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Monthly Report of Prospects for Japan's Economy

July 2026

Macro-economics Research Center
Economics Department

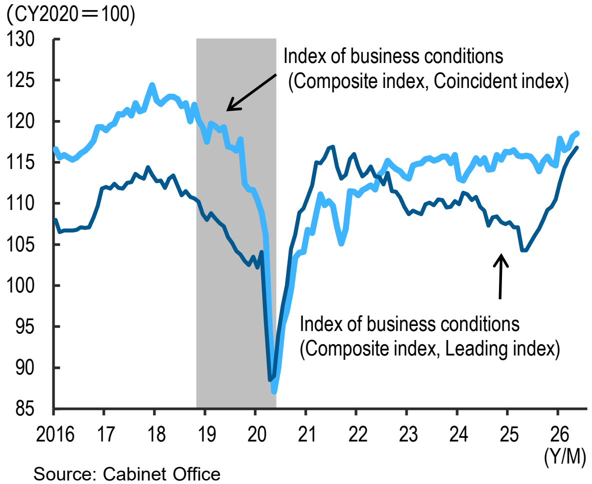
The Japan Research Institute, Limited

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

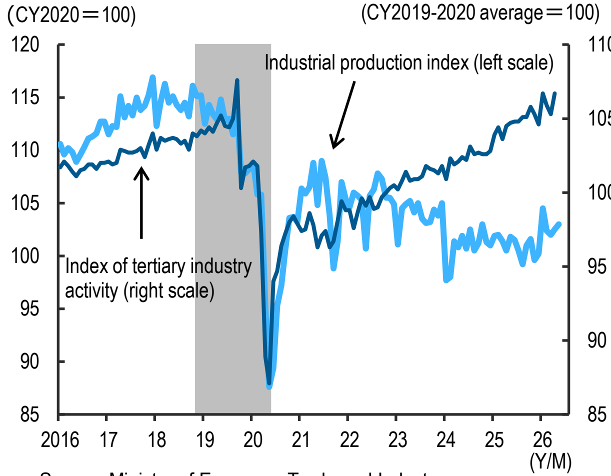
The coincident index of business conditions is picking up.
The leading index is improving.



Source: Cabinet Office

Figure 1-2 The Corporate Sector

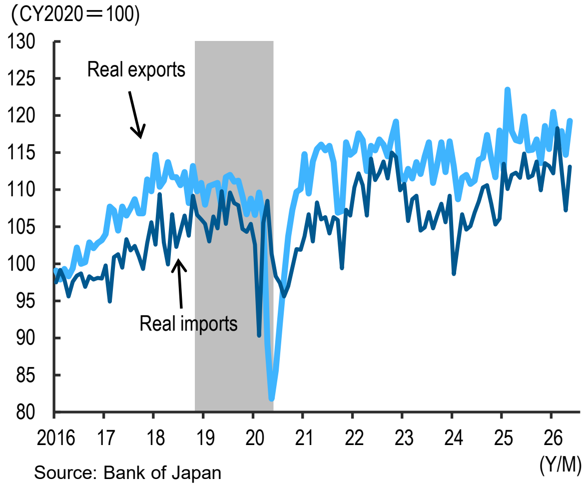
Industrial production is solid.
Economic activity in the service sector is firm.



Source: Ministry of Economy, Trade and Industry

Figure 1-3 External Demand

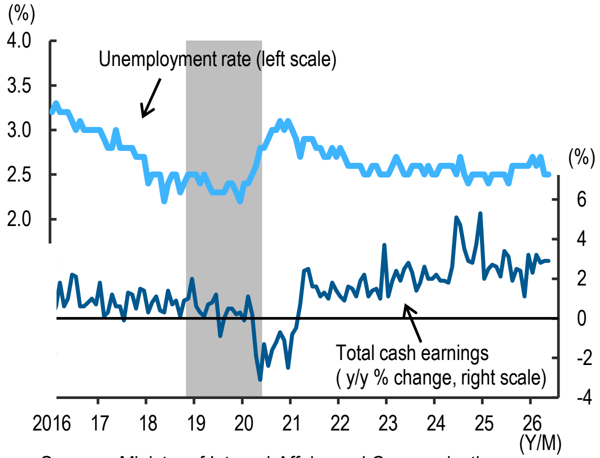
Exports are fluctuating.
Imports are flat overall.



Source: Bank of Japan

Figure 1-4 Employment and Income

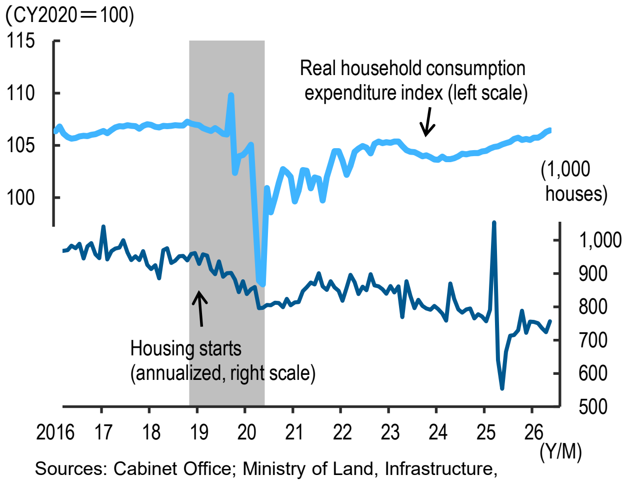
The unemployment rate is low, hovering around 2.5%.
Nominal wage growth is solid on average.



