English translation published in November 2026

Monthly Report of Prospects for Japan's Economy

October 2026

Macro-economics Research Center
Economics Department

The Japan Research Institute, Limited

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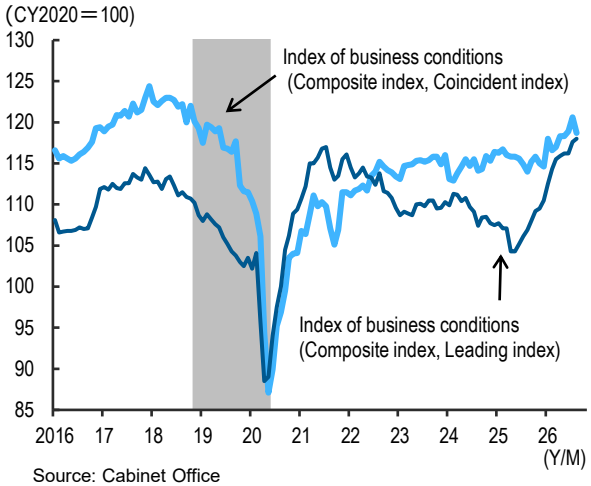
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The General Situation – The economy is gradually recovering, though activity has stalled in some areas

Figure 1-1 Economic Activity

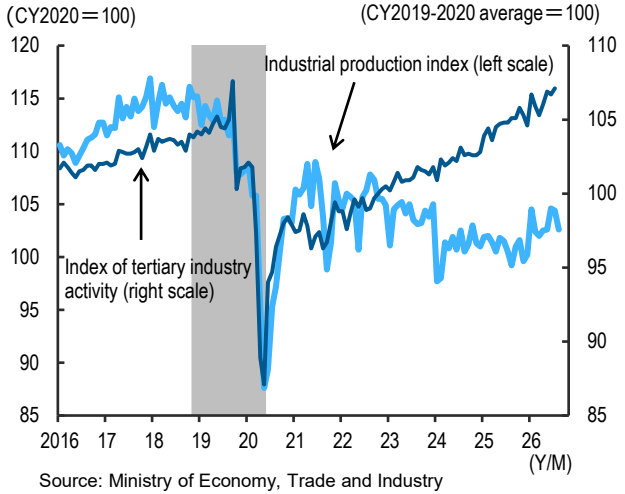
The coincident index of business conditions is picking up.
The leading index is on the rise.



Source: Cabinet Office

Figure 1-2 The Corporate Sector

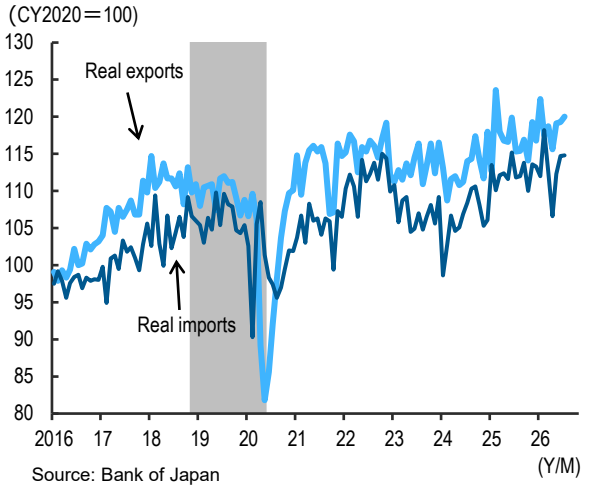
Industrial production is picking up.
Economic activity in the service sector is firm.



Source: Ministry of Economy, Trade and Industry

Figure 1-3 External Demand

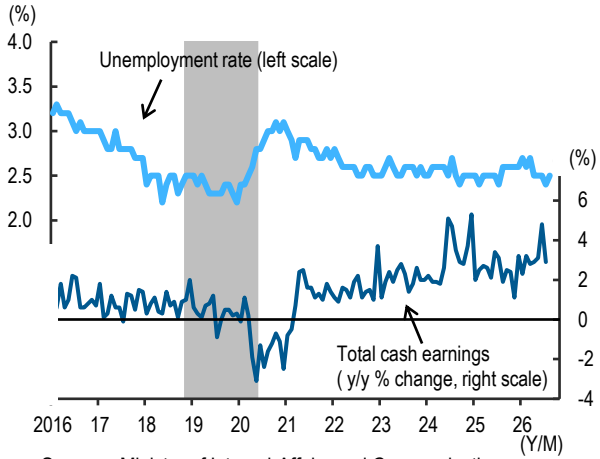
Exports are gradually rising.
Imports are flat overall.



