

English translation published in January 2026

Monthly Report of Prospects for Japan's Economy

December 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 stalled in some areas

Figure 1-1 Economic Activity

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

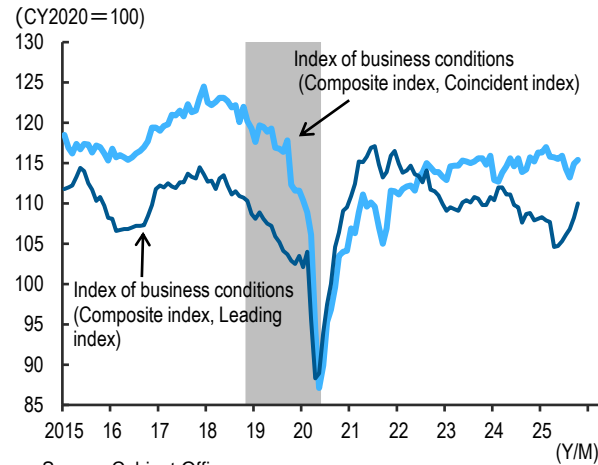


Figure 1-2 The Corporate Sector

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

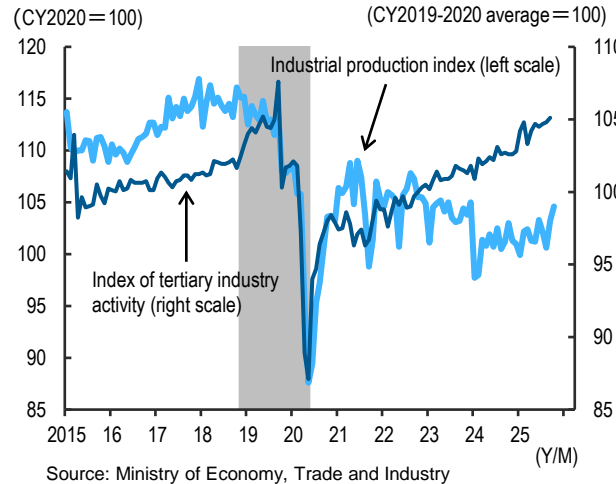


Figure 1-3 External Demand

Exports are weak overall.
Imports are also down.

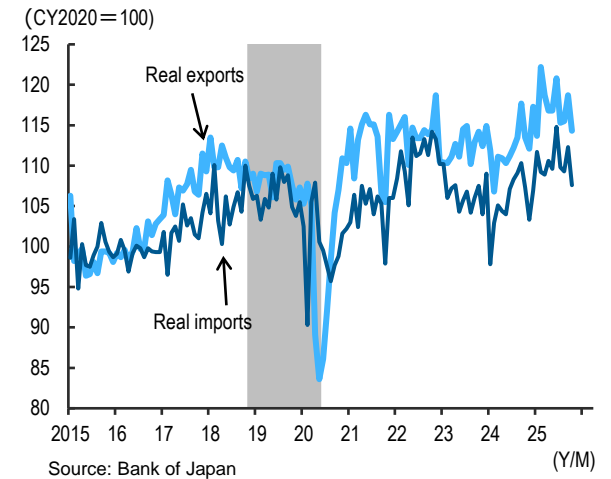


Figure 1-4 Employment and Income

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

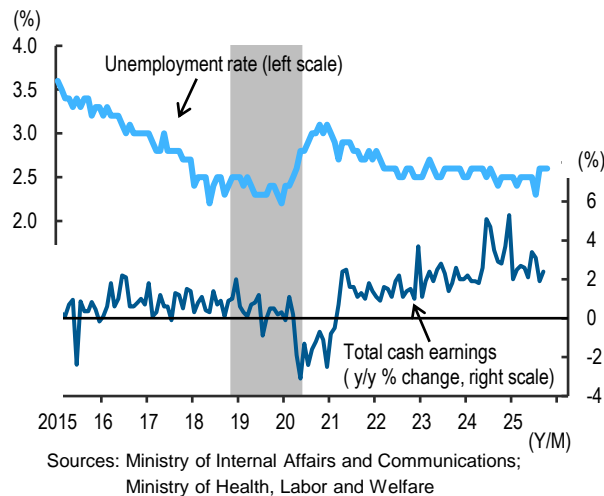


Figure 1-5 The Household Sector

Consumption continues to gradually recover.
Housing starts are picking up.

