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Monthly Report of Prospects for Japan's Economy

February 2026

Macro-economics Research Center
Economics Department

The Japan Research Institute, Limited

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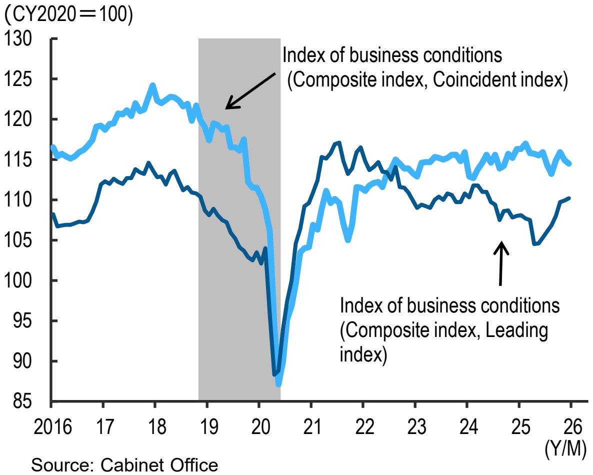
The General Situation – The economy is gradually recovering, though activity has stalled in some areas

Figure 1-1 Economic Activity

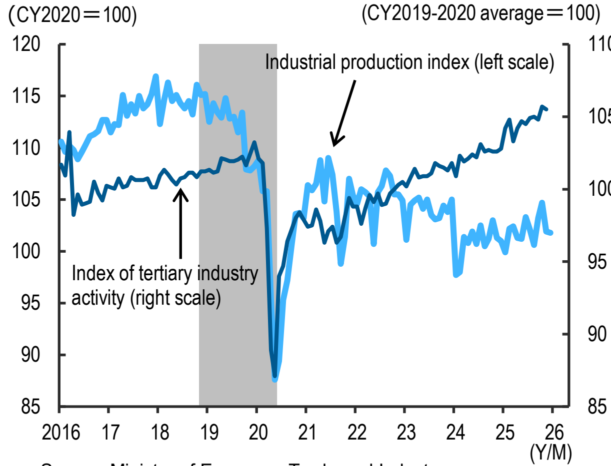
The coincident index of business conditions is falling slightly.
The leading index is picking up.



Source: Cabinet Office

Figure 1-2 The Corporate Sector

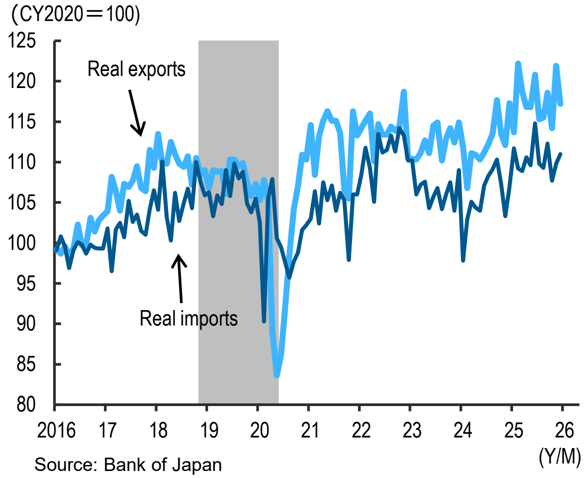
Industrial production is fluctuating.
Economic activity in the service sector is recovering.



Source: Ministry of Economy, Trade and Industry

Figure 1-3 External Demand

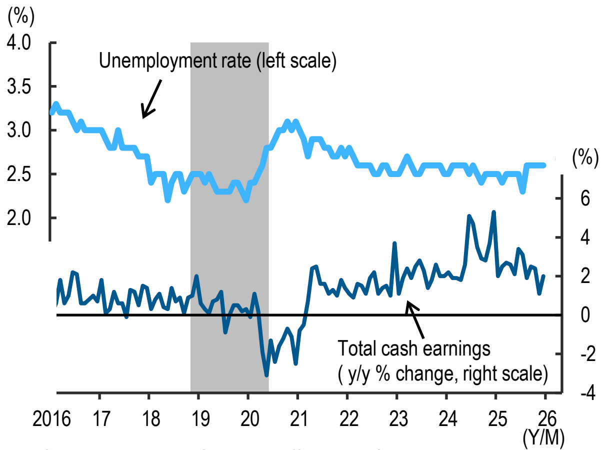
Exports are showing signs of bottoming out.
Imports are weak.



Source: Bank of Japan

Figure 1-4 Employment and Income

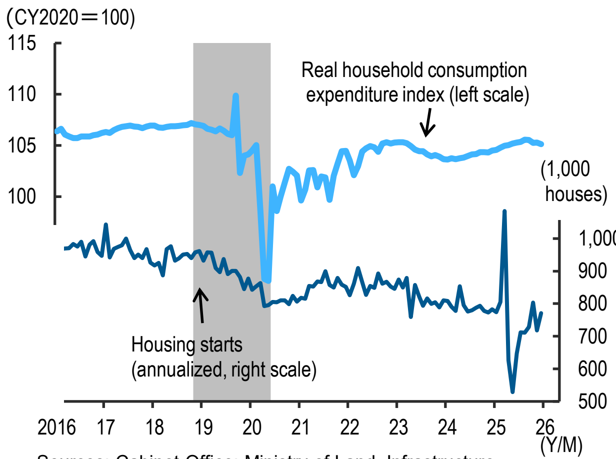
The unemployment rate is low, hovering around 2.5%.
Nominal wage growth is solid on average.