Source: Bank of Japan

Figure 1-4 Employment and Income

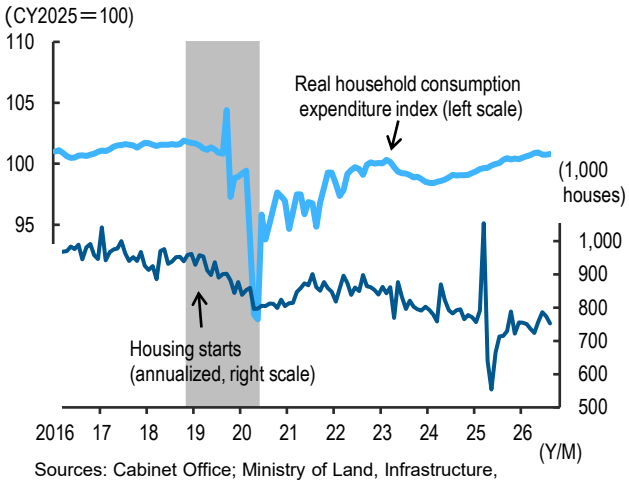
The unemployment rate is low, hovering around 2.5%.
Nominal wage growth is trending higher



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

Figure 1-5 The Household Sector

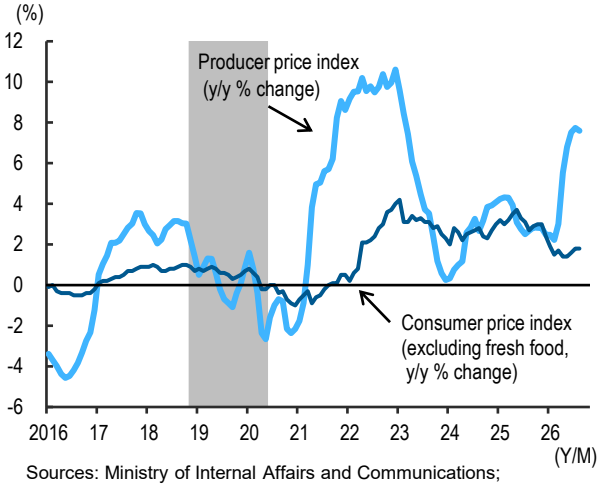
Consumption continues to gradually recover.
Housing starts are weak.



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

Figure 1-6 Prices

Producer price inflation is accelerating.
Consumer prices are bottoming out.



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 in the manufacturing sector has improved

In the September Tankan survey from the Bank of Japan (BOJ), the diffusion index (DI) for business conditions for large manufacturing enterprises was up two percentage points from the previous survey. Production in the machinery sector is brisk, and business confidence in related industries such as non-ferrous metals has also improved, buoyed by an expansion of AI-related and semiconductor demand. The DI for large non-manufacturing enterprises was down two percentage points from the previous survey. Higher costs for fuel, personnel etc. weighed on confidence, which deteriorated in retailing, accommodation and eating/drinking services, and other sectors.

◆ The Kumamoto earthquake has depressed output

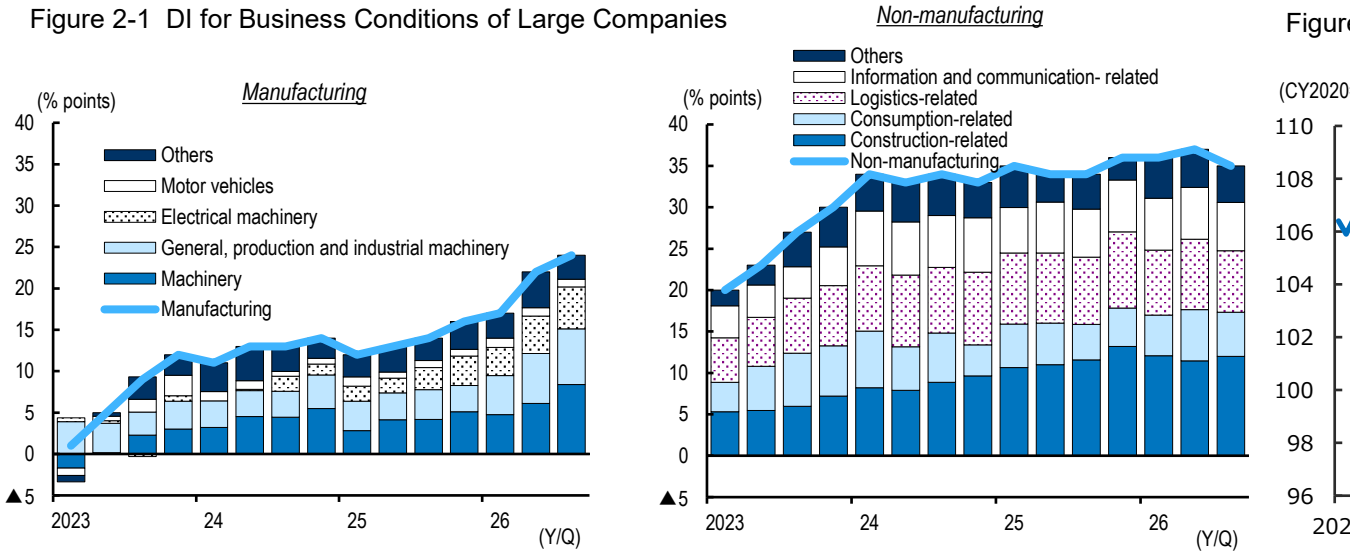
Production activity in the manufacturing sector is recovering. In August, the Industrial Production Index decreased by 1.7% month over month (MoM). Companies in a wide range of industries, and particularly those in the automobile industry, saw lower production due to an earthquake in Kumamoto that caused the suspension of factory operations. However, thanks to firm AI-related demand, output in sectors such as production machinery increased, and the overall tone was one of a pick-up in production activity.

