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Monthly Report of Prospects for Japan's Economy

June 2026

Macro-economics Research Center
Economics Department

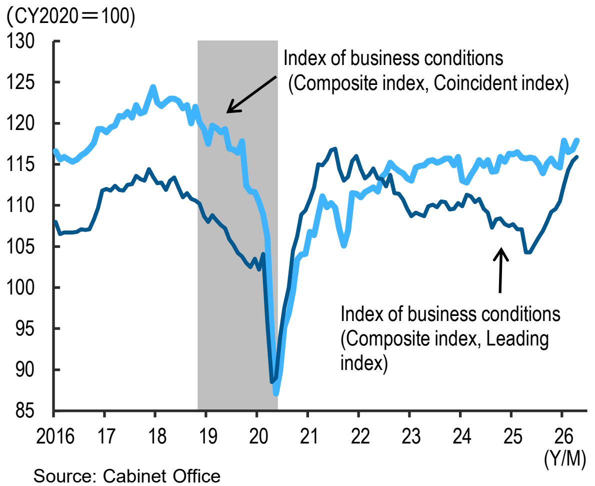
The Japan Research Institute, Limited

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

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

Figure 1-1 Economic Activity

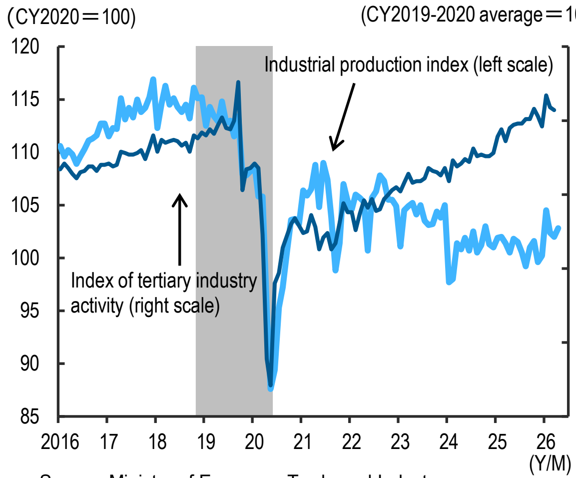
The coincident index of business conditions has stopped falling.
The leading index is picking up.



Source: Cabinet Office

Figure 1-2 The Corporate Sector

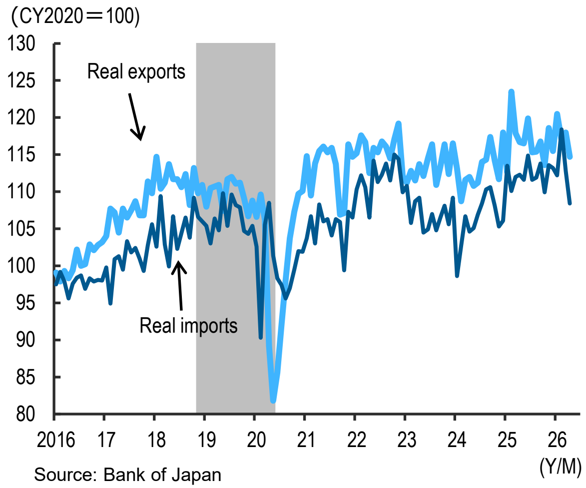
Industrial production is fluctuating.
Economic activity in the service sector is recovering.



Source: Ministry of Economy, Trade and Industry

Figure 1-3 External Demand

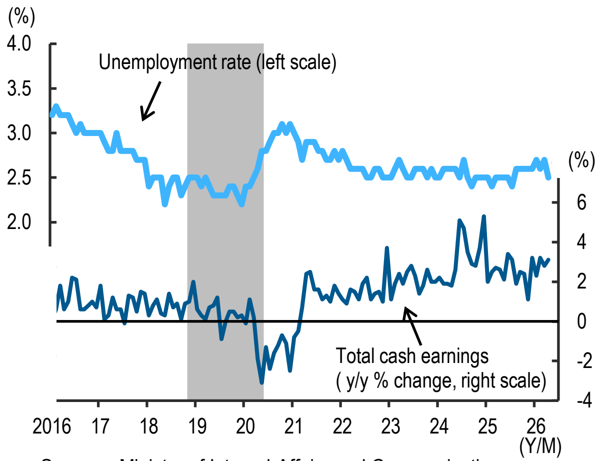
Exports are weak
Imports, particularly of Middle East crude oil, are falling



Source: Bank of Japan

Figure 1-4 Employment and Income

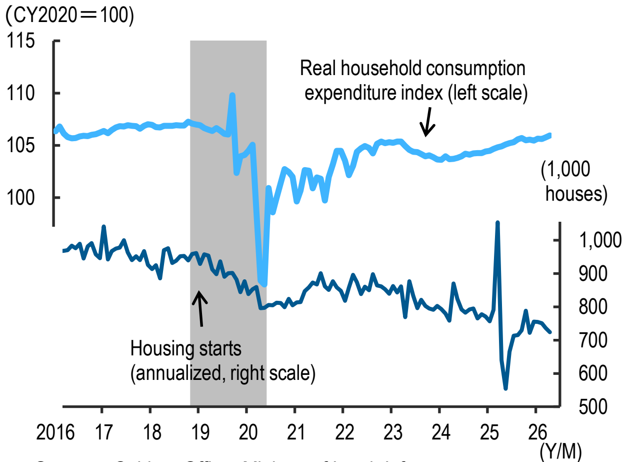
The unemployment rate is low, hovering around 2.5%.
Nominal wage growth is solid on average.



