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Monthly Report of Prospects for Japan's Economy

May 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 has stopped falling. The leading index is picking up.

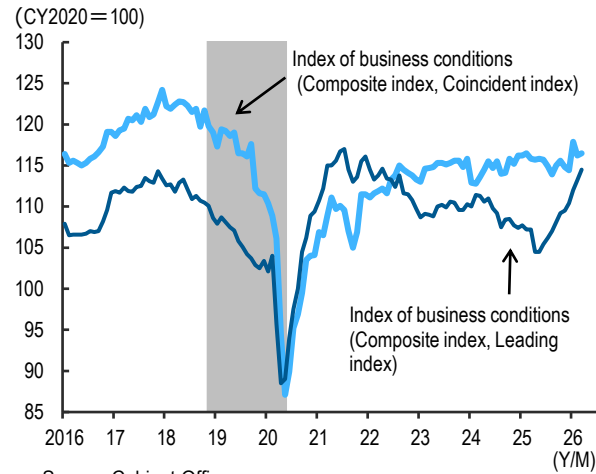


Figure 1-2 The Corporate Sector

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

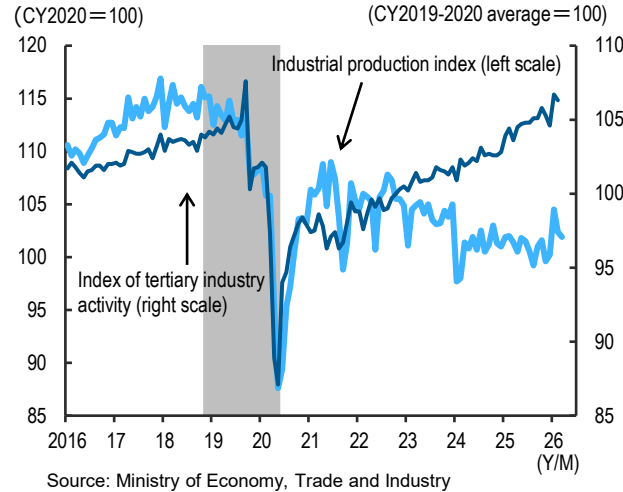


Figure 1-3 External Demand

Exports, particularly to Europe and Asia, are picking up. Imports are fairly flat overall.

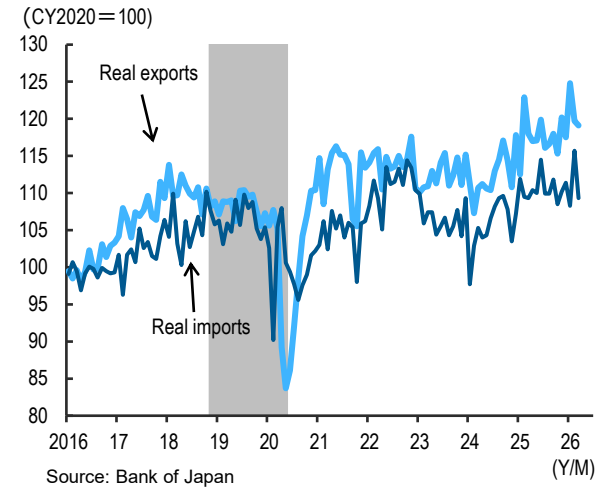


Figure 1-4 Employment and Income

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

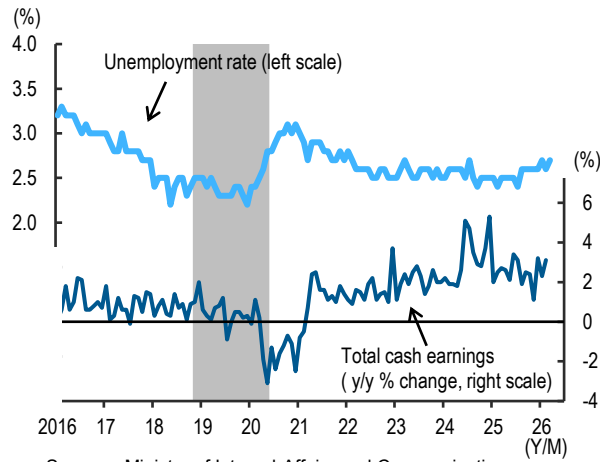


Figure 1-5 The Household Sector

Consumption is holding firm. Housing starts are weak.

