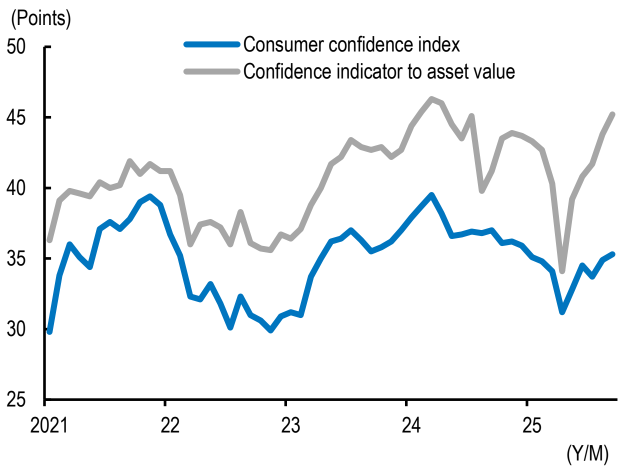
Source: Japan Research Institute, Ltd. based on data from the Ministry of Health, Labour and Welfare
Note: Adjusted for data faults caused by the replacement of surveyed companies.

Figure 4-2 Broad-ranging Personal Services in Index of Tertiary Industry



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

Figure 4-3 Consumer Confidence Index <seasonally adjusted>



Source: Japan Research Institute, Ltd. based on data from the Cabinet Office
Note: Households of two or more persons.

Inflation is slowing

◆ Energy prices are pushing down inflation

In August, core inflation (all items, less fresh food) slowed for the third straight month, dropping to 2.7%. A decline in energy prices, due mainly to the resumption of government subsidies for electricity and gas, pushed the overall figure down. Furthermore, growth of food prices in food prices excluding fresh foods declined for the first time in about a year. In addition to rice prices, prices for processed foods and meals outside the home are also peaking.

Price growth is expected to slow until early next year and then remain around 2%. In response to decelerations in rising agricultural product prices and import prices, food price growth will slow, and energy prices will begin to fall. Although the impact of policies that keep a lid on energy bills will cause some disruption, easing conditions in energy markets, such as the market for crude oil, will put downward pressure on prices.

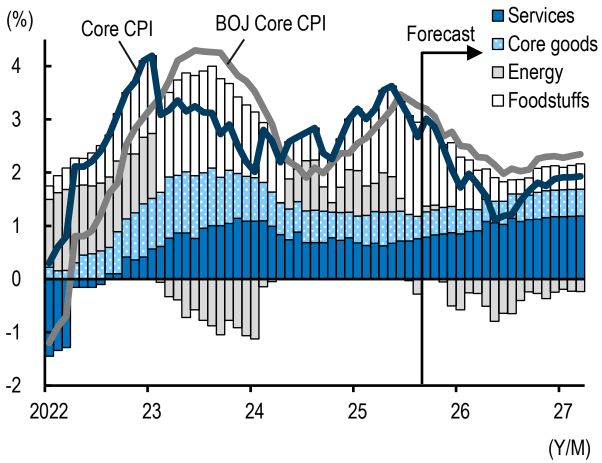
◆ The BOJ will raise interest rates in the new year

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

Long-term interest rates rose in October. In the wake of Sanae Takaichi's victory in the LDP leadership election, expectations of an early rate hike by the BOJ receded, yet long-term interest rates climbed as concern about possible fiscal deterioration mounted.

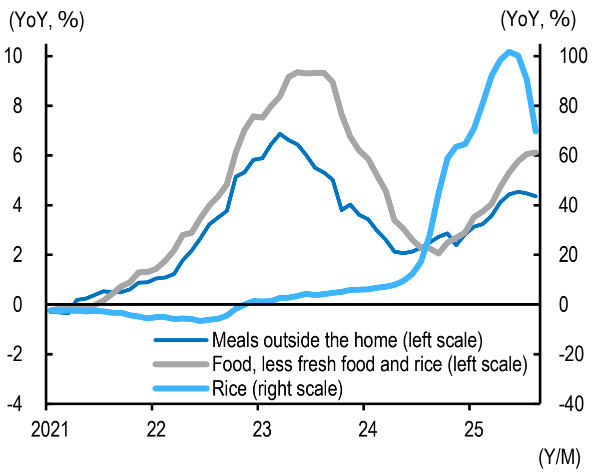
The BOJ is expected to raise interest rates in January 2026, after assessing the likely trend with wage increases in the next fiscal year. Long-term interest rates look likely to rise gradually, reflecting heightened anticipation of a rate hike by the BOJ and increased fiscal spending by the government. However, there is also a risk that long-term interest rates will soar if Ms. Takaichi's policies and coalition negotiations among ruling and opposition parties amplify jitters about possible fiscal deterioration and political turmoil.