According to the Industrial Production Index Forecast (adjusted based on past forecasting errors), near-future production plans indicate an increase in output in September of 1.6% MoM. Output in the machinery sector is expected to rise, buoyed by strong demand for semiconductors.

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

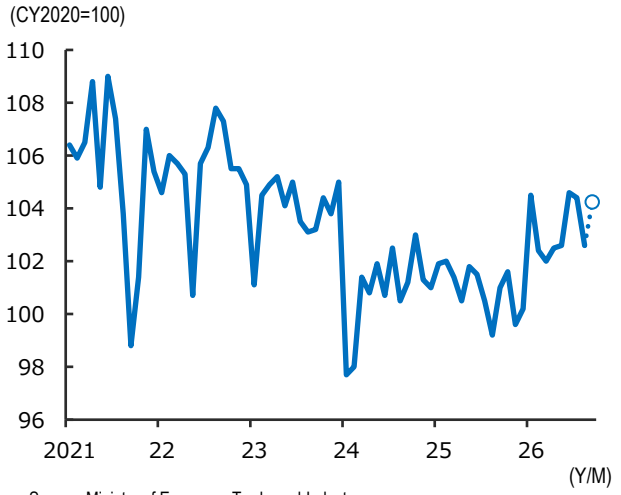
The number of foreign visitors to Japan in August was 9.6% lower than a year earlier. The overall figure was pushed down by a drop in the number of Chinese visitors as the impact of the Chinese government's advisory urging its citizens to refrain from traveling to Japan continued. However, the number of foreign visitors to Japan from major countries/territories other than China has recovered, and moved higher than the pre-COVID level.

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

Exports of goods, particularly capital goods, are picking up

◆ Goods exports are benefiting from strong exports of capital goods

Goods exports are picking up, though with fluctuations. By type, capital goods exports are rising, and have reached their highest level since 2022. Exports of manufacturing equipment for products such as semiconductors are particularly strong, thanks to the global AI boom.

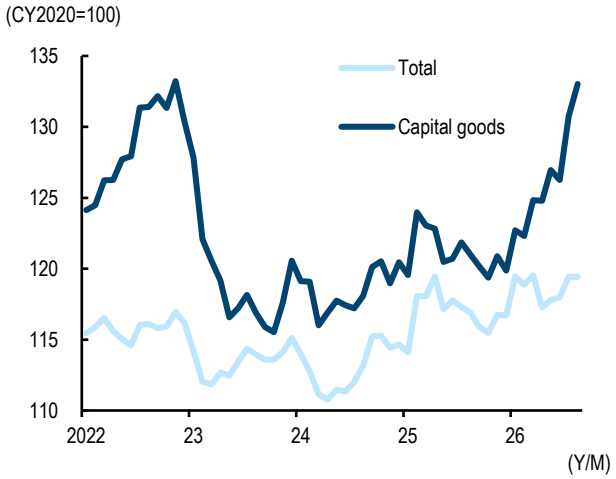
Looking ahead, the pick-up in exports of goods, centered on capital goods, is expected to continue. Orders for production machinery from overseas are soaring, and this will likely push up exports going forward. With the booming semiconductor market leading to rosy outlooks, chipmakers from South Korea, Taiwan and elsewhere are planning to build new fabs. The expansion of capital investment by these global companies is expected to create a tailwind for exports of manufacturing equipment for semiconductors and other products, an area in which Japan has strength.

◆ Appetite for investment among companies remains resilient

Capital investment is picking up overall. Looking at gross fixed capital formation by type, investment in intellectual property products has slumped, largely due to temporary factors related to R&D services, but construction investment is holding up and machinery investment is increasing.

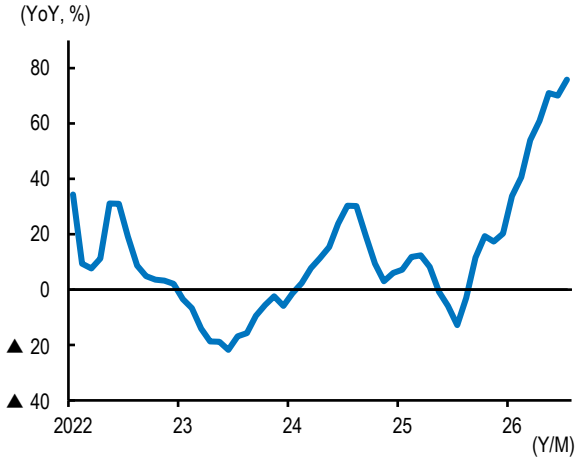
Capital investment is expected to pick up going forward. Appetite for capital investment among companies remains resilient. According to the BOJ's Tankan for September, while software investment is exhibiting weakness in certain areas, planned capital investment for FY2026 remains at a high level overall, and is on par with last year. Against a backdrop of worker and equipment shortages, demand for investment for production capacity expansion and labor-saving remains robust, even at small and medium-sized enterprises, which had indicated concerns about a downturn in the previous survey.

