English translation published in February 2026

Monthly Report of Prospects for Japan's Economy

January 2026

Macro-economics Research Center
Economics Department

The Japan Research Institute, Limited

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

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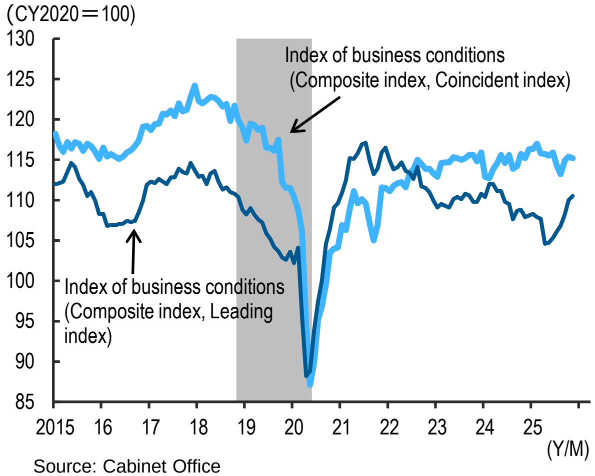
The General Situation – The economy is gradually recovering, though activity has stalled in some areas

Figure 1-1 Economic Activity

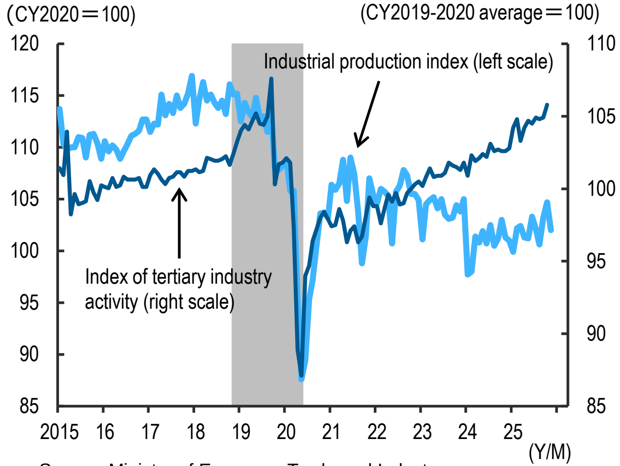
The coincident index of business conditions is falling slightly.
The leading index is picking up.



Source: Cabinet Office

Figure 1-2 The Corporate Sector

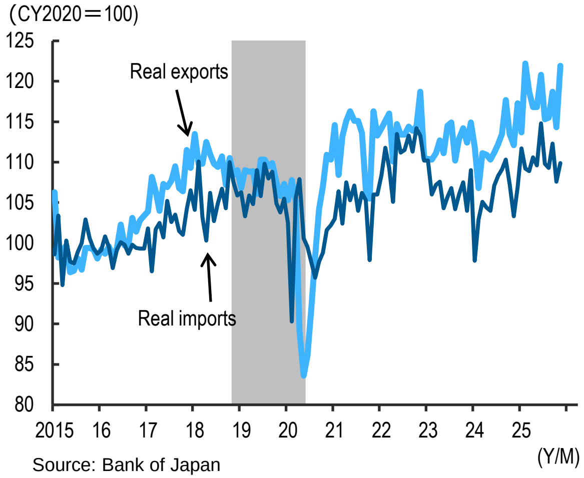
Industrial production is fluctuating.
Economic activity in the service sector is recovering.



Source: Ministry of Economy, Trade and Industry

Figure 1-3 External Demand

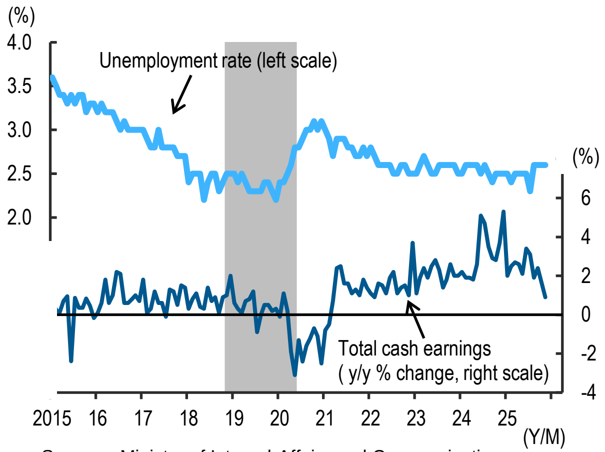
Exports are showing signs of bottoming out.
Imports are on a downward trend.



