

English translation published in April 2026

Monthly Report of Prospects for Japan's Economy

March 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 rebounding. The leading index is picking up.

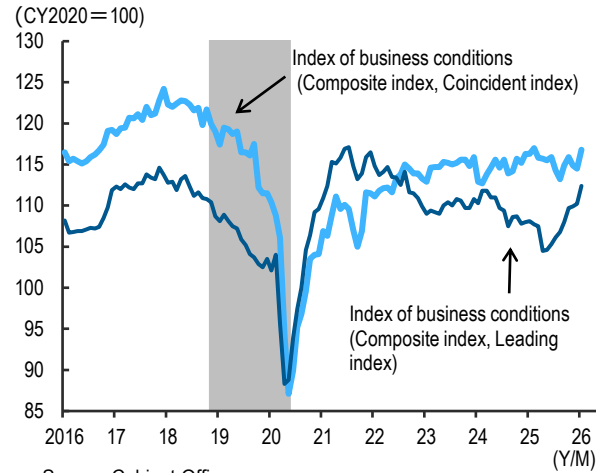


Figure 1-2 The Corporate Sector

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

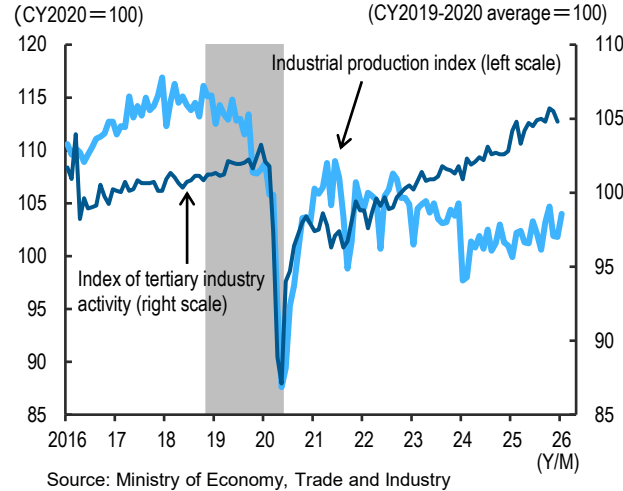


Figure 1-3 External Demand

Exports, particularly to China and other Asian countries/territories, are picking up. Imports are weak.