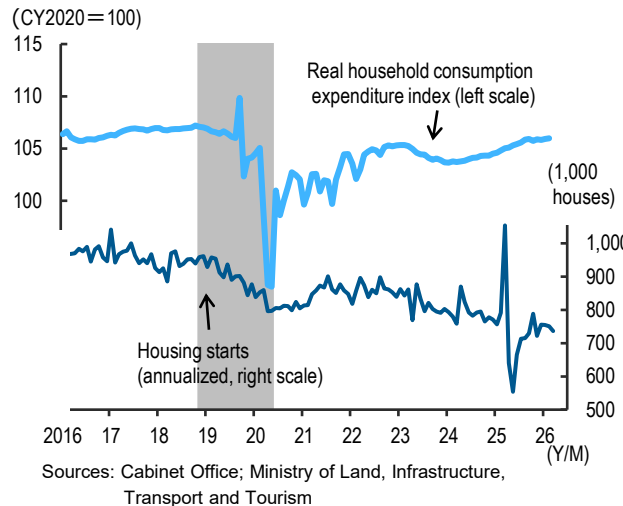
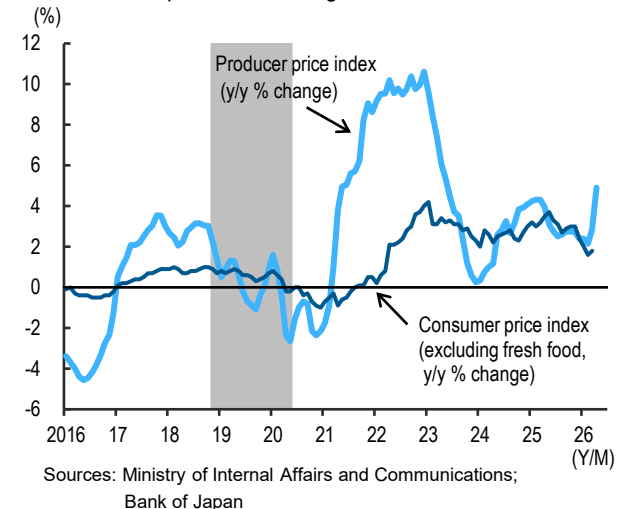


Figure 1-6 Prices

Producer price inflation has rebounded as oil prices rise. Consumer prices are slowing.



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

Annualized real GDP growth was +2.1% quarter over quarter (QoQ) in Q1 2026

◆ Exports and personal consumption are boosting GDP

Annualized real GDP growth in the first quarter was +2.1% QoQ, with growth staying in positive territory for two straight quarters. A pick-up in exports and robust personal consumption boosted the growth rate.

◆ Production in the manufacturing sector is fluctuating

In March, the Industrial Production Index decreased by 0.5% month over month (MoM). Output of transportation machinery rose, but against the backdrop of the crisis in the Middle East, production overall dropped as companies adjusted output due to concerns about the procurement of oil-related raw materials, with the decline centered on the chemicals industry.

According to the Industrial Production Index Forecast (adjusted based on past forecasting errors), near-future production plans indicate a decrease in output of 0.7% MoM in April. This projection reflects the ongoing slump in chemicals production due to the Middle East crisis.

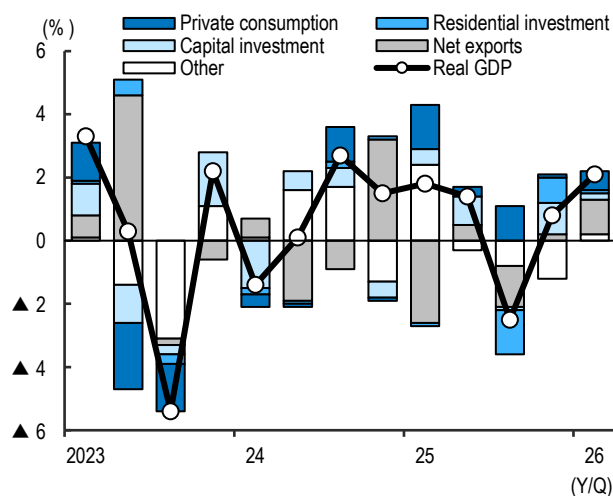
◆ Machinery orders are strong

According to statistics on machinery orders from the Cabinet Office, February saw private-sector machinery orders (excluding those for ships and those from electric power companies), which are regarded as a leading indicator, jump 13.6% MoM. This was because manufacturers enjoyed a flood of large-scale orders, and another factor behind the rise was companies' enthusiasm for investment for strengthening competitiveness in the AI space, achieving labor saving, and pursuing digital transformation.

◆ The number of foreign visitors to Japan remains firm despite weakness in some areas

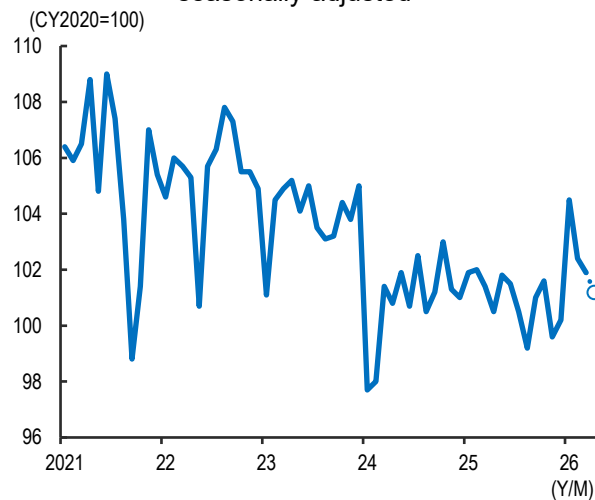
The number of foreign travelers to Japan in March was 3.5% higher than a year earlier, and the highest ever for March. Although the number of people from China visiting Japan is down due to the impact of the Chinese government urging its citizens to refrain from doing so, travelers from seven countries, including the U.S. and Vietnam, reached record highs as a result of such factors as the Easter holidays and the weakness of the yen.