Source: Bank of Japan

Figure 1-4 Employment and Income

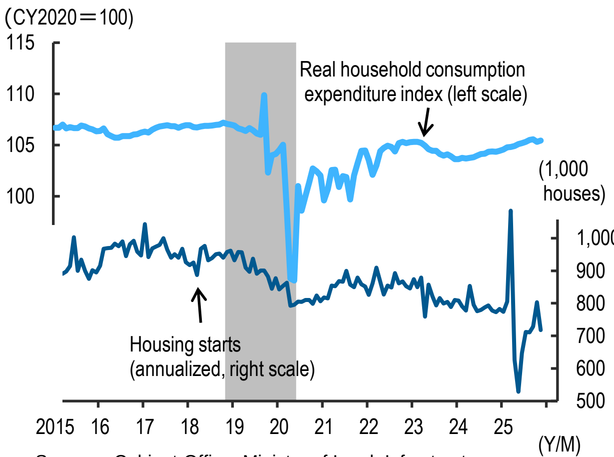
The unemployment rate is low, hovering around 2.5%.
Nominal wage growth is solid on average.



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

Figure 1-5 The Household Sector

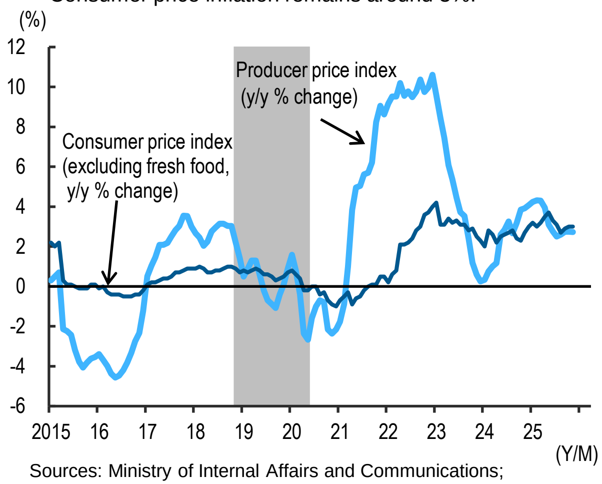
The recovery in consumption has stalled.
Housing starts are weak.



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 remains around 3%.



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 December 2025 Tankan survey from the Bank of Japan (BOJ), the diffusion index (DI) for business conditions for large manufacturing enterprises increased by one percentage point from the previous survey. Business confidence in the petroleum/ coal products and food/beverage sectors improved against the backdrop of lower energy prices and falling costs as soaring crop prices moderated.

The DI for large non-manufacturing enterprises was unchanged from the previous survey. Although business conditions in the information services sector worsened slightly as the effect of the spike in replacement demand for PCs following the end of Windows 10 support tailed off, services for businesses supported the overall figure thanks to factors such as progress with price pass-through.

◆ Production in the manufacturing sector is fluctuating

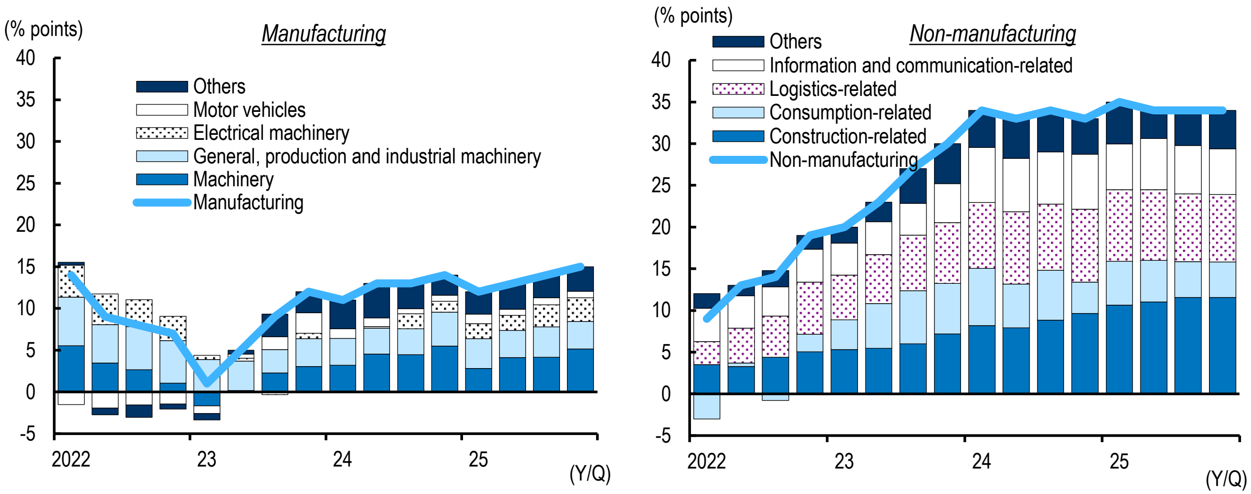
In November 2025, the Industrial Production Index dropped 2.6% month over month (MoM). While output of production machinery, particularly semiconductor equipment, increased, production in the electrical machinery and information/communications equipment sectors fell, as did output of automobiles and metal products.