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

Figure 1-5 The Household Sector

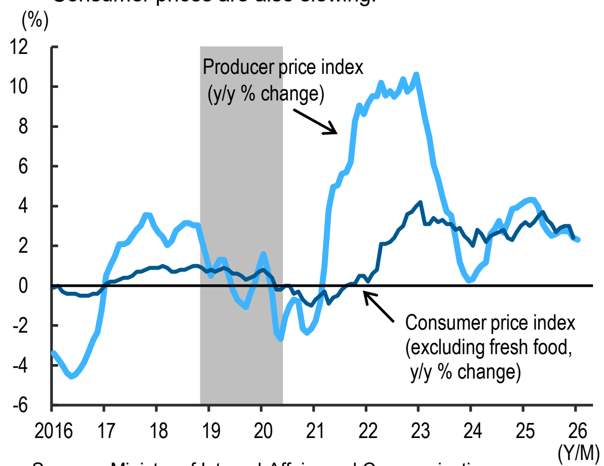
The recovery in consumption has stalled.
Housing starts are weak.



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

Figure 1-6 Prices

Producer price inflation is slowing, particularly in energy.
Consumer prices are also slowing.



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

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

Annualized real GDP growth was 0.2% quarter over quarter (QoQ) in Q4 2025

◆ Positive growth is being driven by domestic demand

Annualized real GDP growth in the fourth quarter was 0.2% QoQ, the first positive growth in two quarters. While exports were weak, personal consumption increased for the fourth straight quarter, and housing investment rebounded due to policy factors.

◆ Production in the manufacturing sector is fluctuating

In December 2025, the Industrial Production Index slipped 0.1% month over month (MoM). Lower output of production machinery and automobiles pushed down the overall figure.

According to the Industrial Production Index Forecast (adjusted based on past forecasting errors), near-future production plans indicate a jump in output of 7.2% MoM in January 2026, with the overall figure being pushed up by sectors such as transportation machinery and general-purpose and business-oriented machinery.

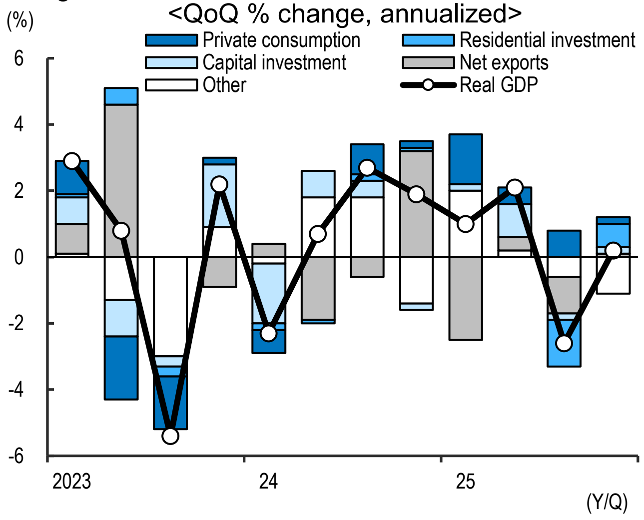
◆ Housing starts are weak

Housing starts were down 1.3% year over year (YoY) in December 2025. For the full year of 2025, the figure was 740,000 units (down 6.5% YoY), registering a YoY decline for the third consecutive year. Rising construction costs and a stricter, slower screening process due to legal changes have created downward pressure.

◆ Import prices are falling

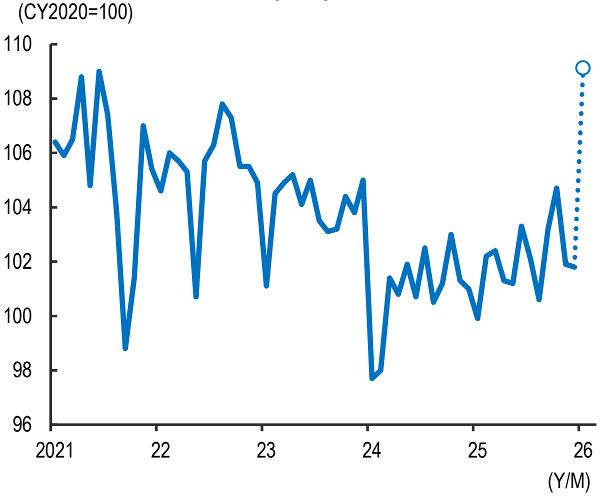
Import prices (in yen terms) were lower than a year earlier in almost every month of 2025. In the latter half of the year, a weaker yen lifted import prices, but price factors centered on energy products such as crude oil pushed down the overall figure, easing inflationary pressures from the import side.