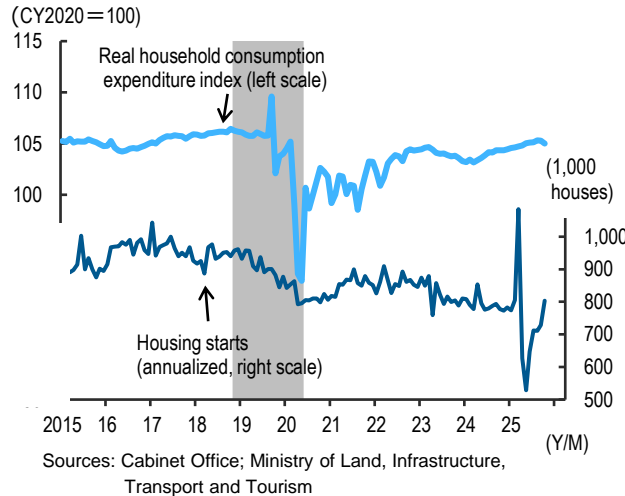
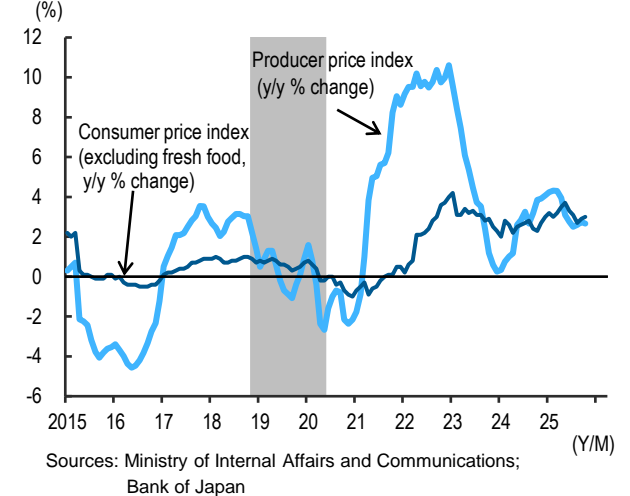


Figure 1-6 Prices

Producer price inflation is slowing, particularly in energy.
Consumer price inflation is accelerating slightly.



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

Real GDP for Q3 2025 has been revised downward

◆ Capital investment and public investment were revised downward

In the second QE (quarterly estimate) for Q3 2025, real GDP growth was put at -2.3% year over year (YoY) (-0.6% quarter over quarter (QoQ)), a downward revision from the -1.8% in the first QE. Personal consumption and external demand were revised upward, while capital investment and public investment saw downward revisions, dragging the overall figure down.

◆ The sluggish manufacturing sector is weighing heavily on the economy

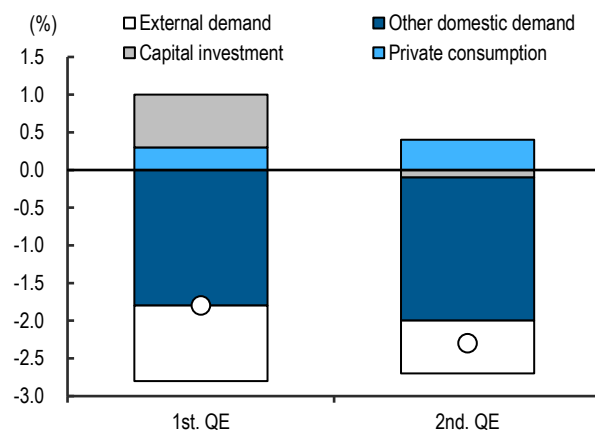
Production in the manufacturing sector is soft. Among the "New Indices to Capture Business Conditions" announced by the Cabinet Office, goods-related indicators have been weak since the beginning of 2025.

The main reason is lower exports. By country/ territory, exports to Asia, where semiconductor demand is firm, have continued to rise, but a slump in exports to the U.S. has pulled down the overall figure. The rush of exports in anticipation of U.S. tariff hikes has slowed, and companies have begun passing through tariff costs to selling prices in the U.S., causing demand within the U.S. to weaken.

◆ The service sector is recovering

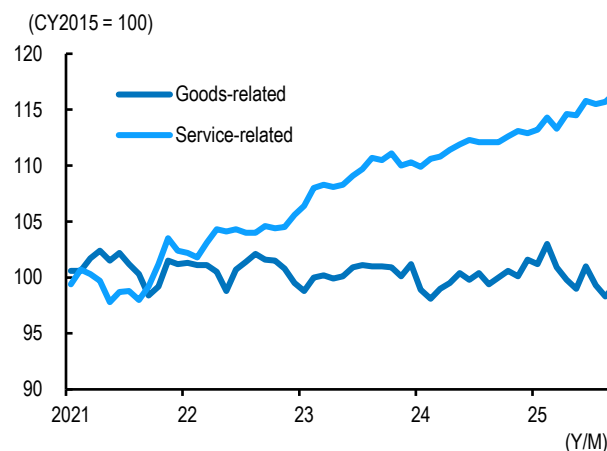
On the other hand, the service sector is driving an economic recovery. Looking at rates of change compared to 2022 in the Indices of Tertiary Industrial Activity, sectors, such as wholesale, that do a lot of business with the manufacturing industry have seen decreases, while living and amusement-related services, finance/ insurance, and information/ communications have been performing well. Business conditions in these sectors have been boosted by 1) firm amusement-related consumption, 2) increased financial-related transactions in response to rising stock prices and interest rates, and 3) strong IT-related demand.

