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# *Outlook for Economic Activity and Prices*

*October 2025*



(English translation prepared by the Bank's staff based on the Japanese original)

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## Outlook for Economic Activity and Prices (October 2025)

### The Bank's View<sup>1</sup>

#### Summary

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- Japan's economic growth is likely to be modest, as trade and other policies in each jurisdiction lead to a slowdown in overseas economies and to a decline in domestic corporate profits and other factors, although factors such as accommodative financial conditions are expected to provide support. Thereafter, Japan's economic growth rate is likely to rise, with overseas economies returning to a moderate growth path.
  - The year-on-year rate of increase in the consumer price index (CPI, all items less fresh food) is likely to decelerate to a level below 2 percent through the first half of fiscal 2026, with the waning of the effects of the rise in food prices, such as rice prices. Meanwhile, underlying CPI inflation is likely to be sluggish, mainly affected by the growth pace of the economy. Thereafter, since it is projected that a sense of labor shortage will grow as the economic growth rate rises and that medium- to long-term inflation expectations will rise, it is expected that underlying CPI inflation and the rate of increase in the CPI (all items less fresh food) will increase gradually and, in the second half of the projection period, be at a level that is generally consistent with the price stability target.
  - Comparing the projections with those presented in the previous *Outlook for Economic Activity and Prices* (Outlook Report), the projected real GDP growth rates and the projected year-on-year rates of increase in the CPI (all items less fresh food) are more or less unchanged.
  - There are various risks to the outlook. In particular, it still remains highly uncertain how overseas economic activity and prices will react to trade and other policies in each jurisdiction. It is therefore necessary to pay due attention to the impact of these developments on financial and foreign exchange markets and on Japan's economic activity and prices.
  - With regard to the risk balance, risks to economic activity are skewed to the downside for fiscal 2026. Risks to prices are generally balanced.
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<sup>1</sup> "The Bank's View" was decided by the Policy Board at the Monetary Policy Meeting held on October 29 and 30, 2025.

## **I. Current Situation of Economic Activity and Prices in Japan**

Japan's economy has recovered moderately, although some weakness has been seen in part. Overseas economies have grown moderately on the whole, although some weakness has been seen in part, reflecting trade and other policies in each jurisdiction. Exports and industrial production have continued to be more or less flat as a trend, although there has been some front-loading and a subsequent reactionary decline, due to the increase in U.S. tariffs. Corporate profits have remained at high levels on the whole, although downward effects due to tariffs have been seen in manufacturing, and business sentiment has stayed at a favorable level. In this situation, business fixed investment has been on a moderate increasing trend. Private consumption has been resilient against the background of an improvement in the employment and income situation, although it has been affected by price rises. On the other hand, housing investment has declined. Meanwhile, public investment has continued to be more or less flat. Financial conditions have been accommodative. On the price front, with moves to pass on wage increases to selling prices continuing, the year-on-year rate of increase in the CPI (all items less fresh food) has been at around 3 percent recently, due to the effects of the rise in food prices, such as rice prices, and other factors. Inflation expectations have risen moderately.

## **II. Baseline Scenario of the Outlook for Economic Activity and Prices in Japan<sup>2</sup>**

### **A. Baseline Scenario of the Outlook for Economic Activity**

Japan's economic growth is likely to be modest, as trade and other policies in each jurisdiction lead to a slowdown in overseas economies and to a decline in domestic corporate profits and other factors, although factors such as accommodative financial conditions are expected to provide support.

Exports and production are likely to show some weakness against the background of the slowdown in overseas economies, although global AI-related demand is expected to push up exports and production. Reflecting these developments, corporate profits are also likely to decrease, while being at high levels. In this situation, the growth rate of business fixed investment is likely to decelerate, affected by the slowdown in overseas economies, although it is expected that investment to address labor shortages, digital-related investment, research and development (R&D) investment related to growth areas and decarbonization, and investment associated with strengthening supply chains will continue and that accommodative financial conditions will provide support. Regarding the employment and income situation, despite the modest growth of the economy, labor market conditions are likely to remain tight, as it will become more difficult for labor supply of women and seniors to increase. Against this backdrop, nominal wages are highly likely

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<sup>2</sup> Each Policy Board member makes their forecasts taking into account the effects of past policy decisions and with reference to views incorporated in financial markets regarding the future conduct of policy.

to continue increasing, partly due to minimum wage increases, although the growth rate of nominal wages is likely to decelerate somewhat, affected by the decline in corporate profits. Although private consumption is expected to be more or less flat for the time being due to the remaining impact of price rises, it is projected to gradually return to a moderate increasing trend, with a continued rise in employee income. Meanwhile, private consumption is also projected to be underpinned by the government's initiatives such as the measures to reduce the household burden of higher energy prices and the tax reform in fiscal 2025. Housing investment is expected to follow a declining trend for the time being, and the subsequent pace of recovery is likely to remain moderate. Public investment is expected to be more or less flat, and government consumption is expected to increase moderately in reflection of an uptrend in healthcare and nursing care expenditures.

Thereafter, Japan's economic growth rate is likely to rise, with overseas economies returning to a moderate growth path. Exports and production are likely to return to an uptrend. Corporate profits are likely to improve with an increase in domestic and external demand, and business fixed investment is likely to continue on an increasing trend, partly due to investment for capacity expansion to address the rise in demand. Looking at the employment and income situation, the growth rate of nominal wages is expected to accelerate, with a growing sense of labor shortage, and private consumption is projected to increase moderately.

The projected real GDP growth rates are more or less unchanged from those presented in the previous Outlook Report.

Meanwhile, the potential growth rate is expected to rise moderately.<sup>3</sup> This is mainly because productivity is likely to increase due to advances in digitalization and investment in human capital, and because capital stock growth is projected to accelerate due to a rise in business fixed investment. Potential growth is likely to be supported by the government's various measures and other factors.

## **B. Baseline Scenario of the Outlook for Prices**

The year-on-year rate of increase in the CPI (all items less fresh food) is likely to decelerate to a level below 2 percent through the first half of fiscal 2026, with the waning of the effects of the rise in food prices, such as rice prices. Meanwhile, underlying CPI inflation is likely to be sluggish, mainly affected by the growth pace of the economy. However, it is likely that the mechanism in which wages and prices rise moderately in

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<sup>3</sup> Under a specific methodology, Japan's recent potential growth rate is estimated to be around 0.5 percent. However, the rate should be interpreted with considerable latitude. This is because the estimate is subject to change depending on the methodologies employed and could be revised as the sample period becomes longer over time. In addition, there are high uncertainties over how factors such as advances in digitalization will affect the trends in productivity or labor supply.

interaction with each other will be maintained, and since it is projected that a sense of labor shortage will grow as the economic growth rate rises and that medium- to long-term inflation expectations will rise, it is expected that underlying CPI inflation and the rate of increase in the CPI (all items less fresh food) will increase gradually thereafter and, in the second half of the projection period, be at a level that is generally consistent with the price stability target.

The projected year-on-year rates of increase in the CPI (all items less fresh food) are more or less unchanged from those presented in the previous Outlook Report.

The outlook for the CPI (all items less fresh food) depends on the assumptions regarding crude oil prices and the government's measures. Crude oil prices are assumed to be more or less flat throughout the projection period, based, for example, on developments in futures markets. Looking at the CPI (all items less fresh food and energy) -- which is not directly affected by fluctuations in energy prices -- the year-on-year rate of increase is likely to be temporarily below 2 percent because it is expected that the effects of the rise in food prices, such as rice prices, will gradually wane and that this CPI will be affected by factors such as the growth pace of the economy. Thereafter, however, the rate of increase in this CPI is likely to be at around 2 percent as the economic growth rate rises.

The main factors that determine underlying inflation are assessed as follows. The output gap, which captures the utilization of labor and capital, has followed an improving trend, albeit with fluctuations. Based on the aforementioned outlook for economic activity, it is likely that the gap will remain at around the current level, but will improve again toward the end of the projection period. Meanwhile, labor market conditions have tightened to a greater extent than can be explained by the changes in the output gap, partly due to a deceleration in the pace of increase in labor force participation of women and seniors. In this situation, upward pressure on wages and prices is likely to be stronger than suggested by the output gap, given that firms in many industries have started to face labor supply constraints.

Medium- to long-term inflation expectations have risen moderately. Regarding the outlook, although it is projected that firms will maintain their active wage- and price-setting behavior and will continue their moves to reflect higher costs -- including increased personnel expenses and distribution costs -- in selling prices, inflation expectations are expected to be sluggish, mainly affected by the growth pace of the economy. Thereafter, as the economic growth rate rises and labor market conditions tighten notably, it is expected that firms' active wage- and price-setting behavior will become more widespread, and that inflation expectations will rise moderately again.

### III. Risks to Economic Activity and Prices

#### A. Risks to Economic Activity

Regarding the aforementioned baseline scenario of the outlook for economic activity, the main upside and downside risks that require attention are as follows.

The first is developments in overseas economic activity and prices under the impact of trade and other policies in each jurisdiction. Regarding trade and other policies, many countries and regions, including Japan, have reached agreements in negotiations with the United States since the summer. That said, high uncertainties still remain regarding the impact of trade and other policies on economic activity and prices at home and abroad. The trade policies announced so far are likely to push down domestic and overseas economies through various channels, such as the impact on global trade activity and the impact on business and household sentiment around the world and on global financial and capital markets. On this point, with regard to the U.S. economy, there are high uncertainties regarding the channels and timing through which downward effects due to tariffs will materialize, and attention is warranted on factors such as the impact on employment and income formation through a deterioration in corporate profits and the impact on private consumption through the pass-through to consumer prices of increased costs due to tariffs. Meanwhile, depending on factors such as the course of the situation surrounding Ukraine and the Middle East, downward pressure on overseas economies could heighten. Regarding the Chinese economy, there remain high uncertainties surrounding the future pace of growth, as adjustment pressure has continued in the real estate and labor markets. In addition, it is necessary to pay attention to how excessive supply capacity of some goods -- coupled with the effects of trade policies -- will affect global economic activity and prices. Moreover, attention needs to be paid to the possibility that developments such as recent moves toward fiscal expansion, particularly in the United States and Europe, could push up the global economy. Regarding AI, depending on developments in global demand, the global economy could be pushed either upward or downward, alongside other factors such as changes in asset prices.

The second risk is developments in import prices. Reflecting the aforementioned effects of trade and other policies in each jurisdiction, if disruptions in global logistics were to arise or moves to restructure supply chains were to take place and incur considerable costs, import prices could rise, and this could in turn push down domestic demand. In addition, attention continues to be warranted on the risk that prices of grains and other commodities will fluctuate significantly due to geopolitical factors, such as those concerning Ukraine and the Middle East. Furthermore, in the medium to long term, there are extremely high uncertainties surrounding, for example, efforts by countries around the world toward addressing climate change. Moreover, if import prices were to rise significantly, households' defensive attitudes toward spending could strengthen further,

and this could push down the economy. On the other hand, if import prices decline, the economy could deviate upward.

The third risk considered from a somewhat long-term perspective is the impact of various changes in the environment surrounding Japan on firms' and households' medium- to long-term growth expectations and on Japan's potential growth rate. It is expected that factors such as the experience of COVID-19, intensifying labor shortages, and progress on efforts with a view to decarbonization and on labor market reform will change Japan's economic structure and people's working styles. Intensifying labor shortages -- which are partly due to demographic changes -- could accelerate labor-saving investment, such as for digitalization. On the other hand, if such a substitution of labor with capital does not sufficiently progress, there is a risk that supply-side constraints in some industries will push down the growth rate. Furthermore, the trade policies announced so far could trigger a change in the trend of globalization, and depending on the future course of these policies, this change may accelerate.

## **B. Risks to Prices**

If the aforementioned risks to economic activity materialize, prices also are likely to be affected. In addition, it is necessary to pay attention to the following two risks that are specific to prices.

The first is firms' wage- and price-setting behavior and its impact on inflation expectations. Firms' behavior has shifted more toward raising wages and prices, and it is expected in the baseline scenario that the mechanism in which wages and prices rise moderately in interaction with each other will be maintained, although the modest growth of the economy is likely to affect price developments. However, if corporate profits going forward are significantly lower than expected due to the impact of trade and other policies in each jurisdiction, this could lead firms to focus more on cost cutting. As a result, moves to reflect price rises in wages could also weaken. On the other hand, moves to reflect wages in selling prices could strengthen to a greater extent than expected, and upward pressure on wages could intensify with growing expectations that labor market conditions will continue to be tight. In this situation, there is also a possibility that both wages and prices will deviate upward from the baseline scenario, accompanied by a rise in medium- to long-term inflation expectations. Meanwhile, the recent rise in food prices, such as rice prices, largely reflects temporary supply-side factors, and it is therefore expected that the contribution of this rise to the CPI will gradually wane. That said, attention is warranted on the possibility that, if new temporary factors arise or if the pass-through of increased personnel expenses and distribution costs to selling prices strengthens, the rise in food prices could persist for longer than expected. Since consumers purchase food items on a frequent basis, if the price rises persist, the CPI could be pushed up through changes in inflation expectations. On the other hand, it is also possible that the CPI could be pushed



down, as private consumption could decline through a deterioration in household sentiment.

The second risk is future developments in foreign exchange rates and import prices, including international commodity prices, as well as the extent to which such developments will spread to domestic prices. This risk may lead prices to deviate either upward or downward from the baseline scenario. There are still high uncertainties over the outlook for the global economy, including the impact of trade and other policies in each jurisdiction, which could lead to a rise in import prices from the supply side or to significant fluctuations in foreign exchange rates and international commodity prices. In this regard, with firms' behavior shifting more toward raising wages and prices recently, exchange rate developments are, compared to the past, more likely to affect prices.

#### **IV. Conduct of Monetary Policy**

In the context of the price stability target, the Bank assesses the aforementioned economic and price situation from two perspectives and then outlines its thinking on the future conduct of monetary policy.<sup>4</sup>

The first perspective involves an examination of the baseline scenario of the outlook. The year-on-year rate of increase in the CPI (all items less fresh food) is likely to decelerate to a level below 2 percent through the first half of fiscal 2026. Meanwhile, underlying CPI inflation is likely to be sluggish, mainly affected by the growth pace of the economy. Thereafter, since it is projected that a sense of labor shortage will grow as the economic growth rate rises and that medium- to long-term inflation expectations will rise, it is expected that underlying CPI inflation and the rate of increase in the CPI (all items less fresh food) will increase gradually and, in the second half of the projection period, be at a level that is generally consistent with the price stability target.

The second perspective involves an examination of the risks considered most relevant to the conduct of monetary policy. There are various risks surrounding Japan's economic activity and prices. In particular, it still remains highly uncertain how overseas economic activity and prices will react to trade and other policies in each jurisdiction. It is therefore necessary to pay due attention to the impact of these developments on financial and foreign exchange markets and on Japan's economic activity and prices. With regard to the risk balance, risks to economic activity are skewed to the downside for fiscal 2026. Risks to prices are generally balanced.