Figure 2-1 Real GDP Growth Rate <QoQ % change, annualized>



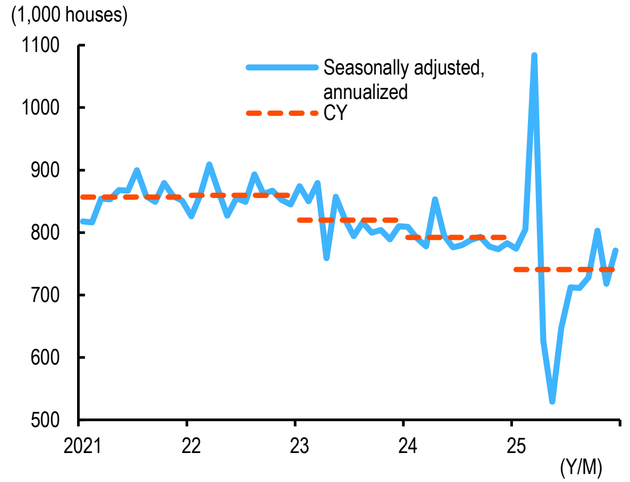
Source: Japan Research Institute, Ltd. based on data from the Cabinet Office

Figure 2-2 Industrial Production Index <seasonally adjusted>



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

Figure 2-3 Housing Starts



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

The pace of the recovery in external demand is moderate

◆ Goods exports seem to be bottoming out

Goods exports have stopped falling. By country/territory, exports to the U.S. slumped through the middle of the year due to the impact of the Trump tariffs, but have showed signs of bottoming out recently, particularly in automobiles. In addition, exports to the EU and ASEAN countries, centered on automobiles and capital goods, continue to rise, and this is supporting exports overall.

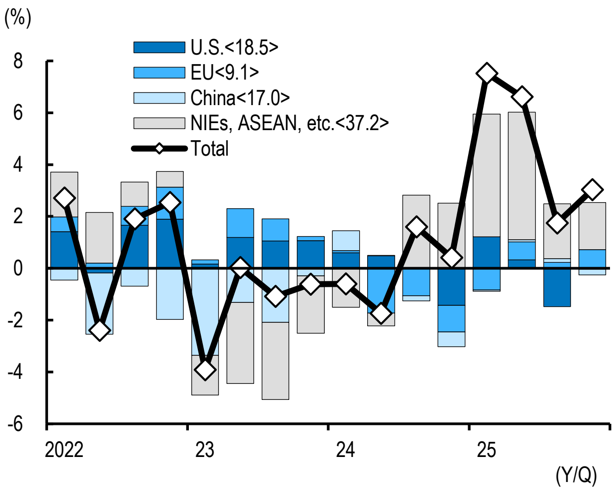
Looking ahead, goods exports should remain firm. Exports of IT-related goods are expected to lift goods exports overall, thanks in part to the global AI boom. In addition, the resilience of the world economy will provide a tailwind for goods exports. According to the IMF, in 2026 the global economy is projected to maintain a similar growth rate to the previous year. While the slowdown in the Chinese economy will weigh on growth, support will be provided by looser fiscal and monetary policies in the U.S. and Europe.

◆ Deterioration in Japan–China relations is depressing inbound tourism demand

Inbound tourism demand remains robust. In December 2025, the number of Chinese visitors to Japan fell 45.4% YoY as the impact of worsening Japan-China relations became apparent. However, thanks to demand for travel to Japan from countries other than China, total inbound tourism demand rose 3.7% YoY, keeping growth in positive territory.

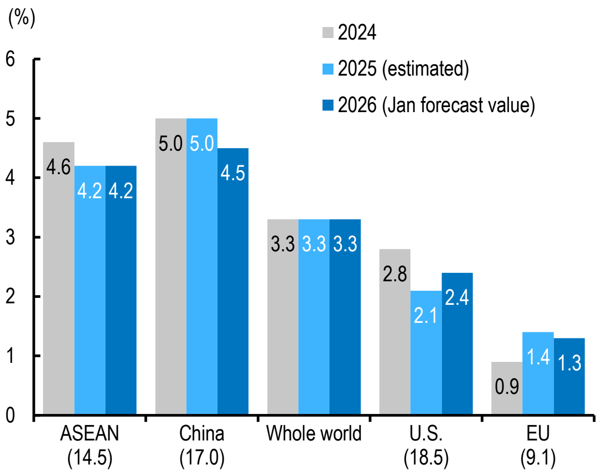
A near-term collapse in inbound tourism demand should be avoided. Although there are concerns about the impact of a protracted slump in the number of Chinese people visiting Japan as a result of them being told to refrain from doing so by their government, the ongoing weakness of the yen is expected to support overall demand for travel to Japan. Estimates indicate that even if the number of Chinese travelers to Japan halves due to the deterioration in Japan-China relations, Japan is likely to receive more than 40 million foreign visitors in 2026, on par with the level recorded in 2025.

