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Monthly Report of Prospects for Japan's Economy

August 2026

Macro-economics Research Center
Economics Department

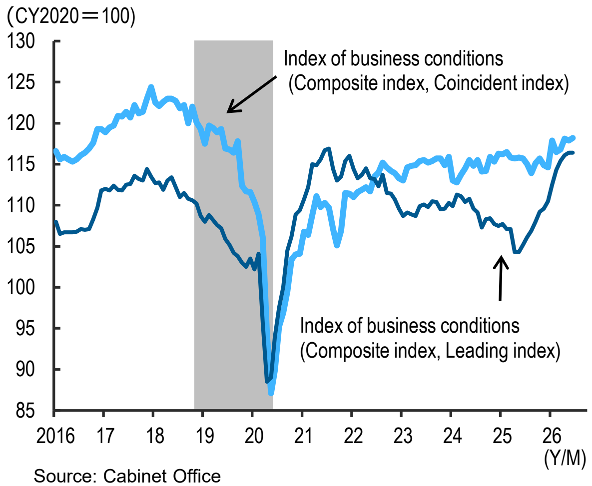
The Japan Research Institute, Limited

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

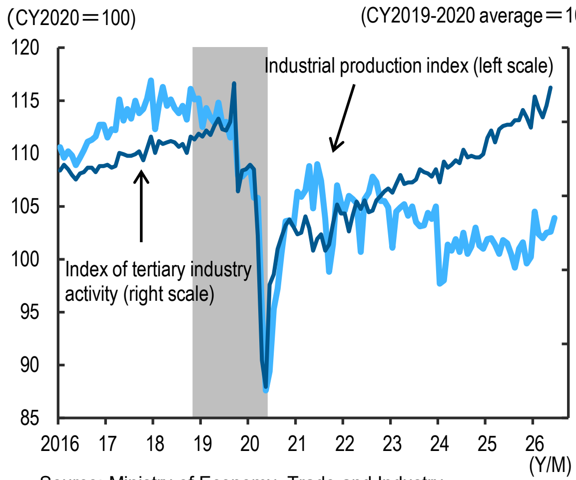
The coincident index of business conditions is picking up.
The leading index is improving.



Source: Cabinet Office

Figure 1-2 The Corporate Sector

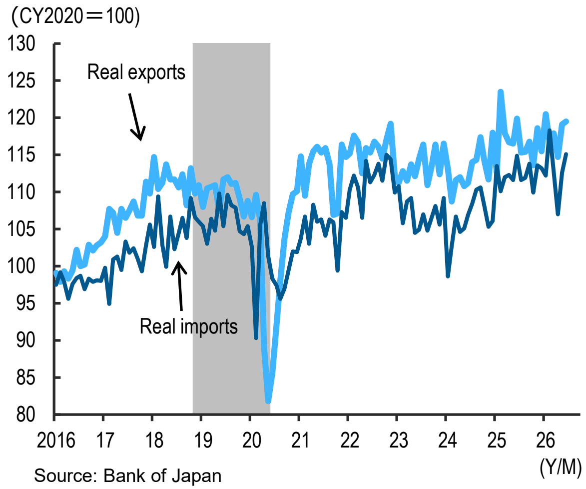
Industrial production is picking up.
Economic activity in the service sector is firm.



Source: Ministry of Economy, Trade and Industry

Figure 1-3 External Demand

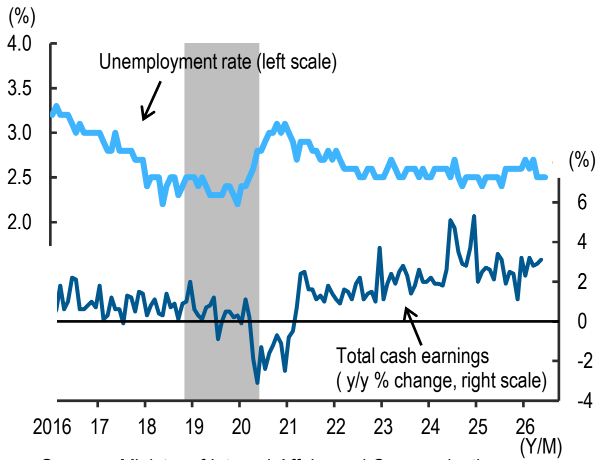
Exports are fluctuating.
Imports are flat overall.