Figure 2-1 Real GDP Growth Rate for Q3 2025 <YoY annual growth rate>



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

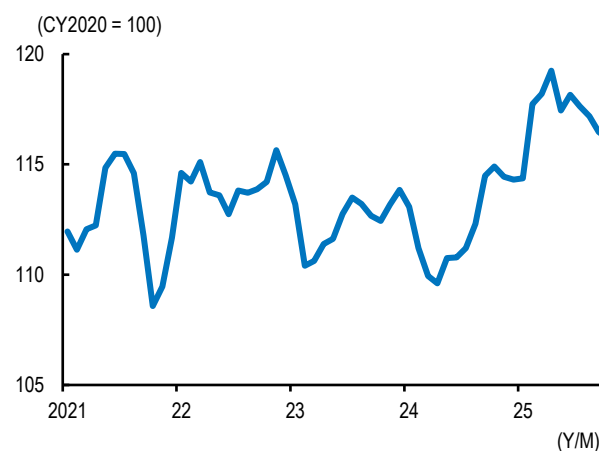
Figure 2-2 "New Indices to Capture Business Conditions" <the Coincident Index>



Source: Cabinet Office

Note: The 17 indicators designated by the Cabinet Office as reference indicators for the Indices of Business Conditions, categorized into goods-related indicators and services-related indicators.

Figure 2-3 Real Exports <seasonally adjusted>



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

Corporate earnings are increasing, but the rise in capital investment has paused

◆ Profits are up thanks to cheaper energy and the weak yen

According to the Financial Statements Statistics of Corporations, ordinary profit (all industries, seasonally adjusted, same below) for the third quarter increased 3.3% YoY, rising for the second consecutive quarter. While net sales declined from the previous fiscal year due to the impact of U.S. tariffs, ordinary profit was boosted by lower energy costs and higher income in yen terms from overseas operations thanks to the weaker yen.

The rising profit trend is expected to continue going forward. It is expected that 1) lower costs due to cheaper energy, 2) firm digital demand, and 3) solid personal consumption as real wage growth turns positive will contribute to improved business performance.

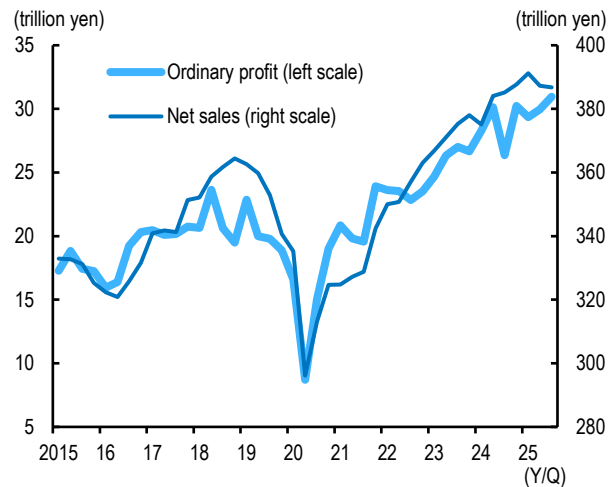
◆ Capital investment has slowed temporarily

Capital investment (including software investment) was down 1.4% QoQ, falling for the first time in six quarters. In terms of categories, the strong growth in software investment lost steam, and machinery investment and construction investment were weak, particularly in the manufacturing sector. In response to declines in net sales

due to U.S. tariffs, some companies may have revised their capital investment plans.

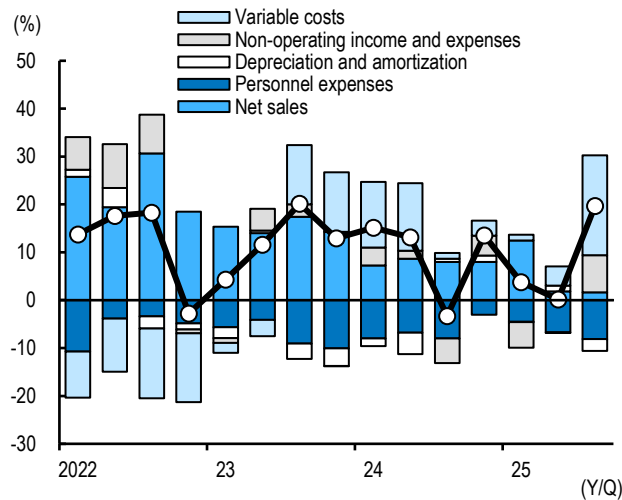
Supported by profit growth, companies are expected, in the near term, to proactively invest in solving medium- to long-term problems. In the Sakura Report (Regional Economic Report) released by the Bank of Japan (BoJ) in October this year, companies frequently mentioned their appetite for investment over the medium to long term, such as for labor saving, DX, and the replacement/ upgrade of existing equipment. However, amid growing labor shortages, particularly in the construction industry, there is also a risk that some capital investments may not be executed as planned.