Examining risks on the financial side, overheating has generally not been seen in asset markets and financial institutions' credit activities, although attention is warranted on

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<sup>4</sup> As for the examination from two perspectives in the context of the price stability target, see the Bank's statement released on January 22, 2013, entitled "The 'Price Stability Target' under the Framework for the Conduct of Monetary Policy."

developments in asset prices, such as real estate and stock prices. Japan's financial system has maintained stability on the whole. In addition, even in the case of an adjustment in the real economy at home and abroad and in global financial markets, the financial system is likely to remain highly robust on the whole, mainly because Japanese financial institutions have sufficient capital bases. In this regard, given that high uncertainties still remain regarding the impact of trade and other policies in each jurisdiction, it is necessary to carefully monitor the impact these policies have on the financial system through various channels.<sup>5</sup>

As for the conduct of monetary policy, given that real interest rates are at significantly low levels, if the aforementioned outlook for economic activity and prices will be realized, the Bank, in accordance with improvement in economic activity and prices, will continue to raise the policy interest rate and adjust the degree of monetary accommodation. In this regard, considering that high uncertainties still remain regarding the impact of trade and other policies in each jurisdiction, it is important for the Bank to carefully examine factors such as developments in economic activity and prices as well as in financial markets at home and abroad, and judge whether the outlook will be realized, without any preconceptions. With the price stability target of 2 percent, the Bank will conduct monetary policy as appropriate, in response to developments in economic activity and prices as well as financial conditions, from the perspective of sustainable and stable achievement of the target.

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<sup>5</sup> For details, see the Bank's *Financial System Report* (October 2025).

### Forecasts of the Majority of the Policy Board Members

y/y % chg.

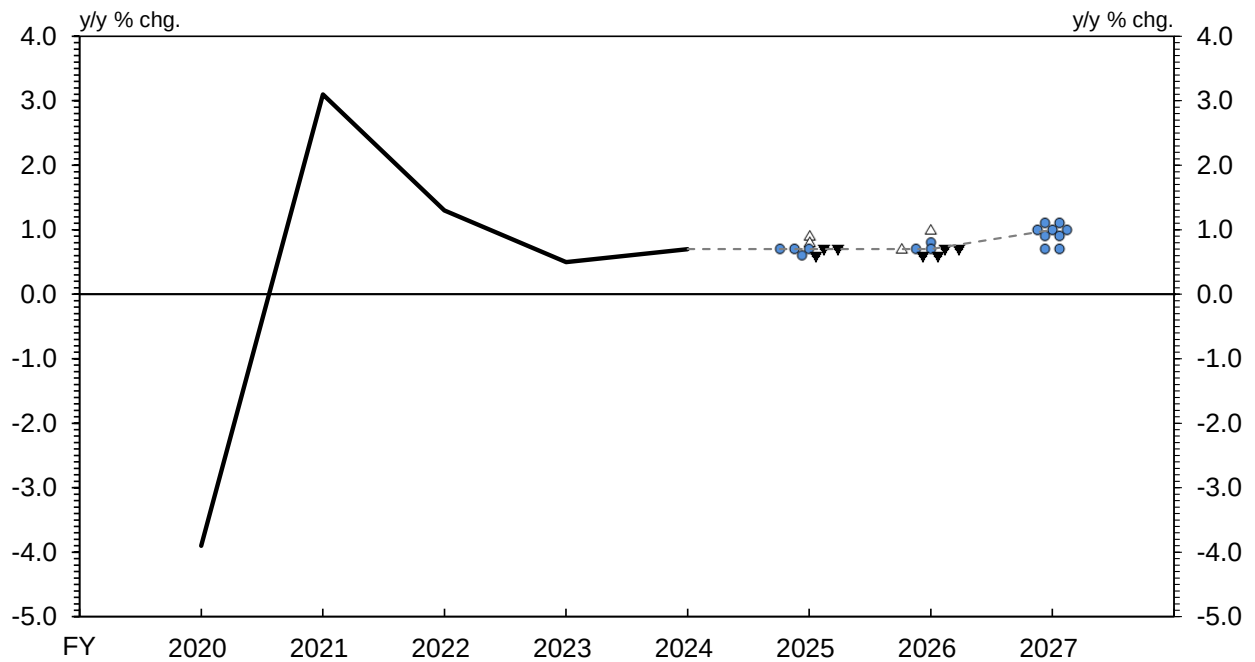
|                             | Real GDP               | CPI (all items less fresh food) | (Reference)<br>CPI (all items less fresh food and energy) |
|-----------------------------|------------------------|---------------------------------|-----------------------------------------------------------|
| Fiscal 2025                 | +0.6 to +0.8<br>[+0.7] | +2.7 to +2.9<br>[+2.7]          | +2.8 to +3.0<br>[+2.8]                                    |
| Forecasts made in July 2025 | +0.5 to +0.7<br>[+0.6] | +2.7 to +2.8<br>[+2.7]          | +2.8 to +3.0<br>[+2.8]                                    |
| Fiscal 2026                 | +0.6 to +0.8<br>[+0.7] | +1.6 to +2.0<br>[+1.8]          | +1.8 to +2.2<br>[+2.0]                                    |
| Forecasts made in July 2025 | +0.7 to +0.9<br>[+0.7] | +1.6 to +2.0<br>[+1.8]          | +1.7 to +2.1<br>[+1.9]                                    |
| Fiscal 2027                 | +0.7 to +1.1<br>[+1.0] | +1.8 to +2.0<br>[+2.0]          | +2.0 to +2.2<br>[+2.0]                                    |
| Forecasts made in July 2025 | +0.9 to +1.0<br>[+1.0] | +1.8 to +2.0<br>[+2.0]          | +2.0 to +2.1<br>[+2.0]                                    |

Notes: 1. Figures in brackets indicate the medians of the Policy Board members' forecasts (point estimates).

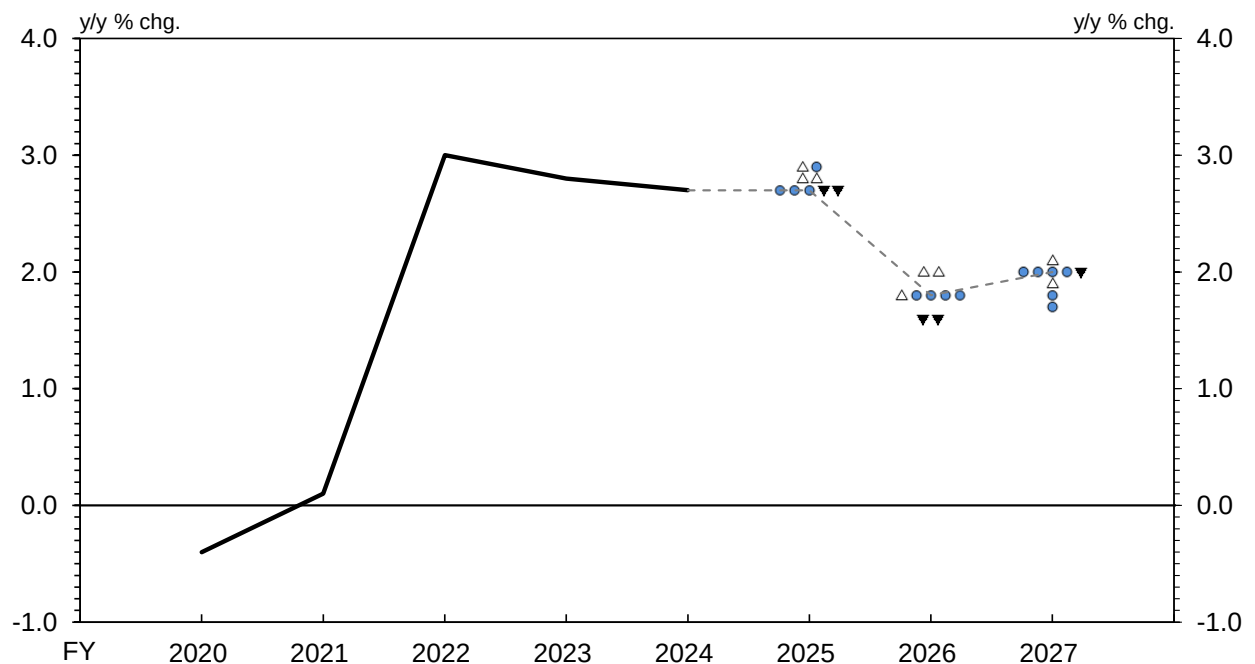
2. The forecasts of the majority of the Policy Board members are constructed as follows: each Policy Board member's forecast takes the form of a point estimate -- namely, the figure to which they attach the highest probability of realization. These forecasts are then shown as a range, with the highest figure and the lowest figure excluded. The range does not indicate the forecast errors.
3. Each Policy Board member makes their forecasts taking into account the effects of past policy decisions and with reference to views incorporated in financial markets regarding the future conduct of policy.
4. The forecasts for prices in this Outlook Report do not take into account the possible abolition of the former provisional gasoline tax rate, which is currently being considered. When estimating the impact of an abolition of the tax rate, it is likely that the year-on-year rate of increase in the CPI (all items less fresh food) will be pushed down by around 0.2 percentage point for a year. The impact for each fiscal year is subject to change depending on the timing of the abolition.

## Policy Board Members' Forecasts and Risk Assessments

### (1) Real GDP



### (2) CPI (All Items Less Fresh Food)



Notes: 1. The solid lines show actual figures, while the dotted lines show the medians of the Policy Board members' forecasts (point estimates).

2. The locations of ●, △, and ▼ in the charts indicate the figures for each Policy Board member's forecasts to which they attach the highest probability. The risk balance assessed by each Policy Board member is shown by the following shapes: ● indicates that a member assesses "upside and downside risks as being generally balanced," △ indicates that a member assesses "risks are skewed to the upside," and ▼ indicates that a member assesses "risks are skewed to the downside."

## The Background<sup>6</sup>

### I. Current Situation of Economic Activity and Its Outlook

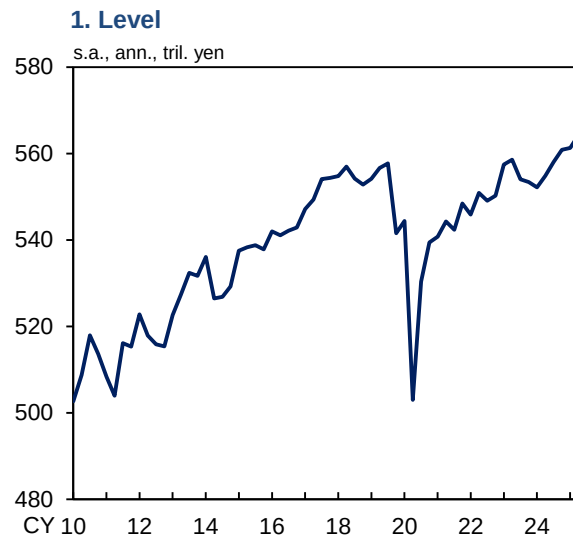
#### A. Economic Developments

Japan's economy has recovered moderately, although some weakness has been seen in part.

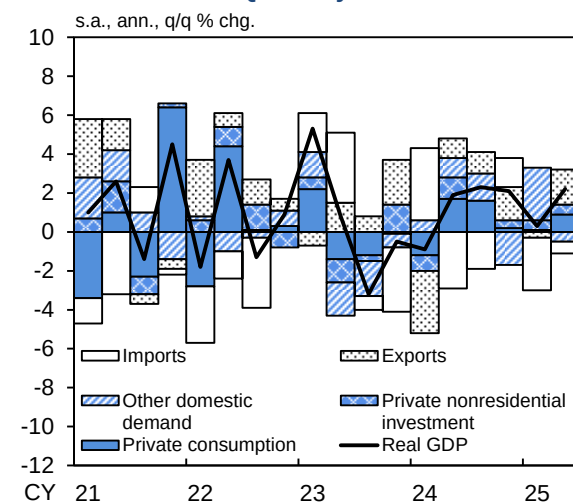
The real GDP growth rate for the April-June quarter of 2025 was 0.5 percent on a quarter-on-quarter basis and 2.2 percent on an annualized basis, registering positive growth for five consecutive quarters (Chart 1). Looking at the breakdown, although affected by a deterioration in consumer sentiment due to price rises, private consumption rose, partly reflecting front-loading of demand for summer merchandise due to high temperatures. Business fixed investment continued to increase moderately. With AI-related demand providing support, exports increased, partly reflecting front-loading due to tariff increases. In this situation, the output gap -- which captures the utilization of labor and capital -- narrowed slightly within negative territory in the April-June quarter, reflecting a further tightening of labor market conditions (Chart 2).

It can be judged from monthly indicators and high-frequency data since then that Japan's economy has maintained its moderate recovery trend, but its growth has moderated. This is because, on the external demand side, some effects of tariff increases have materialized, while

Chart 1: Real GDP



**2. Annualized Quarterly Growth Rate**

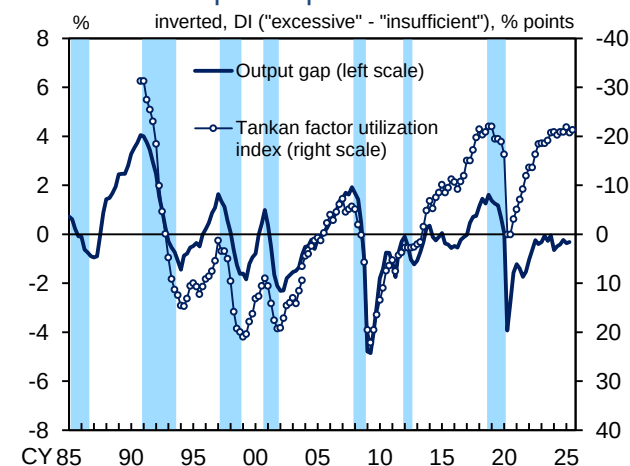


Source: Cabinet Office.