Source: Bank of Japan

Figure 1-4 Employment and Income

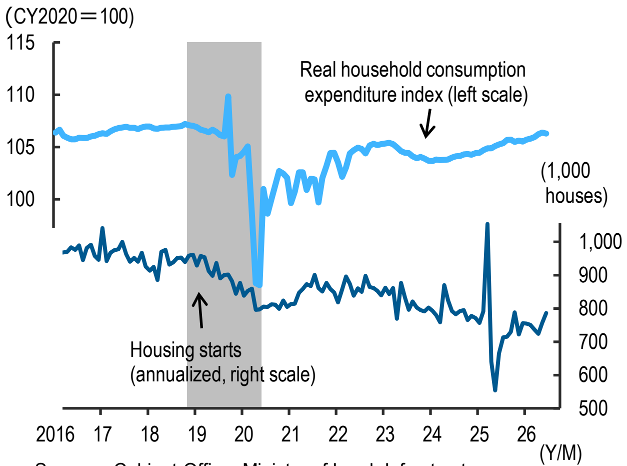
The unemployment rate is low, hovering around 2.5%.
Nominal wage growth is solid on average.



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

Figure 1-5 The Household Sector

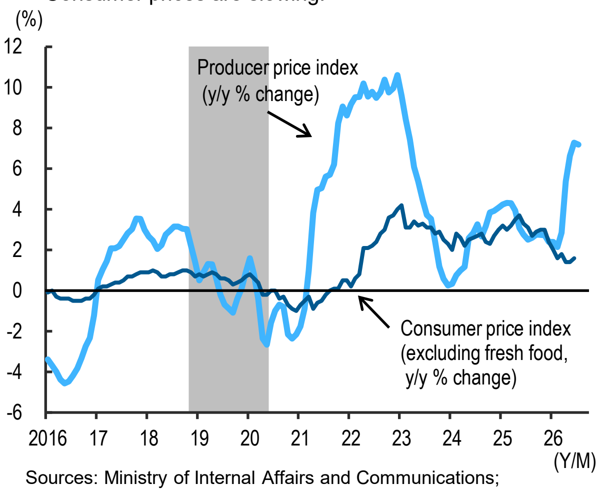
Consumption continues to gradually recover.
Housing starts are weak.



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.

Annualized real GDP growth was +1.1% quarter over quarter (QoQ) in Q2 2026

◆ The economy remains on the recovery track despite weakness in some areas

Annualized real GDP growth in the second quarter was +1.1% QoQ, with growth staying in positive territory for three straight quarters. Although personal consumption exhibited weakness and capital investment declined, overall growth was lifted by foreign demand. Exports, particularly of services, increased, and the drop in imports of Middle Eastern crude oil also helped foreign demand turn positive.

◆ Housing starts are weak

Housing starts surged 18.6% YoY in June. They have continued to rise on a YoY basis, but the jump was mainly due to a rebound from the slump in the same month of the previous year. The recovery in the number of starts is actually moderate, reflecting higher interest rates and soaring construction costs.

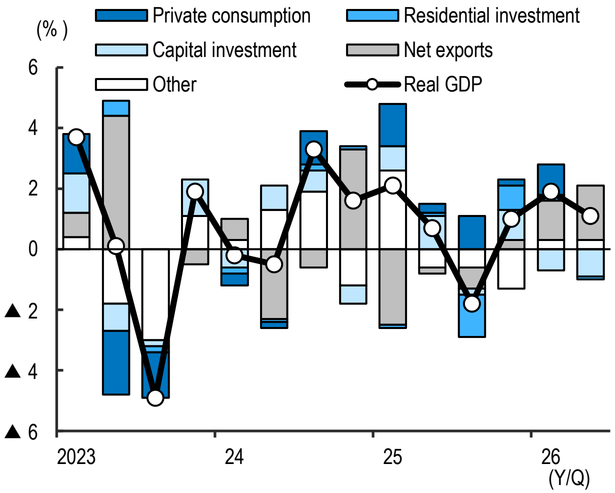
◆ Earthquake impact will need to be watched

Damage from the earthquake that occurred in Kumamoto Prefecture at the end of July is weighing on economic activity in the affected areas. Although moves toward recovery can be seen, with many companies having already resumed operations, the impact could become prolonged in the following scenarios:

The first is if damage to capital stock such as factories and roads has been severe. Some companies have sustained damage to production facilities, making an early resumption of operations difficult in some cases.

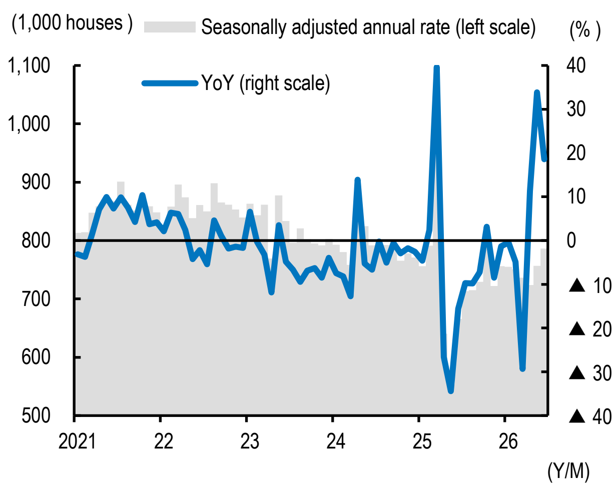
The second is if a downturn in tourism demand occurs. According to some media reports, there has been an uptick in cancellations of accommodation reservations in Kumamoto Prefecture and neighboring prefectures since the earthquake. After the 2016 Kumamoto earthquake, the decline in travel demand from Japanese visitors was short lived, but lower demand from foreign tourists persisted for a long period.