Figure 3-1 Ordinary Profit and Net Sales
<seasonally adjusted>



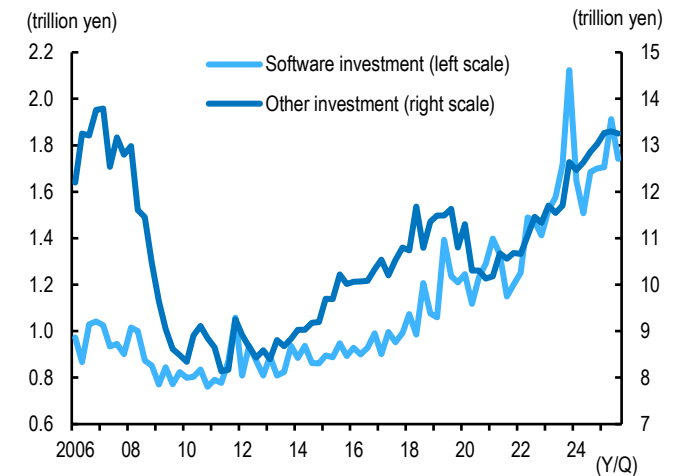
Source: Japan Research Institute, Ltd. based on data from the Ministry of Finance
Note: Firms of all sizes and in all industries apart from financial and insurance are included.

Figure 3-2 Factors Affecting Ordinary Profit



Source: Japan Research Institute, Ltd. based on data from the Ministry of Finance
Note: Firms of all sizes and in all industries apart from financial and insurance are included.

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



Source: Japan Research Institute, Ltd. based on data from the Ministry of Finance
Note: Firms of all sizes and in all industries apart from financial and insurance are included.

The employment/ income environment is favorable and consumer confidence is also improving

◆ A favorable employment/ income environment is supporting personal consumption

Personal consumption continues to gradually recover. By type, goods consumption is picking up as a result of a pause in the surge of food prices, while services consumption is also increasing moderately.

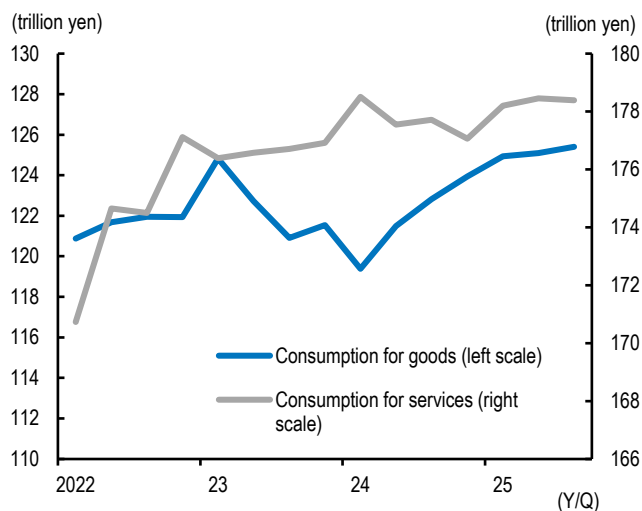
Personal consumption is expected to keep rising in the near term, supported by the favorable income environment. While inflation will slow, nominal wages are anticipated to continue increasing at a relatively rapid pace as rising prices and labor shortages fuel heavy pressure for higher pay from workers. At a three-way meeting between government, labor, and management representatives at the end of November, Prime Minister Takaichi, ahead of next year's shunto (spring wage negotiations), called for wages to be raised by over 5%, and all three groups are maintaining a proactive stance toward generous, ongoing wage increases. Given such developments, the rates of wage increases to be agreed at the 2026 shunto are expected to be around 4.8%. Wage increase rates will be lower than last year, but still look set to remain at high levels.

◆ Improved confidence and rising stock prices are providing a tailwind for confidence

Improved consumer confidence is also expected to lift consumption. As the inflation rate falls, the Consumer Confidence Index is picking up. Slower price rises for frequently purchased items like energy and food, in particular, are highly likely to give a significant boost to consumer confidence.

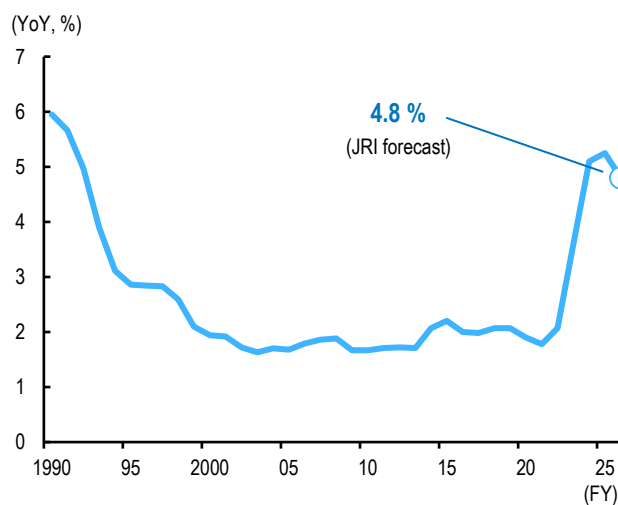
Rising stock prices are also providing a tailwind for consumption via the wealth effect. Household asset income has increased due to such factors as the recent stock market rally, and consumer perceptions concerning asset values have also improved markedly.