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



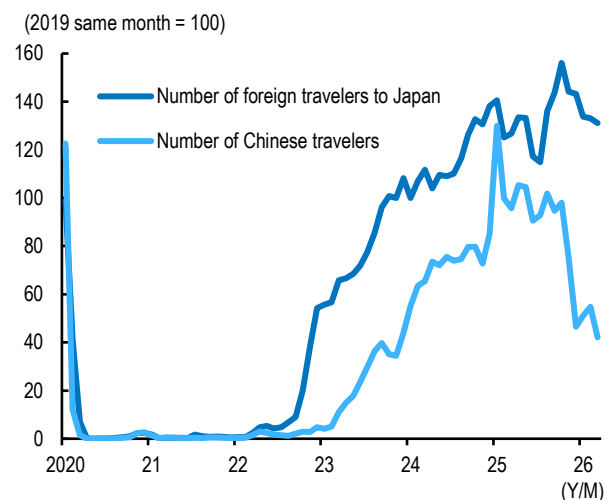
Source: Japan Research Institute, Ltd. based on data from the Cabinet Office

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 (Apr) calculated by the Ministry of Economy, Trade and Industry based on past adjustment patterns.

Figure 2-2 Number of Foreign Travelers to Japan



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

Turmoil in the Middle East is weighing on corporate activity

◆ The growth in exports has slowed

Exports are continuing to increase gradually overall. Recently, exports to most destinations, including the U.S. and Asia, have been firm. However, with the effective closure of the Strait of Hormuz, exports to the Middle East, particularly auto exports, are half what they were a year ago.

Going forward, this export weakness is expected to spread to encompass other destination regions. Because of the prolonged turmoil in the Middle East, the world economy will likely experience a near-term slowdown, which will weigh on exports.

◆ Constraints on production activity are intensifying

The turmoil in the Middle East is expected to constrain corporate production activities via two channels on the import side.

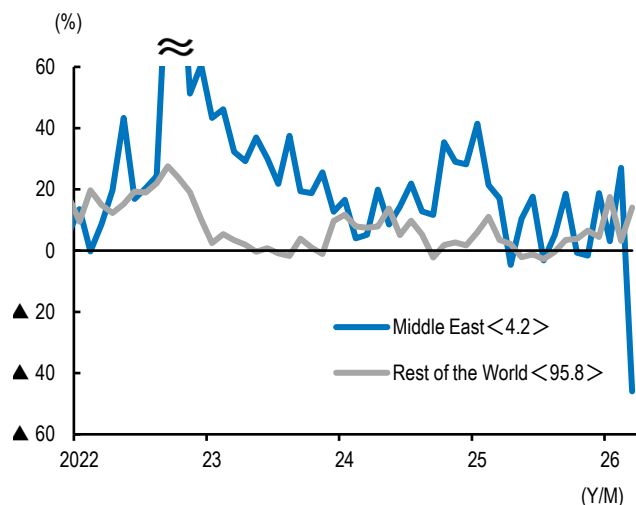
The first is rising import costs. With crude oil prices surging and ocean freight rates increasing, import prices are projected to rise significantly. This could squeeze profits across a wide range of industries.

The second is difficulties in procuring raw materials. Although petroleum reserves are being released, the supply of crude oil-derived raw materials such as naphtha

has stalled in some areas, curtailing production of goods. A wide range of chemical products, including plastics, rubber, and paints, are in short supply, affecting a swathe of industries such as construction and automobiles. If such disruptions persist, more and more companies may face supply constraints, raising the risk of further stagnation in production activity.

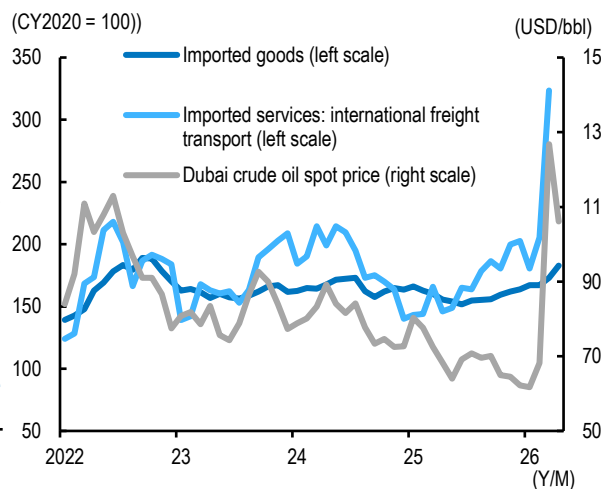
According to estimates, in the worst-case scenario, where fossil fuel imports from the Middle East are cut off, Japan's GDP would be pushed down by roughly 16 trillion yen. The negative impact would be particularly severe in the chemical sector, but essential service industries such as transportation, electricity, and healthcare could also be significantly impacted.

Figure 3-1 Regional Export Growth <Nominal, YoY>



Source: Japan Research Institute, Ltd. based on data from the Ministry of Finance
Note: Figures in angle brackets represent the share of customs-cleared exports.