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



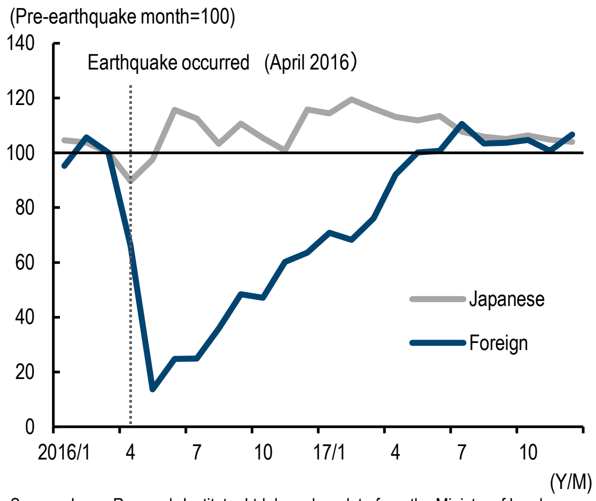
Source: Japan Research Institute, Ltd. based on data from the Cabinet Office

Figure 2-2 Housing Starts



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

Figure 2-3 Number of Overnight Stays in Kumamoto Prefecture <seasonally adjusted>



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

Exports and inbound demand remain solid despite weakness in some areas

◆ Goods exports are on the verge of picking up

Goods exports are treading water. A sharp rise in memory chip prices is among factors pushing up export prices, resulting in record high levels of exports in value terms recently. On the other hand, the increase in volume terms is limited. One possible reason is that Japan's export competitiveness has declined in fields such as semiconductors, where global demand is growing.

Looking ahead, exports are expected to pick up. Capital investment by chipmakers is expanding worldwide, and this should lift exports of semiconductor manufacturing equipment, an area in which Japan has strength. However, continued caution is needed regarding the effects of prolonged turmoil in the Middle East. A global slowdown due to elevated crude oil prices could weigh on exports.

◆ Reluctance to visit among Chinese travelers is weighing on demand for travel to Japan

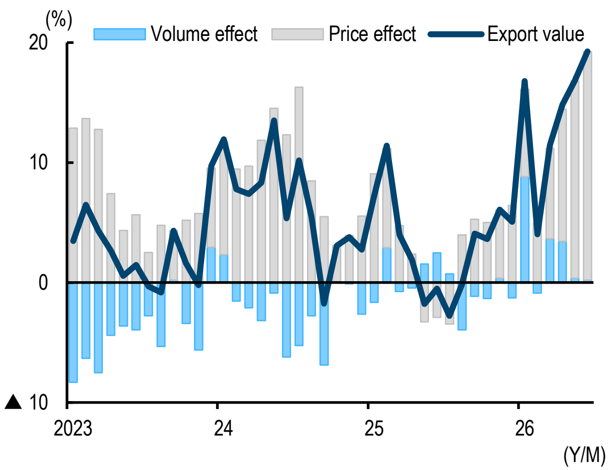
Inbound demand is currently soft. The Chinese government's advisory urging its citizens to refrain from traveling to Japan is having an adverse impact. The number of Chinese visitors to Japan has fallen to about half the level prior to the advisory. Meanwhile, the number of tourists from countries other than China remains firm.

Inbound demand is expected to stay robust going forward. Continued increases in tourists from countries other than China will remain a supporting factor. The expectation that the yen will remain weak will also act to push up inbound consumption. However, there are two downside risks going forward:

The first is that the Chinese government keeps the advisory in place for a prolonged period. When China banned group travel to South Korea in 2017, tourist numbers stayed low for two to three years.

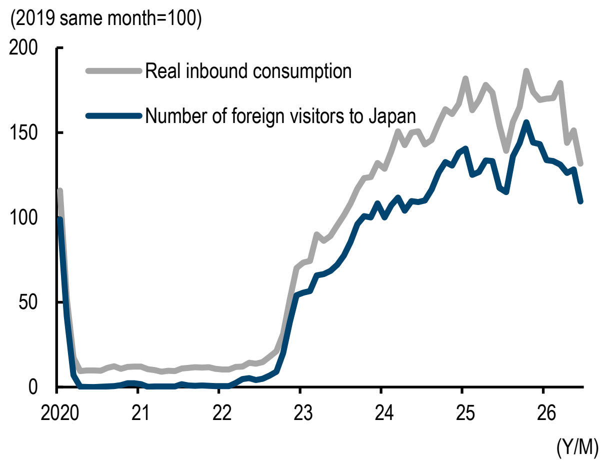
The second is the impact of higher crude oil prices. Major airlines have embarked on phased increases in fuel surcharges, which could weigh on inbound demand during the summer.