According to the Industrial Production Index Forecast (adjusted based on past forecasting errors), near-future production plans indicate a decrease in output in December 2025 of 0.6% MoM. One of the main reasons will be a fallback in output of production machinery.

◆ Consumption is on the recovery track

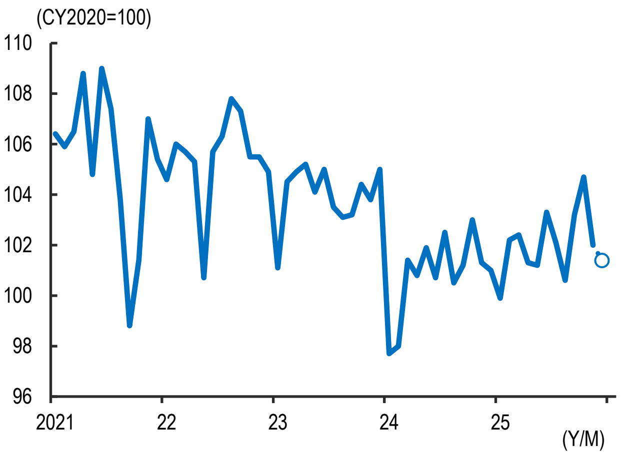
Personal consumption is gradually recovering. Consumption of goods, particularly non-durable items, remains weak due to persistent inflation, but consumption of durable goods such as home appliances is picking up. Services consumption is also firm, especially in amusement-related services.

Figure 2-1 DI for Business Conditions of Large Companies



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

Figure 2-2 Industrial Production Index <seasonally adjusted>



Source: Ministry of Economy, Trade and Industry
Note: The latest data is based on the adjustment value (Dec 2025) calculated by the Ministry of Economy, Trade and Industry based on past adjustment patterns.

Goods exports, particularly to the U.S., are picking up

◆ Exports to the U.S. have bottomed out

Goods exports, particularly to the U.S., are picking up. The impact of the U.S. tariff hikes has faded, and exports, particularly automobiles, are increasing. Exports to countries other than the U.S., particularly those to Europe, are also robust.

Looking ahead, goods exports are expected to recover through the middle of the year due to the following two background factors: The first is a pick-up in the world economy. Looser fiscal and monetary policies, particularly in the U.S. and Germany, are expected to give the global economy a boost. The second is strong semiconductor demand. According to the forecast released by World Semiconductor Trade Statistics in December 2025, the semiconductor market in 2026 is likely to see an acceleration in growth on the back of AI-related demand and other factors.

◆ Capital investment plans remain at high levels

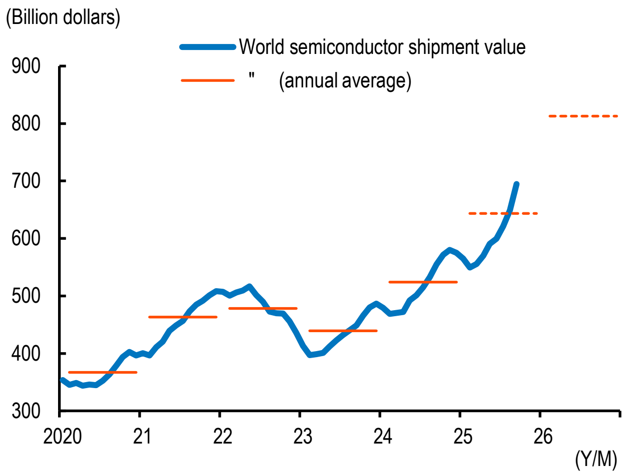
Appetite for capital investment among companies is strong. By type, software investment is still at high levels, and investment in machinery and construction is holding firm as companies replace or upgrade existing equipment. Investment is being supported by an improved earnings environment for companies, driven by lower costs. These are the result of cheaper energy and higher profits (in yen terms) from overseas operations due to the weaker yen.

Capital investment is also expected to hold firm going forward. According to the BOJ Tankan for December 2025, planned capital investments (including software but excluding land) for FY2025 are up 10% 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, investment demand driven by such factors as the aging of equipment is expected to support overall investment.

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

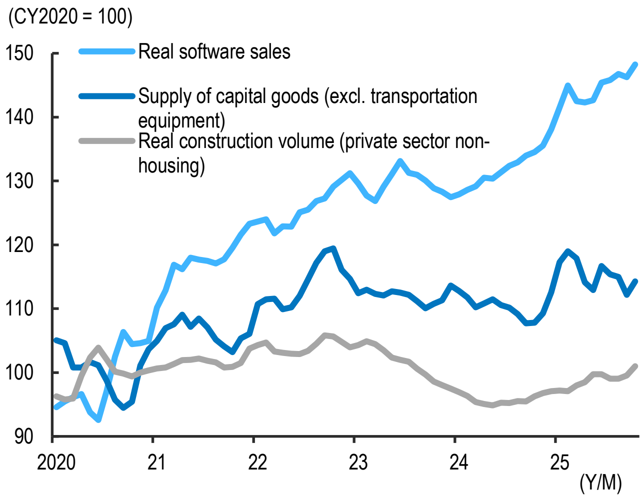
Source: Japan Research Institute, Ltd. based on data from the Bank of Japan
Note: Backward 3-month average.