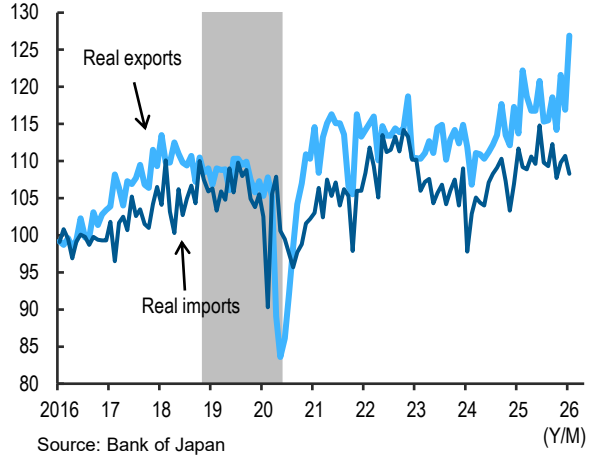


Figure 1-4 Employment and Income

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

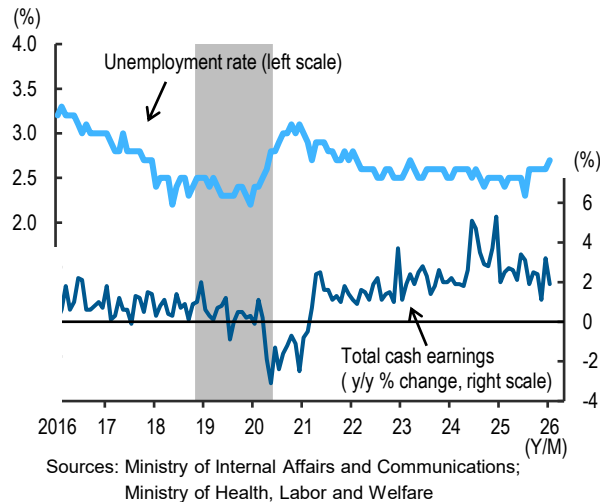


Figure 1-5 The Household Sector

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

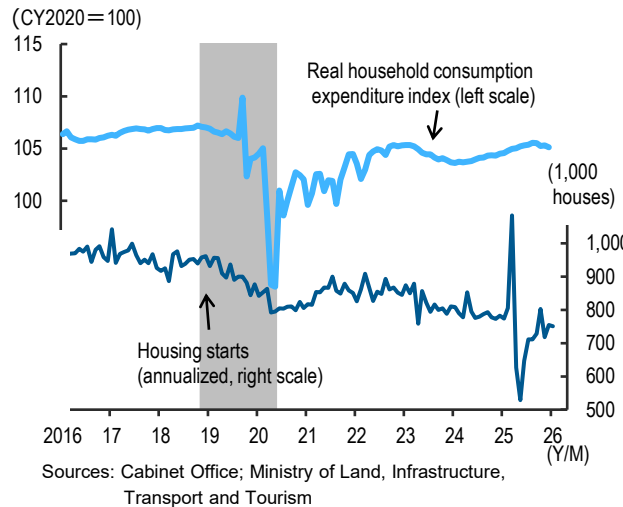
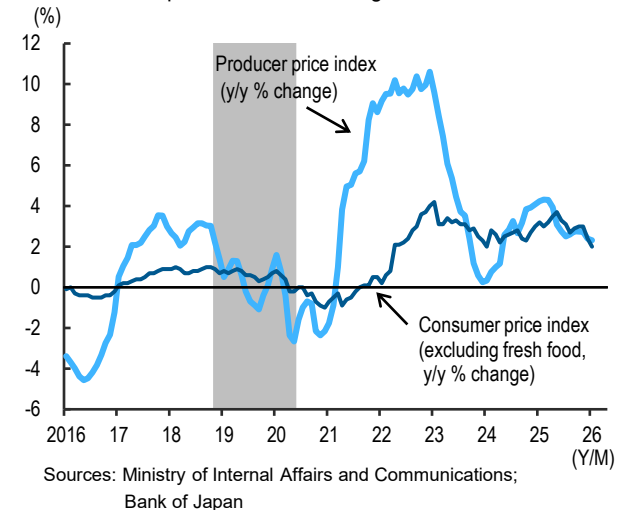


Figure 1-6 Prices

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



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

Real GDP for Q4 2025 has been revised upward

◆ Personal consumption and capital investment were revised upward

In the second QE for Q4 2025, annualized quarter-over-quarter real GDP growth was revised upward to 1.3% from the 0.2% growth figure in the first QE. While foreign demand was revised downward, personal consumption and capital investment were revised upward, lifting the overall figure.

◆ Production in the manufacturing sector is fluctuating

In January, the Industrial Production Index increased by 2.2% month over month (MoM). Automobiles and plastic products were among the key drivers pushing up the overall figure.

According to the Industrial Production Index Forecast (adjusted based on past forecasting errors), near-future production plans indicate a decrease in output of 1.9% MoM in February. While sectors such as general-purpose and business-oriented machinery will push up the overall figure, output of such products as electronic parts and devices is expected to fall.

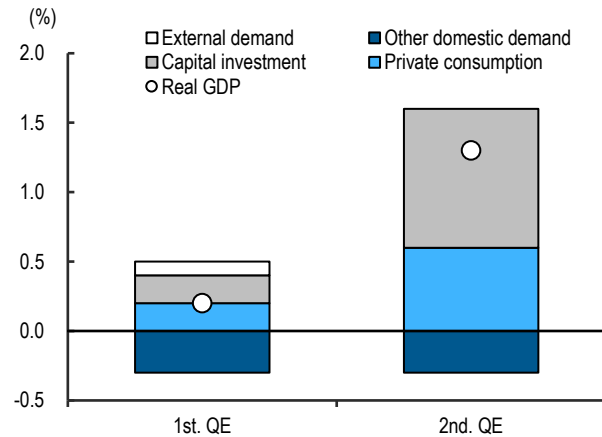
◆ Consumer confidence is improving

The Consumer Confidence Index for February increased significantly. Confidence related to overall livelihood and income growth rose against a backdrop of rising wages and slower price increases for items such as food.

◆ The number of foreign visitors to Japan is falling

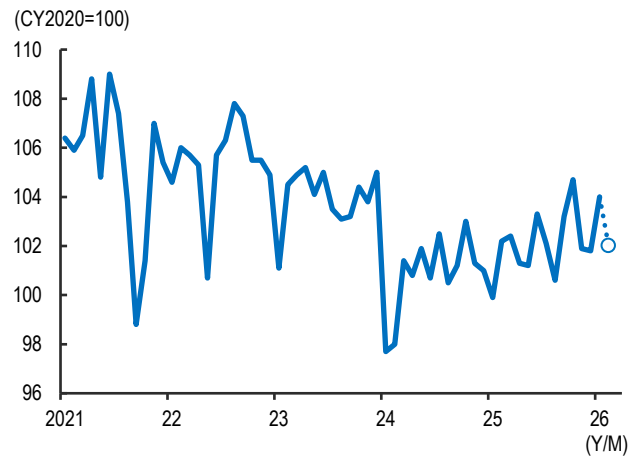
The number of foreign visitors to Japan dropped in January, marking the first year-over-year (YoY) decline since January 2022. By country, the number of foreign visitors from Western countries and Southeast Asia held steady, but the number of arrivals from China plunged 60%. Reasons for this include the Chinese government urging its citizens to refrain from visiting Japan and the fact that Chinese New Year fell in mid-February this year, later than usual.