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

Figure 1-5 The Household Sector

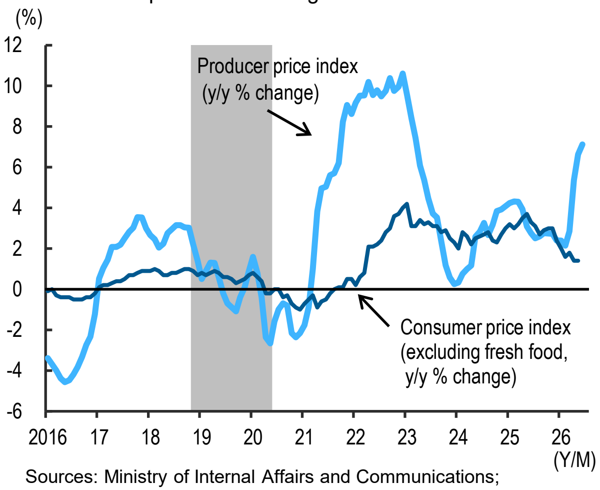
Consumption continues to gradually recover.
Housing starts are weak.



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

Figure 1-6 Prices

Producer price inflation is accelerating.
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.

Business confidence among companies is favorable overall

◆ Business confidence is generally improving

In the June Tankan survey from the Bank of Japan (BOJ), the diffusion index (DI) for business conditions for large manufacturing enterprises was up five percentage points from the previous survey. Although business confidence deteriorated in the petroleum and coal products industry against the backdrop of the turmoil in the Middle East, it improved in the non-ferrous metals and machinery sectors, which were supported by an expansion in investment in data centers and other semiconductor-related equipment, as semiconductor demand remained firm.

The DI for large non-manufacturing enterprises was up one percentage point from the previous survey. Higher energy prices caused by the Middle East crisis weighed on electric and gas utilities, but solid personal consumption and inbound demand supported business confidence in retailing as well as accommodation and eating/drinking services.

◆ Production activity in the manufacturing sector is solid

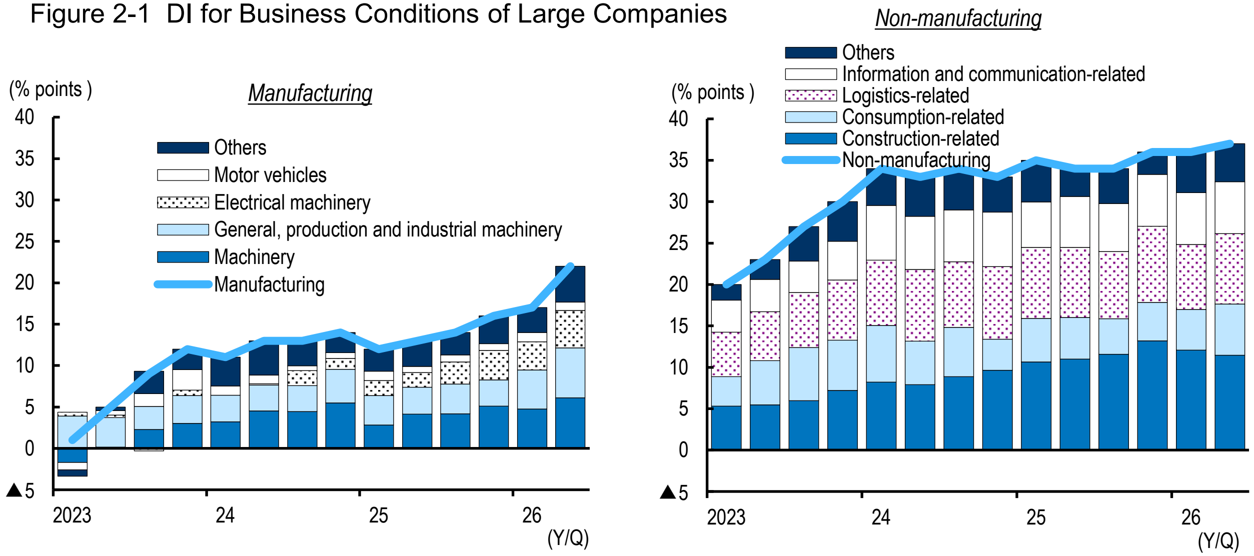
In May, the Industrial Production Index increased by 0.5% month over month (MoM). Production of chemicals and petroleum/coal products, which had declined following the escalation of conflict in the Middle East, has bottomed out, supported by progress in securing alternative sources of crude oil and related products.

According to the Industrial Production Index Forecast (adjusted based on past forecasting errors), near-future production plans indicate an increase in output in June of 2.6% MoM. The machinery sector is expected to be the driver, buoyed by strong demand for semiconductors.