Figure 5-1 Consumer Price Index <YoY>



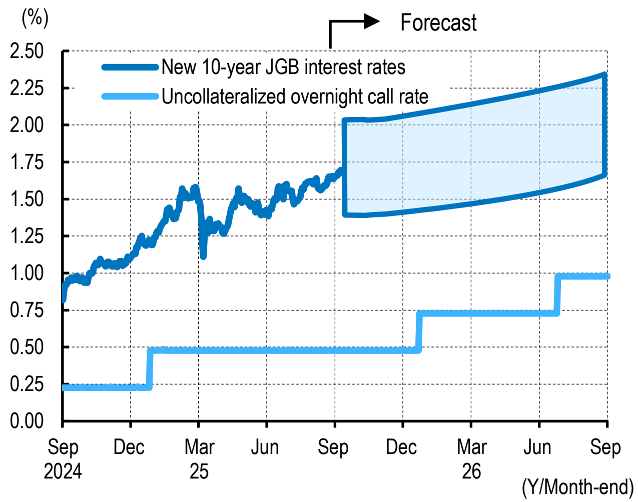
Source: Japan Research Institute, Ltd. based on data from the Ministry of Internal Affairs and Communications

Figure 5-2 Consumer Price of Food, less Fresh 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: Impact on prices of new LDP president Takaichi's policies

◆ Abolition of the provisional tax rate will have significant short-term ramifications

The LDP leadership election has been won by Sanae Takaichi. Like the other candidates, she pledged to scrap the provisional tax rate for gasoline and diesel fuel. It is estimated that the drop in gasoline prices that this will cause will push the core CPI down 0.2 percentage points compared to a year earlier.

However, there are numerous issues with this policy, including on the financial resource and green transformation fronts. It will be vital for the new tax regime to address these issues.

◆ Underlying inflationary pressures could intensify

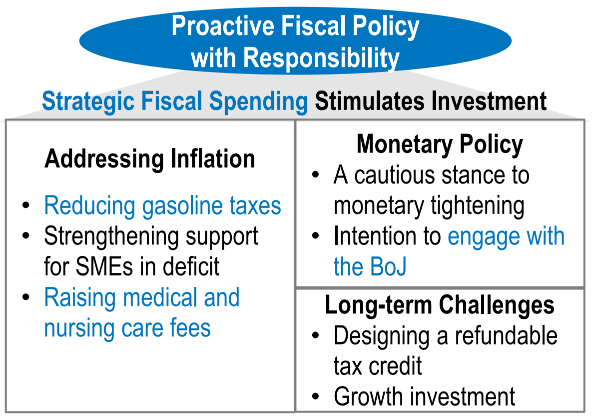
The impact of the abolition of the provisional tax rate aside, two other policies could also exacerbate underlying inflationary pressures.

The first is higher payments to providers of medical and nursing care. Increases in these payments have hitherto been kept below the rate of inflation out of consideration for the financial health of the social security system and the financial burden on patients. However, new LDP president Takaichi has expressed her intention to move swiftly to raise payments to providers of medical and nursing care, and if such increases become a trend, underlying inflation will be pushed up.

The second is her emphasis on stimulating demand. Japan is faced with serious supply constraints, including the size of its labor force, and so there cannot really be said to be a clear shortage of demand. If demand is stimulated to the point that it greatly exceeds supply capacity, the supply-demand mismatch is likely to cause inflationary pressures to intensify.

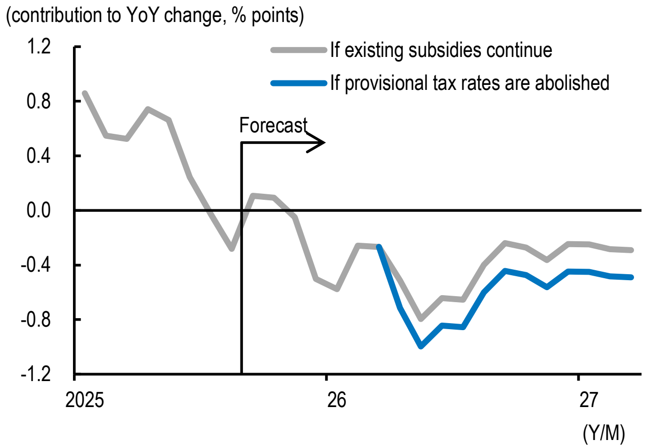
Taking this underlying inflation into account, the BOJ is expected to raise interest rates at the beginning of next year and continue raising them thereafter. Ms. Takaichi, however, has long expressed a cautious stance about interest rate hikes, and it is possible that the BOJ will hold back on raising interest rates during the process of coordinating policy with the government. If the normalization of monetary policy stalls, the yen could depreciate, causing a resurgence in imported inflation.