<sup>6</sup> "The Background" provides explanations of "The Bank's View" decided by the Policy Board at the Monetary Policy Meeting held on October 29 and 30, 2025.

on the domestic demand side, the reactionary decline following the increase in the April-June quarter, in addition to the impact of price rises, is likely to push down the economy. While exports and industrial production have continued to be more or less flat as a trend, they have recently declined somewhat, pushed down by the reactionary decline following the front-loading of demand due to the tariff increases and by the effects of the suspension of production lines at some manufacturers. Corporate profits have remained at high levels on the whole, although profits in manufacturing have been pushed down by a deterioration in export profitability due to tariffs. Business sentiment has stayed at a favorable level, partly reflecting the decline in uncertainty following the agreement in the Japan-U.S. tariff negotiations. In this situation, business fixed investment -- especially digital-related investment and investment related to urban redevelopment projects -- has been on a moderate increasing trend. Looking at the employment and income situation, employee income has continued to increase steadily, as the number of employed persons has continued to rise and scheduled cash earnings have increased reflecting a higher wage growth rate (rate of base pay increases). In this situation, private consumption has been resilient, although there has been downward pressure stemming from the effects of the rise in food prices, such as rice prices, and from a reactionary decline in seasonal merchandise following the rise in the previous quarter. Housing investment has declined recently, due to a delay in recovery from the reactionary decline following the front-loading of construction starts ahead of the enforcement of revisions to the Building Standards Act and other regulations this April. Meanwhile, the diffusion index (DI) for

**Chart 2: Output Gap**



Source: Bank of Japan.

Notes: 1. Figures for the output gap are staff estimates.

2. The *Tankan* factor utilization index is calculated as the weighted average of the production capacity DI and the employment conditions DI for all industries and enterprises. The capital and labor shares are used as weights. There is a discontinuity in the data for December 2003 due to a change in the survey framework.

3. Shaded areas denote recession periods.

employment conditions for all industries and enterprises in the September *Tankan* (Short-Term Economic Survey of Enterprises in Japan) shows that a pronounced sense of labor shortage persists -- particularly in nonmanufacturing -- with the DI remaining at about the same level as in the early 1990s. As a result, the weighted average DI for production capacity and employment conditions has continued to show a significantly large net "insufficient" (Chart 2). As explained, although the increase in U.S. tariffs has exerted downward effects on profits, there are no signs so far that the effects have spread to business fixed investment or to employment and wage developments.

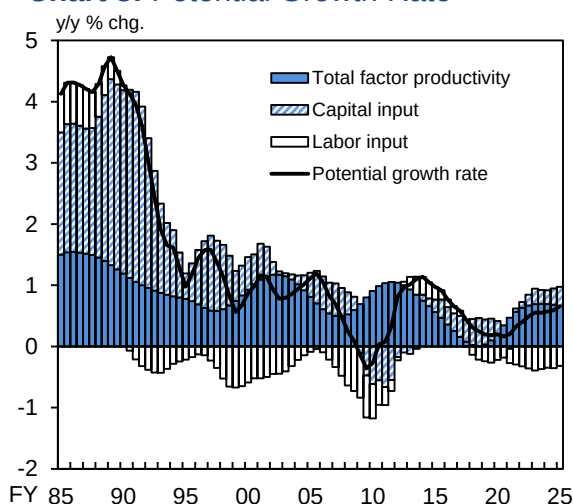
Japan's economic growth is likely to be modest, as trade and other policies in each jurisdiction lead to a slowdown in overseas economies and to a decline in domestic corporate profits and other factors, although factors such as accommodative financial conditions are expected to provide support. Thereafter, Japan's economic growth rate is likely to rise, with overseas economies returning to a moderate growth path. Comparing the projections with those presented in the previous Outlook Report, the projected real GDP growth rates are more or less unchanged.

The estimate of the potential growth rate has been at around 0.5 percent recently: while the downtrend in working hours reflecting working-style reforms has continued to push down the rate, capital stock has increased moderately and total factor productivity (TFP) has

continued to rise (Chart 3).<sup>7</sup> As for the outlook, the potential growth rate is expected to rise moderately. This is based on the projection that, although there will be less room for the number of employed persons to increase, (1) growth in TFP will accelerate, mainly on the back of advances in digitalization and the resulting improvement in the efficiency of resource allocation, as well as an expansion in investment in human capital; (2) the decline in working hours will come to a halt, reflecting the diminishing effects of working-style reforms; and (3) capital stock will continue to increase. These developments are likely to be encouraged by the government's various measures and by accommodative financial conditions.

Details of the outlook for each fiscal year are as follows. In the second half of fiscal 2025, Japan's economic growth is likely to be modest. This is because goods exports are projected to decelerate, mainly due to a slowdown in overseas economies, affected by trade and other policies in each jurisdiction, and because growth momentum in domestic demand, such as business fixed investment and private consumption, is also likely to decelerate somewhat, reflecting the heightened uncertainty in the past and the decline in corporate profits in manufacturing.<sup>8</sup> Goods exports are likely to show some weakness, pushed down by a reactionary decline following the front-loading due to the increase in U.S. tariffs, and due to the effects of the slowdown in

**Chart 3: Potential Growth Rate**



Source: Bank of Japan.

Note: Figures are staff estimates. Figures for the first half of fiscal 2025 are those for 2025/Q2.

<sup>7</sup> However, the output gap and the potential growth rate, which are estimated based on specific assumptions regarding trends in production factors, should be interpreted with considerable latitude.

<sup>8</sup> See Box 1 for an update on the impact of tariff policies thus far and an outline of the outlook for exports by goods.



overseas economies, although global AI-related demand is expected to push up goods exports. On the other hand, inbound tourism demand, which is categorized under services exports, is highly likely to decelerate temporarily, mainly due to the appreciation of the yen compared with the previous year. Corporate profits are expected to decline, mainly in manufacturing, pushed down by factors such as a deterioration in export profitability due to tariffs and a decline in exports due to the slowdown in overseas economies. In this situation, although business fixed investment is likely to continue on an increasing trend, supported by moves to clear the high levels of order backlogs and by labor-saving investment to address labor shortages, mainly in nonmanufacturing, the pace of increase in business fixed investment is expected to decelerate against the background of uncertainties regarding trade policies and the decline in corporate profits.<sup>9</sup> Employee income is expected to continue to see a steady increase, partly supported by the rise in minimum wages, while winter bonuses are highly likely to see a deceleration in growth from the previous year, reflecting corporate profits. In this situation, private consumption is projected to be more or less flat, as downward effects stemming from the rise in food prices are likely to remain for the time being.<sup>10</sup> Regarding housing investment, the pace of recovery from the reactionary decline following the front-loading of construction starts, due to the enforcement of revisions to the Building Standards Act and other regulations this April, is likely to remain moderate.

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<sup>9</sup> See Box 2 for the background to the resilient business fixed investment.

<sup>10</sup> See Box 3 for the increase in food prices and its impact on private consumption.

In fiscal 2026, Japan's economic growth rate is likely to be at around the same level as fiscal 2025, as exports and business fixed investment are expected to be pushed down by tariff increases with a time lag. Goods exports are expected to remain sluggish due to the effects of the slowdown in overseas economies. The slowdown in growth momentum in business fixed investment is likely to continue due to the lingering effects of the heightened uncertainty, although an upturn in corporate profits is expected to push up business fixed investment. The growth rate in nominal wages is projected to decelerate with some time lag, reflecting the deterioration in corporate profits in fiscal 2025. That said, with a continued uptrend in employee income, partly due to minimum wage increases, private consumption is highly likely to be resilient. Meanwhile, housing investment is projected to head toward a recovery from the decline in fiscal 2025.

In fiscal 2027, Japan's economy is likely to accelerate at a pace above its potential growth rate. The uptrend in goods exports is expected to become clear as overseas economic growth accelerates. With a continued improvement in corporate profits, business fixed investment is likely to increase firmly, pushed up by labor-saving investment to address labor shortages, investment for capacity expansion, and investment projects to adapt to changes in the trade structure and supply chains, among other investments. Private consumption is expected to return to a moderate increasing trend, as the growth rate in nominal wages accelerates again reflecting the increase in corporate profits.

## B. Developments in Major Expenditure Items and Their Background

### Government Spending

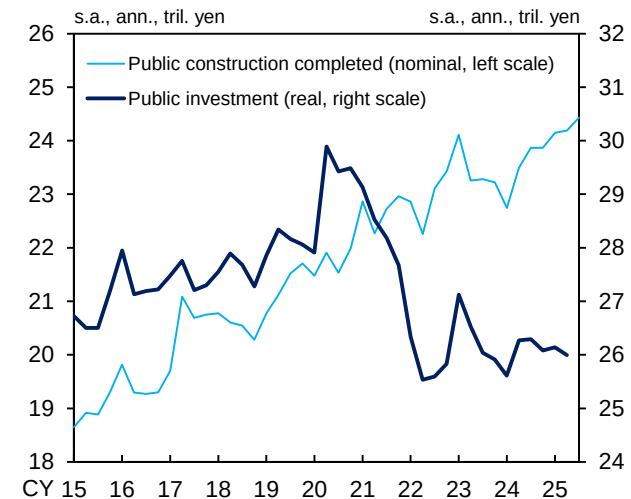
Public investment has continued to be more or less flat (Chart 4). While construction based on the government's economic measures, including construction related to building national resilience, has progressed, the amount of public investment (in real terms) has been more or less flat, when fluctuations are smoothed out. The amount of public construction completed (in nominal terms) -- a coincident indicator of public investment -- has been on a moderate increasing trend, reflecting a rise in construction costs.

Considering the developments in various leading indicators, public investment is likely to be more or less flat. Government consumption is projected to continue increasing moderately, reflecting an uptrend in healthcare and nursing care expenditures.

### Overseas Economies

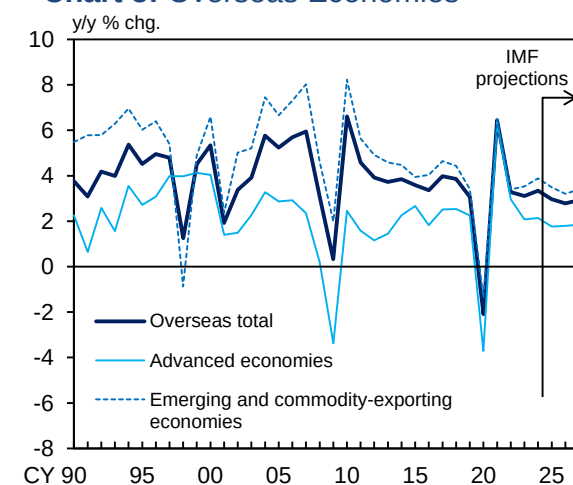
Overseas economies have grown moderately on the whole, although some weakness has been seen in part, reflecting trade and other policies in each jurisdiction (Chart 5). By region, the U.S. economy has maintained solid growth on the whole, although some weakness has been seen in part. European economies have continued to be relatively weak on the whole, partly reflecting that exports saw a reactionary decline following earlier front-loading. The Chinese economy has decelerated, mainly due to the impact of tariff increases and the gradually diminishing effects of government policies, and as adjustment pressure

**Chart 4: Public Investment**



Sources: Cabinet Office; Ministry of Land, Infrastructure, Transport and Tourism.  
Note: The figure for 2025/Q3 is the July-August average.

**Chart 5: Overseas Economies**



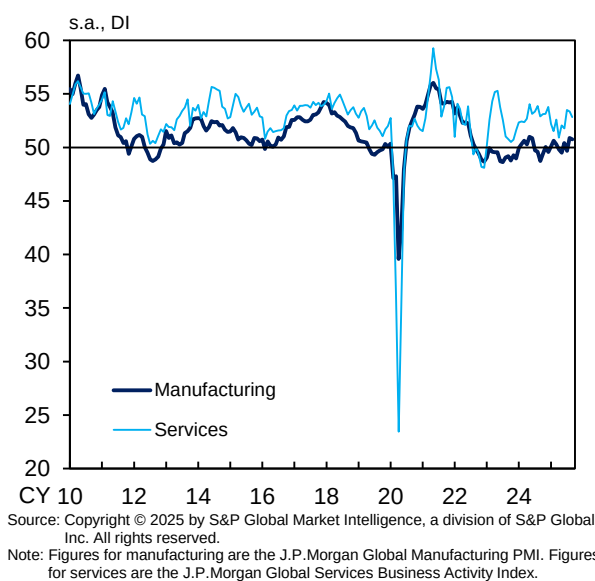
Sources: IMF; Ministry of Finance.  
Note: Figures are the weighted averages of real GDP growth rates using countries' share in Japan's exports as weights. The real GDP growth rates are compiled by the IMF, and the rates from 2025 onward are its projections in the October 2025 *World Economic Outlook* (WEO). Figures for advanced economies are those for the United States, the euro area, and the United Kingdom. Figures for emerging and commodity-exporting economies are those for the rest of the world.

has continued in the real estate and other markets. Emerging and commodity-exporting economies other than China have improved moderately on the whole. Among those in Asia, which have close links to Japan's economy, the NIEs and ASEAN economies have improved moderately as global demand for IT-related goods, mainly for AI, has recovered.

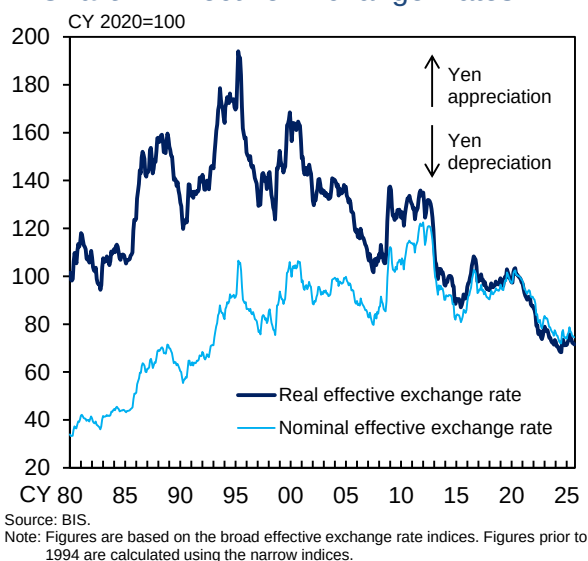
Looking at the Global PMI to see the current situation for the global economy, figures for the services industry have been clearly above 50 -- the break-even point between improvement and deterioration in business conditions -- and figures for the manufacturing industry have risen somewhat and have been slightly above 50 (Chart 6).

As for the outlook, although trade and other policies in each jurisdiction are expected to lead to a slowdown in overseas economies for a while, overseas economies are projected to see a gradual acceleration in their growth rate thereafter, and then return to a moderate growth path. The trade policy in each jurisdiction is likely to push down overseas economies for a while by affecting (1) global trade activity and (2) business and household sentiment around the world due to uncertainties. Looking at such developments by region, the U.S. economy is likely to decelerate for a while, reflecting the impact of uncertainties and price rises; thereafter, however, the economy is expected to return to a moderate growth path. Other major economies are likely to decelerate for a while because it is projected that trade and other policies will lead to pushing down trade activity and increase uncertainties; thereafter,

**Chart 6: Global PMI**



**Chart 7: Effective Exchange Rates**

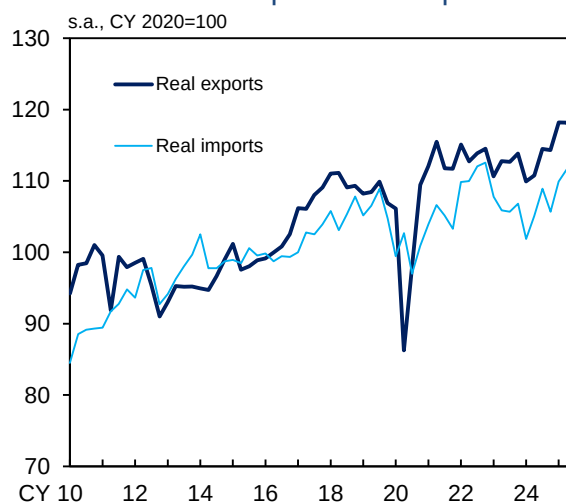


however, these economies are likely to return to a moderate growth path.