Figure 4-1 Real Private Consumption <by Type>



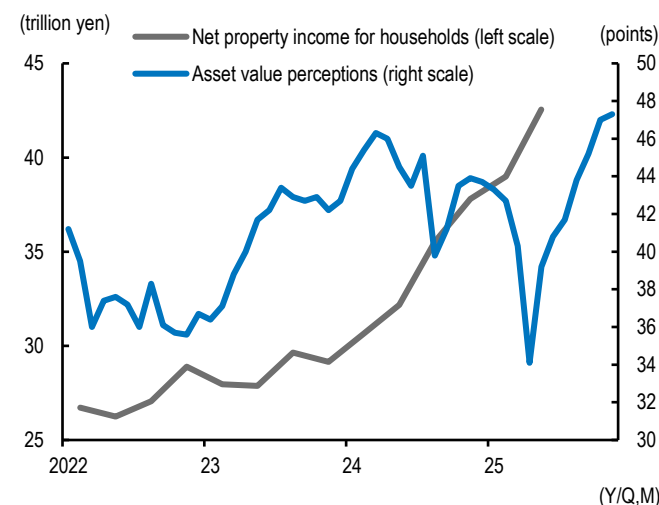
Source: Japan Research Institute, Ltd. based on data from the Cabinet Office

Figure 4-2 Rate of Wage Increases from Spring Negotiations



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

Figure 4-3 Net Property Income for Households and Asset Value Perceptions



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

Note: Perceptions of asset value apply to households with two or more members.

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Inflation set to slow

◆ Energy prices are pushing down inflation

In October, core inflation (all items, less fresh food) accelerated slightly from the previous month to hit 3.0%. While the pace of rising goods prices was stable, prices of services such as hotel accommodation and dining out rose at a faster clip.

Price growth is expected to slow until the middle of next year and then remain around 2%. The main reason is that energy prices will fall due to lower market prices and the implementation of measures to control prices, such as the abolition of the provisional tax rate for gasoline. In addition, with prices of agricultural produce and imported food climbing more slowly, food price growth is also expected to weaken.

However, prices of services will rise faster, and this is highly likely to support prices overall. As higher labor costs are passed through to prices, general service prices will continue to increase, and the government and local authorities are planning to raise standard prices for public services, something that they have held off from doing for many years.

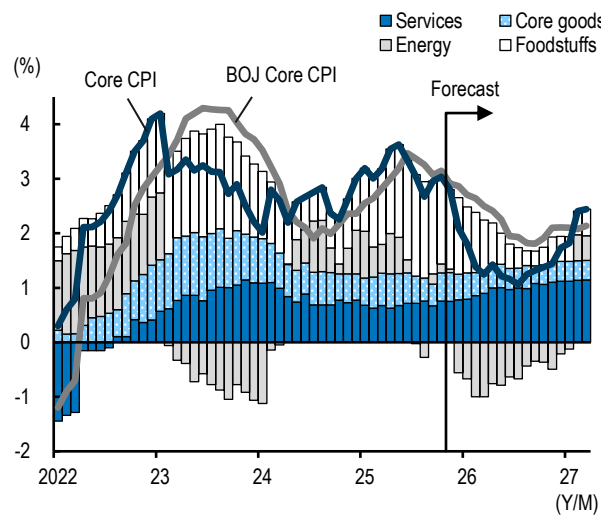
◆ The BOJ will raise interest rates in the new year

At its monetary policy meeting in October, the Bank of Japan (BOJ) decided to keep its policy rate unchanged.

Long-term interest rates rose in December. Rates were driven higher due to concerns about fiscal deterioration and growing expectations of an interest rate hike by the BOJ.

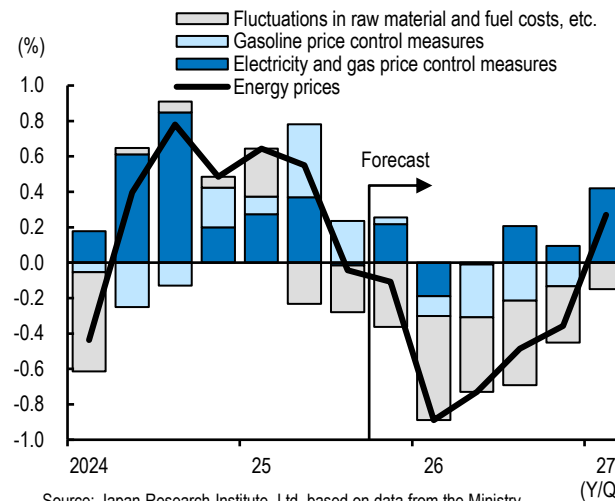
It is highly probable that the BOJ will raise interest rates before the end of this year or early next year, after assessing the likely trend with wage increases in the next fiscal year. Long-term interest rates look likely to trend upward, reflecting heightened anticipation of a rate hike by the BOJ and increased fiscal spending by the government. However, if jitters about a deterioration in fiscal discipline or political turmoil take hold, there is also a risk that long-term interest rates will soar.