Figure 3-1 Real Exports by Partner Country <contributions to QoQ>



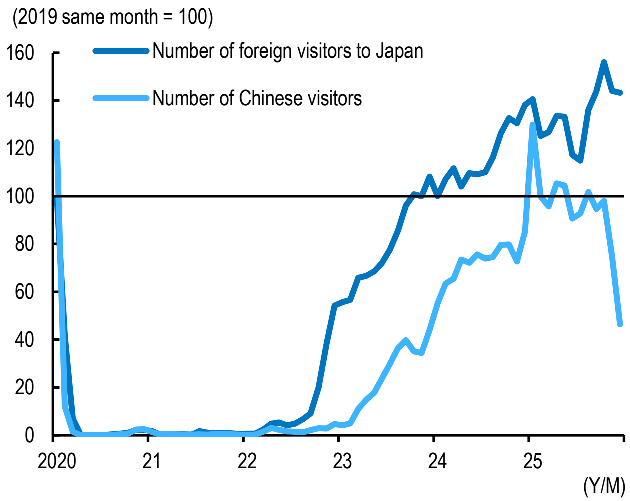
Source: Japan Research Institute, Ltd. based on data from the Bank of Japan
Note: Figures in angle brackets represent the overall percentage of total nominal exports in 2025.

Figure 3-2 IMF Real GDP Growth Outlook



Source: Japan Research Institute, Ltd. based on data from the Ministry of Finance and IMF
Note: Figures in angle brackets represent the overall percentage of total nominal exports in 2025. ASEAN refers to the five major countries.

Figure 3-3 Number of Foreign Visitors to Japan



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

The employment/ income situation for households is favorable

◆ Personal consumption is gradually increasing

Shored up by a favorable employment/income environment, personal consumption is gradually recovering. In most months since the middle of 2024, the total real income of employees has risen YoY. Although per-employee real wages are static due to inflation, an increase in the number of people employed, particularly in non-manufacturing sectors, is pushing up the household income overall.

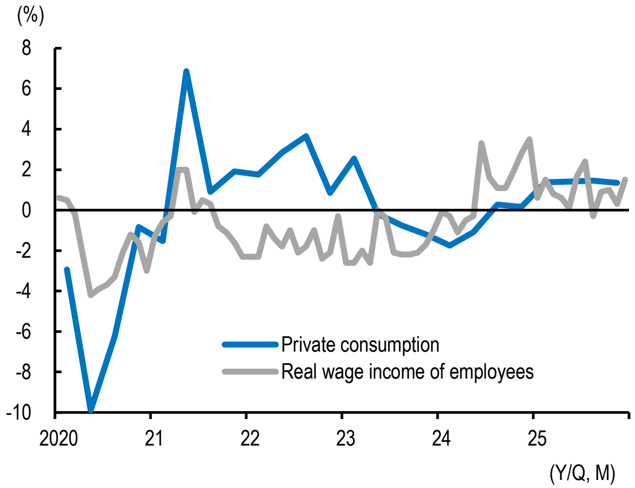
◆ Large wage increases set to be realized

Looking ahead, personal consumption is expected to continue its recovery, supported by higher real incomes of employees. With labor supply reaching its ceiling, the pace of increase in the number of employees looks set to slow, but nominal wages are projected to continue rising rapidly.

Amid persistent inflation, pressure from labor unions for wage increases is strong. Rengo (Japan's largest union group) is sticking with the same wage increase target as the previous year, and industry-specific unions are also seeking wage hikes at or above the previous year's.

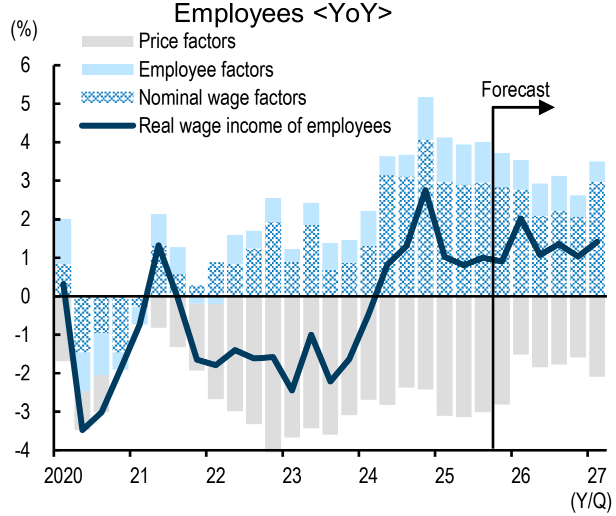
Employers also remain committed to raising wages. Keidanren (Japan Business Federation) has called for the establishment of strong momentum for wage increases, and is asking employers to consider raising base pay in particular. According to a survey by the Institute of Labour Administration, 66.4% of companies plan to increase base pay at the 2026 shunto (spring wage negotiations). This is a bigger proportion than in the previous year, so the momentum for wage hikes could be becoming more widely and deeply established. Given these stances on the labor and management sides, it is highly likely that generous wage increases will be seen again this year. And with inflation slowing, per-employee real wage growth should also turn positive before long.