## Exports and Imports

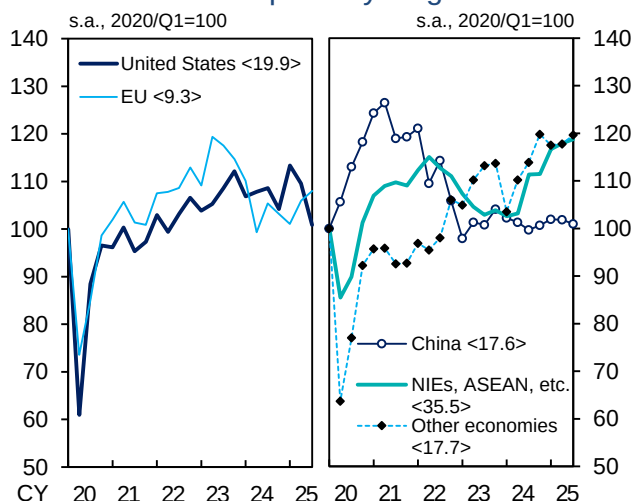
Exports have continued to be more or less flat as a trend, although there has been some front-loading and a subsequent reactionary decline, due to the increase in U.S. tariffs (Chart 8). By region, exports to the United States decreased in the April-June quarter, partly due to a reactionary decline following the front-loading of exports prior to the increase in tariffs on goods such as automobile parts; they continued to decline in the July-September quarter, due to the additional impact of factors such as the suspension of production lines at some automakers (Chart 9). Exports to Europe had been relatively weak but have picked up, especially of capital goods, reflecting a recovery in demand for business fixed investment in the region. Exports to China have remained more or less flat at low levels, due to greater local production of automobiles and other products by Chinese manufacturers reflecting their increased competitiveness, and due to the peaking-out of demand for semiconductor production equipment. With a solid increase in global AI-related demand, exports to the NIEs, ASEAN, and some other Asian economies have continued on an increasing trend, supported by the front-loading of exports in preparation for the possible introduction of sectoral tariffs on semiconductors by the U.S. administration, and by solid demand for components for new smartphones. Exports to other economies have been on a moderate increasing trend, mainly led by automobiles. By type of goods, exports of automobile-related goods declined in the April-June quarter,

**Chart 8: Real Exports and Imports**



Sources: Bank of Japan; Ministry of Finance.  
Note: Based on staff calculations.

**Chart 9: Real Exports by Region**



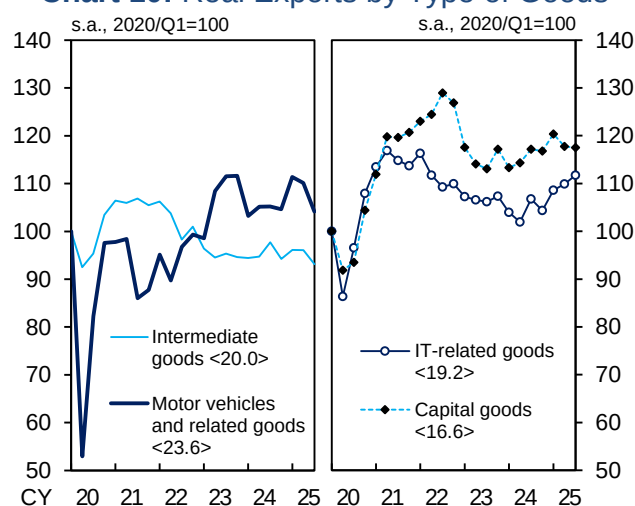
Sources: Bank of Japan; Ministry of Finance.  
Notes: 1. Based on staff calculations. Figures in angular brackets show the share of each country or region in Japan's total exports in 2024.  
2. Figures for the EU exclude those for the United Kingdom for the entire period.

reflecting a reactionary decline following the front-loading of exports of goods such as certain automobile parts ahead of the increase in tariffs; they continued to decline in the July-September quarter, due to the additional impact of factors such as the suspension of production lines at some automakers (Chart 10). Exports of capital goods have declined somewhat recently, mainly against the background of the peaking-out of demand for semiconductor production equipment in China. Exports of IT-related goods have increased firmly, pushed up by a solid increase in AI-related demand, such as for data servers, and due to the positive effects of the front-loading of exports in preparation for the possible introduction of sectoral tariffs on semiconductors by the U.S. administration, and of the solid demand for components for new smartphones. Meanwhile, exports of intermediate goods have been at low levels, due to continued oversupply, particularly in Asia, against the background of excess production capacity in China.

As for the outlook, exports, mainly of automobiles and capital goods, are likely to show some weakness as the reactionary decline following the front-loading due to the increase in U.S. tariffs materializes and overseas economies slow as tariff hikes are increasingly passed on to selling prices. Thereafter, with an acceleration in the growth rate of overseas economies, exports are projected to head toward a recovery.

Imports have been on an increasing trend (Chart 8). They are expected to follow a moderate uptrend, reflecting developments in domestic demand.

**Chart 10: Real Exports by Type of Goods**



Sources: Bank of Japan; Ministry of Finance.  
Note: Based on staff calculations. Figures in angular brackets show the share of each type of goods in Japan's total exports in 2024.

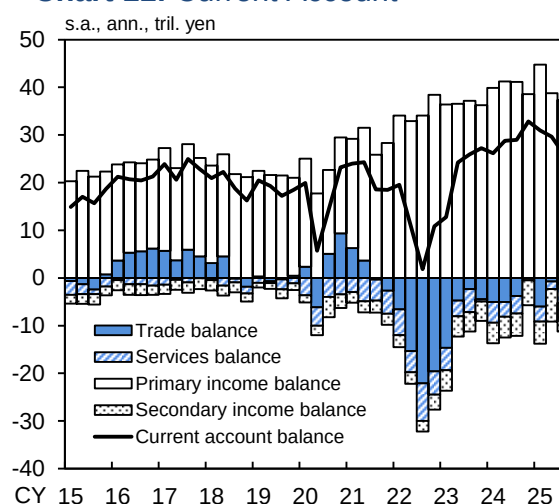
## External Balance

The nominal current account surplus, despite declining somewhat recently, has remained at a high level (Chart 11). The trade balance has remained on a slight deficit trend, albeit with fluctuations. Despite a surplus in the travel balance -- supported by inbound tourism demand (Chart 12) -- the services balance has remained on a slight deficit trend on the whole, as payments for digital-related services have been at high levels. Meanwhile, the primary income balance surplus has remained at a high level, pushed up by factors such as receipts of direct investment income, but has recently declined somewhat, reflecting developments in foreign exchange rates.

The nominal current account balance is highly likely to follow a declining trend for the time being. This is based on the projection that (1) the trade balance will remain on a deficit trend, mainly against the background of the decline in goods exports due to the slowdown in overseas economies and (2) downward pressure will be exerted on the primary income balance, reflecting a deterioration in the profits of overseas subsidiaries. Thereafter, the nominal current account surplus is likely to remain more or less flat for a while and then, with a recovery in overseas economies, turn to a moderate increasing trend.

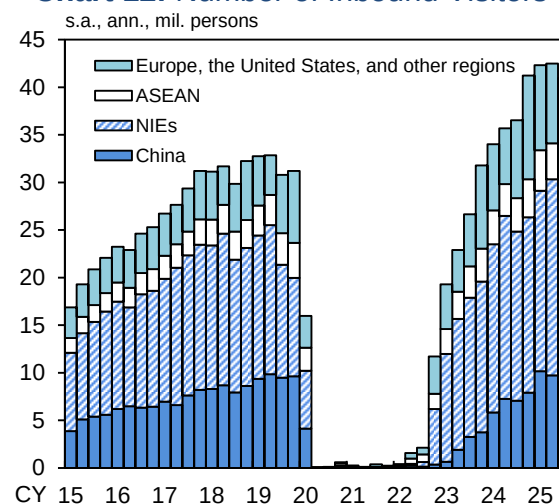
In terms of the savings-investment balance, overall excess savings in Japan have continued on a moderate expanding trend, mainly due to an increase in corporate profits (Chart 13). However, overall excess savings in the economy are

**Chart 11: Current Account**



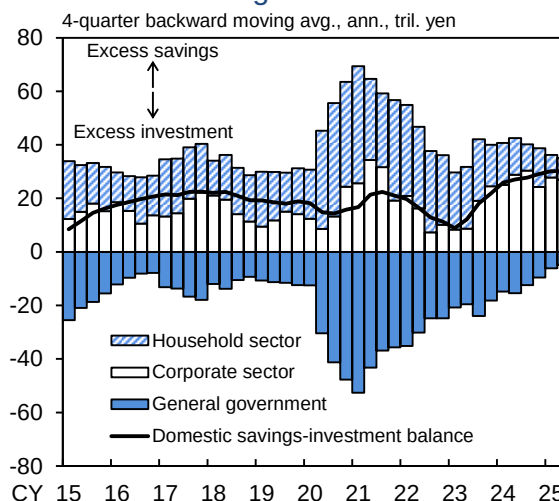
Source: Ministry of Finance and Bank of Japan.  
Note: Figures for 2025/Q3 are July-August averages.

**Chart 12: Number of Inbound Visitors**



Source: Japan National Tourism Organization (JNTO).  
Note: Figures for Europe, the United States, and other regions include seasonal adjustment errors.

**Chart 13: Savings-Investment Balance**



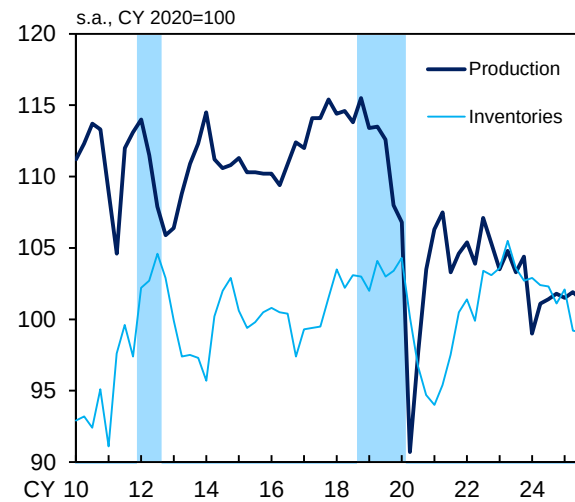
Source: Bank of Japan.

projected to turn to a decline, as corporate profits decrease due to the deterioration in export profitability and the slowdown in overseas economies. Thereafter, overall excess savings are projected to be more or less flat for a while, and then, with a recovery in corporate profits, somewhat increase again.

## Industrial Production

Industrial production has continued to be more or less flat (Chart 14). By major industry, production of "transport equipment" has decreased, reflecting a peaking-out of the earlier front-loading of production -- mainly of automobile parts -- ahead of the increase in tariffs, as well as the suspension of production lines at some automakers. On the other hand, with the solid increase in AI-related demand such as for data servers, production of "electronic parts and devices" has continued to increase, pushed up by the rise in production in preparation for the possible introduction of sectoral tariffs on semiconductors by the U.S. administration, and by the increase in production of components for new smartphones. Production of "electrical machinery, and information and communication electronics equipment" has been resilient due to renewal demand for personal computers in view of the end of support for some operating systems. Production of "general-purpose, production, and business-oriented machinery" has been more or less flat, supported by the completion of inventory adjustments in construction machinery, although it has been weighed down by a decline in shipments of semiconductor production equipment to China. Meanwhile, production of "chemicals (excluding medicine)" -- despite persistent downward pressure stemming from

**Chart 14: Industrial Production**





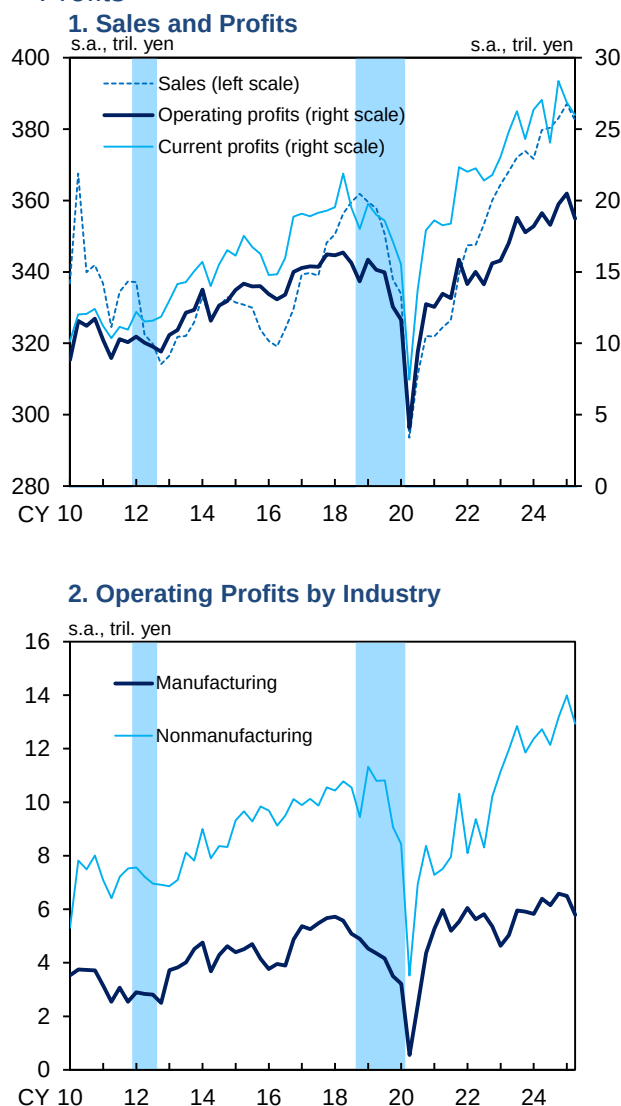
oversupply, particularly in Asia -- has been more or less flat recently, partly due to progress in inventory adjustments.

As for the outlook, despite support from resilient domestic demand, industrial production is expected to be under gradually increasing downward pressure, due to a reactionary decline following the front-loading of production ahead of the U.S. tariff increase and the materialization of the effects of the slowdown in overseas economies. Thereafter, with an acceleration in the growth rate of overseas economies, industrial production is likely to head toward a recovery.