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

Figure 1-5 The Household Sector

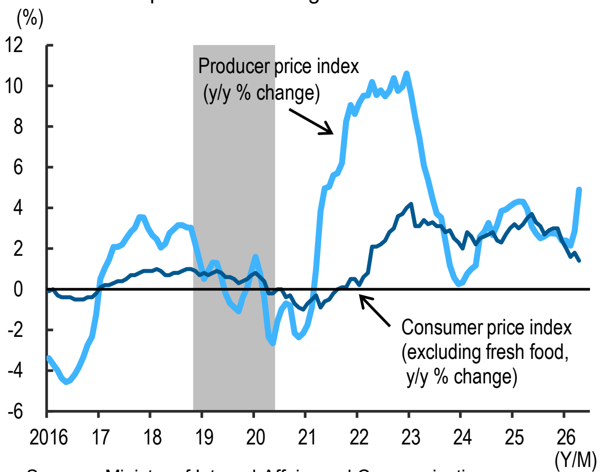
Consumption is holding firm.
Housing starts are weak.



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

Figure 1-6 Prices

Producer price inflation has accelerated as oil prices rise.
Consumer prices are 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.

Real GDP for Q1 2026 has been revised downward

◆ GDP has been revised downward, with lower-than-thought capital investment the key reason

In the second QE for Q1 2026, quarter-over-quarter (QoQ) real GDP growth was revised downward to an annualized figure of +1.8% from the +2.1% growth figure in the first QE. Personal consumption and public demand were revised upward, while capital investment saw a downward revision, dragging the overall figure down.

◆ Production in the manufacturing sector is fluctuating

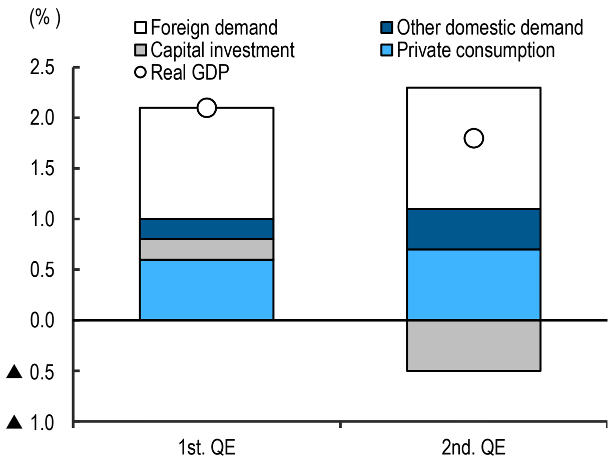
In April, the Industrial Production Index increased by 0.8% month over month (MoM). Against the backdrop of the crisis in the Middle East, output of chemicals fell, but production in many other sectors, centered on production machinery, climbed in response to robust semiconductor demand.

According to the Industrial Production Index Forecast (adjusted based on past forecasting errors), near-future production plans indicate an increase in output in May of 2.1% MoM. The production machinery sector is expected to be the driver, buoyed by strong demand for semiconductors. However, production may be lower than the plans indicate, particularly in the petroleum and chemicals sectors, if shortages of oil-derived products, such as naphtha, resulting from the Middle East crisis become more serious.

◆ Housing starts are weak

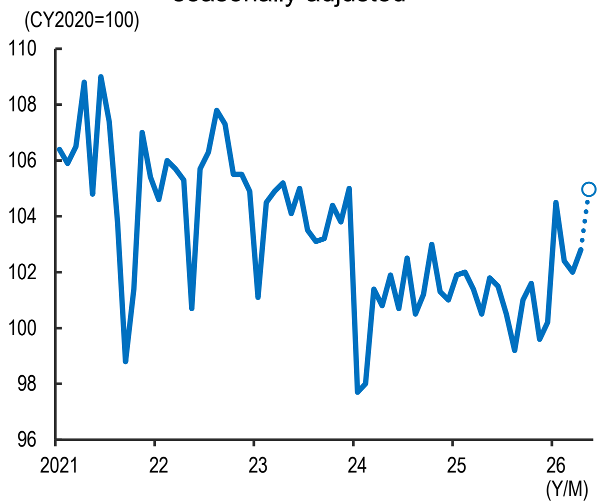
Housing starts surged 11.4% YoY in April. However, in the background to this was the reactionary slump that occurred in the same month the previous year following the spike in demand that had occurred ahead of amendments to the Building Standards Act. Seasonally adjusted, the April pace of housing starts translates into an annualized level of just 724,000 units, indicating persistent weakness amid labor shortages and soaring construction costs.