Figure 3-1 Export Value Index (YoY)



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

Figure 3-2 Number of Foreign Visitors to Japan and Real Inbound Consumption



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

Note: Real inbound consumption is calculated by deflating travel receipts in the balance of services using the Consumer Price Index (all items less imputed rent).

Figure 3-3 Changes in the Number of Chinese Visitors to Japan <seasonally adjusted>

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

Note: February 2017, when the ban on group tours to South Korea was imposed following the deployment of THAAD, and October 2025, when the travel advisory against visiting Japan was issued, are each indexed to 100 in the month prior to the introduction of the restrictions

Personal consumption is gradually recovering thanks to a favorable income environment

◆ Higher disposable incomes are supporting personal consumption

Personal consumption continues to gradually recover. While consumption of non-durable goods remains weak, services consumption is firm, particularly in amusement-related services. In addition, consumption of durable goods has increased significantly. Temporary factors such as the abolition of the environmental performance tax on automobiles (since April 2026) and the tightening of energy-efficiency standards for air conditioners (effective April 2027) have also contributed to this rise.

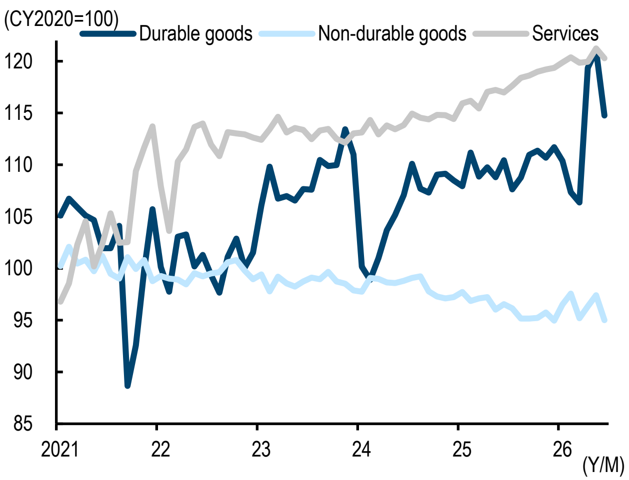
A favorable income environment can also be pointed to as a background factor behind the recovery in personal consumption. YoY real disposable income growth has generally been positive since mid-2024, and the pace of increase has recently accelerated. Employee remuneration is rising, partly as a result of agreements made during the shunto (spring wage negotiations), and net asset income is also increasing at a faster clip as companies hike dividends in line with stock price rises.

◆ Stock price developments could be a source of concern for personal consumption

Personal consumption is expected to continue its gradual recovery going forward. In addition to the favorable income environment and government policy measures to curb price increases, a recovery in consumer confidence driven by easing tensions in the Middle East will also provide a tailwind. Recently, the Consumer Confidence Index has been showing signs of bottoming out.

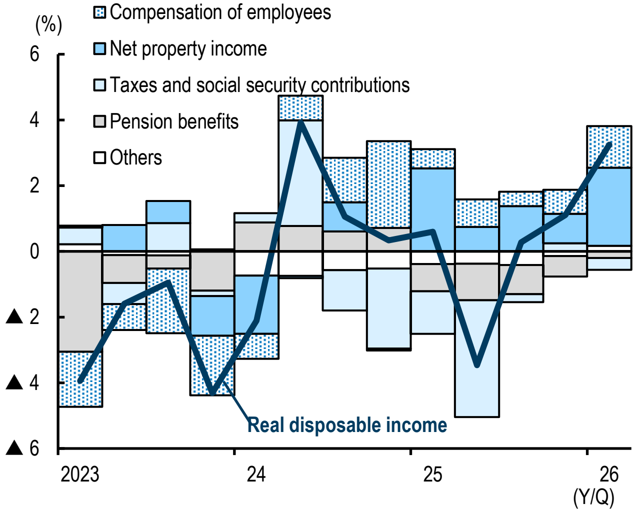
However, a reverse wealth effect stemming from falling stock prices is a potential cause for concern. The Nikkei Stock Average, which reached a new high in June, has been struggling to push higher since the start of July. Estimates suggest the wealth effect is concentrated among elderly households, but in recent years working-age households have also increased their holdings of equity-related assets, and the positive wealth effect for them may have supported consumption to some extent. For this reason, if stock prices were to fall significantly, there is a danger of downward pressure on consumption across a wide range of households.