Figure 3-2 World Semiconductor Shipment Value



Source: Japan Research Institute, Ltd. based on data from the World Semiconductor Trade Statistics (WSTS)
Note 1: World semiconductor shipment value is a 3-month moving average.
Note 2: Dashed line indicates WSTS's annual average forecast (as of Dec 2025).

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.

Wage hikes are continuing as labor shortages intensify

◆ Labor-market tightness is approaching its limit

The unemployment rate is low, hovering in the mid-2% range. This is below the rate that occurs due to market friction (equilibrium unemployment rate), meaning that few people are out of work because of a lack of demand for labor.

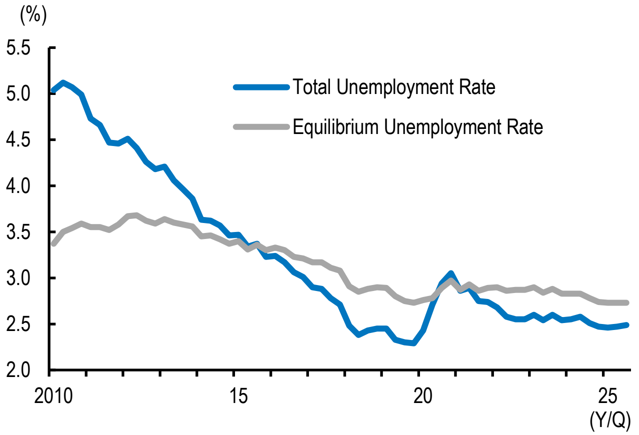
The labor market is expected to remain tight in the near term. On the demand side, willingness to hire in non-manufacturing sectors such as medical/nursing care and information/communications is firm. Meanwhile, on the supply side, the number of persons in the non-labor force population who wish to work has fallen by around 100,000 since COVID, even as labor force participation by women increases, so there is limited room for additional expansion in the supply of labor.

◆ Wage hikes are continuing

In November 2025, basic salaries of ordinary workers (adjusted to reflect data discrepancies arising from a change in the companies surveyed) rose 3.0% YoY, a high rate of increase. Although the official figure of around 2.5% is static, the actual wage situation appears healthy.

Wage growth rates are also expected to stay on the high side going forward. Due to persistent inflation, Rengo (Japan's largest union group) is sticking with the same wage increase target as the previous year for the 2026 shunto (spring wage negotiations). In line with this stance, industry-specific unions are also seeking wage hikes at or above the previous year's. Companies are highly likely to respond to these union demands with high wage increase rates. According to the Japan Chamber of Commerce and Industry's LOBO (Local Business Outlook) survey (December 2025 survey), willingness among small and medium-sized enterprises (SMEs) to raise wages is higher than the previous year, given increases in minimum wages and the need to secure and retain human resources.

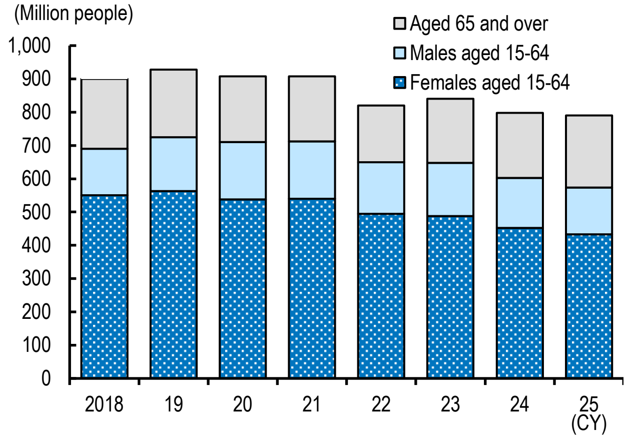
Figure 4-1 Total Unemployment Rate and Equilibrium Unemployment Rate



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

Note: The equilibrium unemployment rate represents the proportion of unemployed persons that would exist simultaneously with job vacancies in firms. It arises due to market frictions, such as the time required for labor mobility. The Japan Institute for Labor Policy and Training calculated this rate based on the historical relationship between vacancy rates and the employment-unemployment rate.