◆ Personal consumption is gradually recovering

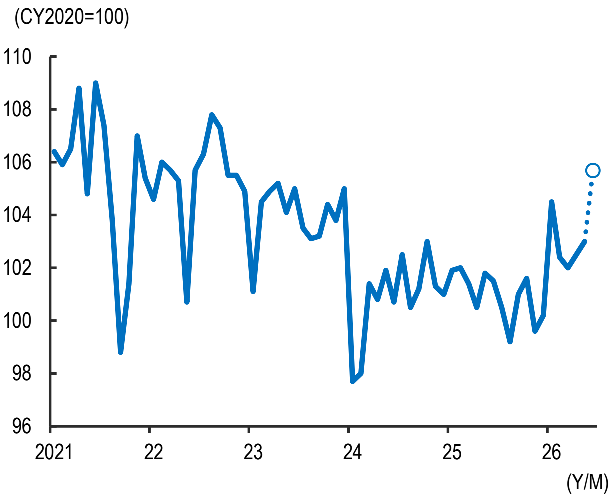
Personal consumption continues to gradually recover. Supported by a favorable income environment, services consumption continues to rise, and durable goods consumption has increased significantly. Automobile purchases have risen following tax changes, and air-conditioner replacement demand has grown ahead of the introduction of stricter energy-efficiency standards, which will make air-conditioners more expensive and apply to those sold from next spring.

Figure 2-1 DI for Business Conditions of Large Companies



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

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

Production activity and capital investment remain solid despite the turmoil in the Middle East

◆ Production activity is solid

Corporate production activity is solid overall. In manufacturing, production of chemicals and petroleum products is weak, reflecting the turmoil in the Middle East, while production of electronic parts and devices is increasing, buoyed by rising exports of products related to AI, demand for which is expanding worldwide.

In the service sector, too, business activity is firm in both services for companies and services for individuals. Tourism-related industries are also showing resilience, supported by inbound demand. Although the number of visitors from overseas is being pushed down by the Chinese government's advisory urging its citizens to refrain from traveling to Japan, arrivals from many other countries/territories, and particularly from Asia ex. China, are increasing.

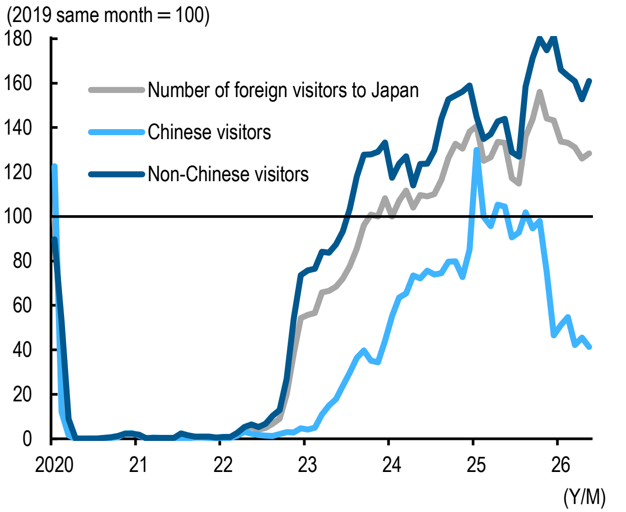
Looking ahead, corporate production activity is expected to pick up gradually, but the impacts of factors such as the ongoing elevation in crude oil prices warrant attention. Major airlines have already embarked on phased increases in fuel surcharges, which could weigh on inbound demand during the summer.

◆ Demand for capital investment is strong

Capital investment is firm. While construction investment continues to show weakness, investment in intellectual property products such as software is increasing, and machinery investment is also holding up.

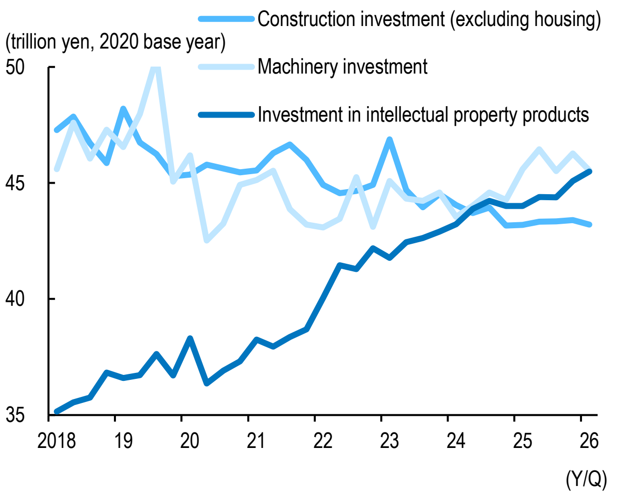
Capital investment is also expected to gradually increase going forward. According to the BOJ's Tankan for June, planned capital investment for FY2026 remains at a high level, comparable with last year. Appetite for investment is strong in both manufacturing and non-manufacturing, with demand centered on labor saving and software upgrades. However, due to recent increases in raw material costs and other factors, capital investment plans among small and medium-sized enterprises have become somewhat more cautious.