Figure 5-1 Consumer Price Index <YoY>



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

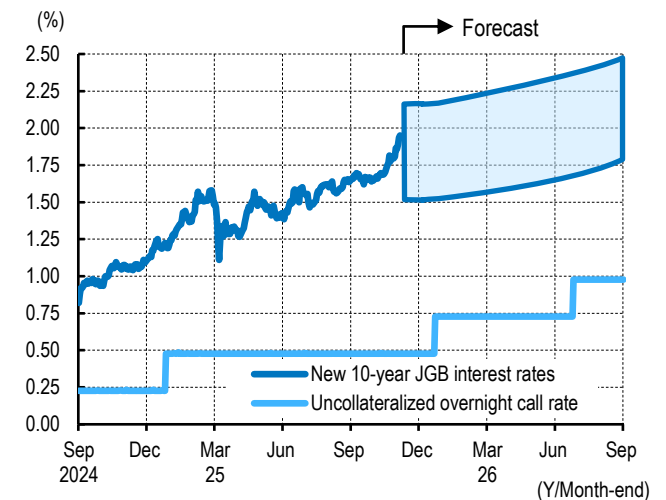
Figure 5-2 Energy's Impact on Core CPI



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

Note: Electricity and gas price suppression measures incorporate effects through March 2026 usage. Gasoline price suppression measures incorporate the abolition of the provisional tax rate and the preceding expansion of subsidies.

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



Source: NEEDS-FinancialQUEST

Topic ①: Worsening Sino-Japanese relations to have a major impact on demand from foreign tourists

◆ Danger of prolonged impact on demand for travel to Japan

Following Prime Minister Takaichi's Diet remarks regarding a potential Taiwan contingency, the Chinese government issued an advisory urging tourists and students to refrain from traveling to Japan. China accounts for over 20% of both visitor numbers and total inbound spending, so the impact on overall demand from foreign tourists will be substantial.

Worsening Sino-Japanese relations has also depressed demand from foreign tourists in the past. When anti-Japan protests erupted in 2012 over the nationalization of the Senkaku Islands, the number of Chinese visitors to Japan fell by as much as 30%. However, the Chinese government did not impose official travel restrictions then, and visitor numbers rebounded sharply within less than a year.

A comparable case that did prompt government-imposed travel restrictions was China's 2017 sanctioning of South Korea. As retaliation for South Korea's deployment of the THAAD (Terminal High Altitude Area Defense) missile system,

China banned group tours to South Korea. As a result, the annual number of Chinese visitors to South Korea halved. The ban was subsequently lifted, but only in phases, and low traveler numbers persisted for an extended period.

◆ The key factor is whether China restricts travel to Japan

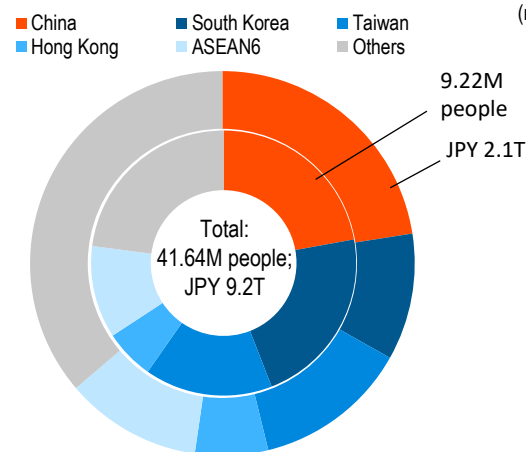
The impact on demand from foreign tourists will depend heavily on the stance of the Chinese government. If China's hardline posture toward Japan eases and no restrictions on Japan travel are imposed, the drop in inbound spending would be estimated to be only about 500 billion yen. However, if China imposes a long-term travel ban similar to the one it used to punish South Korea, spending by Chinese visitors to Japan would fall by 1.2 trillion yen over the next year, with cumulative losses reaching 2.3 trillion yen over three years.

Figure 6-1 Impact of Deteriorating Relations with China on Tourism

2025: Retaliatory measures following Prime Minister Takaichi's remarks
<ul style="list-style-type: none"> Chinese government urges tourists and students to refrain from traveling to Japan State-owned travel agencies cancel group tours Airlines waive cancellation fees for Japan-bound tickets
2012: Anti-Japan demonstrations over Senkaku Islands nationalization
<ul style="list-style-type: none"> Temporary decline in demand for travel to Japan due to heightened anti-Japanese sentiment Chinese government did not restrict tourism
2017: Sanctions against South Korea over missile deployment
<ul style="list-style-type: none"> Chinese government imposed a comprehensive, long-term ban on group tours Clear administrative guidance issued to travel agencies Sanctions gradually lifted starting the following year, but full lifting took six years

Source: Japan Research Institute, Ltd. based on various reports as of December 8, 2025

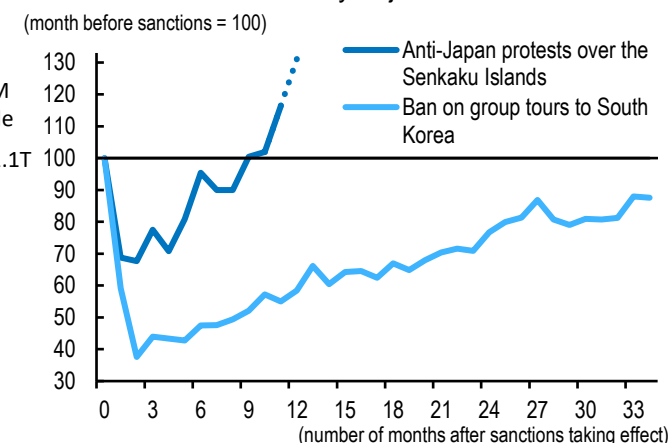
Figure 6-2 Breakdown of Inbound Demand



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

Note: Inner circle: Number of inbound visitors; Outer circle: Inbound spending. October 2024 to September 2025..