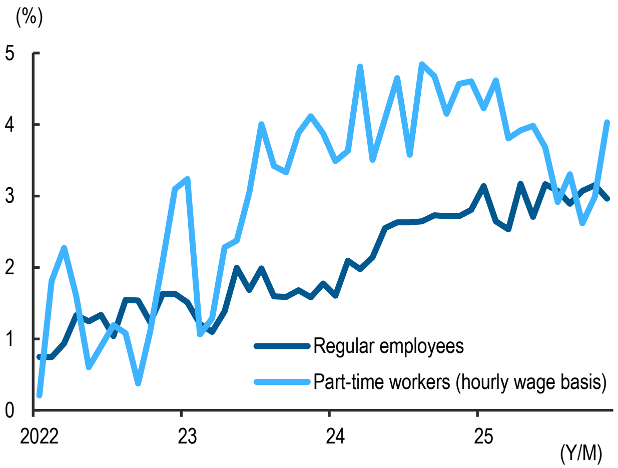
Figure 4-2 People not in the Labor Force Wishing to work



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

Note: Number of "job seekers who are able to work" among the non-labor force population. 2025 figure is the average for the July-September quarter.

Figure 4-3 Basic Salary <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.

Inflation set to slow

◆ Energy prices are pushing down inflation

In November 2025, core inflation (all items, less fresh food) slowed slightly from the previous month, dropping to 2.9%. While electricity price growth expanded in the absence of the previous year's measures to control prices, inflation was held down by moderation in the rapid ascent of food prices as well as lower gasoline prices resulting from increased subsidies ahead of the abolition of the provisional tax rate.

Price growth is expected to slow until the middle of 2026 and then remain at around 2%. 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, and food price inflation is expected to continue to moderate. According to a survey by Teikoku Databank, the number of items for which food manufacturers are planning to raise prices in 2026 is much lower than forecast in the previous year, so upward pressure on prices is highly likely to weaken going forward.

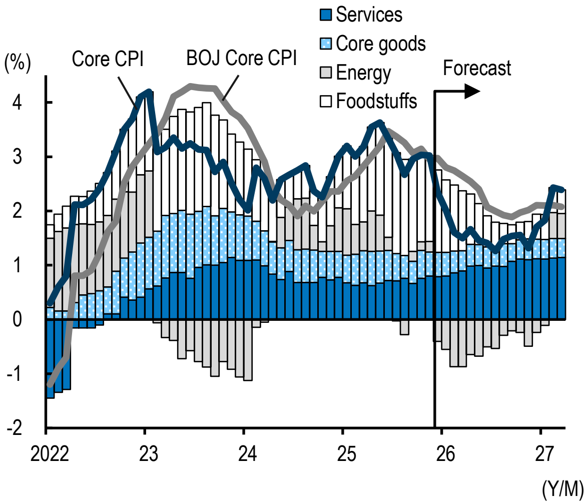
◆ The BOJ will continue to raise interest rates in phases

At its monetary policy meeting in December 2025, the Bank of Japan (BOJ) increased its policy rate to 0.75%.

Long-term interest rates rose through early January 2026. Rates were driven higher due to lingering concerns about fiscal expansion and growing expectations of further interest rate hikes by the BOJ.

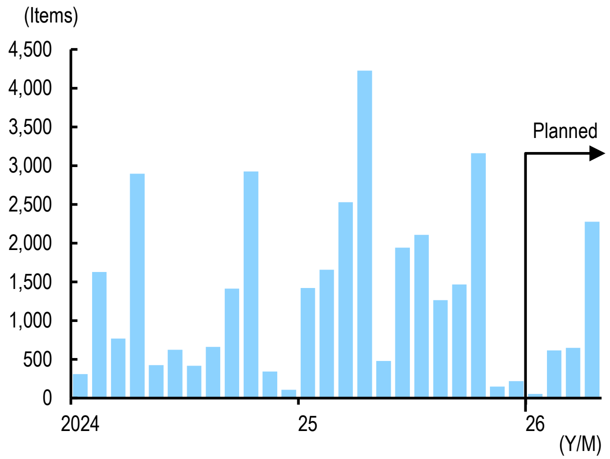
It is highly likely that the BOJ will continue to raise interest rates in stages while closely monitoring the impact on the real economy and financial/capital markets. The next rate hike is expected to be in July 2026. Long-term interest rates look likely to rise gradually, reflecting heightened anticipation of rate hikes by the BOJ and increased fiscal spending by the government. Should jitters about the possibility of a deterioration in fiscal discipline or political turmoil intensify, there is also a risk that long-term interest rates will soar.