## Corporate Profits

Corporate profits have remained at high levels on the whole, although downward effects due to tariffs have been seen in manufacturing. According to the *Financial Statements Statistics of Corporations by Industry, Quarterly*, operating profits for all industries and enterprises in the April-June quarter of 2025 remained at a high level -- around their historical peak -- despite declining to a somewhat lower level, mainly due to a deterioration in export profitability in manufacturing due to the increase in U.S. tariffs (Chart 15). By industry, operating profits of manufacturers have declined, mainly among large firms in transportation machinery, pushed down by the deterioration in export profitability reflecting the increase in U.S. tariffs, and by the past appreciation of the yen. As for nonmanufacturers, operating profits have continued to be at a high level, despite declining recently due to falling commodity prices (large firms in wholesaling) and

**Chart 15: Indicators Related to Corporate Profits**



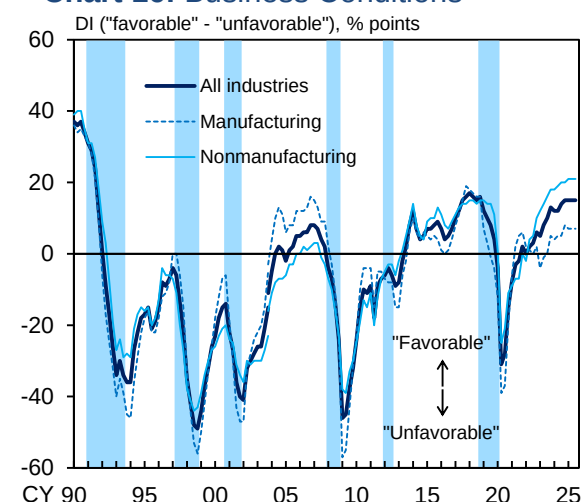
Source: Ministry of Finance.  
Notes: 1. Based on the *Financial Statements Statistics of Corporations by Industry, Quarterly*. Excluding "finance and insurance" and "pure holding companies."  
2. Shaded areas denote recession periods.

rising construction costs (small and medium-sized firms in construction).

Business sentiment has stayed at a favorable level on the whole amid the decline in uncertainty following the agreement in the Japan-U.S. tariff negotiations. Looking at the September *Tankan*, the business conditions DI for all industries and enterprises has remained clearly positive (net "favorable"), registering a value of 15 for four consecutive quarters (Chart 16). By industry, the DI for manufacturing as a whole has been unchanged from the previous survey. This reflects the fact that the DIs in some industries have been under downward pressure from tariff increases, while the decline in uncertainty following the agreement in the Japan-U.S. tariff negotiations and solid IT-related demand have exerted upward pressure. The DI for nonmanufacturing as a whole has been unchanged from the previous survey: while progress in the pass-through of cost increases to selling prices has exerted upward pressure, a slowdown in inbound tourism demand and consumers' increased thriftiness have exerted downward pressure.

Regarding the outlook, corporate profits are likely to remain on a declining trend for the time being, mainly in manufacturing, reflecting the deterioration in export profitability due to tariffs and the slowdown in overseas economies. Thereafter, corporate profits are expected to return to an improving trend due to an increase in domestic and external demand.

**Chart 16: Business Conditions**



Source: Bank of Japan.

Notes: 1. Based on the *Tankan*. All enterprises. There is a discontinuity in the data for December 2003 due to a change in the survey framework.

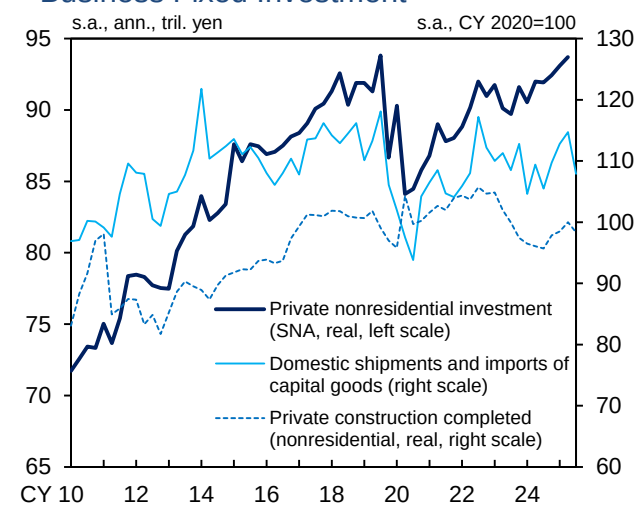
2. Shaded areas denote recession periods.

## Business Fixed Investment

Business fixed investment has been on a moderate increasing trend (Chart 17). The aggregate supply of capital goods -- a coincident indicator of machinery investment -- has been resilient, albeit with fluctuations, supported by demand for AI- and labor saving-related investments. Despite being affected by delays in construction projects due to high construction material prices and labor shortages, private construction completed (nonresidential, real) -- a coincident indicator of construction investment -- has increased moderately, supported by strong construction demand related to logistics facilities and urban redevelopment.

The growth momentum in machinery orders -- a leading indicator of machinery investment -- has decelerated somewhat recently (Chart 18). Developments in machinery orders by industry are as follows. In manufacturing, orders have remained at relatively high levels on the whole, supported by solid AI-related demand and resilient demand for investment in growth areas, such as semiconductor components; that said, orders by the automobile-related industry have been relatively weak recently. Orders from the nonmanufacturing industry have increased, supported by strong demand for digital- and labor saving-related investments. Construction starts (in terms of planned expenses for private and nonresidential construction) -- a leading indicator of construction investment -- had increased, mainly reflecting large-scale construction of logistics facilities and large-scale construction related to urban redevelopment; however, construction starts have recently declined somewhat as the increase in such large-scale

**Chart 17: Coincident Indicators of Business Fixed Investment**

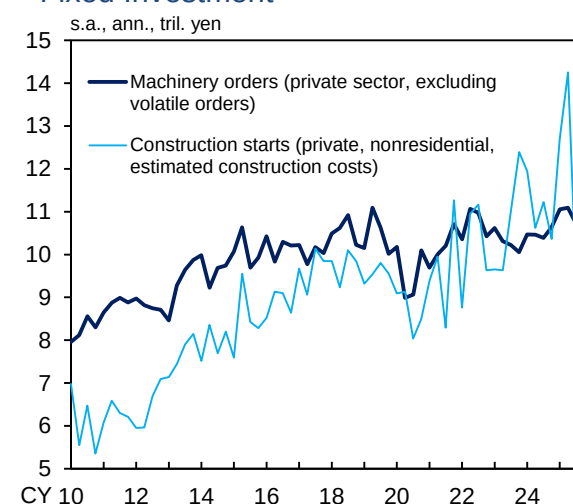


Sources: Cabinet Office; Ministry of Economy, Trade and Industry; Ministry of Land, Infrastructure, Transport and Tourism.

Notes: 1. Figures for 2025/Q3 are July-August averages.

2. Figures for real private construction completed are based on staff calculations using the construction cost deflators.

**Chart 18: Leading Indicators of Business Fixed Investment**



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

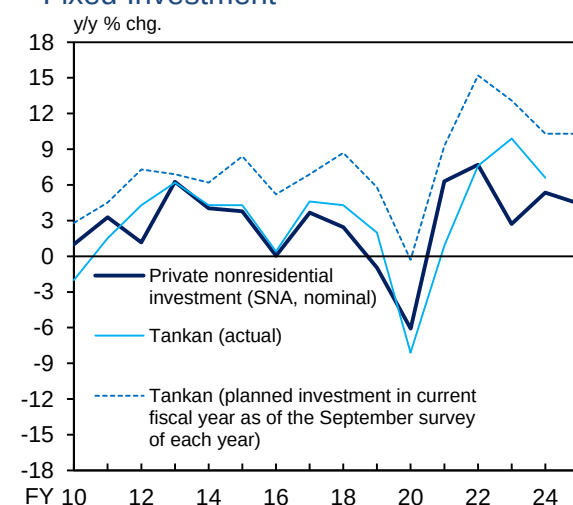
Notes: 1. Volatile orders are orders for ships and orders from electric power companies.

2. Figures for 2025/Q3 are July-August averages.

construction projects has paused. Looking at business fixed investment plans (in nominal terms) in the September *Tankan*, business fixed investment (on a basis close to the GDP definition; business fixed investment -- including software and R&D investments but excluding land purchasing expenses -- for all industries and enterprises including financial institutions) for fiscal 2025 registered a year-on-year rate of increase of 10.3 percent, which represents an upward revision from the June survey and a firm increase similar in size to that in the September survey last year (Chart 19).

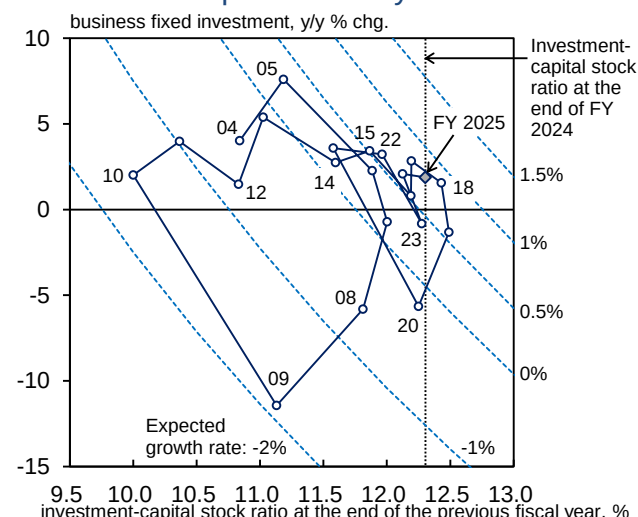
Business fixed investment is likely to continue on an increasing trend, supported by moves to clear accumulated order backlogs and by strong demand for labor-saving investment; that said, the growth momentum in business fixed investment is highly likely to slow gradually against the background of a decline in corporate profits and uncertainty regarding trade policies. Thereafter, with an upturn in corporate profits and a waning of the adverse effects of the uncertainties, the growth momentum in business fixed investment is likely to increase because it is expected that investment for capacity expansion and for restructuring supply chains will become active. Medium- to long-term investment that is expected to support business fixed investment during the projection period includes (1) labor-saving and efficiency-improving investment to address structural labor shortages and IT-related investment to digitalize business activities; (2) construction investment in logistics facilities, resulting from expanding e-commerce, and in offices and commercial facilities related to urban redevelopment; (3) R&D investment related

**Chart 19: Planned and Actual Business Fixed Investment**



Sources: Bank of Japan; Cabinet Office.  
 Notes: 1. The *Tankan* figures include software and R&D investments and exclude land purchasing expenses. R&D investment is not included before the March 2017 survey. The figures are for all industries including financial institutions.  
 2. The figure for private nonresidential investment for fiscal 2025 is that for 2025/Q2.

**Chart 20: Capital Stock Cycles**



Source: Cabinet Office.  
 Note: Each broken line represents the combination of the rate of change in business fixed investment and the investment-capital stock ratio at a certain expected growth rate. The figure for fiscal 2025 is that for 2025/Q2.

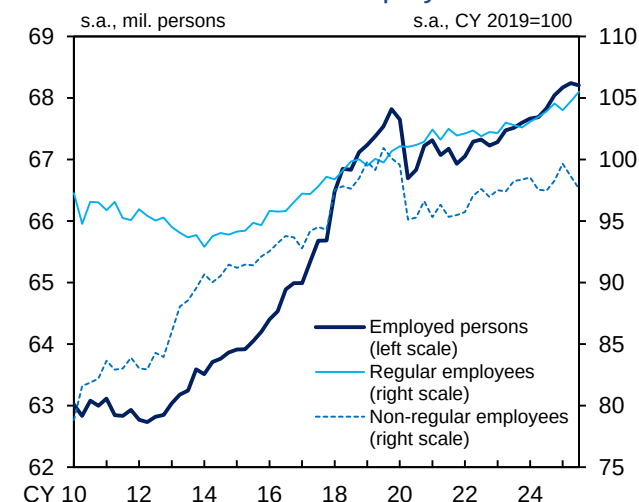
to growth areas and decarbonization; and (4) semiconductor-related investment that is mainly aimed at strengthening supply chains and that also reflects government support. Regarding software investment toward digitalization and R&D investment related to growth areas, capital accumulation tends to take time and adjustment pressure is less likely to be exerted due to high economic depreciation rates (Chart 20).

## Employment and Income Situation

The employment and income situation has improved moderately.

The number of employed persons has continued to increase steadily (Chart 21). The number of regular employees has increased firmly, mainly in the information and communications industry and in the medical, healthcare, and welfare services industry, both of which have faced severe labor shortages. The number of non-regular employees has recently declined to a somewhat lower level, as firms have shifted toward regular employment. With regard to labor market conditions, the unemployment rate has remained at a low level of around 2.5 percent (Chart 22). The DI for employment conditions in the *Tankan* and firms' perceptions on whether they have an excess or a shortage of full-time employees, etc. in the *Survey on Labour Economy Trend* have been flat at levels indicating a strong sense of labor shortage (Chart 23). The labor force participation rate has remained -- albeit with fluctuations -- on a moderate uptrend, particularly for women (Chart 22).

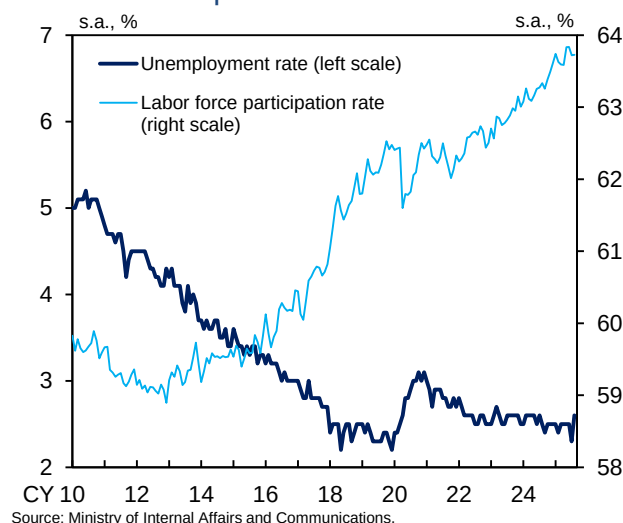
**Chart 21: Number of Employed Persons**



Source: Ministry of Internal Affairs and Communications.