Figure 4-1 Real Consumption Activity Index <seasonally adjusted>



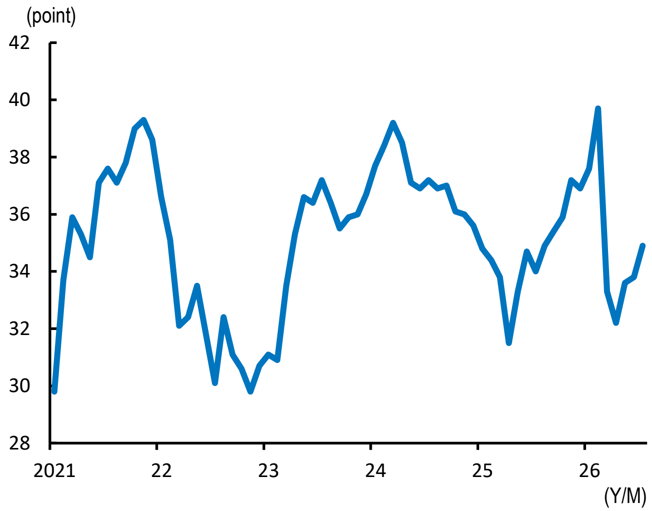
Source: Japan Research Institute, Ltd. based on data from the Bank of Japan

Figure 4-2 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 4-3 Consumer Confidence Index <seasonally adjusted>



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

Weakness in the manufacturing sector is rippling across the labor market

◆ The unemployment rate has settled in the mid-2% range

While the employment situation is generally favorable, weakness can be seen in some areas. The unemployment rate has remained in the mid-2% range since 2022. The number of employed persons in non-manufacturing, where business conditions are favorable, is holding firm, while in manufacturing the number remains at a level below that seen before the COVID-19 pandemic.

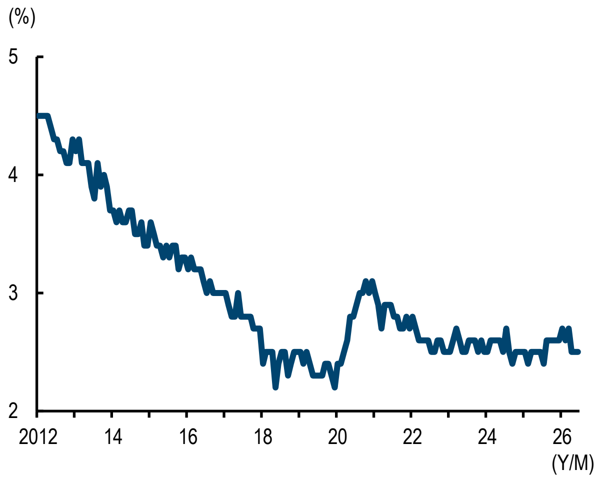
In the background to the drop in manufacturing employment is a slump in production activity. Manufacturing output has been shrinking due to the effects of U.S. tariff policy, soaring raw material prices, and a decline in the international competitiveness of Japanese firms. As a result, pressure to reduce headcounts has been building. Even in non-manufacturing, some industries closely linked to manufacturing, such as transportation and wholesale/retail, are also exhibiting weakness in labor demand.

◆ The employment situation could remain fragile in the near term

Looking ahead at the employment situation in the short term, a sense of stagnation may persist. The contraction in output in the manufacturing sector will continue to weigh on labor demand. Although production activity has been brisker recently, particularly in semiconductor-related industries, the employment-creation capacity of such industries is small. The employment-inducement coefficient per unit of new demand tends to be lower than in other sectors, meaning that the industries lack the strength to serve as drivers of employment.

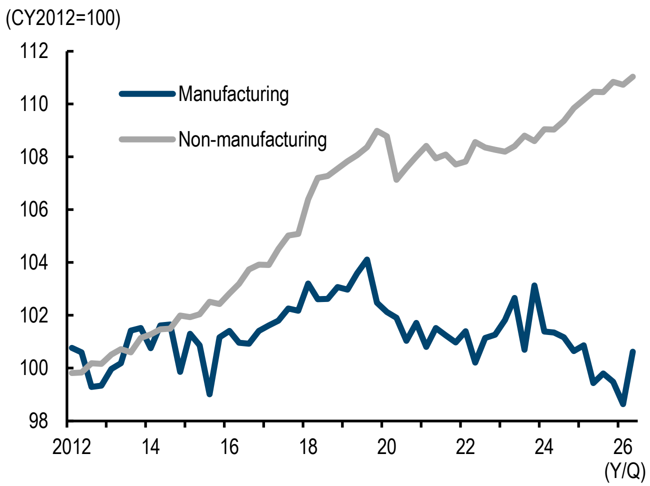
However, in the medium to long term, the unemployment rate is expected to see a gradual decline. Demand for labor is projected to stay solid, especially in face-to-face services such as medical/nursing care and accommodation and eating/drinking services, but the number of people seeking employment from the non-labor force population has declined significantly due to the expansion in elderly and female workforce participation. With limited room for expansion in the labor supply, the job market is expected to tighten further.