Figure 2-1 Real GDP Growth Rate for Q4 2025 <YoY annual growth rate>



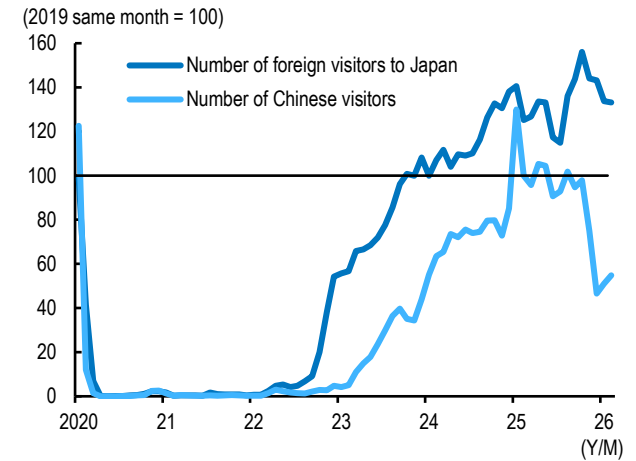
Source: Japan Research Institute, Ltd. based on data from the Cabinet Office

Figure 2-2 Industrial Production Index <seasonally adjusted>



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

Figure 2-3 Number of Foreign Visitors to Japan



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

Corporate earnings are increasing and capital investment is firm

◆ Corporate earnings are firm

Ordinary profit (all industries) for October-December 2025 rose YoY for the fifth consecutive quarter. Corporate earnings are being supported by lower variable costs due to such factors as declining energy prices, as well as solid net sales. Looking at net sales by sector, in non-manufacturing, the momentum of rising sales was maintained thanks to such factors as progress with price pass-through. In manufacturing, meanwhile, net sales are showing signs of bottoming out as the impact of Trump tariffs runs its course.

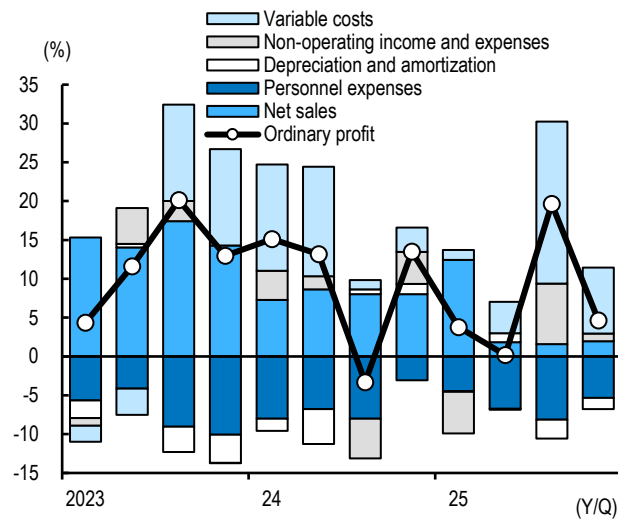
As for the near-term outlook, real wage growth is expected to turn positive in the January-March 2026 quarter, and higher personal consumption should push up net sales. However, if tensions in the Middle East persist and crude oil prices soar, there is also a risk that cost increases will put pressure on corporate earnings.

◆ Appetite for investment among companies is strong

Capital investment (including software investment) increased for the first time in two quarters. Software investment remains at a high level, and the momentum of machinery and construction investment is being maintained.

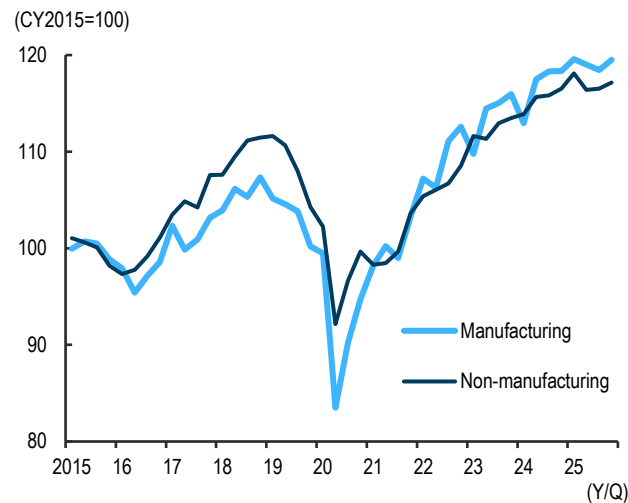
Capital investment is also expected to hold firm going forward. Companies are highly likely to remain eager to invest in software to address medium- to long-term challenges such as labor shortages and digital transformation. In addition, the share of ICT devices and intangible assets, which rapidly become obsolete, in total investment will expand, making it more likely that consumption of fixed capital will increase. As a result, investment demand associated with the replacement/upgrade of existing equipment will provide support to overall investment.