Figure 6-3 Changes in Chinese Tourist Numbers <seasonally adjusted>



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

Note: Anti-Japan protests over the nationalization of the Senkaku Islands began in September 2012, while the ban on group tours to South Korea following the THAAD deployment began in February 2017.

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Topic②: Building the foundations needed for "crisis-management investment"

◆ Growing importance of "crisis-management investment"

Prime Minister Takaichi has positioned "crisis-management investment" as a core pillar of her growth strategy, emphasizing it as a means of fundamentally strengthening supply capacity in anticipation of risks and social challenges. With numerous domestic and international risks surrounding Japan's economy and the overall supply-demand balance in the economy tightening, such investment is crucial both for economic security and for enhancing supply capabilities.

◆ Need to focus on who will undertake capital investment

However, in the government's FY2025 economic stimulus package, measures to support households are what stand out. Spending on household support, such as abolishing the provisional tax rate for gasoline and giving cash handouts to families with children, runs to a total of 11.7 trillion yen, a significant increase from the previous fiscal year. Given that the current economy cannot be described as suffering from a clear shortage of demand, broad-based household support risks adding inflationary pressure by upsetting the supply-demand balance.

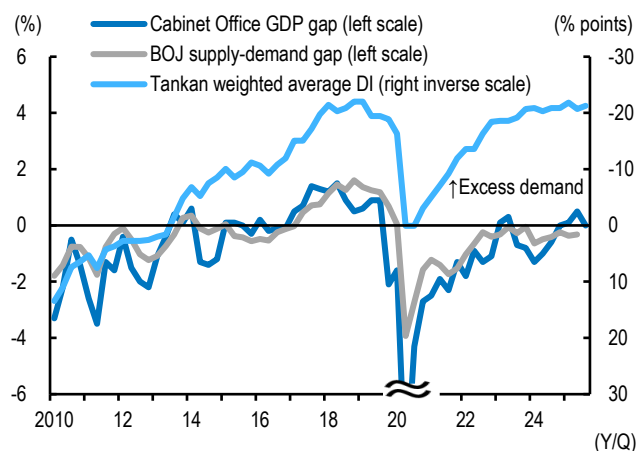
Meanwhile, support for investment remains roughly on the same scale as last year,

and there are two key issues with it: The first is that many of the measures target growth sectors, which is not a particularly new approach. Similar growth-oriented investments have been emphasized under previous governments, so the additional boost may be limited.

The second is that most of the investment support is financial in nature. With backlogs of unfilled orders and construction delays already suppressing investment, there is a danger of further reinforcing a situation in which "even with money, things can't get built."

Looking ahead to the formulation of the main budget for next fiscal year, it is essential to strengthen the foundations for executing capital investments by improving productivity and working conditions in the construction and manufacturing sectors. Moreover, given the supply constraints on physical investment, placing greater emphasis on intangible investment, such as in human capital, could be another viable approach.

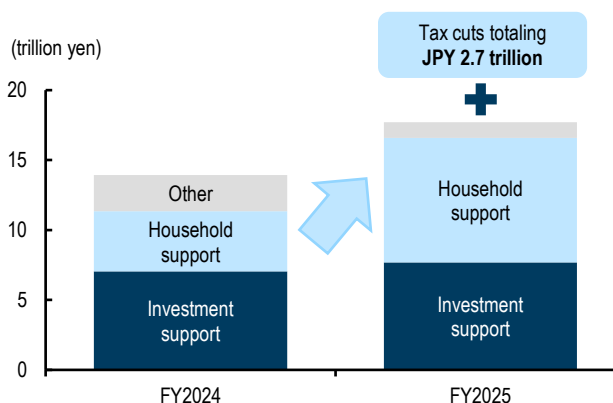
Figure 7-1 Supply-Demand Gap Related Indicators



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

Note: The Tankan Weighted Average DI is calculated by weighting the DI for production/ business equipment and the DI for employment levels using the capital-labor distribution ratio.