Figure 4-1 Private Consumption and Real Wage Income of Employees <YoY>



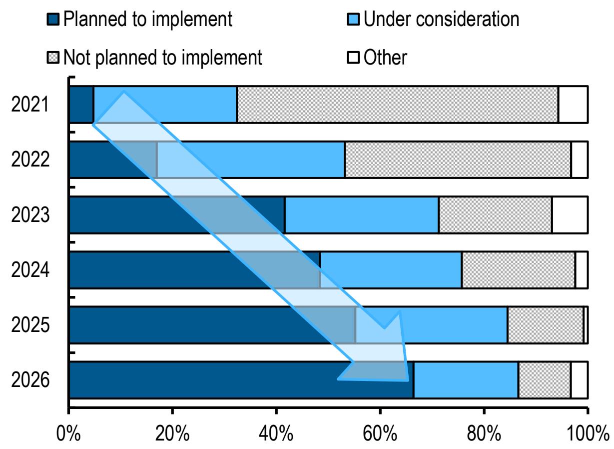
Source: Japan Research Institute, Ltd. based on data from the Cabinet Office
Note: Real employee compensation is deflated using the household final consumption expenditure deflator.

Figure 4-2 Forecast of Real Wage Income of Employees <YoY>



Source: Japan Research Institute, Ltd. based on data from the Cabinet Office
Note: Real wage income of employees is deflated by consumption of households, excluding imputed rent deflator.

Figure 4-3 Planned Basic Wage Increases by Companies



Source: Japan Research Institute, Ltd. based on data from the Labor Administration Research Institute
Note: Survey of HR/ Labor Directors at listed companies and comparable unlisted companies. Survey period: Dec 2025 to mid-Jan 2026.

Inflation set to slow

◆ Energy prices are pushing down inflation

In December 2025, core inflation (all items, less fresh food) fell from the previous month, dropping to 2.4% (previous month: 3.0%). The pace of energy price growth slowed due to government measures to control prices, and inflation was also held down by moderation in the rapid rise of food prices.

Price growth is expected to slow until the middle of 2026 and then remain around 2%. Energy prices will fall significantly due to lower market prices and government measures to control prices, and food price inflation should also continue to moderate as the prices of ingredients stabilize.

However, factors such as higher personnel expenses are likely to cause service-driven inflationary pressures to intensify. In sectors such as lodging, food/beverage service, and retail, where personnel expenses account for a high proportion of intermediate inputs, price increases are expected to be sustained.

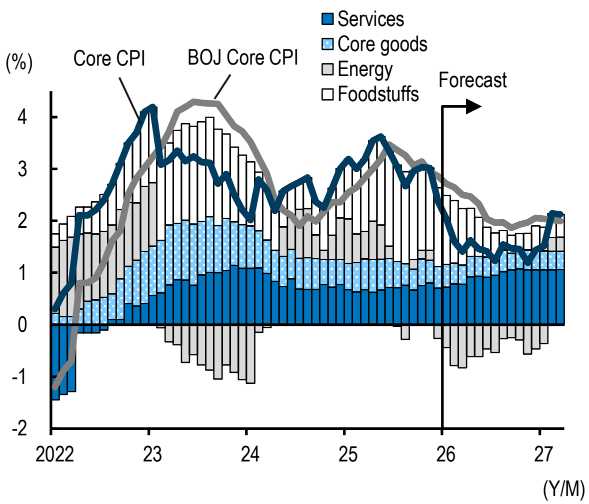
◆ The BOJ will continue to raise interest rates in phases

At its monetary policy meeting in January 2026, the Bank of Japan (BOJ) decided to keep its policy rate at 0.75%.

Long-term interest rates remain high. Expectations of a BOJ rate hike persist, and in the wake of the landslide victory by the Liberal Democratic Party in the lower-house election, market eyes remain on Prime Minister Takaichi's fiscal policy stance.

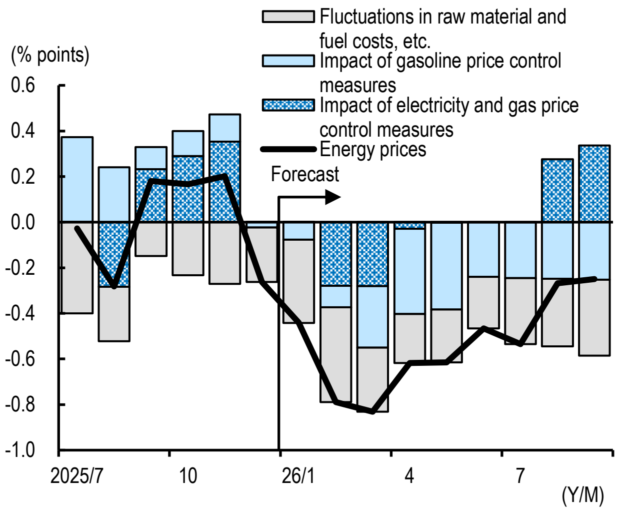
It is highly likely that the BOJ will continue to raise interest rates in stages while closely monitoring the impact on the real economy and financial/capital markets. The next rate hike is expected to be in July 2026. Long-term interest rates look likely to rise gradually, reflecting heightened anticipation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