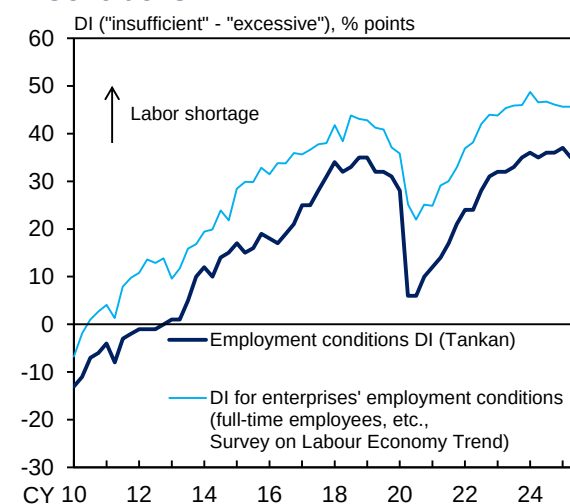
Note: Figures for regular employees and non-regular employees prior to 2013 are based on the "detailed tabulation" in the *Labour Force Survey*. Figures for 2025/Q3 are July-August averages.

**Chart 22: Unemployment Rate and Labor Force Participation Rate**



Source: Ministry of Internal Affairs and Communications.

**Chart 23: Measures of Labor Market Conditions**



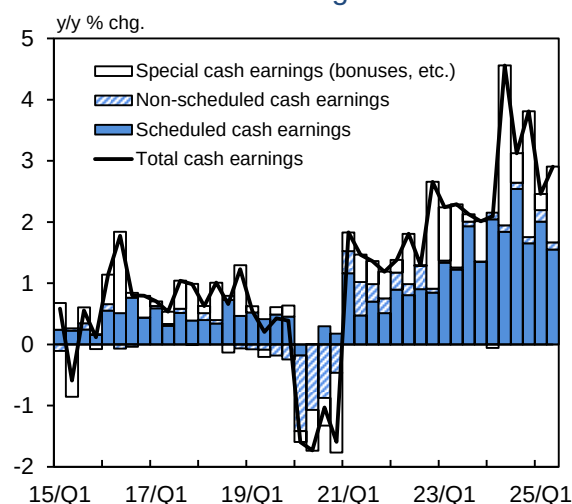
Sources: Bank of Japan; Ministry of Health, Labour and Welfare.

Notes: 1. Figures for the employment conditions DI are for all industries and enterprises. 2. Figures for the DI for enterprises' employment conditions (full-time employees, etc.) are seasonally adjusted.

With regard to the outlook for the employment situation, the number of employed persons is expected to continue increasing moderately, mainly for regular employees in industries with a strong sense of labor shortage. However, with labor force participation of women and seniors having advanced to a high degree thus far, the pace of increase is highly likely to decelerate, because it has become more difficult for labor supply to increase from a demographic perspective. Under these circumstances, the unemployment rate is expected to follow a moderate declining trend, and is likely to be flat at a low level toward the end of the projection period, as the pace of increase in labor demand reflecting economic growth and that in labor force participation are expected to be more or less the same.

On the wage side, nominal wages per employee have continued to increase steadily (Chart 24).<sup>11</sup> Looking at the breakdown, the year-on-year rate of increase in scheduled cash earnings has maintained its relatively high level, although the pace of increase has decelerated recently (Chart 25). Specifically, while progress has been made in reflecting the results of the annual spring labor-management wage negotiations, the year-on-year rate of increase in scheduled cash earnings for full-time employees has decelerated recently, reflecting a decline in the number of working days as compared with the previous year, as well as weak developments in scheduled cash earnings in the wholesale and retail trade industries, which may be due to sample bias.

**Chart 24: Nominal Wages**

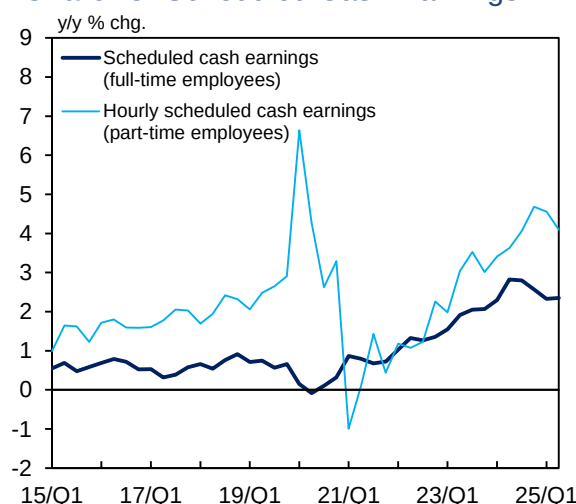


Source: Ministry of Health, Labour and Welfare.

Notes: 1. Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February.

2. Figures from 2016/Q1 onward are based on continuing observations following the sample revisions.

**Chart 25: Scheduled Cash Earnings**



Source: Ministry of Health, Labour and Welfare.

Notes: 1. Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February.

2. Figures from 2016/Q1 onward are based on continuing observations following the sample revisions.

<sup>11</sup> Wages in the *Monthly Labour Survey* are assessed on the basis of continuing observations, which are less susceptible to fluctuations due to sample revisions.

While the year-on-year rate of increase in hourly scheduled cash earnings for part-time employees had been on an uptrend reflecting tight labor market conditions, it has recently decelerated. Moreover, while the year-on-year rate of increase in the average hourly wage for temporary and part-time jobs at the time of recruitment had also been accelerating following an increase in minimum wages last autumn, this acceleration has recently come to a halt. The year-on-year rate of change in non-scheduled cash earnings has been positive, mainly led by an increase in hourly wages for overtime work. Although the rate of increase has decelerated from the previous fiscal year, special cash earnings (bonuses, etc.) have increased firmly, with the year-on-year rate of increase being at around 4 percent, reflecting the improvement in corporate profits in the second half of fiscal 2024 and a rise in the rate of base pay increases.

With regard to the outlook for wages, the rate of increase in scheduled cash earnings is highly likely to continue to show relatively high growth for the time being, reflecting the rise in the rate of base pay increases and the minimum wage increases from this autumn.<sup>12</sup> On the other hand, downward pressure on non-scheduled cash earnings and special cash earnings (bonuses, etc.) is expected to materialize, mainly in the manufacturing industry, reflecting the growing

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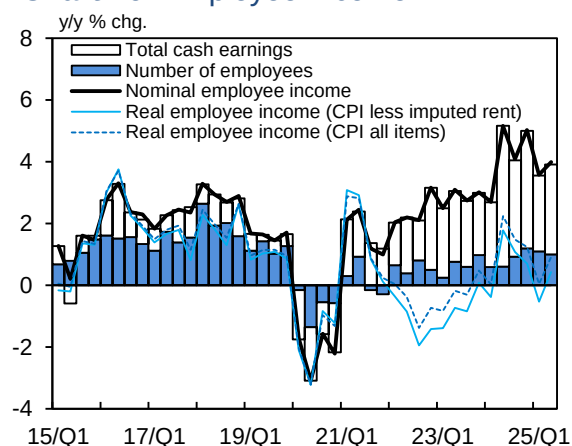
<sup>12</sup> The year-on-year rate of increase in the minimum wage for fiscal 2025 in terms of the national weighted average was 6.3 percent, which represents a higher rate of increase than in typical years. That said, given that the rise in minimum wages this year is larger than usual, many prefectures are deferring the timing at which the increase becomes effective compared with typical years in order to allow firms to adjust smoothly. As a result, the impact of the large increase in minimum wages is highly likely to materialize later than usual.



impact of the increase in U.S. tariffs. In light of these factors, nominal wages per employee are highly likely to continue increasing at their current pace for the time being but then see a deceleration in their growth rate. In the middle of the projection period, base pay increases and scheduled cash earnings are projected to be under downward pressure, as they are expected to be affected, with some time lag, by the deterioration in corporate profits stemming from tariff increases. However, toward the end of the projection period, the rate of increase in nominal wages per employee is likely to accelerate again as corporate profits improve on the back of a recovery in domestic and external demand. On this point, a notable feature of Japan's labor market is that, in the annual spring labor-management wage negotiations, the results of wage agreements reached by large manufacturing firms tend to have a significant impact on forming the so-called prevailing wage; given this, there are high uncertainties over the extent to which a decline in corporate profits of large manufacturing firms -- stemming from the deterioration in export profitability and the slowdown in overseas economies -- will have a negative impact on the momentum in wage hikes, which has been strengthening due to a strong sense of labor shortage.

In light of the aforementioned employment and wage conditions, employee income has continued to increase steadily in nominal terms (Chart 26). The year-on-year rate of change in employee income in real terms -- based on the CPI (all items less imputed rent) -- has been slightly positive recently. With regard to the outlook, nominal employee income is likely to continue to see a

**Chart 26: Employee Income**



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

Notes: 1. Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February.

2. Nominal employee income = Total cash earnings (*Monthly Labour Survey*) × Number of employees (*Labour Force Survey*)
3. Figures from 2016/Q1 onward are based on continuing observations following the sample revisions of the *Monthly Labour Survey*.
4. Figures for real employee income are based on staff calculations using the price indicators shown in parentheses.



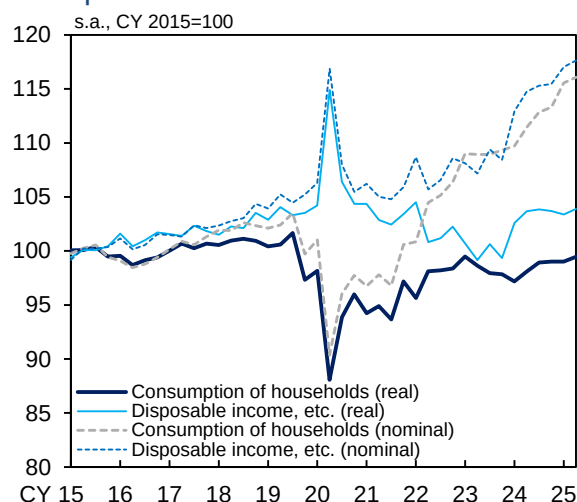
steady increase for the time being. However, as downward pressure on special cash earnings (bonuses, etc.) is likely to materialize due to a deterioration in corporate profits, the pace of increase in nominal employee income is projected to decelerate. Toward the end of the projection period, the growth momentum in nominal employee income is likely to increase somewhat, as the nominal wage growth rate accelerates again in reflection of the recovery in corporate profits.

## Household Spending

Private consumption has been resilient against the background of the improvement in the employment and income situation, although it has been affected by price rises.

The Consumption Activity Index (CAI; real, travel balance-adjusted) -- which is calculated by combining various sales and supply-side statistics -- has recently been more or less flat on the whole: the index increased slightly in the April-June quarter, but then decreased on average in the July-August period relative to the April-June quarter, mainly due to developments in nondurable goods (Charts 27 and 28).<sup>13</sup> Looking at recent developments in private consumption from various sources, such as high-frequency indicators, statistics published by industry organizations, and anecdotal information from firms, it appears that consumers have continued to be selective in their consumption on the whole: while consumers' increased thriftiness regarding

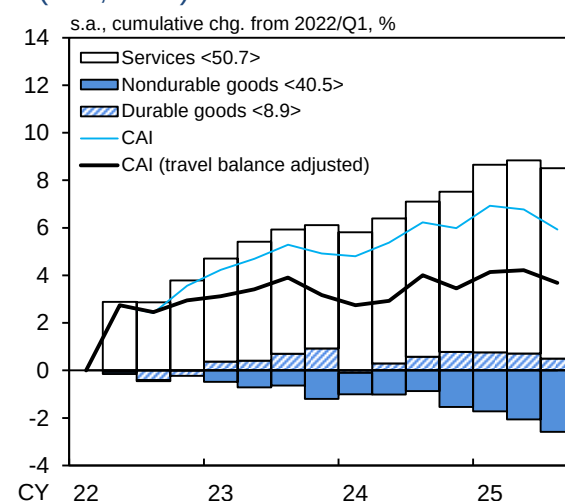
**Chart 27: Consumption of Households and Disposable Income**



Source: Cabinet Office.

Notes: 1. Figures for consumption of households exclude imputed rent.  
2. "Disposable income, etc." consists of disposable income and adjustment for the change in pension entitlements. Real values are based on staff calculations using the deflator of consumption of households.

**Chart 28: Consumption Activity Index (CAI, Real)**



Sources: Bank of Japan, etc.

Notes: 1. Based on staff calculations. Figures for the CAI (travel balance adjusted) exclude inbound tourism consumption and include outbound tourism consumption. Figures for 2025/Q3 are July-August averages.  
2. Nondurable goods include goods classified as semi-durable goods in the SNA.  
3. Figures in angular brackets show the weights in the CAI.

<sup>13</sup> Regarding the CAI, see the Bank's research paper "Revision of the Consumption Activity Index to Capture Recent Changes in Consumption Patterns" released in July 2021.

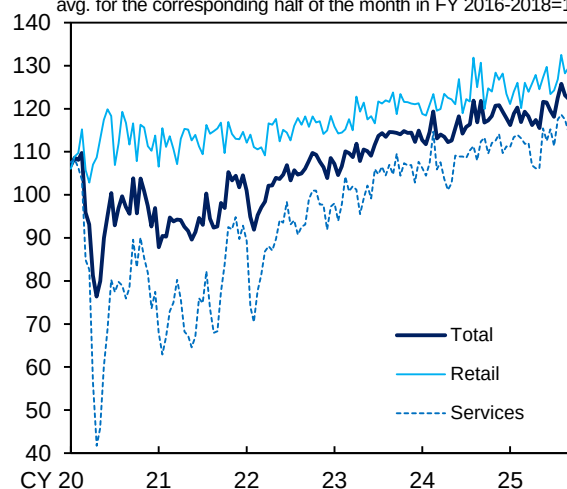
items such as daily necessities has been entrenched partly due to elevated food prices, spending has been firm in areas that consumers perceive as offering high value-added, supported by improvement in the employment and income situation and by the rise in stock prices (Chart 29).

By type, consumption of durable goods has recently declined, albeit slightly (Chart 28). While automobile sales had been at relatively high levels as progress was made in reducing order backlogs, they have recently declined, partly due to the impact of the suspension of production lines at some automakers. Sales of household electrical appliances have been on a moderate uptrend. This is mainly due to solid sales of air conditioners, supported by subsidies provided by some local governments for their purchase, and an increase in sales of personal computers reflecting the end of support for some operating systems. Consumption of nondurable goods (e.g., "beverages and food" and "clothes") has continued on a decreasing trend, reflecting consumers' increased thriftiness due to the rise in food prices.

Services consumption has turned more or less flat, from the moderate uptrend seen previously (Charts 28 and 29). Although the shift to dining-out has continued, the growth momentum in dining-out has levelled off recently, reflecting sluggish average spending per customer due to consumers' increased thriftiness. Domestic travel has been at a relatively high level, supported by a strong willingness to travel among working households who have benefitted from wage increases. Overseas travel has been somewhat

**Chart 29: Consumption Developments  
Based on Credit Card Spending**

avg. for the corresponding half of the month in FY 2016-2018=100



Source: Nowcast Inc./ JCB, Co., Ltd., "JCB Consumption NOW."