Figure 5-1 Consumer Price Index <YoY>



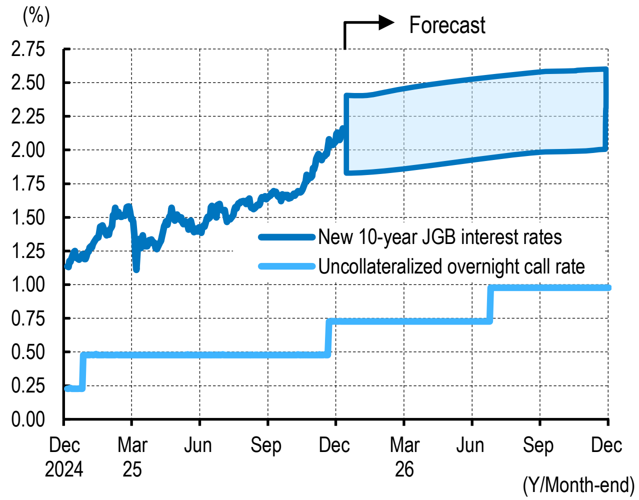
Source: Japan Research Institute, Ltd. based on data from the Ministry of Internal Affairs and Communications

Figure 5-2 Number of Items Subject to Price Increases by Food Manufacturers



Source: Japan Research Institute, Ltd. based on data from the Teikoku Databank
Note: Price revision plans of 195 major food manufacturers as of December 31.

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



Source: NEEDS-FinancialQUEST

Topic ①: Demand from foreign tourists is approaching the supply ceiling

◆ Hotel room supply will be constrained by strong demand for travel to Japan

The government is currently formulating its fifth Tourism Nation Promotion Basic Plan, with 2030 targets of 60 million visitors to Japan and 15 trillion yen in consumption by visitors. Inbound demand remains solid, with the number of visitors in 2025 expected to have surpassed 40 million, a new record high.

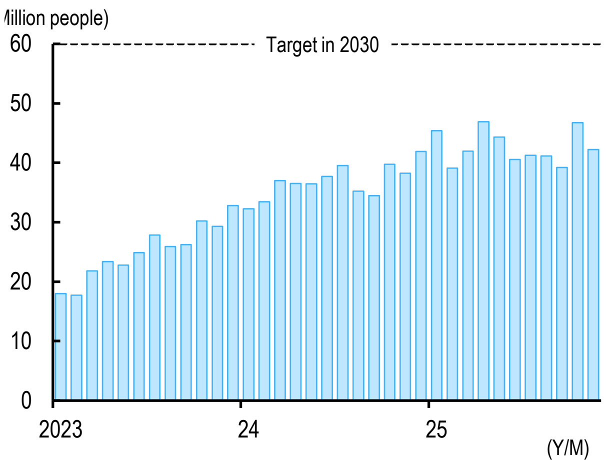
Against this backdrop, the supply of rooms in cities such as Osaka and Tokyo is approaching a ceiling. Large cities are served by numerous international flights, and nearly half of hotel guests in Tokyo and Osaka are foreigners visiting Japan. In Osaka during the Expo run, there were more months when the room occupancy rate reached close to 85%, a figure regarded as the upper limit for stable occupancy.

◆ There are also fears of a halving of the increase in demand for travel to Japan

Supply constraints may tighten further going forward. In the mid-2010s, when the term "bakugai" (explosive buying) became a buzzword, room occupancy rates also rose, exceeding 90% in Tokyo and Osaka. Later, in the late 2010s, room supply expanded as hotel operators looked ahead to the Tokyo Olympics. In this current phase, however, there is little prospect of improvement on the supply side, as the increase in hotel room supply has topped out, and the construction and hotel sectors are suffering from serious worker shortages.

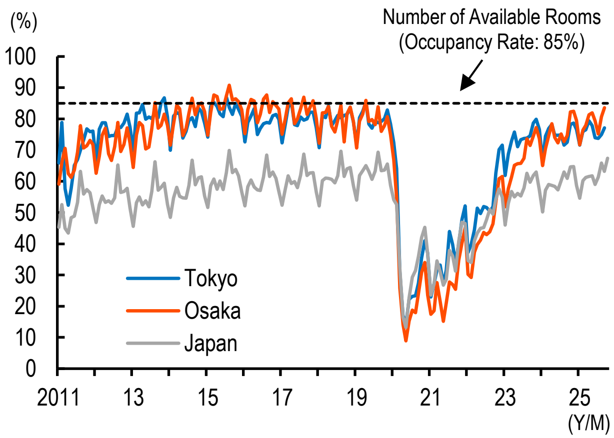
There are fears that these heightened supply constraints will curtail expansion of demand for travel to Japan. According to demand-side estimates, the number of foreign visitors to Japan will reach 55 million in 2030, while annual room occupancy rates in Tokyo and Osaka will hit 85%, the ceiling for hotel room supply, in 2027. If this scenario plays out, the increase in demand for travel Japan could halve. Efforts to achieve the 2030 target should focus on increasing per capita consumption through high-value-added offerings and promoting the geographical dispersion of demand from foreign tourists.