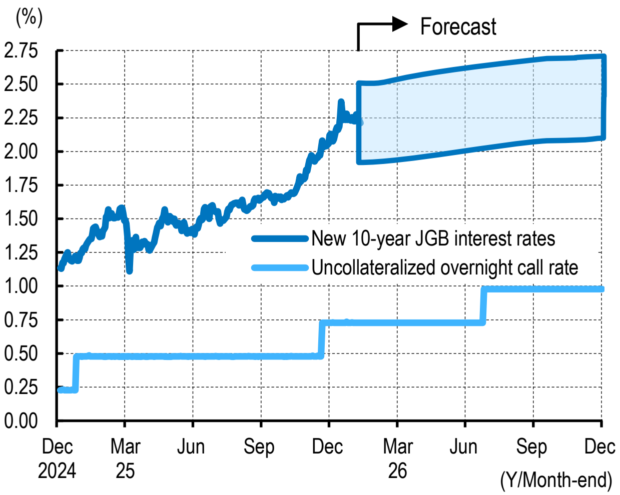
Figure 5-2 Energy's Impact on Core CPI <YoY>



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 (payment in April)

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



Source: NEEDS-FinancialQUEST

Topic ①: Shorter equipment replacement cycles provide tailwind for capital investment

◆ Capital investment is moving in line with increased consumption of fixed capital

Capital investment has been solid recently. One contributing factor is replacement investment, which reflects increased consumption of fixed capital. Since the 2010s, capital investment in Japan has moved in line with increased consumption of fixed capital.

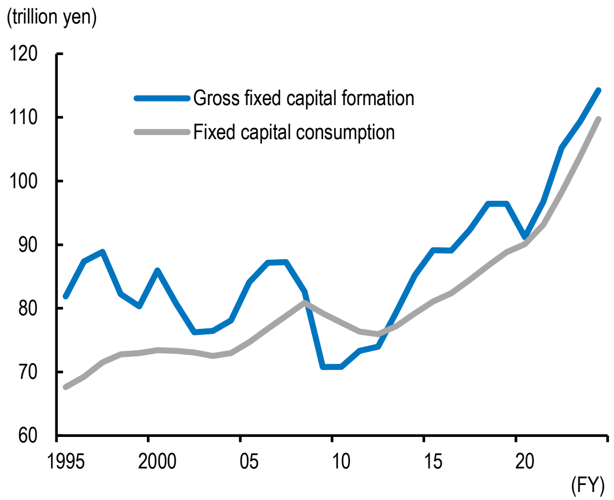
The rise in consumption of fixed capital can be attributed to the digitalization and "intangibilization" of the economy. Looking at the breakdown of corporate fixed capital stock, the share of structures and buildings has declined, while the shares of information and communication equipment and intangible assets have expanded. These assets, which are susceptible to the effects of technological innovation, become obsolete quickly, and their increasing share has pushed up the average rate of consumption, shortening the replacement cycle for assets overall.

◆ Replacement demand will support investment in the near term

Going forward, as digitalization and technological innovation progress, the share of assets with high consumption rates will increase, and replacement investment is also expected to rise. Companies have not wavered in their stance of investing in replacements and upgrades even during shocks such as the COVID pandemic, and higher replacement investment has the potential to moderate economic fluctuations.

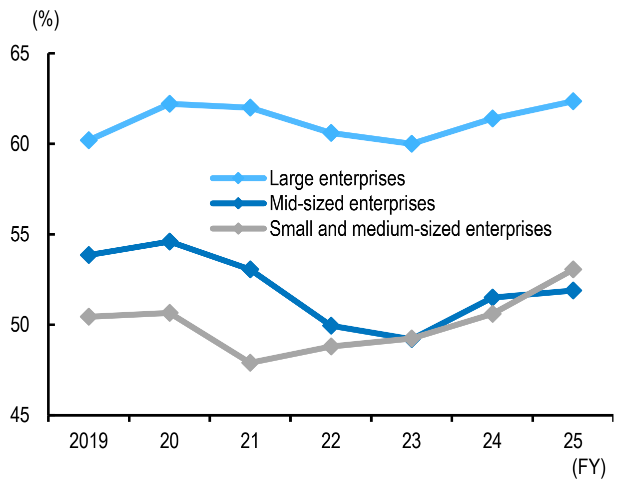
However, the productivity improvement effect of replacement investment alone is limited. Net investment, which excludes consumption of fixed capital, has not increased significantly, and the growth rate of real fixed capital stock in the 2020s has not reached the levels of the late 2010s. It has remained at a level comparable with the growth of the number of employed persons, and the capital-labor ratio (fixed capital stock per worker) has stagnated. To translate capital investment into increased labor productivity, it will be important to boost net investment and raise the capital-labor ratio.