Figure 3-1 Number of Foreign Visitors to Japan <by Country/Region>



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

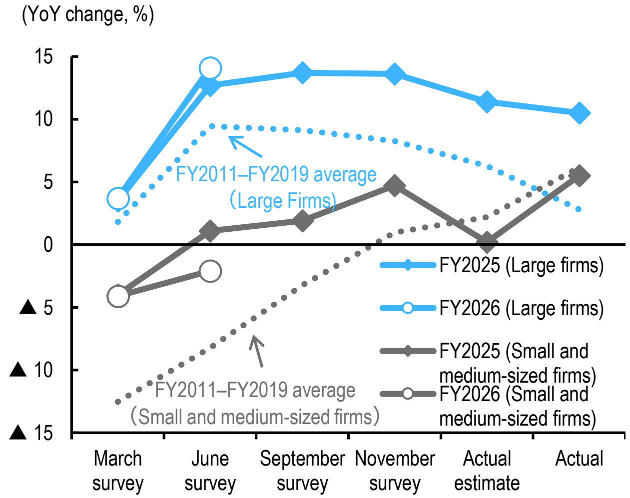
Figure 3-2 Gross Fixed Capital Formation <Real, seasonally adjusted, by Type>



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

Note: Total investment is the sum of public and private investment. Construction investment (excluding housing) comprises "Other Buildings and Structures," while machinery investment comprises "Transport Equipment" and "Other Machinery and Equipment."

Figure 3-3 Capital Investment Plans <Large Firms and Small and Medium-Sized Firms>



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

Note: All industries (including software, excluding land).

Against the backdrop of a tight job market, nominal wage growth is firm

◆ There is limited room for expansion in the labor supply

The unemployment rate is low, hovering in the mid-2% range. As a structural factor, population decline is keeping the unemployment rate down, while an increase in the number of people employed, particularly in non-manufacturing, has absorbed the rise in labor force participation among women and other groups.

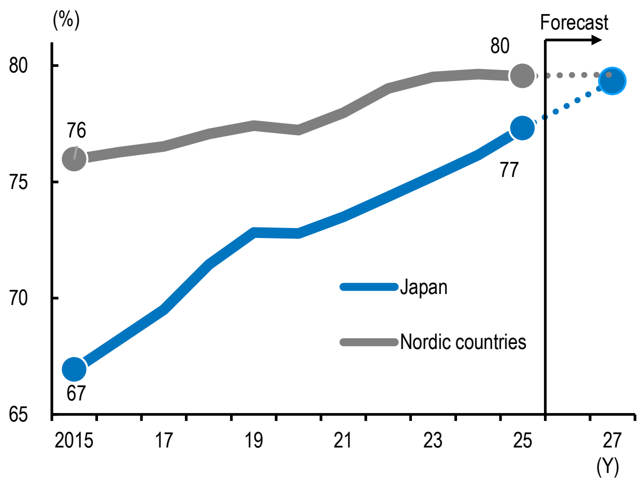
The labor market is expected to remain tight in the near term. Demand for labor is projected to stay solid, especially in face-to-face services such as medical/nursing care and accommodation and eating/drinking services, but there is limited room for expansion in the labor supply. In the case of women aged 15–64, who have hitherto been the chief contributors to the increase in the number of people employed, continued growth at the same pace as recent years would, by around the year 2027, bring their labor force participation rate close to the levels seen in Nordic countries, which are currently among the highest in the developed world.

◆ Wage hikes are continuing

Wages are rising steadily. In May, the YoY increase in basic salaries of ordinary workers was fairly high, registering 3.5%. Reflecting the rise in basic salaries, summer bonuses also appear to have remained solid. According to Keidanren (Japan Business Federation), the weighted average summer bonus at major companies in 2026 exceeded one million yen for the first time since 1981, when the current calculation methodology was adopted. Because bonuses shrank in sectors heavily affected by U.S. tariffs, such as automobiles and steel, the overall growth rate slowed from last year. However, bonuses in industries such as non-ferrous metals and related sectors were generous, with AI demand having provided a tailwind.

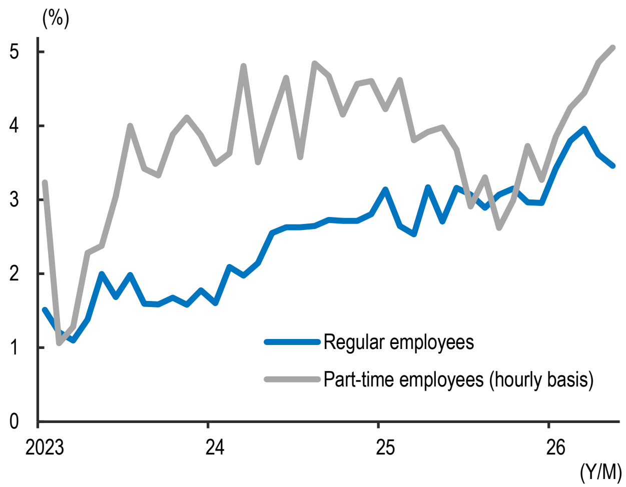
Wage growth rates are also expected to stay on the high side going forward. According to RENGO (Japan Trade Union Federation), rates of wage increase (including regular seniority-based salary increases) agreed at the 2026 shunto (spring wage negotiations) averaged 5.01% (as of the final round of calculations), slightly below the previous year's figure (5.25%) but still maintaining strong growth. The negotiated rise in base pay, which excludes the regular salary increases, was 3.50%, meaning that basic salaries this fiscal year are highly likely to rise by around 3%.