Figure 2-1 Real GDP Growth Rate for Q1 2026 <YoY annual growth rate>



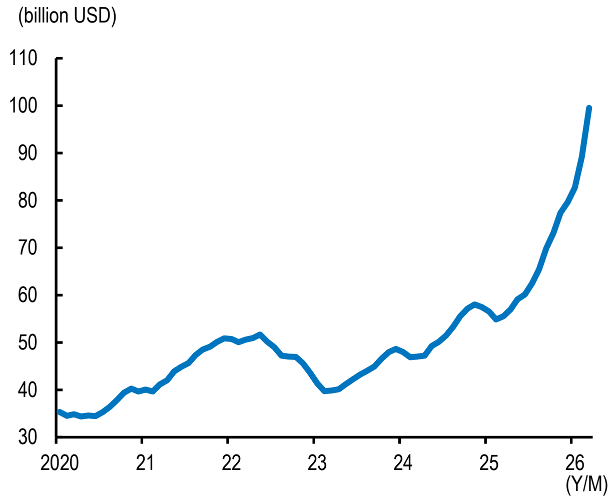
Source: Japan Research Institute, Ltd. based on data from the Cabinet Office

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

Figure 2-3 Global Semiconductor Shipment Value



Source: Japan Research Institute, Ltd. based on data from the World Semiconductor Trade Statistics
Note: Backward 3-month average.

Corporate earnings are firm, but the rise in capital investment is slowing

◆ Corporate earnings are firm

According to the Financial Statements Statistics of Corporations, ordinary profit (all industries) for Q1 of 2026 increased 14.6% YoY, rising for the sixth consecutive quarter. With the yen trending lower, dividend income and other returns from overseas increased in yen terms, which pushed up non-operating income. In addition, variable costs declined because energy prices remained low through February, which was another factor in driving up profits. Ordinary profit in the manufacturing sector saw a particularly large rise, surging 40% YoY.

However, the turmoil in the Middle East is likely to have been weighing on corporate earnings since April. For companies that cannot fully pass through soaring raw material costs to prices, and firms facing supply constraints, profits are expected to come under increasing downward pressure.

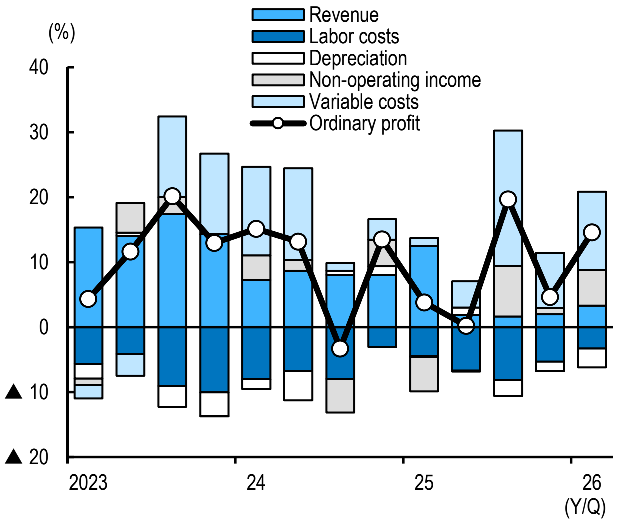
◆ Construction-related investment is expected to decrease

According to the Financial Statements Statistics of Corporations, capital investment (including software) was down 2.0% from the strong figure recorded in the previous quarter. Software investment remains at a high level, but growth in other types of investment has paused.

Capital investment is expected to gradually increase going forward despite weakness in certain areas. Investment in software to address medium- to long-term challenges such as labor saving and digital transformation should remain firm.

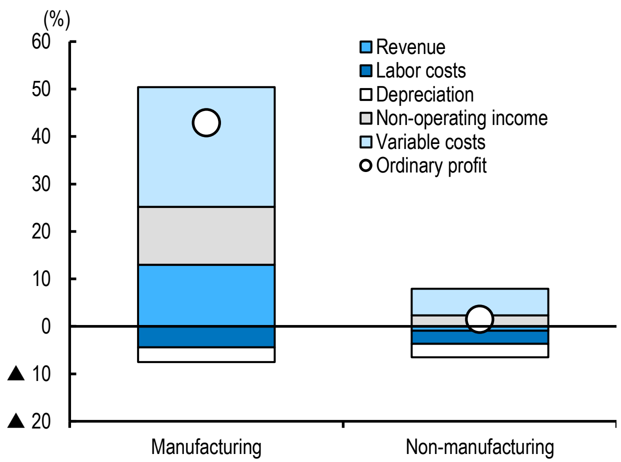
However, the downward trend in construction-related investment, including housing investment, is likely to strengthen. Higher resource prices triggered by the deterioration in the Middle East situation have further pushed up construction costs, and may lead companies to revise their investment plans. In addition, shortages of construction materials derived from crude oil, such as insulation materials and paints, have slowed progress on some projects, which is also curtailing investment.