Figure 6-1 Capital Investment and Fixed Capital Consumption (Nominal)



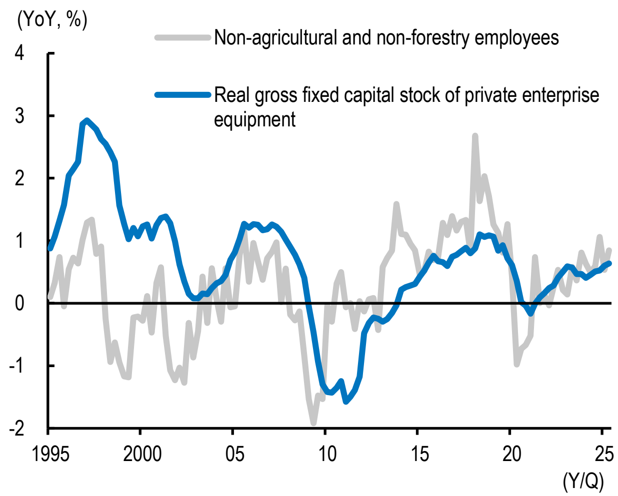
Source: Japan Research Institute, Ltd. based on data from the Cabinet Office
Note: Both figures represent corporate equipment investment by private corporations.

Figure 6-2 Capital Investment Stance for Replacements



Source: Japan Research Institute, Ltd. based on data from the Ministry of Finance and the Cabinet Office
Note: Percentage of companies responding "replacements" as their "investment stance for the current fiscal year." Average of percentages from 2Q and 4Q surveys. Multiple responses allowed for up to three items out of ten.

Figure 6-3 Real Gross Fixed Capital Stock and Number of Employees



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

Topic②: Is a consumption tax cut the optimal solution for supporting households?

◆ Consumption tax cuts were promised by various parties

In their campaigns ahead of the recent lower-house election, various parties called for consumption tax reductions. Securing the financial resources to fund a consumption tax cut presents a major challenge, and even if the money can be found, as a household support measure, a consumption tax reduction will bring with it the following problems:

◆ Comparisons with alternative household support measures are necessary

The first is that the cut might not be reflected in sales prices. Consumption taxes have been reduced in Europe in the past, and there were instances where sales prices did not fall by the amount of the tax reduction. In Japan, considering that price pass-through by companies to consumers is still only halfway through, there is a possibility that prices will not fall by the same percentage as the tax cut, meaning that the benefits might not reach households. Cash handouts or income tax reductions, which support households directly, would be certain to benefit them, and thus avert such a situation.

The second problem is that the cut would amplify economic fluctuations. If prices are going to fall due to a consumption tax reduction, consumers will delay purchases until the cut takes effect, after which buying will surge. This is because of the substitution effect, whereby households prefer to consume more when the tax rate is low. If the tax cut is uniformly applied to all items, this effect will be most pronounced with durable goods, but even if only the tax on food items is reduced, it is highly likely that consumers will bring forward purchases of goods that they can stockpile, such as rice. Rapid changes in demand could disrupt supply chains, and economic assessments will become extremely difficult amid these big consumption swings, making it hard to make decisions on re-increasing the tax.

The third problem is that the redistributive effect is weak. Because consumption taxes are regressive, low-income earners benefit proportionately more from a cut (i.e., the cut represents a higher percentage of income), but the tax reduction amount is larger for high-income earners. Compared to fixed-amount benefits (which benefit low-income earners more in terms of proportion, and the reduction amount is the same for all), the redistributive function is limited. It will therefore be necessary to carefully consider consumption tax cuts in comparison with other household support measures, while keeping policy objectives in mind.

Figure 7-1 Political Parties' Stances on Consumption Tax Cuts

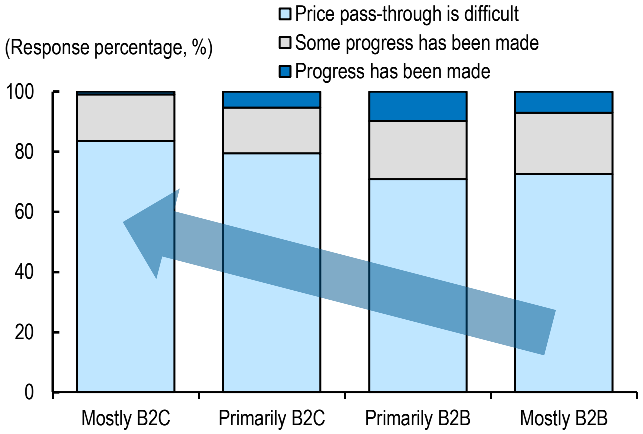
	Food only	All items
Permanent reduction	Centrist Reform Alliance, Japan Conservative Party: Permanent 0%	Sansei Party, Reiwa Shinsengumi, Tax Reduction Japan/ Yukoku Union, Social Democratic Party: Abolish Communist Party: 5%, phased abolition
Temporary reduction	Liberal Democratic Party, Japan Innovation Party: 0% for 2 years	Democratic Party for the People: Temporary uniform 5%

*Team Mirai opposes consumption tax cuts.

Source: Japan Research Institute, Ltd. based on materials from each party and various news reports

Note: The 11 parties holding seats in the Diet..