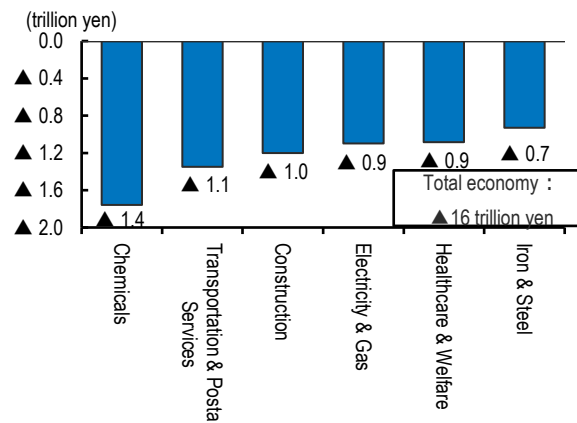
Figure 3-2 Corporate Import Price Index



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

Note: Price index is denominated in yen.

Figure 3-3 Impact of Middle Eastern Resource Disruption on Major Industries



Source: Japan Research Institute, Ltd. based on data from Sano • Nagamachi [2022]
「A Proposed framework for Analyzing the Impact of Supply Shocks on Production and Employment」 RIETI Policy Discussion Paper Series 22-P-008, the Ministry of Internal Affairs and Communications and the Ministry of Finance

Note: Value-added loss assuming a complete disruption of crude oil, natural gas and coal exports from the Middle East, with petroleum reserves and natural gas inventories exhausted. Chemicals include chemical products, plastic products and rubber products.

The household sector will avoid a sharp deterioration despite higher oil prices

◆ Downward pressure on consumption is so far limited

Personal consumption is gradually increasing. Although consumer confidence has deteriorated due to concerns about price increases stemming from higher oil prices, consumption is being supported by government subsidies to curb energy prices and by a recovery in real incomes driven by rising wages.

Personal consumption continued to rise in April and beyond. New vehicle registrations in April jumped from the previous month, partly due to the abolition of the environmental performance tax on automobiles. In addition, household spending on travel remained firm during the Golden Week period from late April to early May as the consecutive national holidays fell straight after the weekend on the calendar.

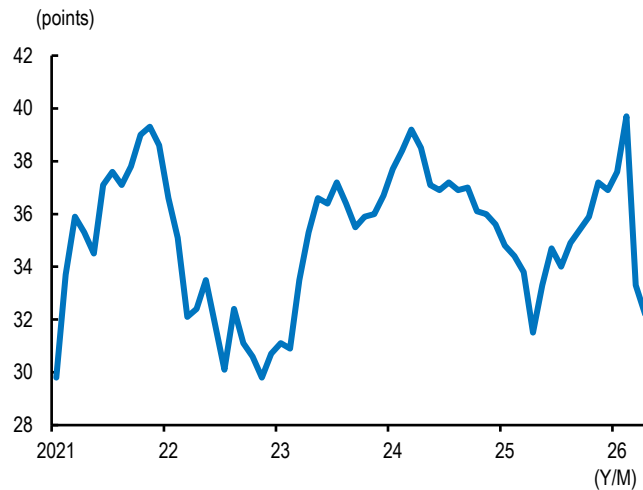
Passenger numbers on the Shinkansen, limited express trains, and domestic flights during the holidays exceeded those of the previous year, when the Osaka-Kansai Expo was taking place, and highway traffic volumes were roughly on par with the year before.

◆ Personal consumption is expected to remain resilient

Personal consumption should also hold firm going forward. Rates of wage increases

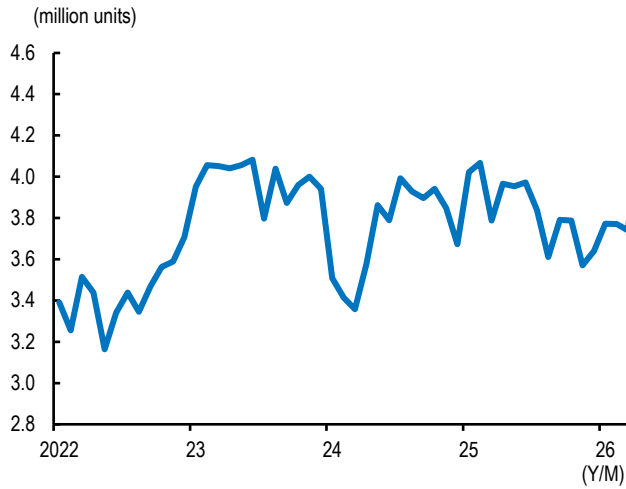
agreed at the 2026 shunto (spring wage negotiations) were high. Because these wage hikes will take effect toward the summer, wage increases will highly likely be on par with the previous year. Inflationary pressure should ease somewhat thanks to energy subsidies from the government, so a significant decline in real incomes is expected to be avoided.

Figure 4-1 Consumer Confidence Index
<seasonally adjusted>



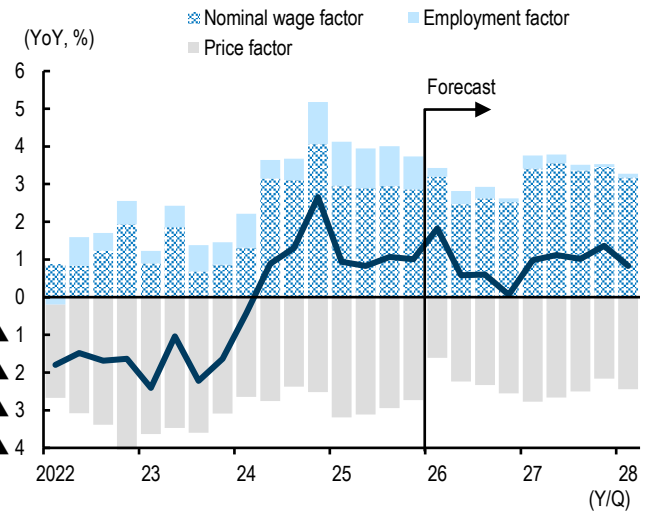
Source: Japan Research Institute, Ltd. based on data from the Cabinet Office
Note: Households with two or more persons.