Figure 3-1 Breakdown of Ordinary Profit
<YoY>



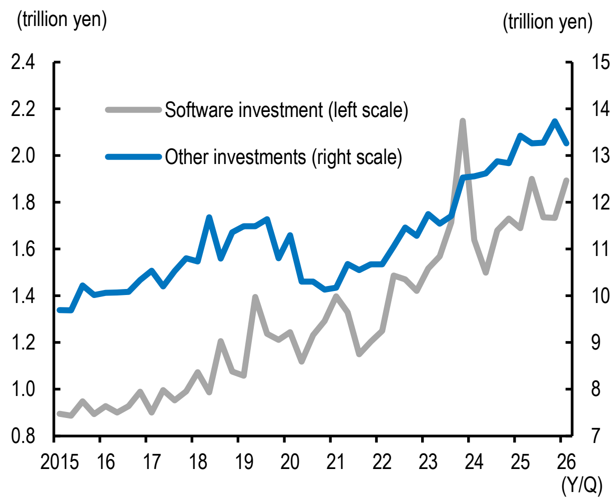
Source: Japan Research Institute, Ltd. based on data from the Ministry of Finance
Note: All sizes, all industries (excluding finance and insurance).

Figure 3-2 Breakdown of Ordinary Profit
<by Industries, YoY>



Source: Japan Research Institute, Ltd. based on data from the Ministry of Finance
Note: Q1 2026 (all sizes). non-manufacturing excludes finance and insurance.

Figure 3-3 Corporate Capital Investment
<seasonally adjusted>



Source: Japan Research Institute, Ltd. based on data from the Ministry of Finance
Note: All sizes, all industries (excluding finance and insurance).

A significant decline in consumption will be avoided despite weakness in certain areas

◆ Households' disposable income is on the recovery track

Households' disposable income is gradually recovering. Although it shrank last summer as a reaction to the lump-sum tax reductions of 2024, the overall trend is that disposable income is increasing moderately, supported by growth in employee remuneration and net asset income. In Q1 of 2026, too, disposable income likely maintained its upward trend, thanks to continued increases in wages and stock prices coupled with a decline in the inflation rate to the 1% range.

◆ The household sector is expected to avoid a sharp deterioration

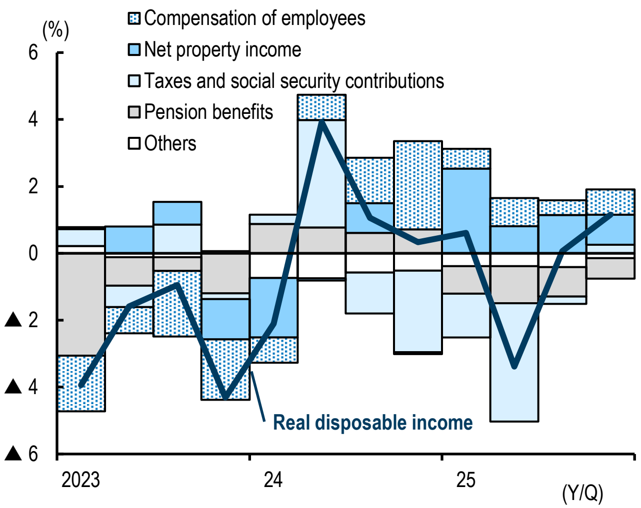
Going forward, inflationary pressure should ease somewhat thanks to energy subsidies from the government, and a significant decline in consumption is expected to be avoided. Specifically, consumption will be supported by two factors:

The first is higher wages. Rates of wage increase (including regular salary increases) agreed at the 2026 shunto (spring wage negotiations) were slightly below the previous year's, but the number of unions winning raises of more than 5% increased. Because these wage hikes will take effect toward the summer, a wider range of households are expected to benefit from higher wages.

The second is that stock prices will continue their ascent. Looking ahead, stock prices are expected to continue to rise gradually, with AI-related issues driving overall prices higher. As a result, net asset income will maintain its upward trajectory, and this, coupled with increases in unrealized gains, should provide a tailwind for consumption via the wealth effect.

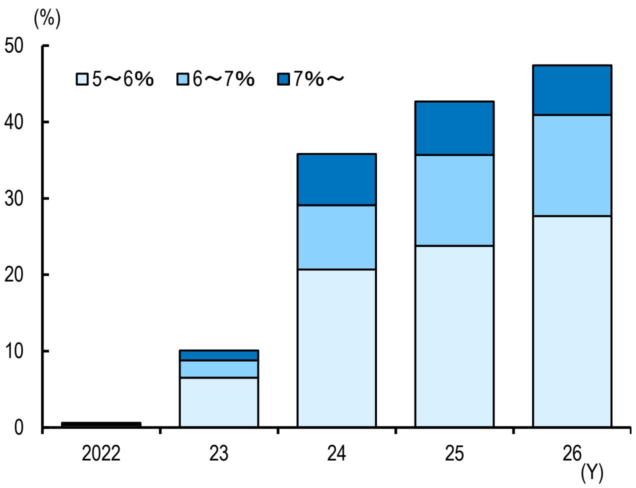
However, as the macroeconomic slide (mechanism for automatically reducing pension benefits in response to increases in average life expectancy and shrinkage of the working population) continues to be applied, pension benefit growth is expected to slip below the inflation rate. Last year, too, a decline in pension benefit payments was a factor in pushing down overall disposable income by 0.9 percentage points YoY. Elderly households with few assets are unlikely to benefit from wage increases and rising stock prices while inflation remains elevated, and this may weigh on the level of consumption of the household sector as a whole.