Figure 3-1 Real Exports <seasonally adjusted>



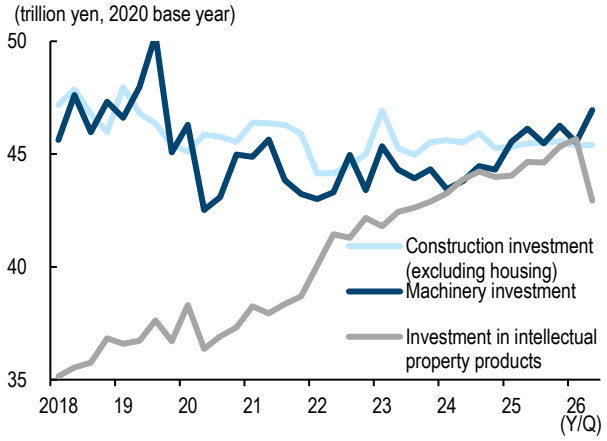
Source: Japan Research Institute, Ltd. based on data from the Bank of Japan
Note: Backward 3-month average.

Figure 3-2 Machinery Orders <External Demand>



Source: Japan Research Institute, Ltd. based on data from the Cabinet Office
Note: Backward 3-month average.

Figure 3-3 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."

A favorable income environment is supporting personal consumption

◆Real wages are rising

In August, the YoY increase in basic salaries of ordinary workers was 3.8%, remaining at a high level. Meanwhile, the hourly pay of part-time workers surged 4.1% YoY. Supported by these rises in nominal wages, YoY real wage growth was +1.5%, staying positive for the eighth month in a row.

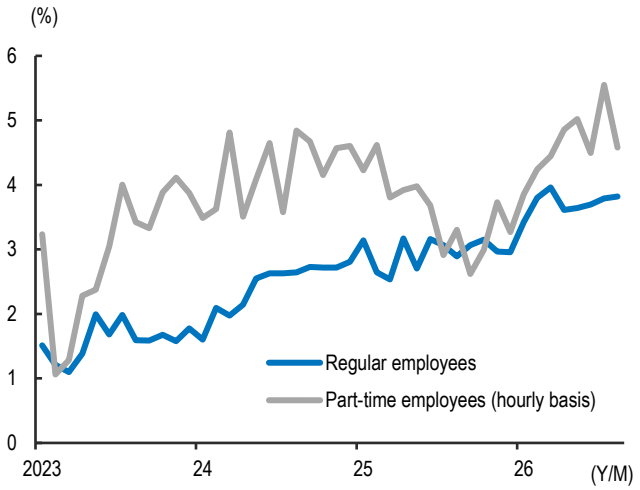
Looking ahead, positive YoY real wage growth is expected to be maintained. Against a backdrop of significant labor shortages, companies are becoming increasingly willing to raise wages, and minimum wage hikes will also push up pay, particularly for part-time workers. The average minimum wage across Japan's 47 prefectures will climb by 5.0% this fiscal year, a high rate of increase though slightly down from the previous fiscal year's.

◆ Consumption will hold firm in the near term

The Consumption Activity Index for August showed continued firmness in services consumption. However, consumption of non-durable goods was sluggish as food price inflation remained high, and the push-up effect on durable goods consumption of rush demand for air conditioners and lower automobile taxes petered out.

Personal consumption is expected to gradually recover going forward. In addition to rising real wages, it will also be supported by an improvement in consumer confidence recently. However, it should be noted that if imported inflationary pressure builds once again due to soaring resource prices, the resultant downturn in real wages could cause consumption to buckle.

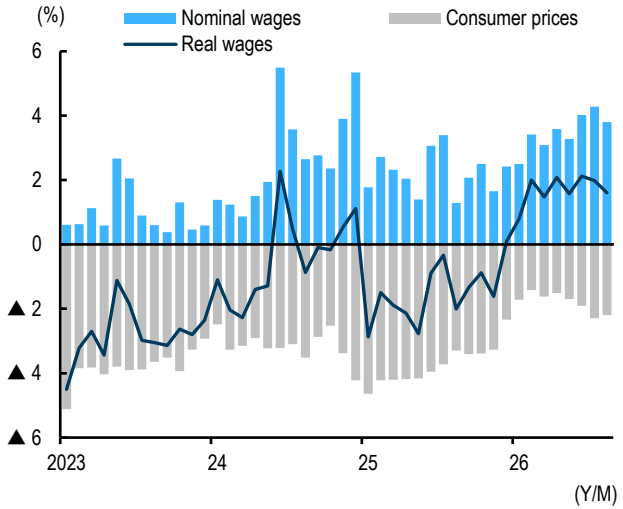
Figure 4-1 Scheduled Cash Earnings <YoY>



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.