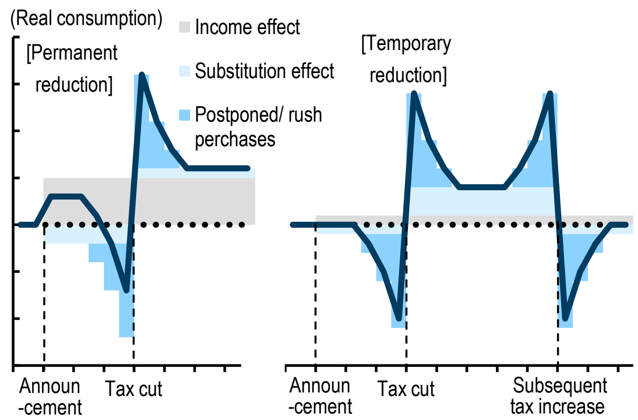
Figure 7-2 Price Pass-Through Trends Among Small and Medium-Sized Businesses



Source: Japan Research Institute, Ltd. based on data from the National Federation of Small Business Associations

Note: Based on survey results regarding wage increases, etc. (October 24 - November 14, 2025).

Figure 7-3 Conceptual Diagram of Real Consumption During Consumption Tax Cuts



Source: Japan Research Institute, Ltd. based on the following literature: Takashi Unayama [2023], Analysis of Consumer Behavior in Contemporary Japan: Current Perspectives on the Life Cycle Theory, Keio University Press

Note: Secondary demand fluctuations associated with postponement/ rush purchases are not considered..

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. Despite not particularly strong external demand, the economy will be supported by domestic demand.

As households' real purchasing power improves, personal consumption is expected to gradually rise. 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 will maintain their enthusiasm for investment addressing medium-to long-term challenges such as labor saving and the digital transformation.

External demand is expected to remain firm. Although the sharp drop in the number of Chinese people visiting Japan as a result of the deterioration in Japan-China relations will weigh on external demand, the ongoing weakness of the yen will support Japan travel demand from countries other than China. In addition, solid AI-related demand worldwide is expected to lift goods exports.

◆ Downside risks exist domestically and internationally

Real GDP growth is projected to remain solid, registering 0.8% 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 tighter. This might trigger an acceleration in inflation and stagnation in corporate activity. 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 February 16, 2026)

(seasonally adjusted, annualized % changes from the previous quarter) / (% changes from the previous fiscal year)

	CY2025	CY2026				CY2027				CY2028	FY2025	FY2026	FY2026
	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3			
	(Actual)	(Projection)									(Projection)		
Real GDP	0.2	1.3	1.3	1.1	1.0	0.9	0.8	0.7	0.7	0.7	0.8	0.7	0.8
Private Consumption Expenditure	0.4	1.2	1.1	0.9	0.7	0.6	0.6	0.5	0.5	0.5	1.3	0.9	0.6
Housing Investment	20.4	1.1	0.6	0.0	-0.1	-0.3	-0.4	-0.5	-0.5	-0.5	-3.7	0.5	-0.4
Business Fixed Investment	1.0	2.0	1.8	1.7	1.7	1.6	1.6	1.5	1.5	1.4	1.5	1.5	1.6
Private Inventories (percentage points contribution)	(-0.7)	(0.1)	(0.0)	(-0.0)	(-0.0)	(-0.0)	(-0.0)	(-0.0)	(-0.0)	(-0.0)	(0.1)	(-0.1)	(-0.0)
Government Consumption Expenditure	0.6	0.9	1.0	1.1	1.1	1.1	1.0	1.0	1.0	1.0	0.5	0.9	1.0
Public Investment	-5.1	0.9	1.0	1.1	1.2	1.2	1.2	1.2	1.2	1.2	-1.8	-0.0	1.2
Net Exports (percentage points contribution)	(0.0)	(-0.4)	(-0.1)	(-0.1)	(-0.1)	(-0.0)	(-0.0)	(-0.0)	(-0.0)	(-0.0)	(-0.2)	(-0.2)	(-0.0)
Exports of Goods and Services	-1.1	-0.2	1.4	1.3	1.6	1.7	1.8	1.8	1.8	1.8	1.9	0.4	1.7
Imports of Goods and Services	-1.3	1.8	1.8	1.8	1.9	1.9	1.9	2.0	2.0	2.0	2.9	1.3	1.9
	(% changes from the same quarter of the previous year)										(% changes from the previous fiscal year)		
Nominal GDP	3.4	2.7	2.3	3.7	3.0	3.7	3.6	3.6	3.7	3.8	3.9	3.2	3.7
GDP deflator	3.4	2.1	2.2	2.7	2.0	2.7	2.7	2.8	2.9	3.1	3.0	2.4	2.9
Consumer Price Index (excluding fresh food)	2.8	1.7	1.5	1.4	1.4	1.9	1.8	1.8	2.0	2.1	2.7	1.6	1.9
Unemployment Rate (%)	2.6	2.6	2.6	2.6	2.6	2.5	2.5	2.5	2.5	2.5	2.5	2.6	2.5
Exchange Rates (JY/US$)	154	155	155	153	154	152	150	151	152	150	152	154	151
Import Price of Crude Oil (US$/barrel)	71	64	60	58	56	55	54	55	56	56	71	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.