Figure 4-1 Households' Real Disposable Income <YoY>



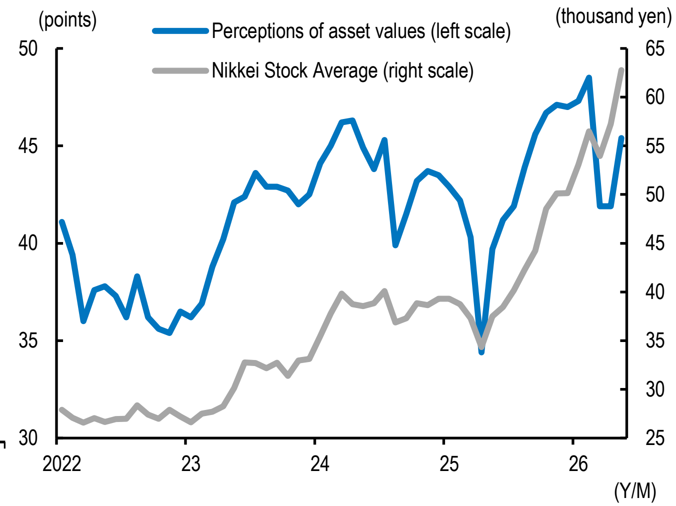
Source: Japan Research Institute, Ltd. based on data from the Cabinet Office
Note: Real disposable income is calculated by deflating the nominal original series using the household final consumption expenditure deflator.

Figure 4-2 Share of Unions with Spring Wage Increases of 5% or More



Source: Japan Research Institute, Ltd. based on data from Japanese Trade Union Confederation
Note: The spring wage increase rates include regular pay raises and are based on all union sizes. Data through 2025 are the final results, while the 2026 figure is based on the fifth tabulation.

Figure 4-3 Perceptions of Asset Values and Nikkei Stock Average



Source: Japan Research Institute, Ltd. based on data from the Cabinet Office and Macrobond
Note: Perceptions of asset values are based on households with two or more persons.

The government is curbing inflation

◆ Policy factors are pushing down the inflation rate

In April, core inflation (all items, less fresh food) was 1.4%, staying under 2% for the third consecutive month. The pace of energy price growth slowed, due in part to government measures to control prices, and the government has basically eliminated high school tuition fees, which has served to push down service prices.

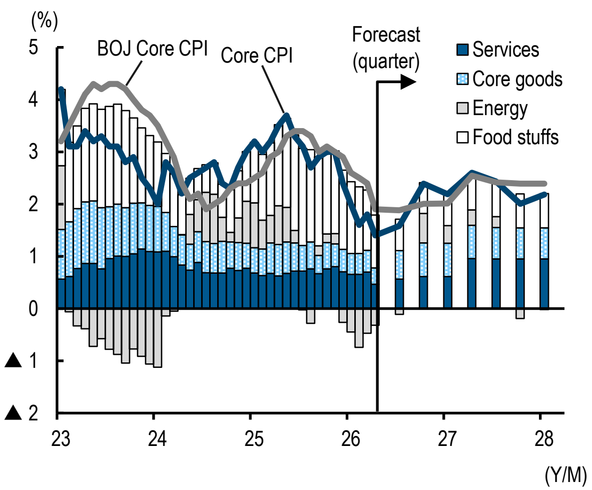
Inflation looks set to quicken to the mid-2% range going into the second half of 2026. Although energy subsidies and other government measures will soften inflationary pressure to some extent, prices are expected to rise as higher raw and packaging material costs caused by elevated oil prices are passed through to selling prices. According to a survey by Teikoku Databank, because of the turmoil in the Middle East and the resulting rise in packaging and other costs, food manufacturers are becoming increasingly willing to raise prices. In addition, from FY2027 onward, the effect on inflation of the elimination of high school tuition fees will be gone, adding to inflationary pressure.

◆ 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, however, are rising. This reflects concerns about inflation resulting from the increase in oil prices and expectations of an expansion in fiscal expenditure.