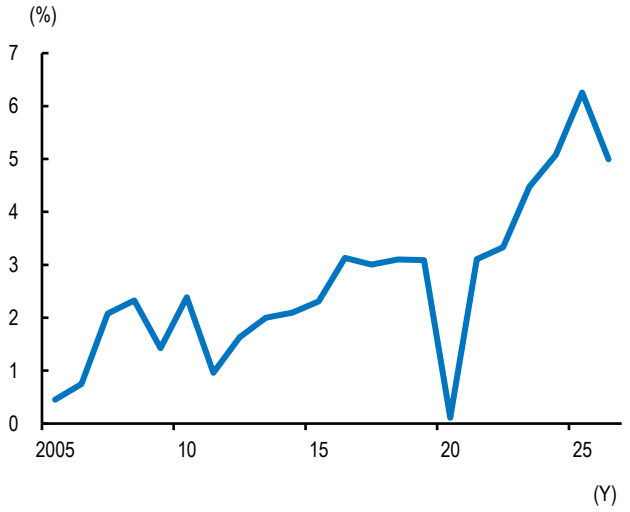
Figure 4-2 Real Wages <YoY>



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

Note: Data are adjusted for discontinuities arising from changes in survey coverage. Consumer prices refer to the overall CPI excluding imputed rent for owner-occupied housing.

Figure 4-3 Minimum Wage Trends <YoY>



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

Note: National weighted average.

Underlying inflationary pressure is intensifying

◆ Inflation remains high when policy factors are excluded

In August, core inflation (all items, less fresh food) was 1.7%, staying under 2%. Price increases for core goods such as smartphones accelerated due to soaring chip prices and other factors, but government measures to tackle high prices kept energy bills in check. When special factors such as these government measures are excluded, the inflation figure (BOJ official figure) was 2.6%, above the BOJ's 2% target, indicating that inflationary pressure remains stubborn.

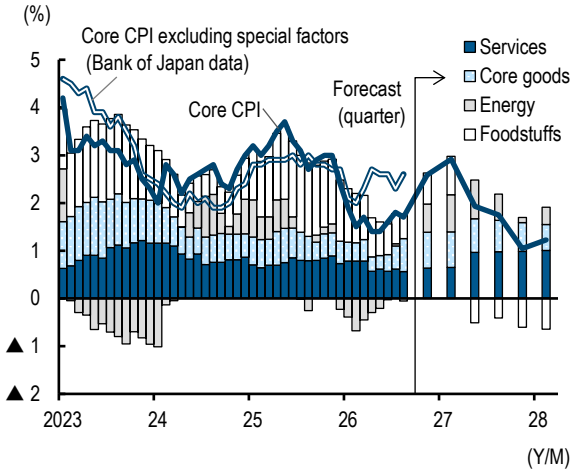
Inflation is expected to quicken in the near term. With the Middle East crisis re-igniting, crude oil prices remain elevated, and heading into the winter, energy prices will be pushed up by the planned ending of electricity and gas subsidies for households. In addition, underlying inflationary pressure stemming from rising wages is expected to intensify. Wages are currently rising at a pace exceeding productivity growth, a situation conducive to selling price increases through corporate price pass-through.

◆ The BOJ will accelerate the pace of interest rate hikes

At its monetary policy meeting in September, the BOJ hiked its policy rate to around 1.25%. The BOJ believes that the underlying inflation rate is close to 2%, and stands ready to continue raising interest rates. The next rate hike is expected to be in January 2027. After that, the BOJ is expected to increase rates at a pace of once every quarter, which will lift the policy interest rate to 2% in mid-2027.

Long-term interest rates look likely to rise gradually, impacted by overseas interest rates and reflecting 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.