Figure 4-1 Female Labor Force Participation Rate <by Country/Region, Ages 15–64>



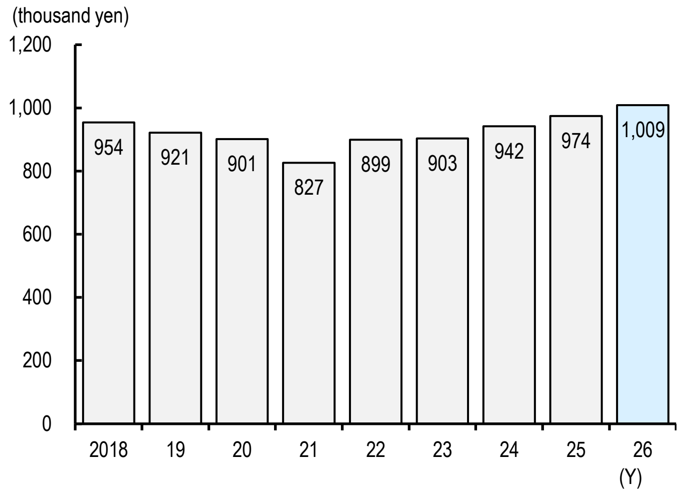
Source: Japan Research Institute, Ltd. based on data from OECD
Note: Nordic countries represent the average of four countries: Sweden, Denmark, Norway, and Finland. Forecasts are based on the assumption that trends observed during 2023–2025 continue.

Figure 4-2 Scheduled Cash Earnings <YoY>



Source: Japan Research Institute, Ltd. based on data from the Ministry of Health, Labor and Welfare
Note: Adjusted for breaks in the data series resulting from changes in the survey sample.

Figure 4-3 Summer Bonus Settlements at Major Companies



Source: Japan Research Institute, Ltd. based on data from the Japan Business Federation
Note: Figures through 2025 are based on the final tabulation, while those for 2026 are based on the first tabulation. The survey covered approximately 150 firms in the final tabulation and 112 firms in the first tabulation for 2026.

The government is curbing inflation

◆ Policy factors are pushing down the inflation rate

In May, core inflation (all items, less fresh food) was 1.4%, staying under 2% for the fourth consecutive month. In addition to slower food price inflation, gasoline subsidies continue to push down energy prices.

Inflation looks set to hover in the 2% range in the second half of FY2026. Although energy subsidies and other government measures will soften inflationary pressure to some extent, prices are expected to be pushed up as higher raw material and other costs are passed through to selling prices. With food products, too, price hikes during the summer and beyond may also become a source of inflationary pressure in the months ahead. According to a survey by Teikoku Databank, the number of food items slated for price increases from the summer has risen compared with the previous survey.

From FY2027 onward, the planned reduction in the consumption tax rate for food items will serve to keep prices down, and inflation is expected to drop into the 1% range.

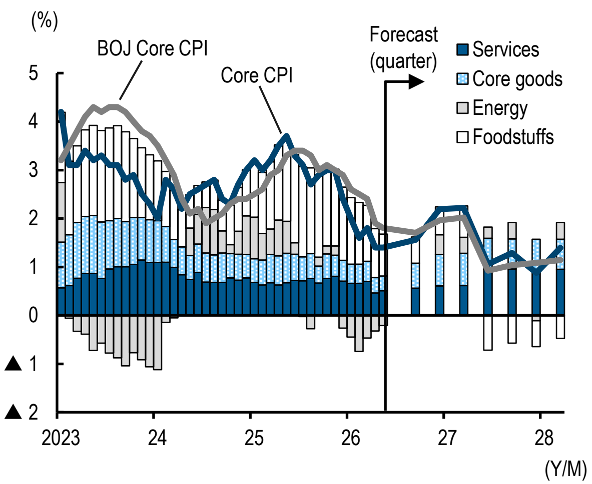
◆ The Bank of Japan will continue to raise interest rates in phases

At its monetary policy meeting in June, the BOJ hiked its policy rate to 1%. This is the highest level in about 31 years.

Long-term interest rates remain high. This reflects concerns about inflation resulting from the increase in oil prices and expectations of an expansion in fiscal expenditure.

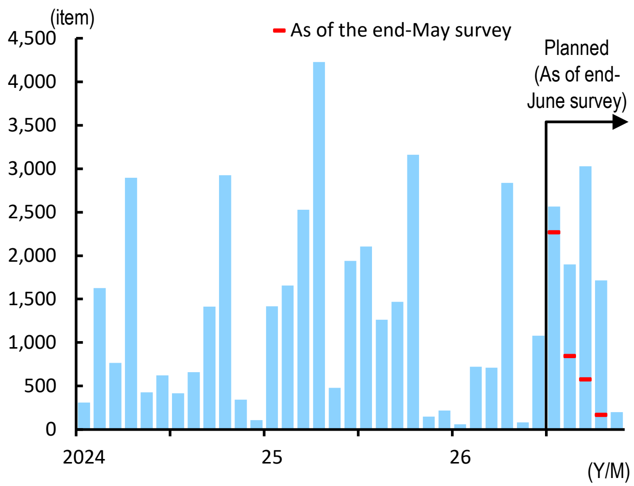
It is highly likely that the BOJ will continue to raise interest rates in stages while closely monitoring the impact of the Middle East crisis on the real economy and financial/capital markets. The next rate hike is expected to be in December. Long-term interest rates look likely to rise gradually, reflecting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