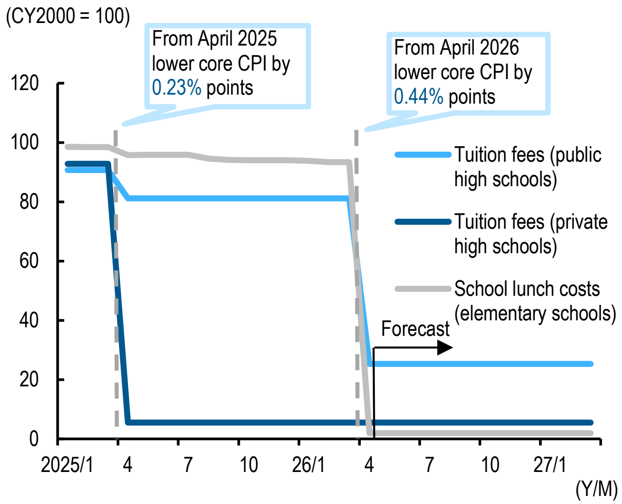
It is highly likely that the BOJ will continue to raise interest rates in stages while closely monitoring the impact of the Middle East crisis on the real economy and financial/capital markets. The next rate hike is expected to be in June. Long-term interest rates look likely to rise gradually, reflecting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



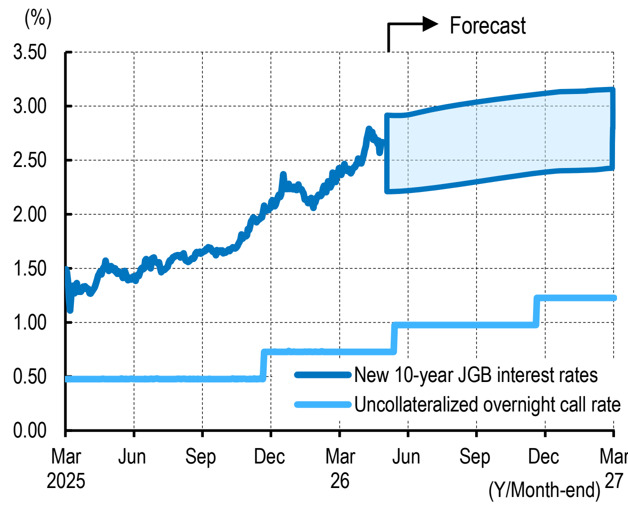
Source: Japan Research Institute, Ltd. based on data from the Ministry of Internal Affairs and Communications

Figure 5-2 The Impact of Free Education on Prices



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: Government compiles a supplementary budget in response to the Middle East situation

◆ Supplementary budget will curb energy prices

In response to the turmoil in the Middle East, the Sanae Takaichi government has compiled a supplementary budget worth just over three trillion yen. Containing measures such as expansion of the Priority Support Local Allocation Grant program (provision of discretionary funds to local governments) and additions to reserves, the extra budget is a clear expression of the government's intention to continue taking action to curtail energy costs.

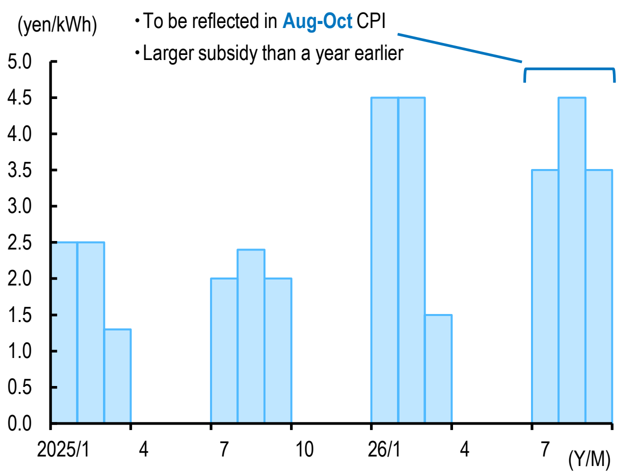
The curbs on energy prices should ease the burden on households to some extent. Gasoline subsidies pushed down April core inflation by 0.6 percentage points, and electricity and gas subsidies for the July–September quarter are expected to reduce the August–October core inflation figure by 0.5 points.

However, given that the import value (CIF basis) of crude oil has risen since April, the cost of electricity and gas used will start moving significantly higher in September (with the increases to be reflected in the October CPI). It is highly likely that the government will be forced to continue subsidizing electricity and gas into the autumn, using general contingency reserves, which have been replenished through the supplementary budget, and a newly established reserve fund for responding to the situation in the Middle East and other matters.

◆ Energy price-suppression measures also present challenges

The measures to curb energy prices also present issues. They tend to benefit high-income households disproportionately, and relative to the scale of the fiscal expenditure involved, the supportive effect for struggling households is insufficient. There is also the side effect of price signal distortion. Even with gasoline, although price elasticity is generally considered to be low, demand declines slightly when prices rise, and over the long term, demand declines further through, for example, advances in energy efficiency. Since 2022, subsidies and the elimination of the provisional tax rate have suppressed gasoline price rises by more than 10%. Because price-suppression measures may hinder energy saving, it is important to move away from permanent reliance on subsidies and to strengthen incentives to save energy by, for example, providing assistance for the introduction of equipment that consumes less fuel.

Figure 6-1 Electricity Subsidy Amount <Based on Month of Usage>



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

Note: The disinflationary impact of the subsidy is reflected in the CPI one month after the month of use.