Figure 6-1 Number of Foreign Visitors to Japan <annualized>



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

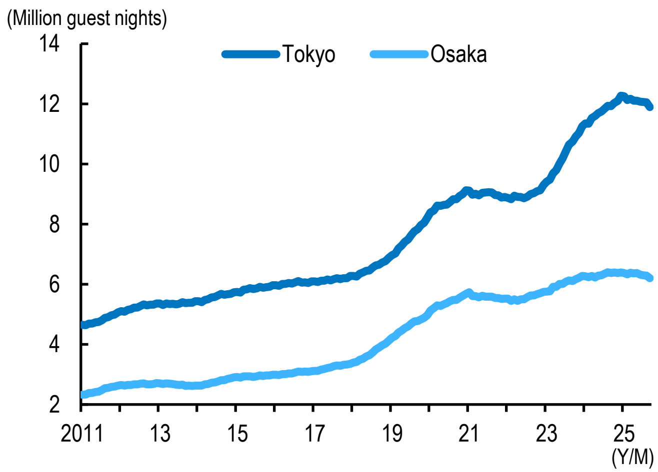
Figure 6-2 Trend in Room Occupancy Rate



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

Note The 85% occupancy rate is set as a feasible rate, as it is difficult to fully utilize all rooms year-round due to operator management and room maintenance. Refer to Development Bank of Japan [2024], "2030 Hokuriku Luxury Hotel Supply and Demand Forecast," etc.

Figure 6-3 Trend in Room Supply Capacity



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

Note: 12-month moving average. Room supply capacity = Number of guests ÷ Occupancy rate × 100.

Topic②: Rents are soaring in Tokyo

◆ Rent increase rates in the 23 special wards of Tokyo are strikingly high

Recent CPI data shows rent inflation turning positive. Rent inflation, which had been stuck in negative territory until the 2010s, still averaged just +0.3% (annualized) nationwide in the first half of 2025, with the positive figure reflecting higher costs for building construction and property management. But there is considerable variation according to city size, with average rent inflation rates being far higher in large cities, and particularly in the 23 special wards of Tokyo (the area of the former Tokyo City; below, "Tokyo 23 wards"), from 2024 onwards.

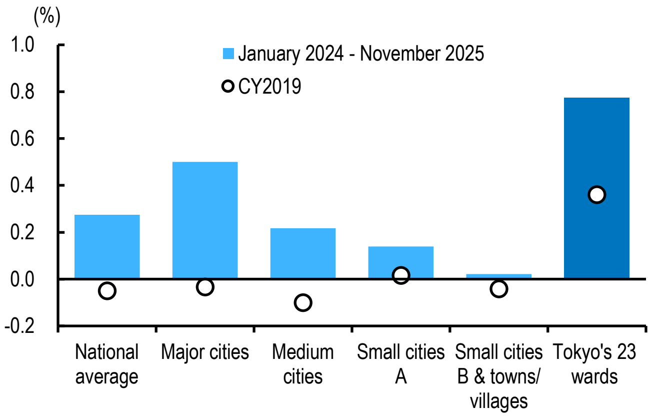
◆ Upward pressure is being applied by people choosing to rent and the concentration of population in Tokyo

Three factors can be pointed to as being behind the rising rents in the Tokyo 23 wards. The first is an increase in short-term property flipping. The proportion of newly-built condominiums for which ownership was registered in January-June 2024 that were sold on within one year was 9.3% in the Tokyo 23 wards, a high level compared to other parts of the Tokyo metropolitan area and the cities of Osaka and Nagoya, and it is possible that rising housing prices resulting from purchases for speculative purposes are driving up rents.

The second is that rents feel low relative to housing prices. Prices of housing, including used condominiums, in the Tokyo 23 wards have risen at a faster pace than rents due to the boost from the demand side and the aforementioned short-term flipping of properties. In response, more people are choosing to rent instead of buy, putting upward pressure on rents.

The third factor concerns demographics. In Tokyo, the excess of people in their 20s and 30s, who often sign rental contracts, moving in over those moving out is high. With so many people relocating to Tokyo, it is easy for landlords to increase rents when signing contracts with new tenants, and this may be contributing to rising rents.

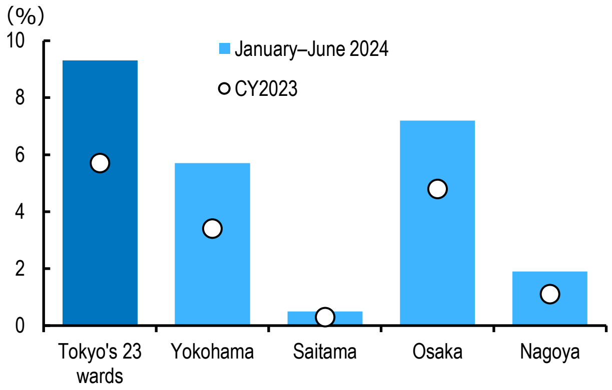
Figure 7-1 CPI Rent Growth Rate



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

Note: Arithmetic average of year-on-year growth rates during the period. Major cities include government-designated cities and Tokyo's 23 wards. Medium cities are cities with populations between 150,000 and 1,000,000 excluding major cities. Small cities A are cities with populations between 50,000 and 150,000. Small cities B are cities with populations under 50,000 and towns/ villages.