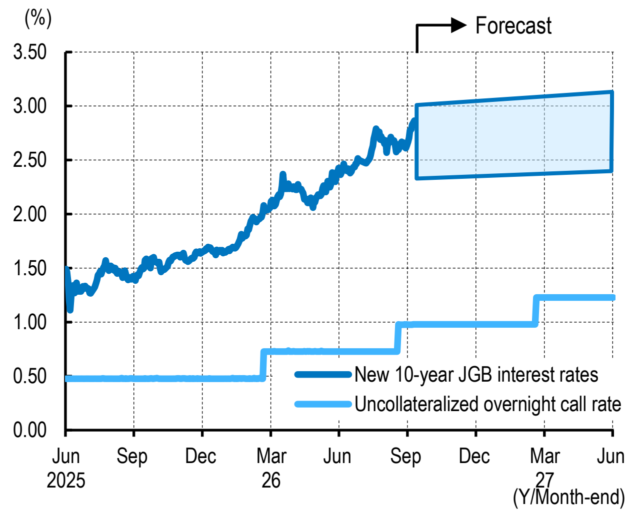
Source: Japan Research Institute, Ltd. based on data from the Ministry of Internal Affairs and Communications

Figure 5-2 Number of Food Products Subject to Price Increases



Source: Japan Research Institute, Ltd. based on data from Teikoku Databank, Ltd.
Note: Based on the price revision plans of 195 major food manufacturers. As of end-June 2026.

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



Source: NEEDS-FinancialQUEST

Topic ①: Turmoil in the Middle East is putting downward pressure on construction investment

◆ Supply constraints will interfere with construction work

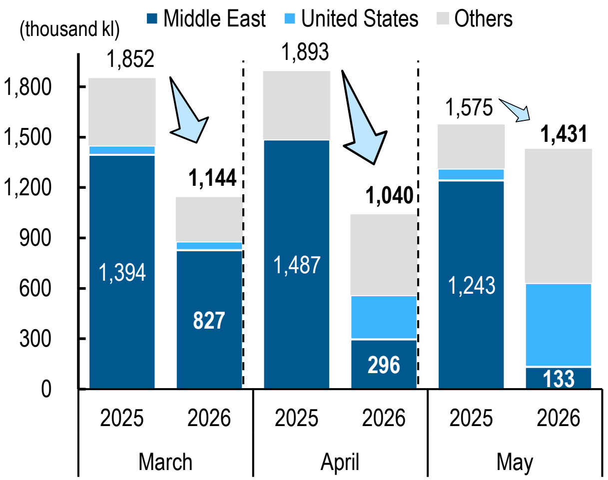
The heightened tensions in the Middle East are exerting downward pressure on domestic construction investment. As background factors, in the short term, ongoing construction projects could suffer delays due to disruptions in the supply of building materials, and in the medium term, rising construction costs will prompt revisions to investment plans.

In the short term, supply constraints for construction materials, particularly naphtha-derived products, are a concern. Although progress is being made with alternative procurement from the U.S. and other countries to offset the shortage of Middle Eastern naphtha, total import volume remains below last year's level. There may also be pockets of supply–demand tightness at the domestic distribution stage, making it difficult to procure materials on the frontlines of construction. The impact is especially large for materials used in the later phases of construction, such as waterproofing and interior finishing, and there have already been cases where construction has had to be suspended. While progress is being made with alternative procurement and supply constraints appear to be easing, these constraints may still be exerting a considerable drag on current construction investment.

◆ Higher oil prices pose downside risks to construction investment

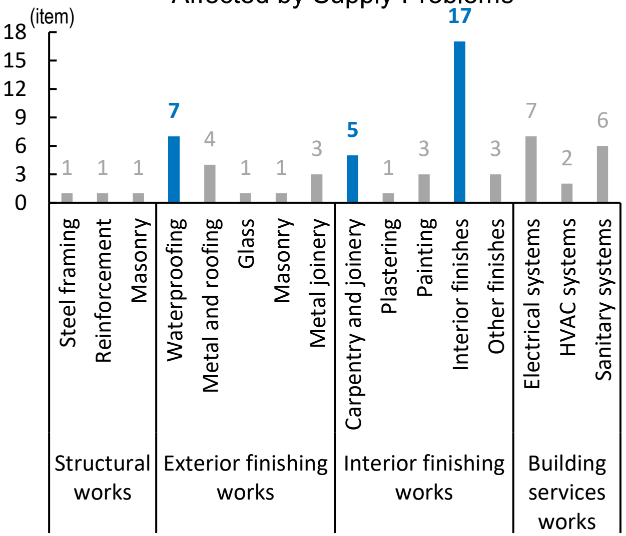
In the medium term, rising costs will be another source of downward pressure. The sharp increase in crude oil prices caused by the Middle East crisis is expected to have ripple effects on the construction industry, albeit with a time lag. In the construction sector, goods and services that are sensitive to crude oil prices, such as metal/chemical products and transportation services, account for a large share of inputs. When material prices and transportation expenses rise, construction costs are pushed higher, and there is a danger that this will lead to investment plans being revised. According to estimates, higher crude oil prices in the April–June quarter will push up construction costs by just under 3%. This will gradually weigh on construction investment, potentially lowering it to 2.3% at the end of 2027 and 3.8% at the end of 2028.