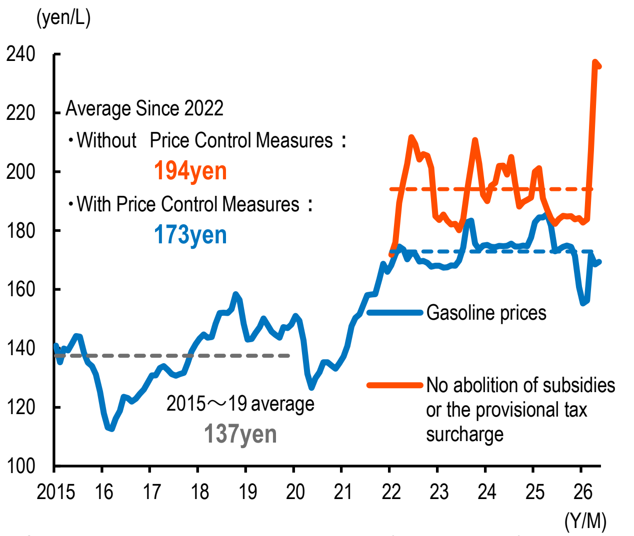
Figure 6-2 Previous Studies on Gasoline Price Elasticity

Paper	Price Elasticity	Notes
Yanagisawa (2007)	Short-run： 0.08(Fixed) 0.06(Variable) Long-run： 0.21(Fixed) 0.14(Variable)	・Estimation of Japan's demand function ・Variable price elasticity ,LWR-based estimate (2007)
Knittel & Tanaka (2019)	Long-run：0.37	・Estimation of demand function using Japanese microdata ・Eco-driving contributes to demand decline in addition to reduced mileage
Dahl (2014)	Short-run： 0.2～0.3 Long-run： 0.6～0.9	・Survey of survey paper, mainly international (1977–2004)
Brons et al. (2008)	Short-run：0.34 Long-run：0.84	・Meta-analysis of existing empirical analyses, mainly international ・Demand adjustment due to mileage and fuel efficiency improvements

Source: Japan Research Institute, Ltd. based on data from each paper

Note: Elasticity is expressed in absolute terms as the percentage decrease in demand resulting from a 1% increase in price, in the short run and long run, respectively.

Figure 6-3 Gasoline Retail Price



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

Note: Gasoline prices assuming no abolition of the provisional tax surcharge are Japan Research Institute, Ltd. estimates.

Topic②: Supply constraints are intensifying for the construction industry in provincial areas

◆ Burden on local construction firms is rising

In provincial areas, supply constraints in the construction industry are intensifying, and limited construction capacity is preventing companies from fully responding to incoming orders. The total value of outstanding construction work in all regions excluding Kanto has risen to a record high of around 29 trillion yen, while the rise in completed construction volume has been sluggish.

Looking at public works orders, the number of contracts per company in regions outside the Tokyo metropolitan area has increased to roughly twice the level seen in the Tokyo area. With little change in the number of construction firms, the burden on each company is rising steadily.

◆ Aging and slow improvement in pay and working conditions are exacerbating constraints

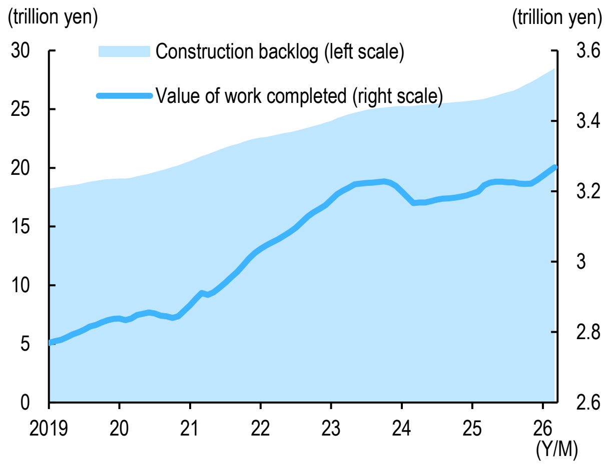
Supply constraints in provincial areas may intensify further due to two factors:

The first is the aging of workers. The share of workers engaged in construction is relatively high in provincial regions, and in northern Japan it is close to 10%. Such regions have many older workers, and room to expand the labor force is limited. As a result, shortages of experienced workers due to aging may reduce construction capacity.

The second factor is slow improvement in pay and working conditions for construction workers in provincial areas. In contrast to the Tokyo metropolitan area, where labor unit prices for public works, i.e., the standard cost of one worker for one day, have risen relative to the minimum wage, labor unit prices in provincial regions have declined. Recently, they have been below the level of the Tokyo metropolitan area, which could be making it difficult for regional construction companies to secure workers.