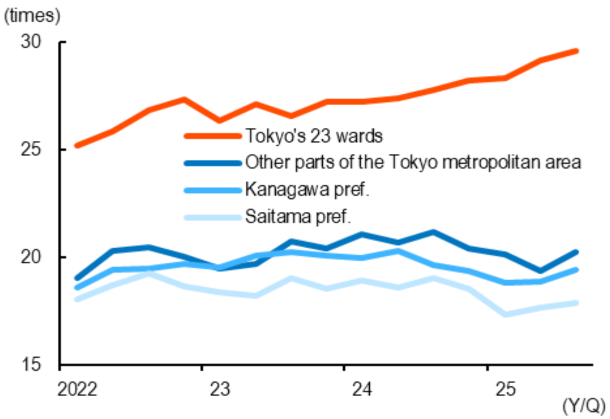
Figure 7-2 Short-Term Sales of Newly Built Condominiums



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

Note: Percentage of properties registered for preservation during the period that were subsequently transferred within one year.

Figure 7-3 Rent-to-Price Ratio for Condominiums (Per Square Meter)



Source: Japan Research Institute, Ltd. based on data from the East Japan Real Estate Distribution Organization

Note: This value is calculated by dividing the transaction price of used condominiums (3-month moving average) by the annual rent.

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 the middle of 2026, centered on energy and food prices, while wage increase rates are projected to remain at relatively high levels. Labor unions are poised to demand wage increases similar to the previous year's due to persistent 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 world 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 January 13, 2026)

(% changes from the previous fiscal year)

	CY2025		CY2026				CY2027		FY2024	FY2025	FY2026	FY2026
	7~9	10~12	1~3	4~6	7~9	10~12	1~3	4~6				
	(Actual)	(Projection)							(Actual)	(Projection)		
Real GDP	-2.3	0.8	1.1	1.0	1.0	1.0	0.9	0.8	0.5	0.9	0.7	0.8
Private Consumption Expenditure	0.8	0.7	1.1	1.1	0.8	0.7	0.6	0.6	0.2	1.2	0.9	0.5
Housing Investment	-29.0	9.2	1.1	0.6	0.0	-0.1	-0.3	-0.4	-0.7	-4.4	-0.7	-0.4
Business Fixed Investment	-0.8	1.0	1.3	1.4	1.6	1.8	1.8	1.6	0.9	1.6	1.3	1.6
Private Inventories (percentage points contribution)	(-0.4)	(0.0)	(0.0)	(-0.0)	(-0.0)	(-0.0)	(-0.0)	(-0.0)	(0.1)	(0.2)	(-0.0)	(-0.0)
Government Consumption Expenditure	0.6	0.9	0.9	1.0	1.1	1.1	1.1	1.0	2.3	0.4	1.0	1.0
Public Investment	-4.2	0.8	0.9	1.0	1.1	1.2	1.2	1.2	0.1	-0.7	0.8	1.2
Net Exports (percentage points contribution)	(-0.7)	(-0.5)	(-0.2)	(-0.2)	(-0.1)	(-0.0)	(-0.0)	(-0.1)	(-0.4)	(-0.2)	(-0.2)	(-0.1)
Exports of Goods and Services	-4.9	-1.7	1.0	1.2	1.6	2.0	1.9	1.9	1.7	2.2	0.6	1.9
Imports of Goods and Services	-1.8	0.6	1.8	1.9	2.0	2.1	2.1	2.2	3.3	2.8	1.5	2.1

(% changes from the same quarter of the previous year) (% changes from the previous fiscal year)

Nominal GDP	4.1	3.7	2.7	2.6	3.2	2.9	3.6	3.2	3.7	3.9	3.1	3.3
GDP deflator	3.4	3.4	2.1	2.5	2.4	2.0	2.6	2.3	3.2	3.1	2.4	2.5
Consumer Price Index (excluding fresh food)	2.9	2.8	1.7	1.5	1.3	1.4	2.0	1.8	2.7	2.7	1.5	1.9
Unemployment Rate (%)	2.5	2.6	2.6	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Exchange Rates (JY/US$)	147	154	155	155	153	154	152	150	153	151	154	151
Import Price of Crude Oil (US$/barrel)	72	70	63	60	58	56	55	54	83	70	57	55

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.