Figure 6-1 Naphtha Import Sources <by Country/Region>



Source: Japan Research Institute, Ltd. based on data from the Ministry of Finance

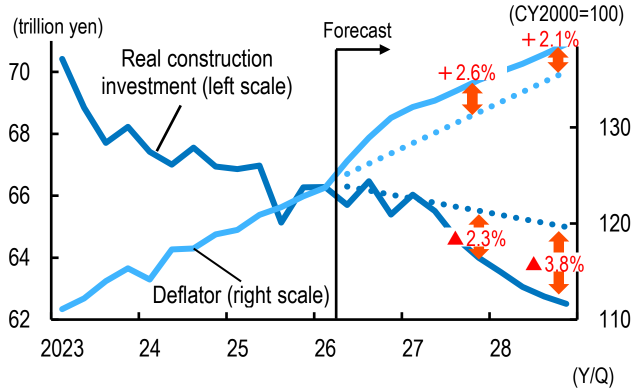
Figure 6-2 Number of Construction Material Items Affected by Supply Problems



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

Note: Based on the results of interviews with JFCC member companies presented in "Impact of the Middle East Situation on the Procurement of Construction Materials" by JFCC (as of April 24, 2026).Finishing works are classified into exterior and interior categories by work type. Figures show the number of items affected by order constraints or delivery delays.

Figure 6-3 Construction Investment Outlook



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

Note: Real construction investment is defined as the sum of "Housing" and "Other Buildings and Structures" in gross fixed capital formation. The deflator is calculated as the weighted average of the deflators for "Housing" and "Other Buildings and Structures." Forecasts are based on a scenario in which crude oil prices rise from Q1 2026 to Q2 2026 and then gradually decline, with recent trends serving as the baseline. The estimates are derived from a VAR model using the logarithms of crude oil prices, the deflator, and real construction investment, and are based on impulse responses to a crude oil price shock. The sample period runs from Q1 1994 to Q4 2025.

Topic②: Policy-driven differences in perceived price burdens across households

◆ Household burden-reduction measures are pushing down inflation

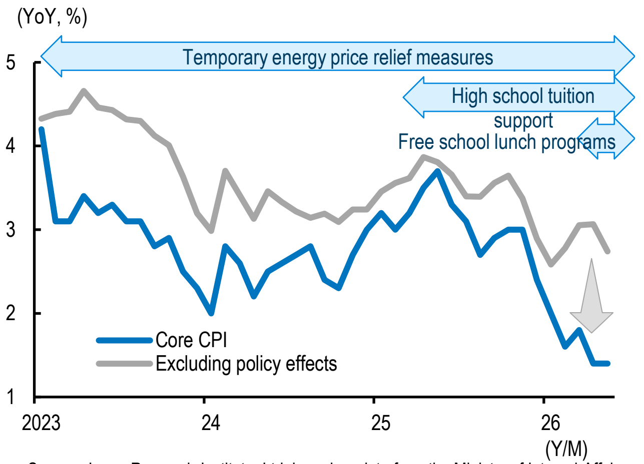
Japan's inflation rate has recently fallen into the 1% range. Food price inflation has already peaked, and government measures to ease the pain felt by households are also suppressing inflation. In addition to its energy-price containment measures, the government is taking steps to lessen the burden of education expenses, an example being the expansion of high-school tuition support beginning in FY2025. Taken together, the measures are serving to mitigate the burden on households.

◆ Policy effects are concentrated on households with children

However, differences in the items covered by policy measures and in the types of households that benefit from them mean that the inflation rates faced by different household categories vary. In particular, the benefits of free education are centered on households with school-age children, including high-school students, and have served to lower the inflation rate experienced by such households. Estimating the inflation rate faced by each household category based on their consumption-expenditure shares in FY2025, working households with children experience an inflation rate 0.3 percentage points lower than the overall household average. By contrast, elderly non-working households, for which food expenditures account for a large proportion of their total spending, face an inflation rate 0.3 percentage points higher than the overall average. Elderly non-working households also benefit less from wage increases, so they are highly likely to be perceiving more of a burden from higher prices, especially if they have few assets to fall back on.

Even for households with children, it may be difficult, for structural reasons to perceive any real reduction in burden. As children grow, spending on education-related items and food tends to rise, meaning that for such households, expenditures increase not only because of inflation but also because of life-stage changes. Although education-cost reduction measures help ease the burden on households, it needs to be noted that, at the level of the household as a whole, the effect may be overshadowed by rising expenditures associated with children's growth.

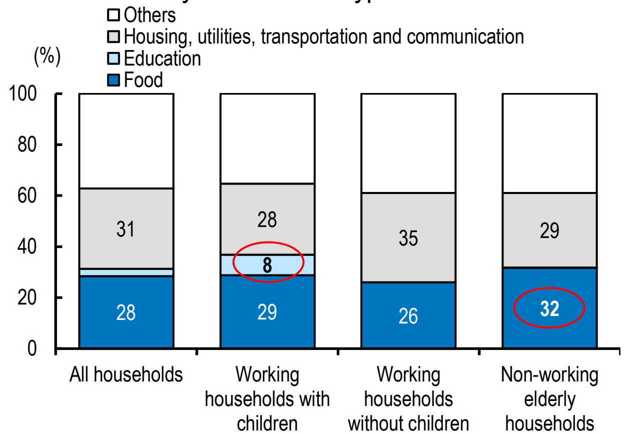
Figure 7-1 Core Inflation Rate <Excluding Policy Effects>



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

Note: Ignoring the effects of policy reversals from the previous year, inflation rates are estimated under a counterfactual scenario in which measures to mitigate gasoline, electricity, and gas costs, as well as education support policies, were not implemented in each month.