Figure 6-1 The Policies of New LDP President Takaichi



Source: Japan Research Institute, Ltd. based on LDP HP and News Reporting

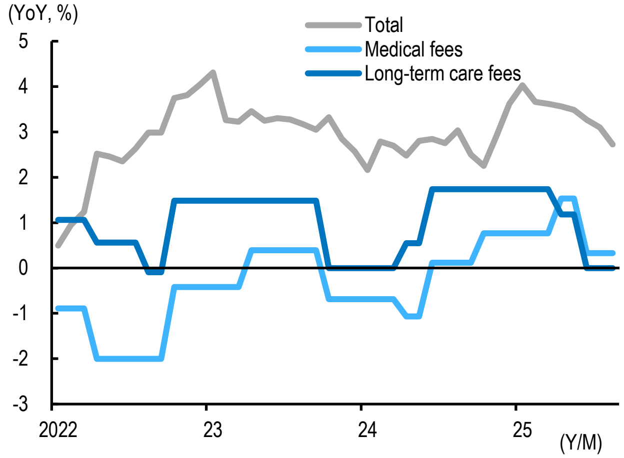
Figure 6-2 Energy Prices Driving Core CPI Higher



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

Note: Illustrates the impact if provisional gasoline tax rates are abolished starting April 2026, simultaneously ending the fixed-amount subsidy for gasoline. Assumes kerosene subsidies continue, while electricity and gas subsidies end with the September 2025 usage period.

Figure 6-3 Consumer Price Index (Items Related to Medical Fees and Long-Term Care Fees)



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

Topic②: Trump tariffs to put downward pressure on bonuses in two phases

◆ Corporate earnings are being squeezed by the Trump tariffs

Corporate operating profits slumped 3.2% YoY in the April-June quarter. President Trump's tariffs are weighing heavily on earnings, particularly in the manufacturing sector. This is expected to have a downward impact on bonuses over the next year, and it will happen in two phases:

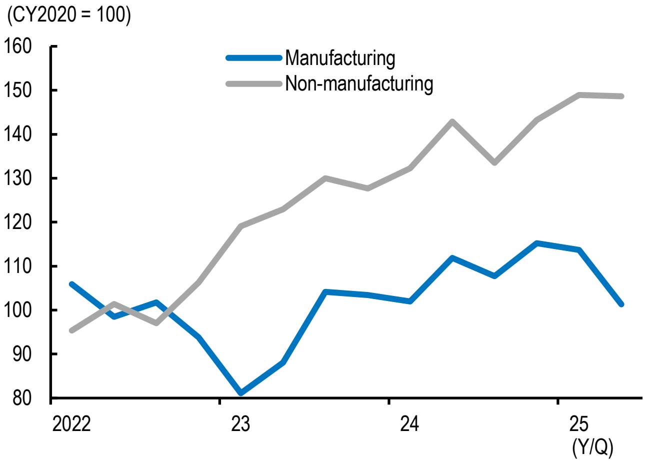
◆ Bonuses will be impacted in two phases

The first phase will be this winter. Downward pressure on bonuses is expected to become apparent at "winter/ summer-type" companies (firms that have negotiations in the winter, during which they consider performance in the first half of the fiscal year, and determine bonuses until the following summer) and "semiannual-type" companies (firms that determine bonuses every six months). Many of these companies are small and medium-sized enterprises (SMEs), so bonus increases may be lower at SMEs. Overall, however, bonuses are unlikely to see large reductions. This is because 1) downward pressure on SME earnings is relatively low, as few of them are exporters, and 2) the strong growth in bonuses seen this summer at large enterprises will be repeated as most of them are "summer/ winter-type" companies (i.e., ones that have negotiations in the summer, during which they consider performance in the previous fiscal year, and determine bonuses until the winter).

The second phase will be next summer. This is when summer/winter-type companies are expected to start reducing their bonuses. Bonuses at big companies tend to strongly reflect increases or decreases in corporate earnings in the previous year. If the operating profits of large enterprises continue to be squeezed as they were in the second quarter, bonuses at major companies next year are predicted to drop by 0.8% YoY across all industries and by 4.1% YoY in the manufacturing sector.