Figure 3-1 Factors Affecting Ordinary Profit <YoY>



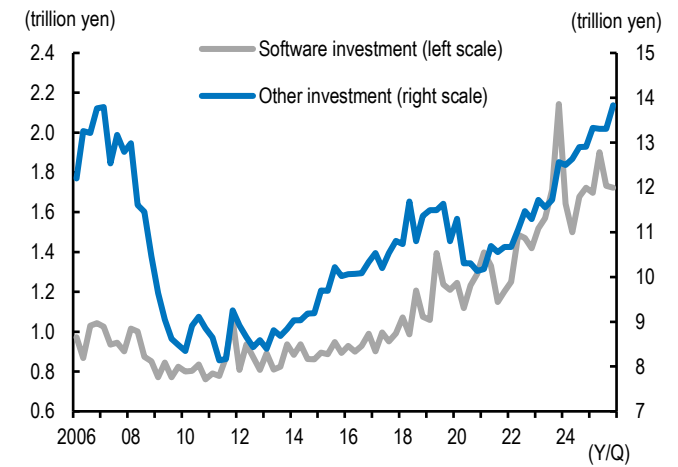
Source: Japan Research Institute, Ltd. based on data from the Ministry of Finance
Note: Firms of all sizes and in all industries apart from financial and insurance are included.

Figure 3-2 Net sales <all sizes, seasonally adjusted>



Source: Japan Research Institute, Ltd. based on data from the Ministry of Finance
Note: The non-manufacturing sector excludes financial and insurance.

Figure 3-3 Capital Investment by Corporate Enterprises



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 income situation for households is favorable

◆ High rates of wage increase will be realized

Wages are rising steadily. In January, basic salaries of ordinary workers increased by 3.2% YoY, and the hourly pay of part-time workers also climbed 3.7% YoY, so both figures saw fairly sharp rises.

Wage growth rates are expected to stay on the high side going forward. Like last year, substantial wage increases are also predicted to be delivered at this year's shunto (spring wage negotiations). According to a tally from RENGO (Japanese Trade Union Confederation), labor unions are demanding wage hikes of 5.94% on average, similar to the level they called for last year (6.09%). And partly because labor shortages are intensifying, companies are ready to become more aggressive in raising pay. According to a survey by Teikoku Databank, 63.5% of companies believe wages will improve in FY2026, marking the fifth straight year that this percentage has increased. Furthermore, 58.3%, a record-high figure, expect to raise base pay. It is therefore likely that the number of companies boosting base pay will climb, and that wage hikes will spread to encompass a broader range of workers.

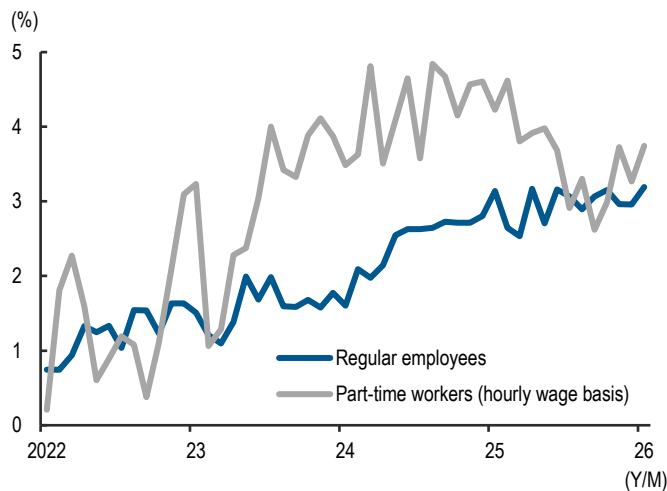
◆ Shored up by a favorable income environment, personal consumption is

recovering

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

Personal consumption is also expected to keep rising in the near term. The main reason is a recovery in real wages. With nominal wage growth continuing and inflation slowing, real wages look set to start rising soon. In addition, household asset income is increasing due to rising share prices and interest rates, and this, coupled with the wealth effect, is highly likely to provide a tailwind for consumption.

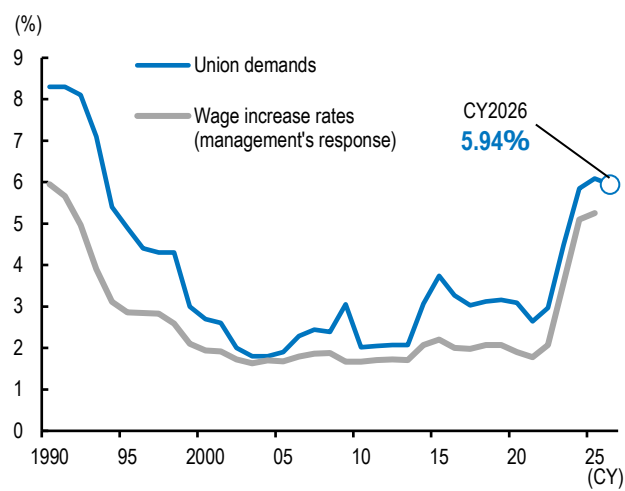
Figure 4-1 Basic Salaries <YoY>



Source: Japan Research Institute, Ltd. based on data from the Ministry of Health, Labour and Welfare