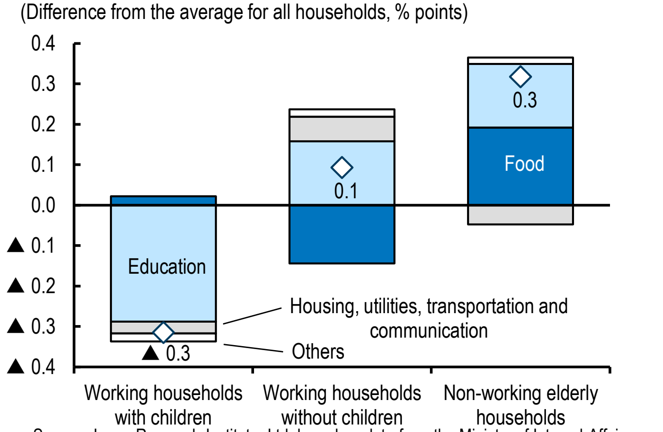
Figure 7-2 Share of Consumer Expenditure by Household Type



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

Note: Based on the 2024 National Survey of Family Income, Consumption and Wealth. Working households with children include couples with one, two, or three or more unmarried children, as well as households consisting of a couple, children, and parents. Working households without children include couple-only households and single -person households. Weighted averages are calculated using the number of households in each category.

Figure 7-3 Differences in Household Inflation Rates in FY2025



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

Note: Household-specific inflation rates are calculated by weighting consumer prices for the 10 major expenditure categories in FY2025 by the expenditure shares of each household type.

The economy is expected to continue to recover, but downside risks are significant

◆ The economy is projected to stay on the recovery track

The Japanese economy should continue its gradual recovery. WTI crude oil futures prices are expected to fall moderately going forward.

In the corporate sector, government support for investment is providing a tailwind, and demand for investment for labor saving and digital transformation remains robust. In addition, rising global demand for AI-related goods should support exports. Although production may be constrained in some industries due to shortages of raw materials, corporate production activity is projected to recover moderately as the impact of the Middle East crisis eases.

In the household sector, inflationary pressure is expected to strengthen from summer onward due to higher crude oil prices. In response, the government will probably ease inflationary pressure through measures such as energy subsidies. While the pace of increase in personal consumption is likely to slow somewhat, consumption is expected to remain resilient amid continued high wage growth.

From FY2027 onward, the planned reduction in the consumption tax rate for food items should boost personal consumption.

◆ The Middle East situation and rising interest rates constitute risks

Real GDP growth is projected to remain solid, registering +0.5% in FY2026 and +1.0% in FY2027.

However, if the Middle East crisis reignites or becomes prolonged, there is a risk that downward pressure on the economy will intensify through three channels: 1) weaker exports, 2) raw material supply constraints, and 3) rising prices. In addition, if market concerns about the fiscal stance of the Takaichi government grow, long-term interest rates could rise, potentially forcing the scaling-back or scrapping of expansionary policies such as investment support measures, energy subsidies, and lower consumption tax.

Figure 8　Projections for Japan's GDP Growth and Main Indicators (as of July 14, 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	0.7	0.7	0.8	0.8	1.5	1.4	1.0	0.9	0.8	0.5	1.0
Private Consumption Expenditure	1.4	0.9	0.7	0.5	0.4	2.0	1.8	1.0	1.0	1.3	0.8	1.2
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	1.8	1.7	1.7	1.5	1.2	1.2	1.0	2.0	1.3	1.4
Private Inventories (percentage points contribution)	(-0.2)	(-1.1)	(-0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.0)	(-0.1)	(-0.5)	(0.1)
Government Consumption Expenditure	1.3	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	0.8	1.1	1.0
Public Investment	6.1	1.0	1.0	1.0	1.0	0.9	0.8	0.8	0.8	-0.5	1.5	0.9
Net Exports (percentage points contribution)	(1.3)	(0.7)	(-0.4)	(-0.3)	(-0.2)	(-0.3)	(-0.2)	(-0.2)	(-0.2)	(-0.2)	(0.2)	(-0.3)
Exports of Goods and Services	7.4	-2.8	2.4	1.0	1.4	1.6	1.6	1.7	1.7	2.0	1.0	1.6
Imports of Goods and Services	1.7	-5.9	4.1	2.3	2.2	2.8	2.7	2.5	2.5	2.5	-0.1	2.6

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

(% changes from the previous fiscal year)

Nominal GDP	3.6	1.9	3.2	3.6	3.5	4.8	2.7	2.4	3.0	4.1	3.1	3.2
GDP deflator	3.2	1.9	2.5	3.0	2.9	3.9	1.7	1.3	1.8	3.3	2.6	2.1
Consumer Price Index (excluding fresh food)	1.8	1.4	1.6	2.2	2.2	1.1	1.3	0.9	1.4	2.8	1.8	1.2
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$)	157	159	161	161	160	159	159	158	157	151	159	159
Import Price of Crude Oil (US$/barrel)	67	107	82	82	80	77	76	76	76	71	88	76

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.