Figure 5-1 Unemployment Rate <seasonally adjusted>



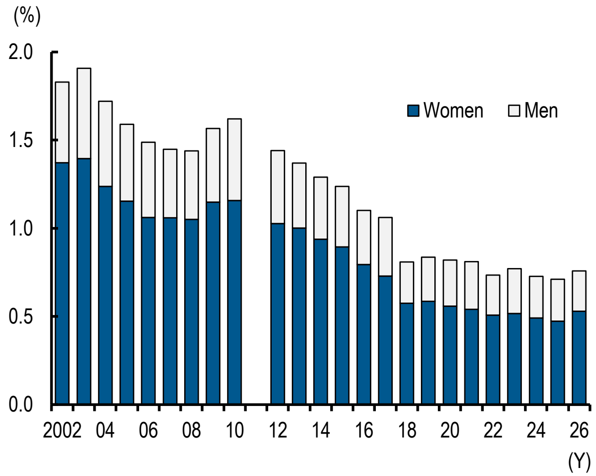
Source: Japan Research Institute, Ltd. based on data from the Ministry of Internal Affairs and Communications

Figure 5-2 Number of Employed Persons <seasonally adjusted>



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

Figure 5-3 Persons Wishing to Work Among Those Not in the Labor Force



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

Note: The ratio of persons not in the labor force who wish to work and are available for employment to the population aged 15 and over. The figure for 2026 is as of Q1. Data for 2011 are unavailable due to the impact of the Great East Japan Earthquake.

The government is curbing inflation

◆ Policy factors are pushing down the inflation rate

In June, core inflation (all items, less fresh food) was 1.6%, staying under 2% for the fifth consecutive month. Food price inflation has slowed, and a major reason for this is a fallback in rice prices, which soared last year. Gasoline subsidies are also continuing to curtail energy price increases.

Inflation looks set to hover in the 2% range in the second half of 2026. Although energy subsidies and other government measures will soften inflationary pressure to some extent, with imported inflationary pressure building, prices are expected to be pushed up as higher costs are passed through to selling prices. From FY2027 onward, the 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 (BOJ) will keep its policy rate unchanged

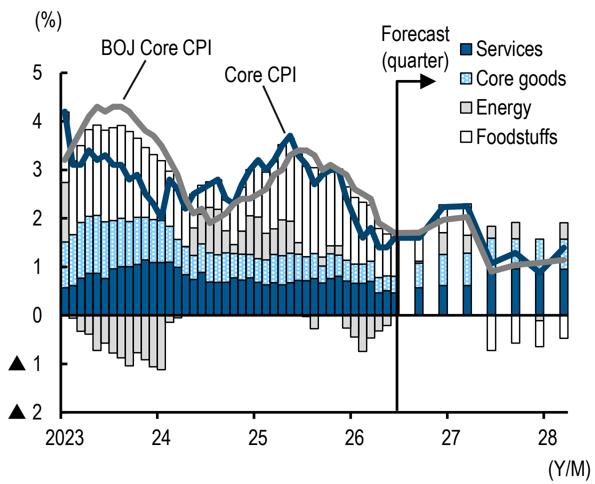
At its July monetary policy meeting, the BOJ decided to keep its policy rate unchanged.

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.

The BOJ is expected to step up the pace of interest rate hikes while closely monitoring the impact of higher rates on the real economy and financial/capital markets. The next rate hike is expected to be in September.

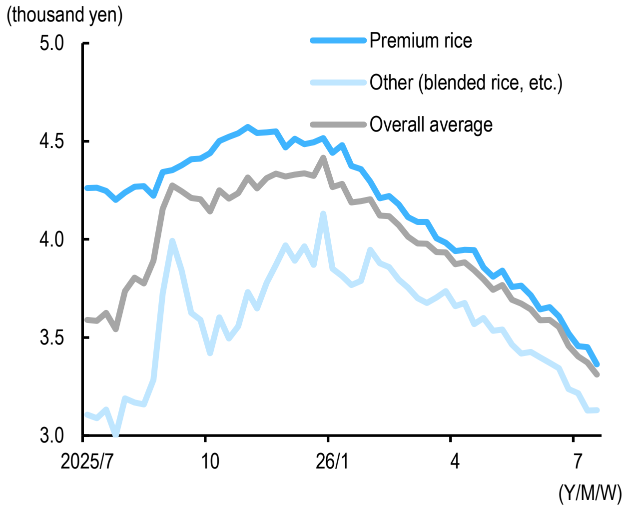
Long-term interest rates look likely to rise gradually, reflecting heightened anticipation of rate hikes by the BOJ and increased fiscal spending by the government. If jitters about a deterioration in fiscal discipline resulting from such measures as energy subsidies or the consumption tax cut take hold, there is also a risk that long-term interest rates will rise.