Figure 4-2 New Vehicle Registrations
<seasonally adjusted>



Source: Japan Research Institute, Ltd. based on data from National Federation of Light Motor vehicle Associations and Japan Automobile Dealers Associations
Note: Total of light passenger Vehicles, small passenger vehicles and standard passenger vehicles.

Figure 4-3 Outlook for Real Total Employee Income



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

Inflation is slowing

◆ Energy prices are pushing down inflation

In March, core inflation (all items, less fresh food) was 1.8%, dropping below 2% for the second straight month. The pace of energy price growth slowed due to government measures to curb inflation, and the rapid rise of prices of rice and other foods also moderated.

Inflation looks set to quicken to the upper half of the 2% range going into the second half of 2026, and then remain around 2%. While some companies are expected to pass on higher wages and higher raw material costs resulting from elevated oil prices to their selling prices, energy subsidies from the government are likely to ease inflationary pressure.

That said, if the Middle East turmoil persists for an extended period, there is a risk that the government may be unable to adequately contain price increases, resulting in a significant rise in the inflation rate.

◆ The Bank of Japan is exercising caution about when to raise interest rates

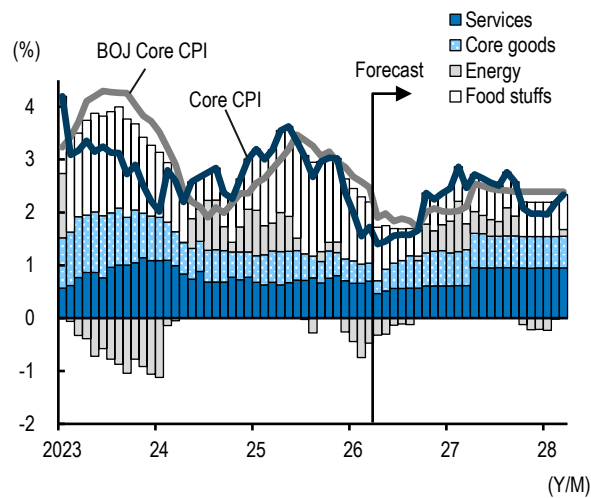
At its monetary policy meeting in April, the Bank of Japan (BOJ) decided to

keep its policy rate at 0.75%.

Long-term interest rates have risen. This reflects a strengthening of the view that surging oil prices could lead to an expansion of government expenditure, as well as continued expectations for a rate hike by the BOJ.

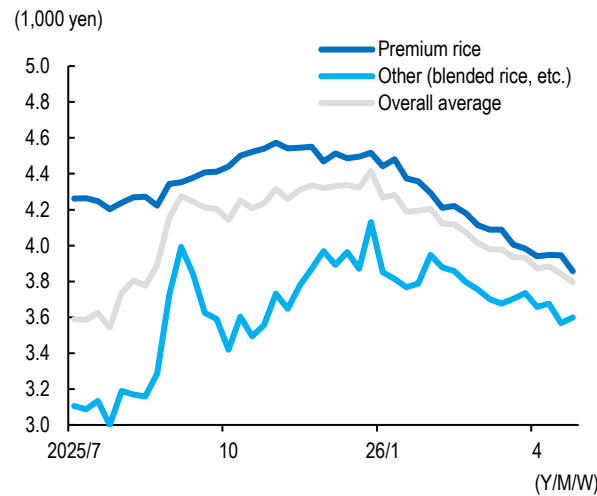
It is highly likely that the BOJ will continue to raise interest rates in stages while closely monitoring the impact of the Middle East crisis on the real economy and financial/capital markets. The next rate hike is expected to be in June. Long-term interest rates look likely to rise gradually, reflecting heightened anticipation of rate hikes by the BOJ and increased fiscal spending by the government. If jitters about a deterioration in fiscal discipline resulting from such measures as energy subsidies or consumption tax cuts take hold, there is also a risk that long-term interest rates will rise.

Figure 5-1 Consumer Price Index <YoY>



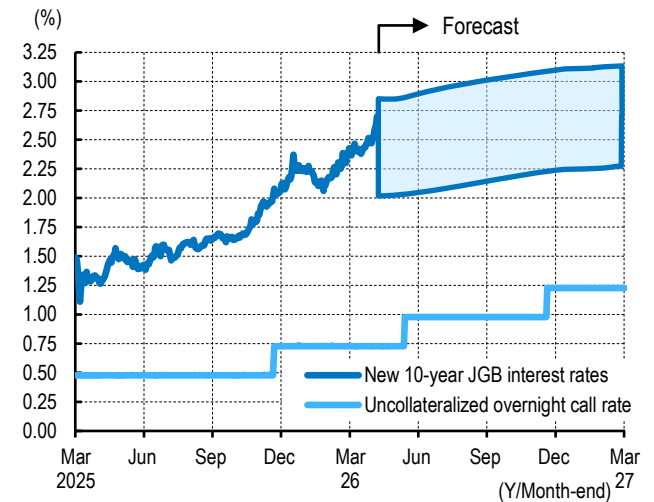
Source: Japan Research Institute, Ltd. based on data from the Ministry of Internal Affairs and Communications