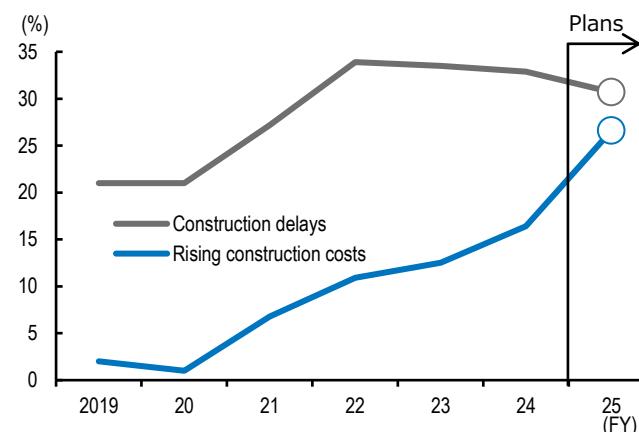
Figure 7-2 Supplementary Budget for FY2024 and FY2025



Source: Japan Research Institute, Ltd. based on data from the Ministry of Finance, the Prime Minister's Office, and various media reports

Note: "Investment support" refers to the total expenditures shown in the lower-left chart (excluding special accounts). "Household support" refers to expenditures aimed at "overcoming high prices" and "creating conditions for wage increases" in FY2024, and "ensuring livelihood security and responding to high prices" in FY2025.

Figure 7-3 Factors Behind Capital Investment Performance Falling Short of Initial Plans



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

Note: Percentage of companies selecting each option. Surveyed large enterprises across all industries, with up to three multiple responses allowed. Note that other options vary by fiscal year.

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The economy to gradually recover, driven by domestic demand

◆ Domestic demand to support the economy

The Japanese economy is expected to continue its gradual recovery going forward. As households' real purchasing power improves, personal consumption will gradually rise, supporting the economy. The inflation rate is expected to decline through mid-next year, centered on energy and food prices, while wage increase rates are projected to remain at a relatively high level. Labor unions are poised to demand wage increases similar to last year's due to continued inflation. With labor shortages intensifying, it is expected that management will agree to their wage demands.

Capital investment also looks set to keep rising. Companies' enthusiasm for investment to address medium- to long-term challenges such as labor saving and digital transformation will not be shaken.

External demand will continue to decelerate in the near term, but should soon bottom out. Exports of IT-related goods to meet firm AI-related demand will provide support, and the global economy, including the U.S. economy, is expected to recover as accommodative fiscal and monetary policies are deployed in various countries, which should give Japan's exports a lift.

◆ Downside risks exist domestically and internationally

Real GDP growth is projected to remain solid, registering 0.9% in FY2025 and

0.7% in FY2026.

However, there are significant downside risks both domestically and internationally. Domestic factors include 1) large-scale demand stimulus measures and 2) rising xenophobia, which could lead to supply constraints becoming apparent. This might trigger an acceleration in inflation due to tight supply-demand conditions, as well as stagnation in corporate activity as a result of labor shortages. As for international factors, 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 December 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	1.5	2.1	-2.3	0.8	1.1	1.0	1.0	1.0	0.9	0.5	0.9	0.7
Private Consumption Expenditure	2.9	1.0	0.8	0.7	1.1	1.1	0.8	0.7	0.6	0.2	1.2	0.9
Housing Investment	-0.2	1.7	-29.0	9.2	1.1	0.6	0.0	-0.1	-0.3	-0.7	-4.4	-0.7
Business Fixed Investment	0.9	5.4	-0.8	1.0	1.3	1.4	1.6	1.8	1.8	0.9	1.6	1.3
Private Inventories (percentage points contribution)	(1.9)	(-0.1)	(-0.4)	(0.0)	(0.0)	(-0.0)	(-0.0)	(-0.0)	(-0.0)	(0.1)	(0.2)	(-0.0)
Government Consumption Expenditure	-1.2	1.4	0.6	0.9	0.9	1.0	1.1	1.1	1.1	2.3	0.4	1.0
Public Investment	-0.4	0.2	-4.2	0.8	0.9	1.0	1.1	1.2	1.2	0.1	-0.7	0.8
Net Exports (percentage points contribution)	(-2.3)	(0.4)	(-0.7)	(-0.5)	(-0.2)	(-0.2)	(-0.1)	(-0.0)	(-0.0)	(-0.4)	(-0.2)	(-0.2)
Exports of Goods and Services	-0.4	8.0	-4.9	-1.7	1.0	1.2	1.6	2.0	1.9	1.7	2.2	0.6
Imports of Goods and Services	9.9	5.7	-1.8	0.6	1.8	1.9	2.0	2.1	2.1	3.3	2.8	1.5

(% changes from the same quarter of the previous year)										(% changes from the previous fiscal year)		
Nominal GDP	5.3	5.3	4.1	3.5	2.5	2.4	3.1	3.1	3.7	3.7	3.8	3.1
GDP deflator	3.6	3.3	3.4	3.2	1.9	2.3	2.3	2.1	2.8	3.2	3.0	2.4
Consumer Price Index (excluding fresh food)	3.1	3.5	2.9	2.6	1.5	1.3	1.2	1.5	2.2	2.7	2.6	1.6
Unemployment Rate (%)	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Exchange Rates (JY/US\$)	153	145	147	153	150	150	148	148	149	153	149	149
Import Price of Crude Oil (US\$/barrel)	79	75	72	70	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.