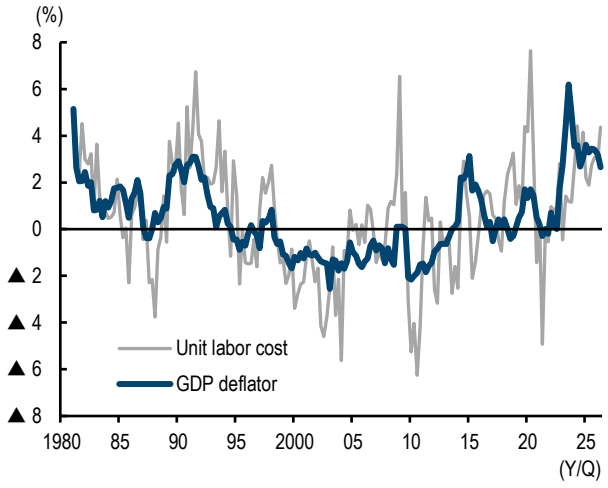
Figure 5-1 Consumer Price Index <YoY>



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

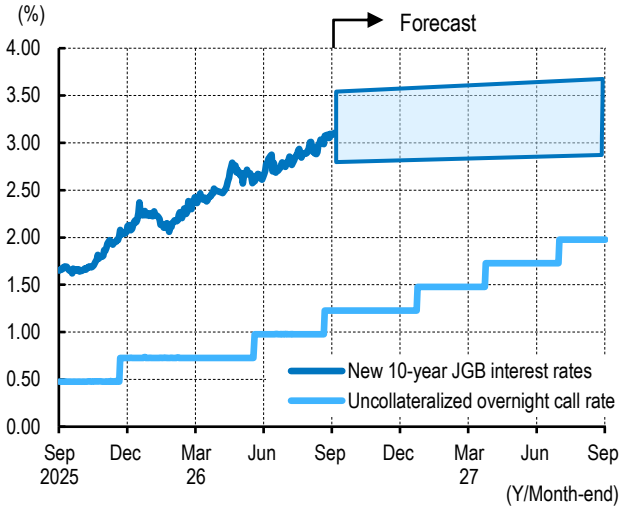
Note: Special factors include the effects of government measures to reduce household energy costs and policies providing free education and school meals, among others.

Figure 5-2 Unit Labor Cost and GDP Deflator <YoY>



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

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



Source: NEEDS-FinancialQUEST

Topic ①: The impact of rising interest rates on the housing market is shifting

◆ The housing transmission channel is changing

Mortgage interest rates have risen. In recent years, the housing channel, i.e., the pathway along which monetary policy impacts the economy via the housing market, has seen a weakening of transmission through housing prices, while transmission through debt repayment burdens may have strengthened. This change can be attributed to the following two factors:

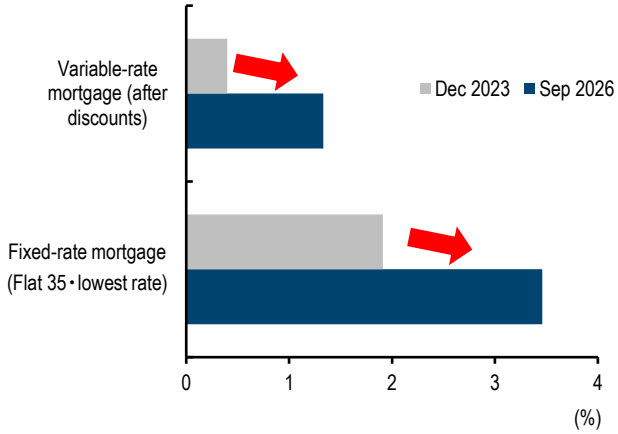
First, the proliferation of floating rate mortgages means that interest rate hikes increasingly affect existing borrowers as well as new ones. Although the loans feature mechanisms to curb sharp increases in repayment amounts, meaning the impact appears gradually over time, if the policy rate were to rise to around 2%, medium- to long-term repayment burdens would increase correspondingly. For households headed by people aged 39 or younger, the annual repayment burden would go up by an average of nearly 400,000 yen.

Second, in major cities such as Tokyo, the pushdown effect on housing prices from rate hikes may have weakened. There are constraints on housing supply in large cities, and the concentration of population and businesses means market expectations for housing price rises are bullish. In addition, there has been an expansion of demand that is less sensitive to interest-rate fluctuations. For example, cash purchases by high-income households have increased. As a result, the demand-suppressing effect of rising interest rates has been partially muted, making housing price adjustments less likely.

◆ Disparities could also widen as a result of delayed asset accumulation and other factors

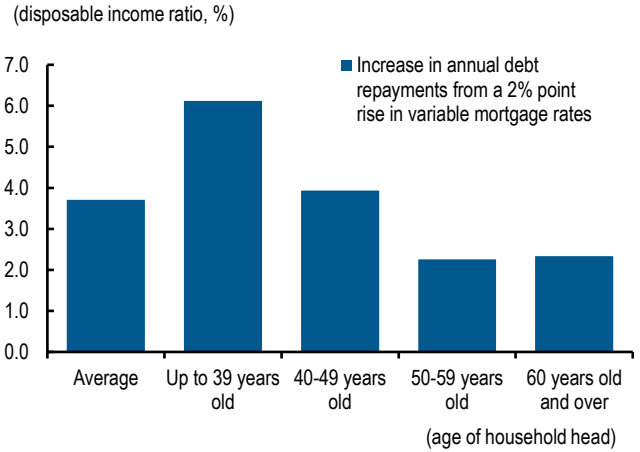
Such changes in the housing channel may increase the burden on younger generations and households with children. The impact on existing borrowers is particularly large among households of people in their 20s and 30s who took out large mortgages during the low-interest-rate era. If housing prices in urban areas do not adjust sufficiently, households seeking to purchase a home for the first time will face the dual burden of high housing prices and rising interest rates, raising the barriers to homeownership. For many, therefore, the start of the process of asset accumulation through homeownership could be delayed, potentially leading to a

Figure 6-1 Major Mortgage Rates



Source: Japan Research Institute, Ltd. based on data from the Japan Housing Finance Agency, websites of major city banks, and various media