Figure 5-2 Retail Price of Rice



Source: Japan Research Institute, Ltd. based on data from the Ministry of Agriculture, Forestry and Fisheries

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



Source: NEEDS-FinancialQUEST

Topic ①: Gap between the Nikkei Stock Average and the TOPIX is widening

◆ The N/T ratio has risen sharply

The Nikkei Stock Average has surpassed 60,000 yen, reaching another all-time high. Meanwhile, the rise in the TOPIX, which covers all the shares listed on the TSE Prime Market, has lagged behind the Nikkei. As a result, the N/T ratio (Nikkei divided by TOPIX), which expresses the divergence between the Nikkei and TOPIX, has increased significantly since last year. There are two main reasons for this:

◆ Earnings and investment inflows are concentrated in specific stocks

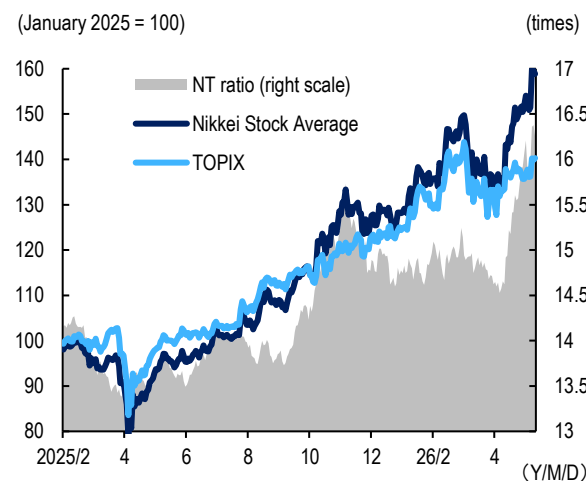
The first is the uneven distribution of earnings growth. A breakdown of the change in the N/T ratio into its component factors reveals that differences in EPS (earnings per share) have been a particularly big contributor to its ascent. Since the COVID-19 pandemic, accelerated global digital investment and the diffusion of generative AI have created extremely favorable business conditions for companies in sectors such as semiconductors, electronic products, and manufacturing equipment. The Nikkei includes many firms that are highly competitive in such fields, which has pushed up the overall EPS of the index. This contrasts with the TOPIX, which comprises a

broad range of domestic-demand-oriented companies and small/mid-cap firms, whose profits are more susceptible to the burden of rising labor and energy costs.

The second reason is the concentration of investment flows into issues such as semiconductor-related stocks. Because the Nikkei is a price-weighted index, it is more sensitive to movements in high-priced stocks. Comparing the index weights of three AI-related large-cap, highly liquid stocks, their combined weight is only about 6% in the TOPIX but roughly 30% in the Nikkei, around five times larger. Capital inflows into such stocks have pushed up their prices, contributing to the rise in the N/T ratio via P/E factors.

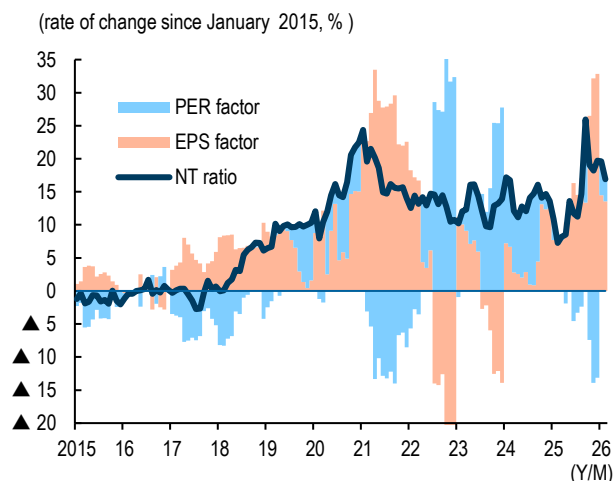
Given the above reasons, the increase in the N/T ratio reflects a structure whereby earnings and investment capital are concentrated in a limited number of large corporations. It must therefore be noted that the Nikkei's record-high level does not necessarily imply uniform strength across Japanese companies as a whole.

Figure 6-1 Trends in Nikkei Stock Average, Topix and NT Ratio



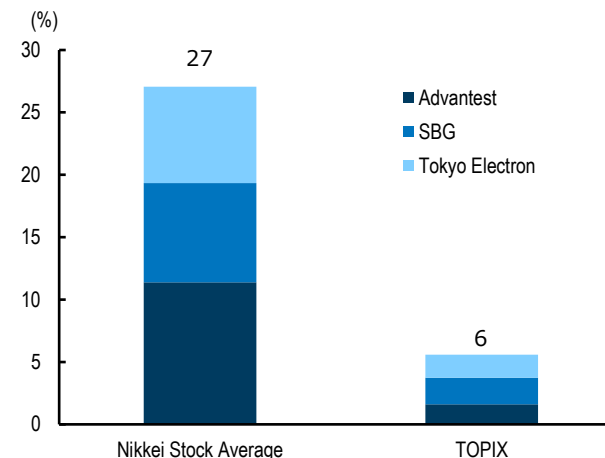
Source: Japan Research Institute, Ltd. based on data from Nikkei NEEDS
Note: NT ratio = Nikkei Stock Average ÷ TOPIX.