Notes: 1. Figures are from the reference series in *JCB Consumption NOW*, which take changes in the number of consumers into account.

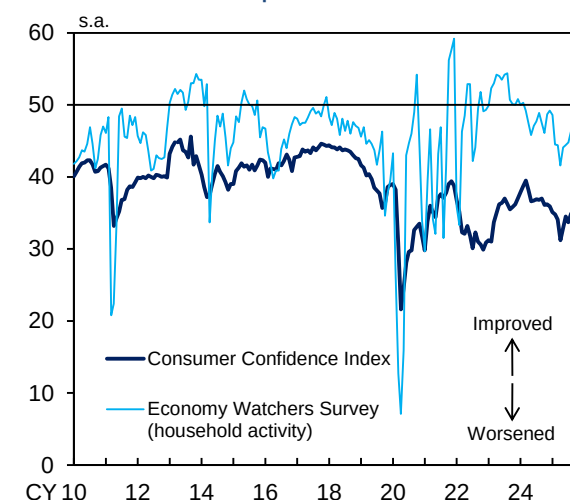
2. Figures exclude telecommunications and energy (fuel, electricity, gas, heat supply, and water). Based on staff calculations.

weak, reflecting relatively high travel costs due to factors such as exchange rate developments.

Looking at confidence indicators related to private consumption, although the Consumer Confidence Index in the *Consumer Confidence Survey* -- which asks consumers for their views on the outlook for the coming six months -- has recently picked up on the back of an increase in summer bonuses and the rise in stock prices, it has remained at a relatively low level (Chart 30). The current economic conditions DI (household activity-related) of the *Economy Watchers Survey* -- which asks firms for their views on the direction of the economy -- had been on a deteriorating trend but has picked up recently, mainly reflecting that sales at department and other stores have been favorable.

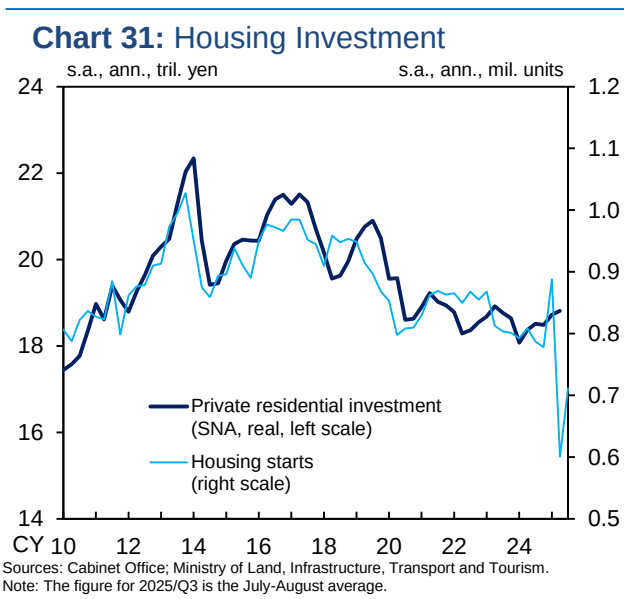
Regarding the outlook, although wage increases reflecting the rise in the rate of base pay increases and hikes in minimum wages are expected to provide some support, private consumption is highly likely to remain more or less flat for a while, since, in addition to elevated food prices, the slower growth in bonuses reflecting a decline in corporate profits will push down consumption. Thereafter, private consumption is projected to return to a moderate increasing trend, since the improvement in real employee income is likely to become pronounced as the pace of price rises moderates.

**Chart 30: Confidence Indicators Related to Private Consumption**



Source: Cabinet Office.  
Note: Figures for the *Economy Watchers Survey* are those for the current economic conditions DI.

Housing investment has declined (Chart 31). The number of housing starts -- a leading indicator of housing investment -- has picked up recently, after having plunged reflecting a reactionary decline following the front-loading of housing starts ahead of the enforcement of revisions to the Building Standards Act and other regulations this April. That said, as can be seen, for example, by the fact that housing starts remain well below the levels observed prior to the front-loading, they have continued to be on a weak trend, reflecting factors such as a rise in housing prices. Housing investment is likely to follow a moderate declining trend due to the rise in housing prices and to a decrease in housing demand reflecting demographic developments, although accommodative financial conditions are expected to provide support.



## II. Current Situation of Prices and Their Outlook

### Developments in Prices

The year-on-year rate of increase in the producer price index (PPI) has been on a decelerating trend, affected by factors such as the past decline in crude oil prices and appreciation of the yen, and has recently been in the range of 2.5-3.0 percent (Charts 32 and 43). The year-on-year rate of increase in the services producer price index (SPPI, excluding international transportation) has remained at a relatively high level, mainly on the back of the rise in personnel expenses. However, the rate of increase has decelerated due to factors such as the dissipation of the impact of the previous year's price hikes, and has recently been in the range of 2.5-3.0 percent (Chart 32).

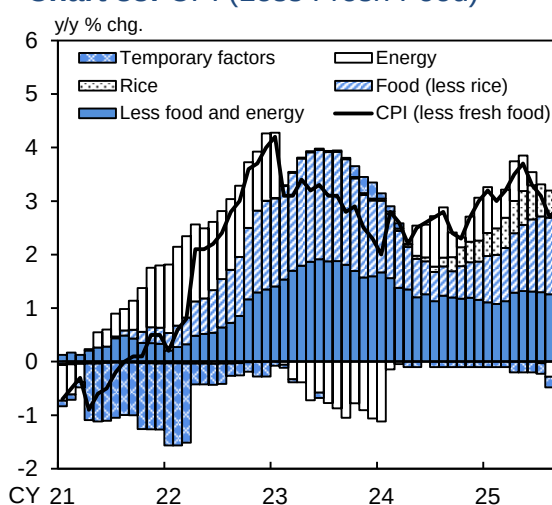
With moves to pass on wage increases to selling prices continuing, the year-on-year rate of increase in the CPI (all items less fresh food) has been at around 3 percent recently, due to the effects of the rise in food prices, such as rice prices, and other factors (Charts 32 and 33). While the year-on-year rate of increase in the CPI (all items less fresh food and energy) until recently had been in the range of 3.0-3.5 percent, it declined to 3 percent in September (Charts 32 and 34). Specifically, the rate of increase in goods prices as a whole has decelerated, mainly because the year-on-year rates of increase in prices of rice and durable goods (household electrical appliances) have decreased, although the rate of increase in prices of food excluding rice has remained elevated. The rate of increase in general services prices had been accelerating since the beginning of the year, mainly led by

**Chart 32: Inflation Indicators**

|                                      | y/y % chg. |       |       |       |
|--------------------------------------|------------|-------|-------|-------|
|                                      | 24/Q4      | 25/Q1 | 25/Q2 | 25/Q3 |
| <b>Consumer Price Index (CPI)</b>    |            |       |       |       |
| Less fresh food                      | 2.6        | 3.1   | 3.5   | 2.9   |
| Less fresh food and energy           | 2.3        | 2.7   | 3.2   | 3.2   |
| Less food and energy                 | 1.6        | 1.5   | 1.6   | 1.5   |
| <b>Producer Price Index</b>          | 3.9        | 4.2   | 3.3   | 2.6   |
| <b>Services Producer Price Index</b> | 3.5        | 3.5   | 3.2   | 2.8   |
| <b>GDP Deflator</b>                  | 2.9        | 3.3   | 3.0   |       |
| Domestic demand deflator             | 2.4        | 2.7   | 2.3   |       |

Sources: Ministry of Internal Affairs and Communications; Bank of Japan; Cabinet Office.  
Notes: 1. Figures for the services producer price index (SPPI) exclude international transportation.  
2. CPI figures "less food and energy" include alcoholic beverages.

**Chart 33: CPI (Less Fresh Food)**

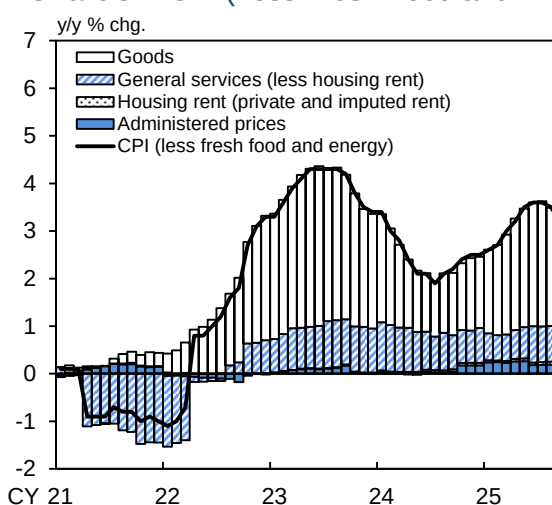


Source: Ministry of Internal Affairs and Communications.

Notes: 1. Figures for energy consist of those for petroleum products, electricity, and gas, manufactured & piped. Figures for food (less rice) exclude fresh food and alcoholic beverages.

2. Figures for "temporary factors" are staff estimates and include the effects of the consumption tax hike, policies concerning the provision of mobile phone charges from fiscal 2021 to 2022.

**Chart 34: CPI (Less Fresh Food and Energy)**



Source: Ministry of Internal Affairs and Communications.

Notes: 1. Administered prices (less energy) consist of "public services" and "water charges."

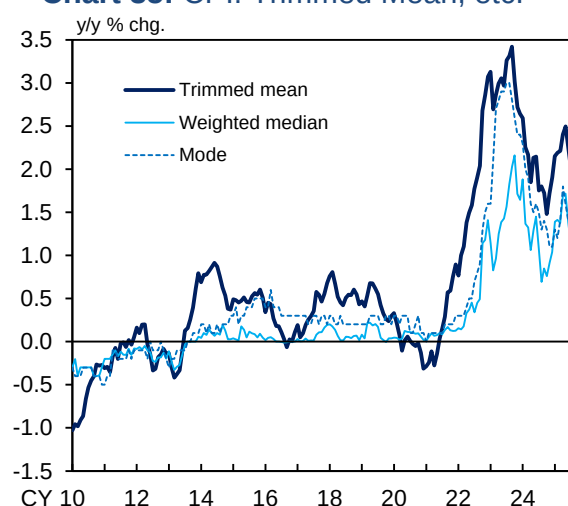
2. The CPI figures are staff estimates and exclude the effects of the consumption tax hike, policies concerning the provision of free education, and travel subsidy programs.

dining-out and mobile phone charges, reflecting factors such as moves to pass on personnel expenses and other costs to selling prices. More recently, however, the rate of increase in general services prices has been flat, partly due to the dissipation of the impact of the previous year's price hikes. The rate of increase in administered prices has decelerated recently, due to the effects of the provision of free childcare implemented by some local governments.

Meanwhile, looking at the CPI (all items less food and energy) -- which is not affected by fluctuations in food and energy prices -- the year-on-year rate of increase declined to 1.3 percent in September from around 1.5 percent previously (Charts 32 and 33).

Core indicators for capturing the underlying trend in the CPI have exhibited the following developments (Chart 35).<sup>14</sup> The rate of increase in the trimmed mean of the year-on-year rate of change in the CPI had been on an accelerating trend, reflecting the effects of the rise in food prices, such as rice prices, in a wide range of items. More recently, however, the rate of increase has decelerated, mainly due to a decline in the growth rate of energy prices, which carry a large weight in the CPI. The rate of increase in the

**Chart 35: CPI: Trimmed Mean, etc.**



Sources: Bank of Japan; Ministry of Internal Affairs and Communications.

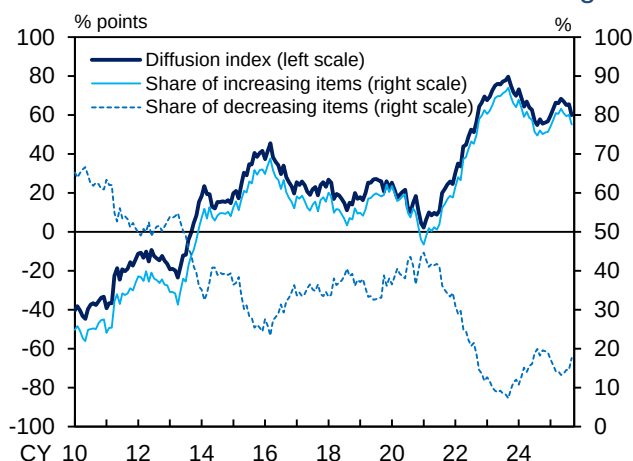
Note: Based on staff calculations using the CPI excluding the effects of the consumption tax hikes, policies concerning the provision of free education, and travel subsidy programs. The CPI figures from April 2020 onward are staff estimates and exclude the effects of measures such as free higher education.

<sup>14</sup> The trimmed mean is calculated by excluding items that belong to a certain percentage of the upper and lower tails of the price change distribution (10 percent of each tail) in order to eliminate the effects of large relative price changes. The mode is the inflation rate with the highest density in the price change distribution. The weighted median is the average of the inflation rates of the items at around the 50 percentile point of the cumulative distribution in terms of weight. Each indicator is calculated using data for each CPI item that excludes the effects of the consumption tax hikes, policies concerning the provision of free education, and travel subsidy programs.

weighted median also had been accelerating, but recently the rate of increase has decelerated somewhat. On the other hand, the rate of increase in the mode has been on an accelerating trend recently, as the number of items with year-on-year changes around 0 percent has declined. Moreover, looking at the year-on-year price changes across all CPI items (less fresh food), the share of items whose prices have increased minus the share of items whose prices have decreased had been on an expanding trend in positive territory, reflecting a rise in the number of items increasing in price such as food, but recently has started to decline (Chart 36). Indicators that exclude the impact of fluctuations in import prices in order to capture the inflationary pressure stemming from wage increases have remained on a moderate uptrend (Chart 37).<sup>15</sup> In addition, indicators of inflation expectations, which represent people's perceptions of price developments and are closely related to the underlying inflation trend, have increased moderately (Chart 38).<sup>16</sup>

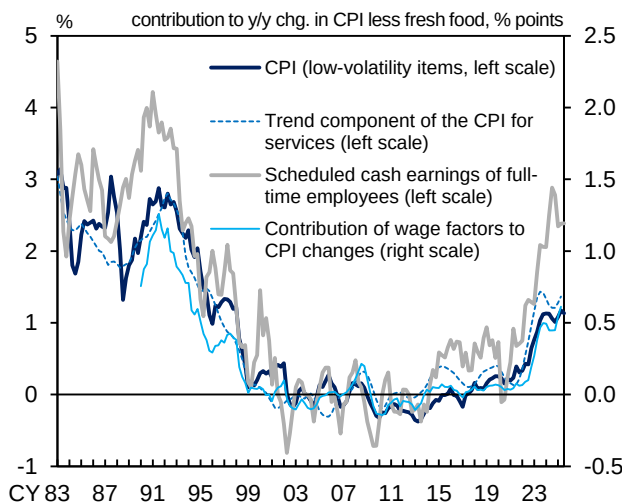
Meanwhile, a decomposition of changes in the GDP deflator from the distribution side shows that, while the acceleration in the rate of increase in the GDP deflator observed in 2023 was mainly led by unit profits, as firms passed on cost increases, since 2024, both unit profits and unit labor costs have been rising in a balanced manner, as the

**Chart 36: Diffusion Index of Price Changes**



Sources: Bank of Japan; Ministry of Internal Affairs and Communications.  
Note: The diffusion index is defined as the share of increasing items minus the share of decreasing items. The share of increasing/decreasing items is the share of items for which price indices increased/decreased from a year earlier. Based on staff calculations using the CPI (less fresh food) excluding the effects of the consumption tax hikes, policies concerning the provision of free education, and travel subsidy programs. The CPI figures from April 2020 onward are staff estimates and exclude the effects of measures such as free higher education.