Increases or decreases in one-time income such as bonuses have a limited impact on personal consumption. Therefore, it is likely that personal consumption will gradually increase from next fiscal year onwards as rises in basic salaries (base pay) will continue amid labor shortages and inflation. However, it is important to pay attention to the risk that lower bonuses could cause people to curb their consumption by making them more anxious about the future.

Figure 7-1 Operating Profits
<seasonally adjusted>



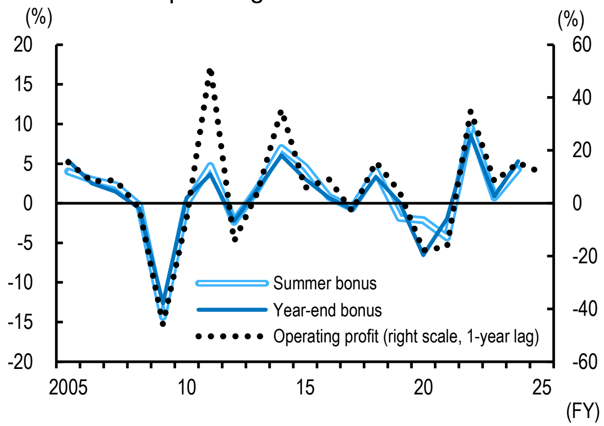
Source: Japan Research Institute, Ltd. based on data from the Ministry of Finance
Note: All sizes.

Figure 7-2 Corporate Earnings and Bonus Outlook

		2024	FY2025		FY2026	
			Apr-Sep	Oct-Mar	Apr-Sep	Oct-Mar
Profit		↑	↓	↓	↑	↑
Bonus	Summer/ winter-type	↑	↑		↓	
	Winter/ summer-type	↑		↓		↑
	Semiannual-type	↑	↑	↓	↓	↑
	Overall picture	High growth		Deceleration	Decline	Bottom out

Source: Japan Research Institute, Ltd.
Note: Earnings are expected to be suppressed by tariffs in fiscal year 2025 and recover in fiscal year 2026 alongside the global economic recovery. The accompanying bonus fluctuation forecast is illustrated.

Figure 7-3 Large Companies' Bonuses and Operating Profits <YoY>



Source: Japan Research Institute, Ltd. based on data from the the Ministry of Health, Labour and Welfare and the Ministry of Finance
Note: Lump-sum payments are weighted averages for companies ¥1 billion or more in capital and labor unions representing 1,000 or more employees, showing year-over-year changes only for companies comparable to the previous year. Operating profit data covers corporations with ¥1 billion or more in capital.

Domestic demand to keep the economy on the recovery track

◆ External demand will dip temporarily, but the economy will be supported by domestic demand

Looking ahead, Japan's economy is expected to stay on the recovery track. Personal consumption will support the economic recovery. While wage hikes that reflect the agreements made at this fiscal year's spring wage negotiations will continue, inflation will fall early next year, especially in energy and food. This should result in real wage growth turning positive this autumn. It should then stay positive next fiscal year as pay continues to be increased by large margins. Although corporate earnings will worsen due to U.S. tariff policy, with labor shortages intensifying, companies are expected to increase labor's share of income and continue wage hikes.

Capital investment also looks set to keep rising. While they will feel the weight of deteriorating earnings, companies' desire to invest in software to address medium- to long-term challenges such as labor shortages and digital transformation will not be shaken.

External demand will dip in the near term, but should soon bottom out. Looser fiscal and monetary policies are expected to be adopted in many countries, including the U.S., later this year. In response, the world economy should pick up at the start of the new year, which will give a boost to the Japanese economy.

◆ Downside risks are significant

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. The risks for domestic demand are 1) a slump in personal consumption due to prolonged food inflation and 2) capital investment and wage downturns due to a decline in corporate earnings. As for external demand, there is a risk of the U.S. imposing additional tariffs if, for example, Japan's trade surplus with the U.S. continues or its investment in the U.S. falls short of the agreed target.

Figure 8　Projections for Japan's GDP Growth and Main Indicators (as of October 10, 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)

	CY2025 1～3	4～6	7～9	10～12	CY2026 1～3	4～6	7～9	10～12	CY2027 1～3	FY2024	FY2025	FY2026
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	2.5	1.8	1.3	1.4	1.8	1.9	2.7	2.7	1.6
Unemployment Rate (%)	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.4	2.4	2.5	2.5	2.4
Exchange Rates (JY/US$)	153	145	147	145	143	141	140	140	141	153	145	141
Import Price of Crude Oil (US$/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 from the Japan Research Institute, Ltd.