Figure 6-1 Consumer Price Index <YoY>



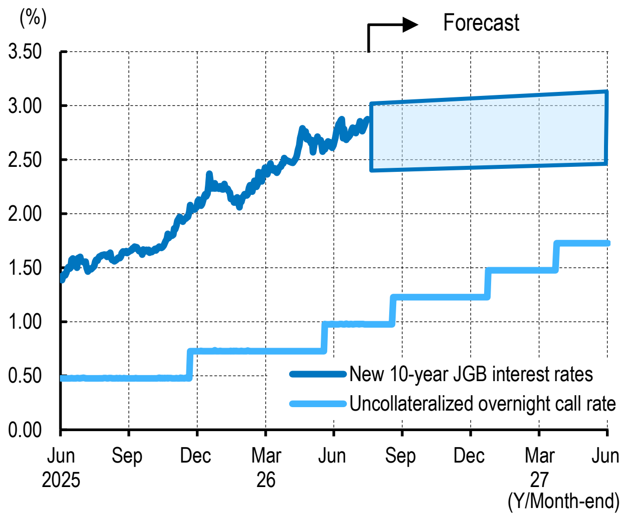
Source: Japan Research Institute, Ltd. based on data from the Ministry of Internal Affairs and Communications

Figure 6-2 Rice Selling Prices



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

Figure 6-3 Outlook for Japan's Main Interest Rates



Source: NEEDS-FinancialQUEST

Topic: Consumer price inflation pressure will strengthen again in the second half of the year

◆ Surging crude oil prices have become a source of upward pressure on prices

With crude oil prices having spiked against the backdrop of the worsening situation in the Middle East, corporate input costs have risen sharply, and pressure for price pass-through is intensifying. Looking at the Final Demand-Intermediate Demand price indexes, the margin of price increases at the upstream stage far exceeds that at the downstream stage, and price pass-through pressure is also substantial at the downstream stage.

According to estimates based on past data, the impact of rising oil prices involves a time lag. Specifically, the push-up effect on the consumer price inflation rate increases for around 10 months and continues to exert influence for a long period thereafter.

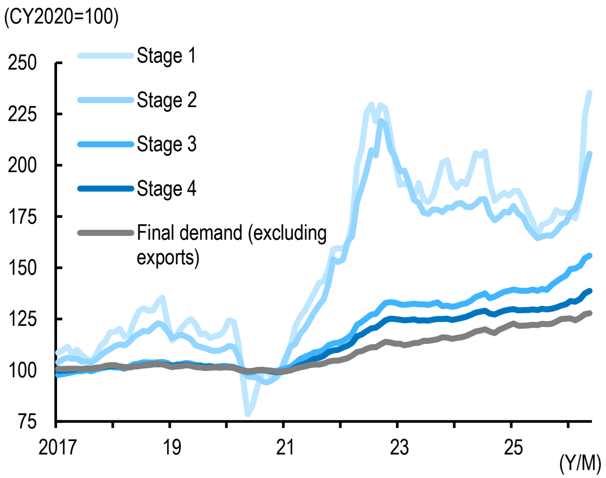
◆ Price pass-through willingness is also stronger than before

Notably, food product manufacturers are planning to raise prices for a huge number of items during the summer and beyond. According to Teikoku Databank, the number of items slated for price increases as of the end of July, when it conducted its latest survey, was higher than in the May and June surveys.

If government subsidies for electricity/gas bills and gasoline prices are scaled back or ended, both energy and food prices will increase concurrently, and the consumer price inflation rate may rise again.

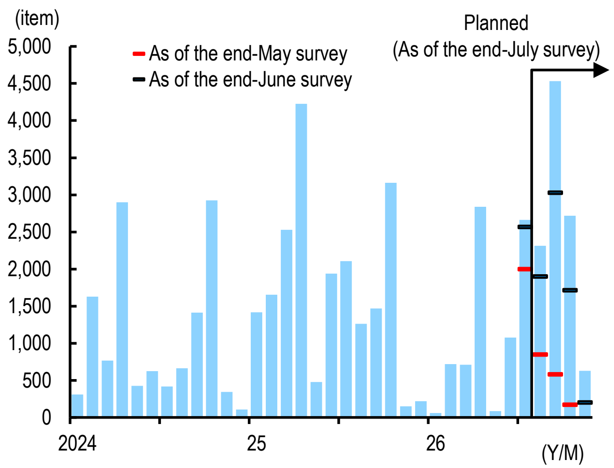
Attention also needs to be paid to the possibility that price pass-through driven by elevated oil prices will become prolonged. In the 2020s, the rate of price increases in transactions between companies has been higher than in the 2010s, and firms' medium-term outlooks for selling prices have also shifted upward. Events that trigger cost increases, such as heightened geopolitical tensions, have been occurring repeatedly, and companies may be more willing to pass through higher costs to prices than they were before.