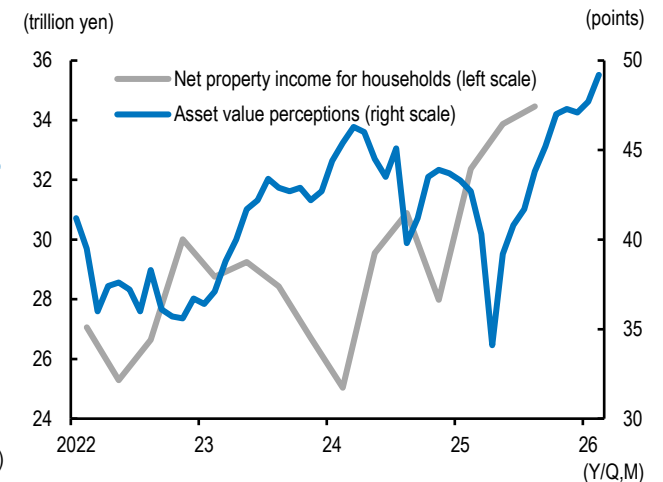
Note: Adjusted for data faults caused by the replacement of surveyed companies. However, the data for January 2026 has not yet been adjusted.

Figure 4-2 Rate of Wage Increases from Spring Negotiations and Union Demands



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.

Inflation is slowing, but the situation in the Middle East poses a risk

◆ All-items CPI increase dropped below 2% for the first time since 2022

In January, consumer price inflation (all items) fell to 1.5%, coming in below 2% for the first time since March 2022. Prices of fresh food fell as a reaction to the previous year's rises, and core consumer price inflation (all items, less fresh food and energy) slowed to 2.0% from the previous month (2.4%). The pace of energy price growth slowed due to government measures to curb inflation, and the rapid rise of food prices also moderated.

Price growth is expected to slow until the middle of this year and then remain around 2%. Food price inflation should continue to moderate as the prices of ingredients stabilize.

However, rising tensions in the Middle East pose the risk of soaring energy prices. If the military confrontation between the U.S. and Iran is resolved quickly, any uptick in the inflation rate will be limited, but if it drags on, the fear is that crude oil prices will rise significantly and inflation will flare up again.

◆ The BOJ will continue to raise interest rates in phases

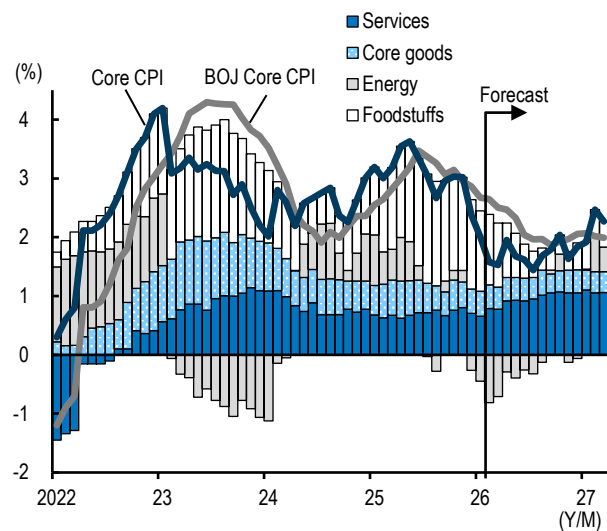
At its monetary policy meeting in January, the Bank of Japan (BOJ) decided to

keep its policy rate at 0.75%.

The rise in long-term interest rates has halted. As background factors, the LDP's landslide victory in the lower-house election has eased concerns about political instability, and expectations of an early BOJ interest rate hike have receded.

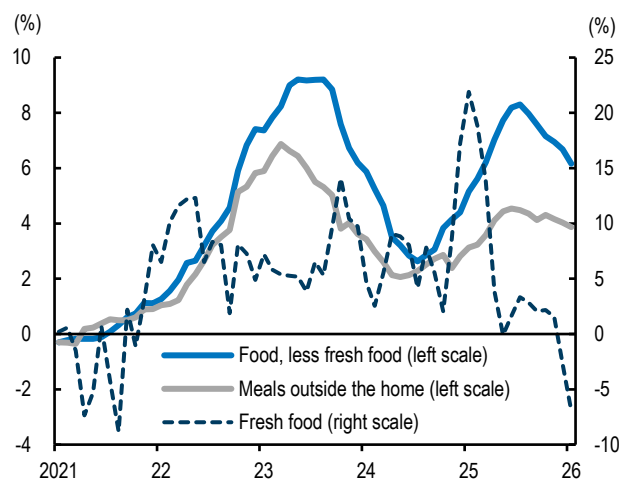
It is highly likely that the BOJ will continue to raise interest rates in stages while closely monitoring the impact on the real economy and financial/capital markets. The next rate hike is expected to be in July. Long-term interest rates look likely to rise gradually, reflecting heightened anticipation 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>