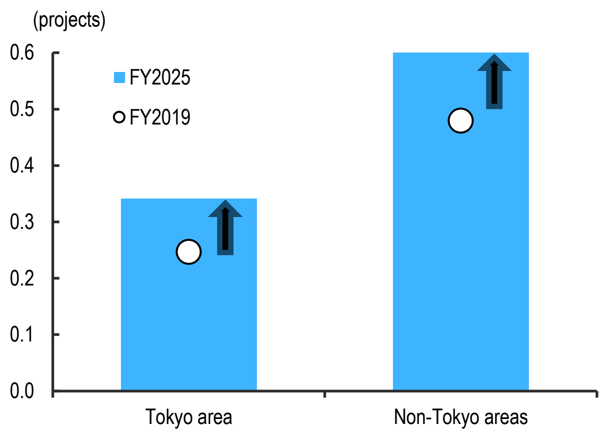
To prevent such supply constraints becoming more serious, measures to alleviate labor shortages, such as improving pay and working conditions and promoting digital transformation, will be vital.

Figure 7-1 Regional Construction Backlog and Value of Work Completed



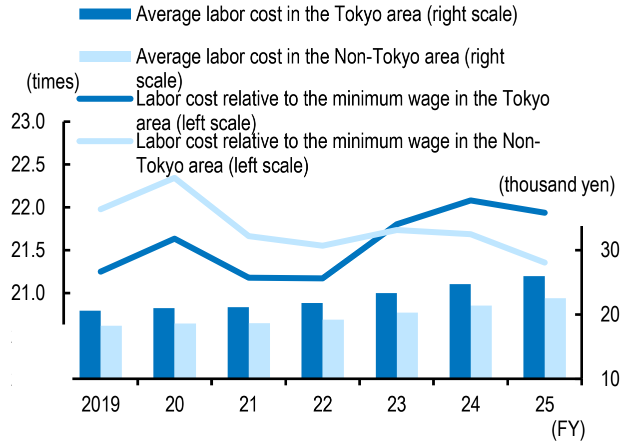
Source: Japan Research Institute, Ltd. based on data from the Ministry of Land, Infrastructure, Transport and Tourism
Note: Backward 12-month average for regions excluding the Kanto region.

Figure 7-2 Public Construction Projects per Contractor



Source: Japan Research Institute, Ltd. based on data from the Ministry of Land, Infrastructure, Transport and Tourism
Note: The number of construction contracts awarded from public works divided by the number of licensed construction firms. Tokyo area comprises Tokyo, Kanagawa, Chiba, and Saitama, while non-Tokyo areas comprise all other prefectures.

Figure 7-3 Labor Cost General Workers



Source: Japan Research Institute, Ltd. based on data from the Ministry of Land, Infrastructure, Transport and Tourism and the Ministry of Health, Labour and Welfare
Note: The labor cost is a benchmark used in calculating the estimated prices of public works, defined as the labor cost per worker. It comprises base wages, standard allowances, and statutory welfare expenses, and partly incorporates adjustments reflecting the impact of the COVID-19 pandemic and unsuccessful bidding outcomes.

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 due to the impact of elevated crude oil prices. The conflict in the Middle East should subside before or during 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 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 industries 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 situation poses downside risks

Real GDP growth is projected to remain solid, registering +0.4% in FY2026 and +0.8% in FY2027.

That said, if tensions in the Middle East remain elevated 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 for 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 June 8, 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			
	(Actual)	(Projection)								(Actual)	(Projection)	
Real GDP	1.8	0.6	0.5	0.5	0.8	1.0	0.9	0.8	0.8	0.8	0.4	0.8
Private Consumption Expenditure	1.4	0.9	0.6	0.2	0.4	0.7	0.6	0.6	0.6	1.3	0.8	0.6
Housing Investment	3.7	0.6	0.0	−0.1	−0.3	−0.4	−0.5	−0.5	−0.5	−3.4	1.1	−0.4
Business Fixed Investment	−2.8	2.4	1.2	1.1	1.0	1.0	0.9	0.9	0.8	2.0	1.1	1.0
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)	(−0.5)	(0.1)
Government Consumption Expenditure	1.3	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.8	1.0	0.8
Public Investment	6.1	1.0	1.1	1.2	1.2	1.2	1.2	1.2	1.2	−0.5	1.5	1.2
Net Exports (percentage points contribution)	(1.3)	(0.2)	(−0.0)	(−0.3)	(−0.1)	(−0.0)	(−0.0)	(−0.0)	(−0.0)	(−0.2)	(0.2)	(−0.1)
Exports of Goods and Services	7.4	−0.9	−0.2	0.8	1.6	1.8	1.8	1.8	1.8	2.0	1.0	1.5
Imports of Goods and Services	1.7	−1.6	−0.2	2.2	1.9	1.9	2.0	2.0	2.0	2.5	0.2	1.8

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

Nominal GDP	3.6	1.4	2.3	2.9	3.1	4.4	4.0	3.5	3.7	4.1	2.4	3.9
GDP deflator	3.2	1.5	1.7	2.4	2.6	3.7	3.2	2.7	2.8	3.3	2.1	3.1
Consumer Price Index (excluding fresh food)	1.8	1.5	1.6	2.3	2.6	2.6	2.6	2.0	2.2	2.8	2.0	2.4

Unemployment Rate (%)	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$)	157	159	158	157	155	154	154	154	154	151	157	154
Import Price of Crude Oil (US$/barrel)	67	105	107	91	85	82	79	78	78	71	97	79

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.