Figure 7-1 Final Demand and Intermediate Demand Price Indexes (Goods)



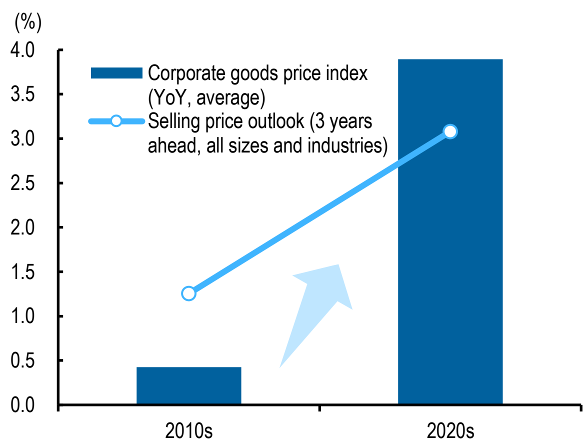
Source: Japan Research Institute, Ltd. based on data from the Bank of Japan

Figure 7-2 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 7-3 Corporate Goods Price Index and Selling Price Outlook



Source: Japan Research Institute, Ltd. based on data from the Bank of Japan
Note: The corporate goods price outlook is the average YoY change. The BOJ Tankan selling price outlook is based on data available from Q1 2014 onward.

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

◆ 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. Supply chain disruptions resulting from the deterioration in the Middle East situation will begin to ease, and corporate production activity is expected to gradually recover.

In the household sector, inflationary pressure is expected to strengthen from the summer onward due to higher crude oil prices. In response, the government will probably ease the 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 reduction in the consumption tax rate for food items should also support personal consumption.

◆ The Middle East situation and rising interest rates constitute risks

Real GDP growth is projected to remain solid, registering +0.8% in FY2026 and +0.9% in FY2027.

However, if the situation in the Middle East worsens again or becomes prolonged, there is a risk that downward pressure on the economy will intensify, mainly 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, the yen could weaken further, and 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 August 17, 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	1.9	1.1	0.3	0.8	0.9	1.4	1.2	0.9	0.8	0.9	0.8	0.9
Private Consumption Expenditure	1.9	-0.1	0.5	0.4	0.4	1.8	1.5	0.9	0.8	1.3	0.7	1.1
Housing Investment	3.8	-1.8	0.0	-0.1	-0.3	-0.4	-0.5	-0.5	-0.5	-2.6	0.6	-0.3
Business Fixed Investment	-3.8	-4.6	2.7	1.7	1.7	1.5	1.2	1.2	1.0	2.3	-0.5	1.5
Private Inventories (percentage points contribution)	(-0.3)	(0.9)	(-0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.0)	(-0.1)	(-0.0)	(0.1)
Government Consumption Expenditure	1.5	6.7	1.1	1.1	1.1	1.1	1.1	1.1	1.1	0.8	2.6	1.1
Public Investment	6.0	-0.4	1.0	1.0	1.0	0.9	0.8	0.8	0.8	-0.3	1.0	0.9
Net Exports (percentage points contribution)	(1.3)	(1.9)	(-1.4)	(-0.3)	(-0.2)	(-0.3)	(-0.2)	(-0.2)	(-0.2)	(-0.1)	(0.4)	(-0.3)
Exports of Goods and Services	7.1	2.1	-1.0	0.9	1.3	1.5	1.6	1.7	1.7	2.0	1.6	1.3
Imports of Goods and Services	1.1	-6.0	4.9	2.3	2.2	2.8	2.7	2.5	2.5	2.5	-0.2	2.7

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

Nominal GDP	3.8	3.2	3.2	3.6	3.5	5.1	2.7	2.3	2.9	4.3	3.4	3.2
GDP deflator	3.2	2.6	2.2	2.8	2.6	4.4	1.7	1.3	1.8	3.3	2.5	2.3
Consumer Price Index (excluding fresh food)	1.8	1.5	1.6	2.3	2.3	1.1	1.3	0.8	1.3	2.8	1.9	1.1

Unemployment Rate (%)	2.7	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.6	2.5	2.5
Exchange Rates (JY/US$)	157	159	160	159	159	158	158	158	156	151	159	158
Import Price of Crude Oil (US$/barrel)	67	111	82	83	82	79	76	73	73	71	89	75

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.