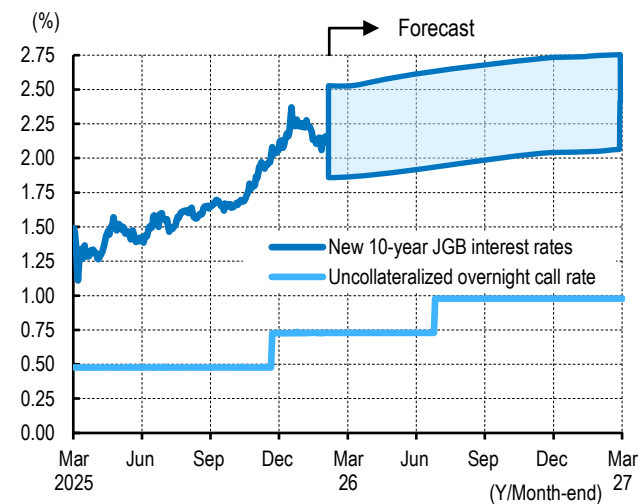
Source: Japan Research Institute, Ltd. based on data from the Ministry of Internal Affairs and Communications

Figure 5-2 Consumer Price of 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: Intensifying headwinds to Japan's economy from rising oil prices

◆ Higher oil prices to push up inflation

The armed conflict between Iran and the U.S. has driven crude oil prices higher. Under our baseline assumptions, if the clash is short-lived, upward pressure on oil prices will subside quickly, but if it is prolonged, there is a risk that the prices could remain elevated at above \$100 per barrel.

Estimating the impact of higher crude oil prices on Japan's economy, the swift resolution scenario would cause only a limited rise in inflation. Under the prolonged scenario, however, Japan's inflation rate for FY2026 would be pushed up by 0.94 percentage points, while GDP would deteriorate by 0.3 percentage points. Japan's real wages, which have only just begun to turn upward on the back of improved terms of trade, would likely fall again.

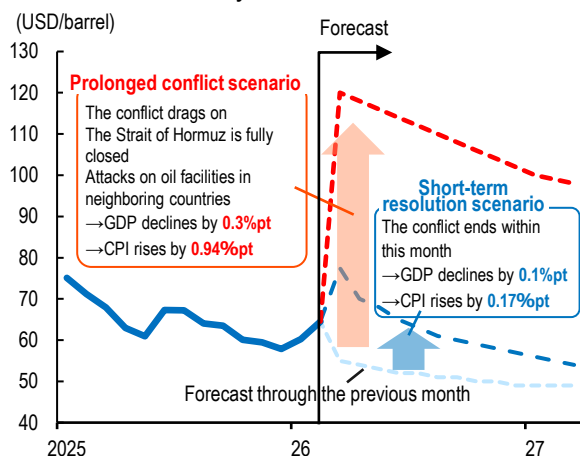
◆ Possibility of government measures to support households

Should high oil prices persist, the government may compile a supplementary budget to curb energy prices. If subsidies are used to suppress electricity and gas bills in order to prevent an overall rise in prices, expenditures of approximately 3–4

trillion yen would be required in FY2026. The cost would exceed even the inflation-relief measures included by the Takaichi government in the FY2025 supplementary budget, which lacked permanent funding sources.

Under a policy of "responsible and proactive public finances," any effort to restrain new bond issuance would force cuts in spending elsewhere, potentially making fiscal management even more challenging for the Japanese government.

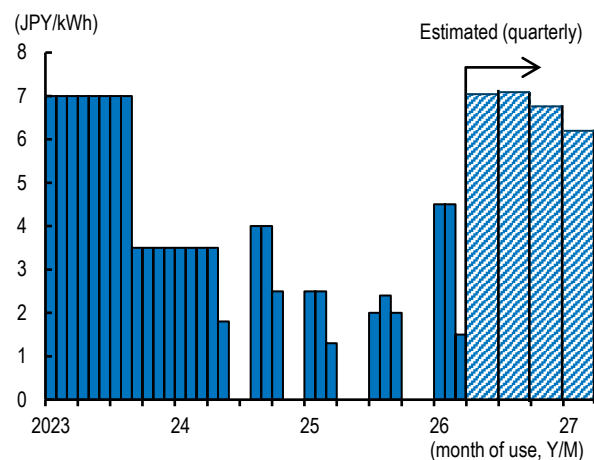
Figure 6-1 WTI Crude Oil Futures Price Scenarios and Their Impact on the Japanese Economy



Source: Japan Research Institute, Ltd. based on data from Macrobond and Nikkei NEEDS

Note: Estimates based on the NEEDS Japanese Economic Model. CPI is the all-items index excluding fresh food.