Figure 6-2 Rate of Change in the NT Ratio



Source: Japan Research Institute, Ltd. based on data from Bloomberg L.P.
Note: Stock prices are calculated based on the relationship: EPS (earnings per share) × PER (price-earnings ratio). Earnings used for EPS and PER are based on actual results.

Figure 6-3 Index Weight



Source: Japan Research Institute, Ltd. based on data from Bloomberg L.P.
Note: As of May 14, 2026.

Topic②: Earnings of U.S. subsidiaries of Japanese firms stay solid even under Trump tariffs

◆ Performance of U.S. subsidiaries is demonstrating resilience

The financial performance of Japanese companies' U.S. subsidiaries has remained solid. According to a survey by the Japan External Trade Organization (JETRO), the earnings environment for Japanese firms operating in the U.S. in 2025 stayed as favorable as the previous year. When the Trump tariffs were implemented in around spring 2025, there were concerns that 1) a slowdown in the U.S. economy and 2) higher procurement costs for imported raw materials would hurt local subsidiaries' earnings. However, at this point, no major negative impact has been observed. There are two main reasons for this:

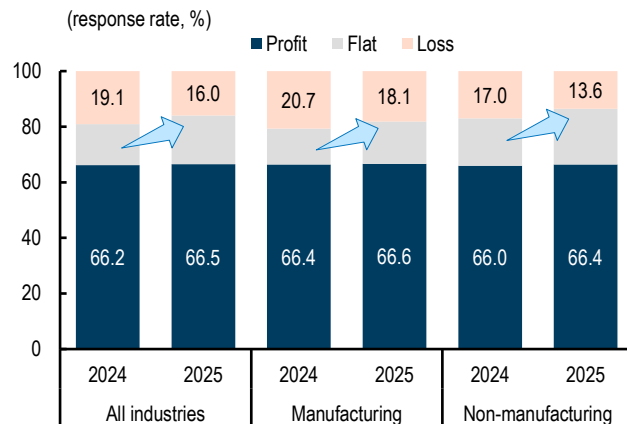
◆ Contributors have been robust U.S. consumption and adjustments to margins

The first is higher sales. According to the Ministry of Economy, Trade and Industry's Quarterly Survey of Overseas Subsidiaries, sales (in USD terms) of Japanese subsidiaries in North America have maintained strong momentum, growing by 3.7% year over year (YoY) in April–June 2025 and 6.5% in July–September 2025. Behind this is robust U.S. consumer spending. Supported by the wealth effect of rising stock prices, expenditure by high-income households has been driving overall

demand. For example, Japanese automakers have seen increased sales of higher-priced models such as hybrids, SUVs, and large vehicles.

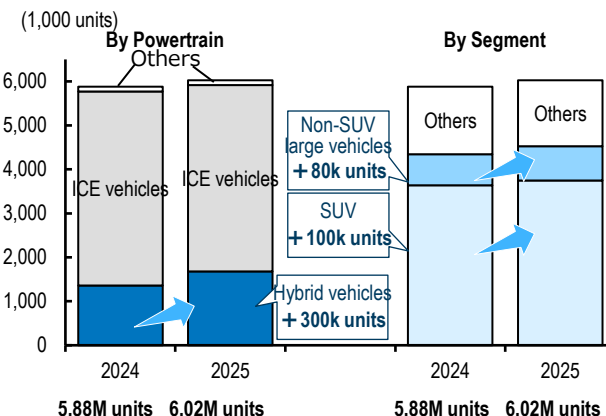
The second reason is that for some subsidiaries, their Japanese parent companies may be absorbing tariff impacts through cost adjustments. After the tariff hikes, prices of Japan's exports to the U.S. declined. Later, the tariff deal reached in summer 2025 brought an end to the wait-and-see period, yet while some firms moved to restore export prices back, others kept prices at the reduced levels. Since tariffs are generally calculated based on import prices, part of the tariff burden may have been shifted to Japanese parents through margin adjustments. While such measures must remain within the limits permitted under transfer pricing rules, they may be contributing to stabilizing the earnings of U.S. subsidiaries.

Figure 7-1 Operating Profit Outlook for Japanese Companies in the U.S.



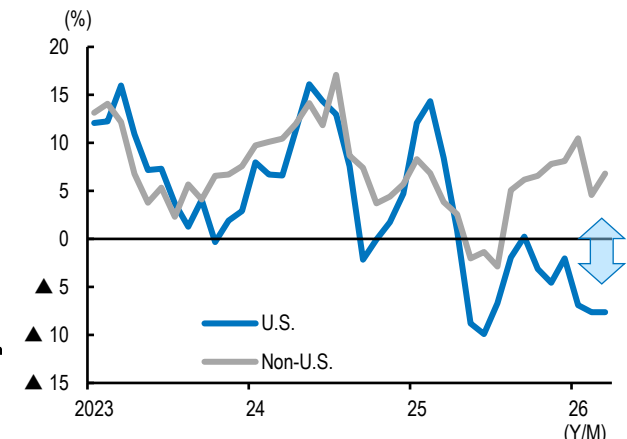
Source: Japan Research Institute, Ltd. based on data from the Cabinet Office
Note: Survey as of September each year. Covers Japanese companies in the U.S., including subsidiaries with 10% or more Japanese ownership and branches of Japanese firms.