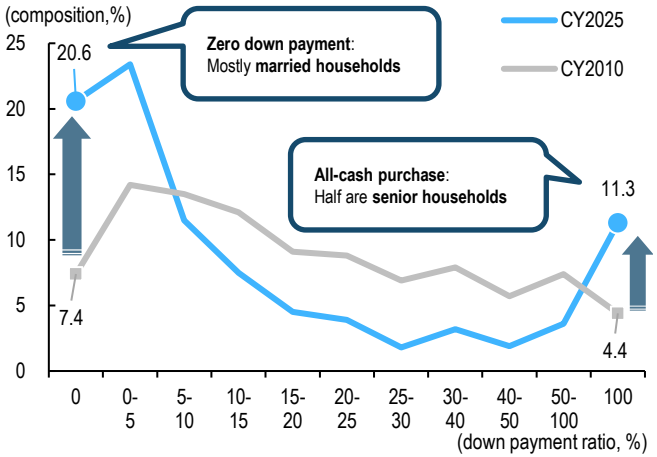
Figure 6-2 Increase in Debt Repayment Burden for Mortgage-Borrowing Households



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

Note: The increase in debt repayments assumes equal principal and interest payments. The remaining loan term is calculated as outstanding mortgage debt divided by annual repayments on housing and land-related loans. Mortgage rates are assumed to rise from 0.5% to 2.5%.

Figure 6-3 Down Payment Ratio for Home Purchases



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

Note: Survey respondents are purchasers of newly built condominiums in the Tokyo metropolitan area.

Topic ②: Surging fresh food prices due to prolonged rain and insufficient sunshine

◆ Cases of poor vegetable growth due to lack of sunshine have been occurring one after another

This summer saw a record-breaking period of prolonged rainfall, centered on eastern Japan. Tokyo bore the brunt, with 37 consecutive rainy days from late August through early October, the most since records began. And nationwide, too, sunshine hours in September were at record-low levels.

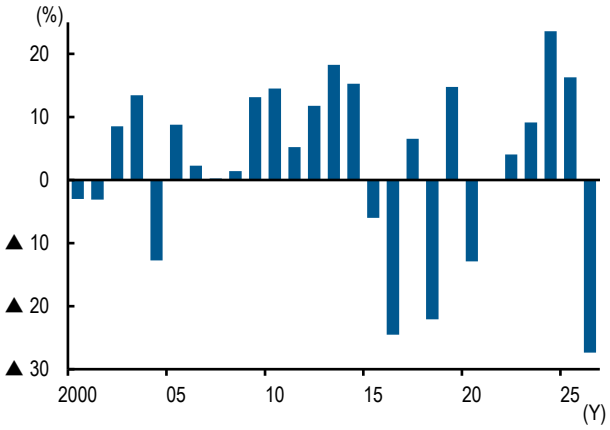
This persistent rain and accompanying lack of sunshine have stunted the growth of vegetables, which could push up the prices of fresh food. According to a survey conducted by the Ministry of Agriculture, Forestry and Fisheries involving interviews in major production areas and with wholesalers, poor growth has been reported for many vegetables, with the main production areas of eastern Japan most affected. Signs of price surges are already appearing for some vegetables: wholesale prices of leafy greens such as lettuce and Chinese cabbage have recently reached almost twice the level of typical years. Growth irregularities have also been observed in winter vegetables such as daikon radish and spinach, so prices could remain elevated going into the winter and beyond.

◆ There are fears of a stall in consumption

The impact of rises in fresh food prices may also spill over into price increases for processed foods and eating out. Food product manufacturers and restaurants have, in recent years, increasingly been passing on their higher purchasing costs to customers in the form of higher menu prices, creating a situation in which spikes in raw ingredient prices quickly feed through to consumer prices.

If food price increases become widespread, concerns about the outlook for consumption could grow. Higher prices for frequently purchased essentials such as food impose a heavy toll on household finances, and tend to lead to lower consumer confidence. Attention should also be paid to the possibility that worsening consumer sentiment could put significant downward pressure on personal consumption, which has been recovering recently.

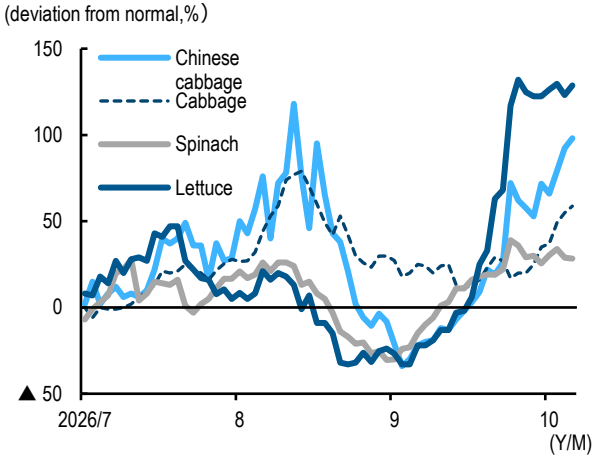
Figure 7-1 September Sunshine Duration <Deviation from Normal>



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

Note: Sunshine duration data for the 11 regional forecast districts are weighted by each region's share of agricultural output. Deviation from normal is measured against the average for 1991-2020.