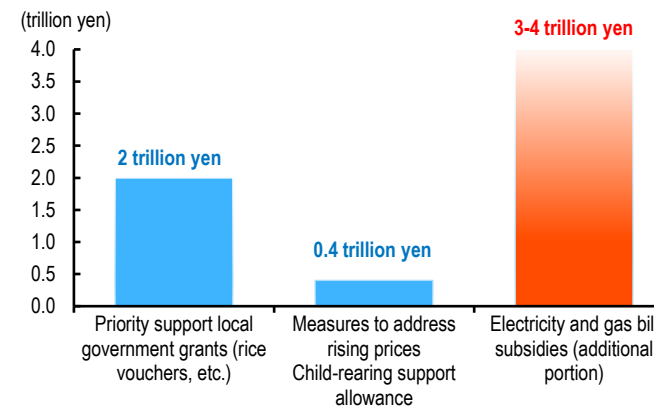
Figure 6-2 Amount of Electricity Bill Subsidy



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

Note: Based on past trends, the subsidy amount per cubic meter of gas is estimated at four times the subsidy amount per kWh of electricity, to calculate a subsidy sufficient to offset the upward pressure on core CPI caused by rising crude oil prices. The resumption of gasoline subsidies is not assumed.

Figure 6-3 Temporary Economic Measures by the Takaichi Administration



Source: Japan Research Institute, Ltd. based on data from the Cabinet Office and the Agency for Children and Families

Note: The priority support grants for local governments and the child-rearing support allowance are based on the FY2025 supplementary budget (general account basis). The required funding for electricity and gas bill subsidies was calculated based on the relationship between the scale of previous subsidies and their budgets.

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Topic②: Rising rents driving widening household inequality

◆ Conditions are becoming more conducive to rent increases

Rents in Japan are rising. In addition to supply-side factors such as soaring construction and renovation costs, weakening homeownership aspirations among the working-age population are also pushing rents higher from the demand side. According to the Ministry of Internal Affairs and Communications' Housing and Land Survey, homeownership rates among middle-aged and older households have declined.

Looking ahead, structural factors, such as 1) population inflows into urban areas where housing prices have risen sharply and 2) an increase in single-person households, may further reduce homeownership rates and exert upward pressure on rents.

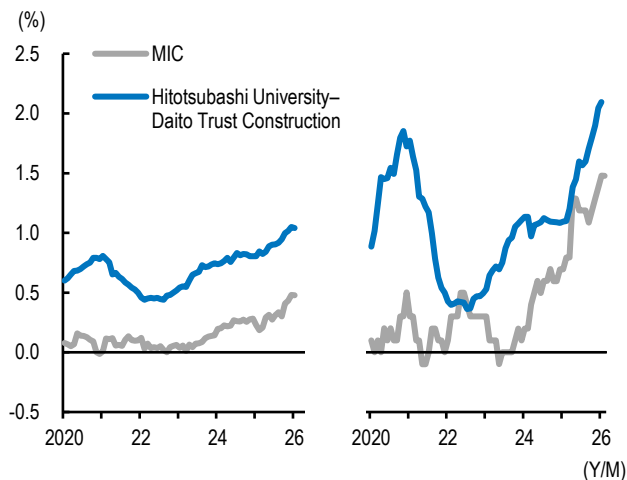
◆ Inter- and intra-generational disparities are being exacerbated

The burden of rising rents is deepening both inter- and intra-generational inequality. From an inter-generational perspective, the burden will be limited for elderly households, for whom the homeownership rate is high, whereas middle-aged, older, and younger households, for whom homeownership rates are lower, will be unable to avoid additional costs. Since rents are often revised when new contracts are signed

or current ones are renewed, younger households, who need to relocate more frequently as their lifestyles change, may face a particularly sharp increase in housing costs.

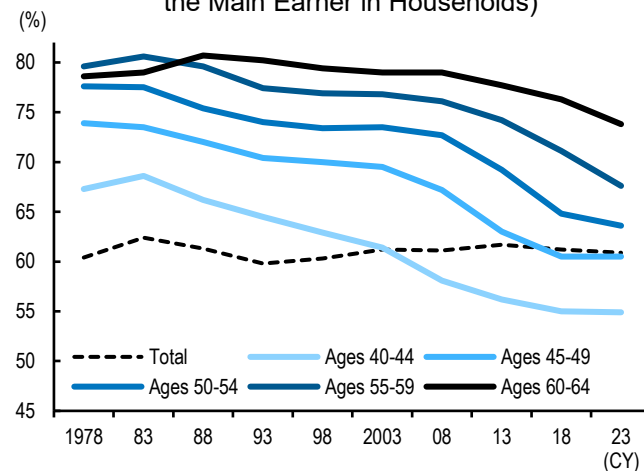
As for intra-generational inequality, the burden will be felt most by lower-income households. For these households, housing typically accounts for a large share of disposable income. If rents continue to rise, such disparities could widen further. While homeowning households see their housing costs reduced after paying off their mortgages, renting households are confronted with a mounting burden during periods of rent increases, raising the prospect that the gap in housing cost burden between these two groups will widen further.