Figure 7-2 Sales Volume of Japanese Automakers in the U.S.



Source: Japan Research Institute, Ltd. based on data from Marklines
Note: Hybrid vehicles are defined as the sum of HV, MHV and PHV. Large vehicles are defined as the sum of segments E and F, minivans and pickup trucks. The data cover passenger cars and light trucks of Toyota, Honda, Nissan, Subaru, Mazda, Mitsubishi and Isuzu.

Figure 7-3 Export Price index (YoY)



Source: Japan Research Institute, Ltd. based on data from the Ministry of Finance
Note: "Non-U.S." is calculated as a simple estimate using the U.S. share of customs export value in each year.

The pace of economic recovery will slow due to high oil prices

◆ Higher oil prices are putting downward pressure on the corporate sector

The pace of Japan's economic recovery is expected to slow in the near term due to the impact of higher crude oil prices. The conflict in the Middle East should subside before the summer, with WTI crude oil futures prices hovering around \$100 before gradually declining.

The corporate sector will weigh on the economy. Although investment demand to address medium- to long-term challenges such as labor saving and digital transformation will hold steady, goods exports are expected to weaken as surging oil prices put downward pressure on national economies, particularly in Asia. Some companies may also face production constraints due to shortages of raw materials.

The dampening effect of higher oil prices on global economic activity, combined with rising fuel costs, is also expected to suppress inbound tourism demand. Coupled with the slump in Chinese visitors to Japan amid deteriorating Japan-China relations, growth in service exports is projected to slow.

The household sector, however, should remain resilient. The government looks set to ease oil price-driven inflationary pressure through measures such as energy subsidies. With high rates of wage growth continuing, a significant decline in real incomes is likely to be avoided.

◆ Middle East tensions pose downside risks

Real GDP growth is projected to remain solid, registering +0.5% in FY2026 and

+0.8% in FY2027.

That said, if tensions in the Middle East persist for an extended period, crude oil prices could rise further. This would intensify downward pressure on the corporate sector, and there is a risk that the government may be unable to fully mitigate the increased burden on households, leading to personal consumption being significantly squeezed. Furthermore, if constraints on the supply of oil and related products tighten, a wide range of industries could be forced to curtail production, posing the risk of a significant economic downturn.

Figure 8 Projections for Japan's GDP Growth and Main Indicators (as of May 19, 2026)

	(seasonally adjusted, annualized % changes from the previous quarter)										(% changes from the previous fiscal year)		
		CY2026				CY2027				CY2028	FY2025	FY2026	FY2026
	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Projection)			
	(Projection)										(Projection)		
Real GDP	2.1	0.5	0.6	0.7	1.0	0.9	0.9	0.9	0.9	0.9	0.8	0.5	0.8
Private Consumption Expenditure	1.1	0.9	0.7	0.4	0.6	0.6	0.6	0.6	0.6	0.6	1.2	0.8	0.6
Housing Investment	2.1	0.6	0.0	-0.1	-0.3	-0.4	-0.5	-0.5	-0.5	-0.5	-3.5	0.8	-0.4
Business Fixed Investment	1.1	1.6	1.6	1.6	1.5	1.5	1.4	1.4	1.3	1.3	2.4	1.9	1.5
Private Inventories (percentage points contribution)	(-0.2)	(-0.8)	(-0.4)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(-0.1)	(-0.5)	(0.1)
Government Consumption Expenditure	0.4	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.8	0.8	0.8
Public Investment	5.7	1.0	1.1	1.2	1.2	1.2	1.2	1.2	1.2	1.2	-0.6	1.4	1.2
Net Exports (percentage points contribution)	(1.2)	(0.2)	(-0.0)	(-0.3)	(-0.1)	(-0.0)	(-0.1)	(-0.0)	(-0.0)	(-0.0)	(-0.2)	(0.2)	(-0.1)
Exports of Goods and Services	7.1	-0.9	-0.2	0.8	1.6	1.8	1.8	1.8	1.8	1.8	1.9	1.0	1.5
Imports of Goods and Services	1.9	-1.6	-0.2	2.2	1.9	1.9	2.0	2.0	2.0	2.0	2.6	0.3	1.8

	(% changes from the same quarter of the previous year)										(% changes from the previous fiscal year)		
Nominal GDP	4.0	1.4	2.7	3.0	3.1	4.4	3.9	3.5	3.9	3.9	4.2	2.5	3.9
GDP deflator	3.4	1.4	2.0	2.4	2.5	3.6	3.0	2.7	3.0	3.0	3.4	2.1	3.1
Consumer Price Index (excluding fresh food)	1.8	1.9	2.1	2.5	2.7	2.5	2.3	1.9	2.3	2.3	2.8	2.3	2.3
Unemployment Rate (%)	2.7	2.7	2.7	2.7	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.7	2.6
Exchange Rates (JY/US\$)	157	157	156	156	156	154	153	153	153	153	151	156	153
Import Price of Crude Oil (US\$/barrel)	67	117	95	87	83	80	78	78	78	78	71	96	78

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.