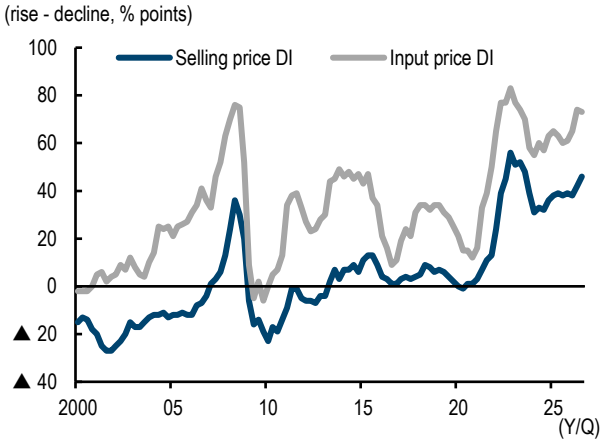
Figure 7-2 Wholesale Prices of Major Vegetables at the Tokyo Metropolitan Central Wholesale Market



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

Note: Deviation from normal is measured against the average for the past.

Figure 7-3 Price DI in the Food Manufacturing Industry



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

The economy will recover gradually in the near term, but downside risks are present

◆ The economy will stay on a moderate recovery track

Although some areas of the Japanese economy are showing signs of stagnation, the outlook is for a return to a moderate recovery track. WTI crude oil futures prices are expected to remain elevated for the time being due to the re-ignition of the Middle East crisis, but to decline gradually thereafter.

In the corporate sector, capital investment is expected to pick up. Although the high oil prices resulting from the re-ignition of the Middle East crisis will weigh on investment, demand for investment for labor saving and other purposes will remain solid, and government measures to support investment will also provide a tailwind. AI-related demand is strong globally, and this is also expected to support exports.

In the household sector, personal consumption should remain resilient. While elevated oil prices will exert inflationary pressure, government measures to support households will probably ease the impact to some degree. With rates of increase in nominal wages still high, real wage growth is in positive territory, and the favorable income environment is expected to continue. From FY2027 onward, the reduction in the consumption tax rate for food items should also support consumption.

◆ The increasingly grave Middle East situation and rising interest rates constitute risks

Real GDP growth is projected to be +1.0% in FY2026 and +0.9% in FY2027. However, if the situation in the Middle East lasts longer or becomes more serious than anticipated, supply constraints could tighten and exports could take a hit, and there is a risk that downward pressure on the economy will intensify significantly through such channels as lower real incomes due to rising prices. In addition, if market concerns about the fiscal stance of the Takaichi government grow, long-term interest rates could rise further than expected, and private-sector demand could be pushed down. Moreover, higher borrowing costs for the government could hamper its ability to implement and sustain policies such as investment support measures, gasoline subsidies, and lower consumption tax.

Figure 8　Projections for Japan's GDP Growth and Main Indicators (as of October 14, 2026)

(seasonally adjusted, annualized % changes from the previous quarter)

	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	1.4	0.1	1.0	0.8	1.4	1.1	0.8	0.6	0.9	1.0	0.9
Private Consumption Expenditure	1.8	0.0	0.5	0.4	0.4	1.8	1.5	0.9	0.8	1.3	0.7	1.1
Housing Investment	3.8	−2.3	0.0	−0.1	−0.3	−0.4	−0.5	−0.5	−0.5	−2.6	0.5	−0.3
Business Fixed Investment	−3.9	−3.7	2.5	1.7	1.7	1.5	1.2	1.2	1.0	2.2	−0.3	1.5
Private Inventories (percentage points contribution)	(−0.2)	(1.0)	(−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	6.9	1.1	1.1	1.1	1.1	1.1	1.1	1.1	0.8	2.6	1.1
Public Investment	5.5	−1.8	1.0	1.0	1.0	0.9	0.8	0.8	0.8	−0.3	0.5	0.9
Net Exports (percentage points contribution)	(1.3)	(1.9)	(−1.5)	(−0.0)	(−0.3)	(−0.3)	(−0.4)	(−0.4)	(−0.3)	(−0.1)	(0.4)	(−0.3)
Exports of Goods and Services	7.0	1.6	−1.4	0.8	1.0	1.1	1.2	1.2	1.3	2.0	1.4	1.0
Imports of Goods and Services	1.0	−6.5	4.7	0.9	2.2	2.3	2.6	2.8	2.8	2.5	−0.5	2.5

(% changes from the previous fiscal year)

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

Nominal GDP	3.8	3.5	4.6	4.6	4.6	3.4	3.5	2.9	3.0	4.3	4.3	3.2
GDP deflator	3.2	2.6	3.4	3.7	3.6	2.7	2.4	1.9	2.1	3.3	3.3	2.3
Consumer Price Index (excluding fresh food)	1.7	1.5	1.8	2.6	2.9	1.9	1.7	1.0	1.2	2.7	2.2	1.5
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$)	157	159	159	158	158	157	156	156	154	151	159	156
Import Price of Crude Oil (US$/barrel)	67	111	102	113	113	112	106	101	95	71	110	103

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.