Figure 7-1 CPI Rent Index <YoY>



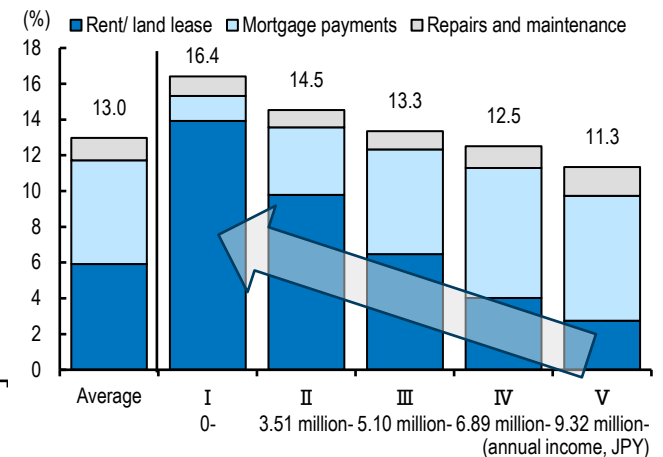
Source: Japan Research Institute, Ltd. based on data from the Ministry of Internal Affairs and Communications, Hitotsubashi University, and Daito Trust Construction
 Note: The "Hitotsubashi University-Daito Trust Construction CPI-style Rent Index" utilizes data from Daito Trust Construction and has a larger sample size compared to the Ministry of Internal Affairs and Communications' CPI.

Figure 7-2 Homeownership Rate (by Age of the Main Earner in Households)



Source: Japan Research Institute, Ltd. based on data from the Ministry of Internal Affairs and Communications
 Note: The Housing and Land Survey is conducted every five years.

Figure 7-3 Share of Housing Costs in Disposable Income (by Annual Income Quintile)



Source: Japan Research Institute, Ltd. based on data from the Ministry of Internal Affairs and Communications
 Note: Based on the income and expenditure of working-class households in October and November 2024.

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. Foreign demand will lack strength, but 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. And 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.

Foreign 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 foreign 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 1.0% in FY2025 and 0.9% 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 external factors, if tensions in the Middle East persist and crude oil prices soar, Japan's income will flow abroad.

Figure 8 Projections for Japan's GDP Growth and Main Indicators (as of March 10, 2026)

	CY2025	(seasonally adjusted, annualized % changes from the previous quarter)									(% changes from the previous fiscal year)		
		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	(Projection)	(Projection)
(Actual)	(Projection)										(Projection)		
Real GDP	1.3	1.3	1.3	1.0	1.0	0.9	0.8	0.7	0.7	0.7	1.0	0.9	0.8
Private Consumption Expenditure	1.1	1.2	1.0	0.7	0.6	0.6	0.6	0.5	0.5	0.5	1.5	1.0	0.5
Housing Investment	21.0	1.1	0.6	0.0	-0.1	-0.3	-0.4	-0.5	-0.5	-0.5	-3.6	0.5	-0.4
Business Fixed Investment	5.4	2.0	1.8	1.7	1.7	1.6	1.6	1.5	1.5	1.4	2.3	2.1	1.6
Private Inventories (percentage points contribution)	(-1.0)	(0.1)	(0.0)	(-0.0)	(-0.0)	(-0.0)	(-0.0)	(-0.0)	(-0.0)	(-0.0)	(-0.0)	(-0.2)	(-0.0)
Government Consumption Expenditure	1.5	0.9	1.0	1.1	1.1	1.1	1.0	1.0	1.0	1.0	0.8	1.0	1.0
Public Investment	-2.0	0.9	1.0	1.1	1.2	1.2	1.2	1.2	1.2	1.2	-1.1	0.4	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)	(-0.1)
Exports of Goods and Services	-1.4	-0.2	1.4	1.3	1.6	1.7	1.8	1.8	1.8	1.8	1.9	0.3	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	2.8	1.3	1.9

	(% changes from the same quarter of the previous year)										(% changes from the previous fiscal year)		
Nominal GDP	3.9	2.9	2.1	2.9	3.0	3.9	3.9	4.0	3.2	3.5	4.1	3.0	3.6
GDP deflator	3.4	1.9	1.8	1.7	2.1	2.9	3.0	3.2	2.5	2.7	3.0	2.1	2.8
Consumer Price Index (excluding fresh food)	2.8	1.7	1.8	1.6	1.8	2.2	1.8	1.7	1.5	1.8	2.7	1.9	1.7
Unemployment Rate (%)	2.6	2.7	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Exchange Rates (JY/US\$)	154	156	154	152	153	151	149	150	148	146	151	153	148
Import Price of Crude Oil (US\$/barrel)	71	68	78	69	65	62	59	56	56	56	72	68	57

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.