**Chart 37: CPI Changes due to Wage Factors**



Sources: Ministry of Internal Affairs and Communications; Ministry of Health, Labour and Welfare; Bank of Japan.

- Notes: 1. Figures for low-volatility CPI items and scheduled cash earnings of full-time employees are year-on-year percentage changes, while those for the trend component of the CPI for services are the 6-quarter backward moving averages of annualized quarter-on-quarter percentage changes. Figures for scheduled cash earnings of full-time employees before 1994 are those for regular employees. Moreover, figures from 2016 onward are based on continuing observations following the sample revisions.
2. Figures for the contribution of wage factors to CPI changes are based on the relationship between the CPI and wages, estimated using a 4-variable VAR model comprising import prices (yen basis), the output gap, wages (scheduled cash earnings of full-time employees), and price indices for low-, medium-, and high-volatility items in the CPI. The estimates are obtained using 20-year rolling regressions for low-, medium-, and high-volatility CPI items.
3. Figures for the trend component of the CPI for services are the composite of the sector-specific price trend for services and the common trend in services prices and wages. The figures are estimated using category-level services prices and industry-level scheduled cash earnings.
4. The figure for scheduled cash earnings of full-time employees for 2025/Q3 is the July-August average.

<sup>15</sup> For details, see "Recent Developments in the Linkage between Wages and Prices," *Bank of Japan Review Series*, no. 24-E-2, May 2024. "CPI (low-volatility items)" is calculated by aggregating CPI items that are classified as having a low degree of price volatility based on past measures of volatility and is one of the indicators used to observe the extent to which price rises have spread to a wide range of items.

<sup>16</sup> For details on indicators for capturing the underlying inflation trend, see Box 4 in the April 2024 Outlook Report.



contribution of unit labor costs has been intensifying in reflection of wage increases (Chart 39).<sup>17</sup>

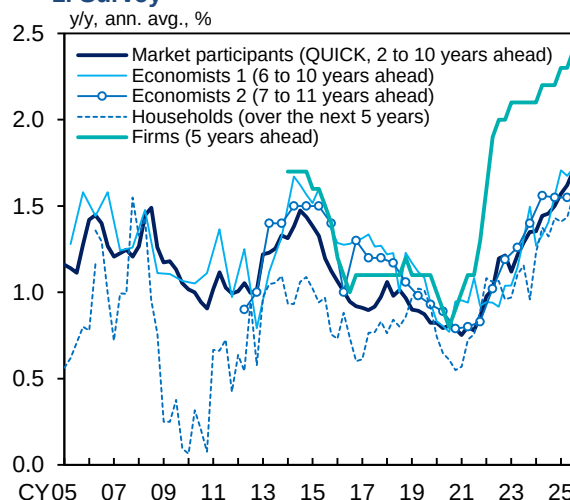
## Environment Surrounding Prices

In the outlook for prices, the main factors that determine inflation rates are assessed as follows. First, the output gap is likely to temporarily widen in negative territory during fiscal 2025, reflecting a decline in the capacity utilization rate for the manufacturing industry; thereafter, toward the end of the projection period, the gap is likely to improve gradually (Chart 2). Meanwhile, it is likely that labor market conditions have tightened to a greater extent than can be explained by the changes in the output gap, due to a deceleration in the pace of increase in labor force participation of women and seniors and to a tightening of regulations on working hours. In this situation, upward pressure on wages and prices is more likely to be stronger than suggested by the output gap, given the current situation that labor shortages have begun to constrain the economic activity of firms, mainly in the nonmanufacturing industry, from the supply side.

Second, medium- to long-term inflation expectations have risen moderately (Chart 38). Regarding the outlook, although it is projected that firms will maintain their active wage- and price-setting behavior and will continue their moves to reflect higher costs -- including increased personnel expenses and distribution costs -- in selling prices, inflation expectations are expected to be sluggish, mainly affected by the

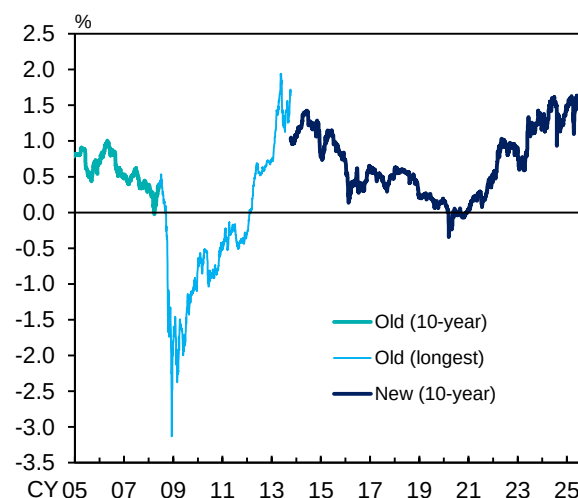
## Chart 38: Inflation Expectations

### 1. Survey



Sources: Bank of Japan; QUICK, "QUICK Monthly Market Survey <Bonds>"; JCER, "ESP Forecast"; Consensus Economics Inc., "Consensus Forecasts."  
 Notes: 1. "Economists 1" shows the forecasts of economists in the *Consensus Forecasts*. "Economists 2" shows the forecasts of forecasters surveyed for the *ESP Forecast*.  
 2. Figures for households are from the *Opinion Survey on the General Public's Views and Behavior*, estimated using the modified Carlson-Parkin method for a 5-choice question.  
 3. Figures for firms show the inflation outlook of enterprises for general prices (all industries and enterprises, average) in the *Tankan*.

### 2. BEI



Source: Bloomberg.  
 Note: The BEI (break-even inflation) rate is the yield spread between fixed-rate coupon-bearing JGBs and inflation-indexed JGBs. Inflation-indexed JGBs issued since October 2013 are designated as "new," while the rest are designated as "old." Figures for "old (longest)" are calculated using yield data for issue No. 16 of inflation-indexed JGBs, which matured in June 2018.

<sup>17</sup> See Box 4 for the impact of wage increases on prices.



growth pace of the economy. Thereafter, as the economic growth rate rises and labor market conditions tighten notably, it is expected that firm's active wage- and price-setting behavior will become more widespread, and that inflation expectations will rise moderately again.

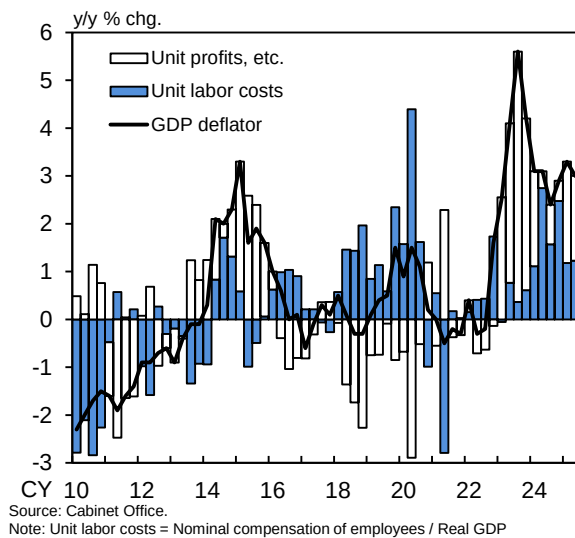
Third, the year-on-year rate of change in the import price index on a yen basis has narrowed within negative territory. This is because, although the decline in the index on a contract currency basis has continued, reflecting developments in international commodity prices, such as crude oil prices, yen-based import prices have recently been pushed up by exchange rate developments (Charts 41 and 42).

Meanwhile, the year-on-year rate of increase in energy prices (e.g., gasoline prices and electricity charges) has been on a declining trend, albeit with fluctuations, and the contribution of energy prices to the year-on-year rate of increase in the CPI (all items less fresh food) in September was in the range of 0.0-0.5 percentage points. If foreign exchange rates and crude oil prices are assumed to be at around the current levels, given the government's measures to reduce the household burden of higher prices such as gasoline prices, electricity charges, and gas charges, the rate of increase in energy prices is likely to decrease further, albeit with fluctuations, and be at around 0 percent.

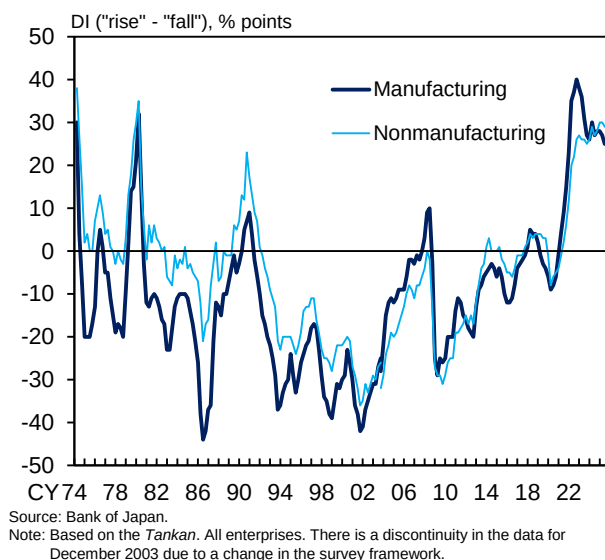
## Outlook for Prices

Based on this underlying scenario, the year-on-year rate of increase in the CPI (all items

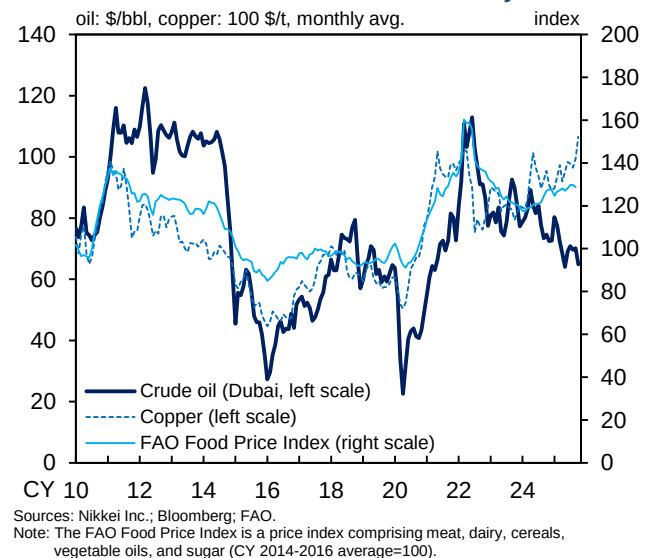
**Chart 39: GDP Deflator**



**Chart 40: Output Prices**



**Chart 41: International Commodity Prices**



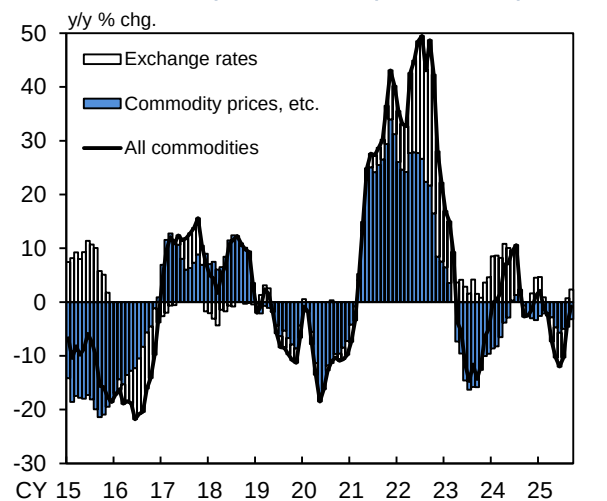
less fresh food and energy) is likely to be temporarily below 2 percent because it is expected that the effects of the rise in food prices, such as rice prices, will gradually wane and that this CPI will be affected by factors such as the growth pace of the economy. Thereafter, however, the rate of increase in this CPI is likely to be at around 2 percent as the economic growth rate rises (Chart 44).

The year-on-year rate of increase in the CPI (all items less fresh food) is likely to decelerate to a level below 2 percent through the first half of fiscal 2026, with the waning of the effects of the rise in food prices, such as rice prices.

Meanwhile, underlying CPI inflation is likely to be sluggish, mainly affected by the growth pace of the economy. Thereafter, since it is projected that a sense of labor shortage will grow as the economic growth rate rises and that medium- to long-term inflation expectations will rise, it is expected that underlying CPI inflation and the rate of increase in the CPI (all items less fresh food) will increase gradually and, in the second half of the projection period, be at a level that is generally consistent with the price stability target.

Firms' behavior has shifted more toward raising wages and prices, and it is expected in the baseline scenario that the mechanism in which wages and prices rise moderately in interaction with each other will be maintained, although the modest growth of the economy is likely to affect price developments. However, if stronger downward pressure is exerted on corporate

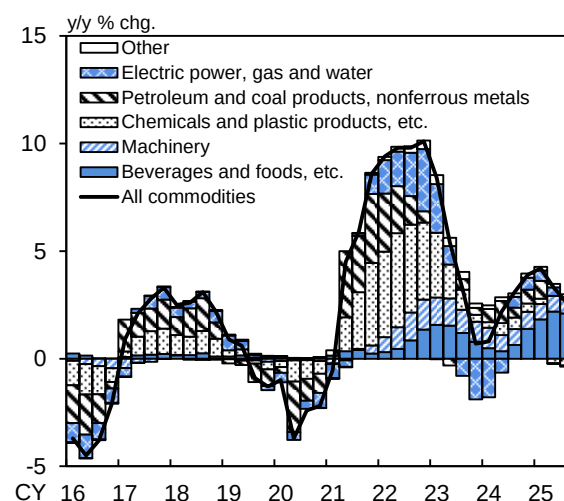
**Chart 42: Import Prices (Yen Basis)**



Source: Bank of Japan.

Note: The contribution of changes in commodity prices, etc. is calculated using changes in the import price index on a contract currency basis. The contribution of changes in exchange rates is calculated using the difference between the import price index on a yen basis and that on a contract currency basis.

**Chart 43: Producer Price Index**

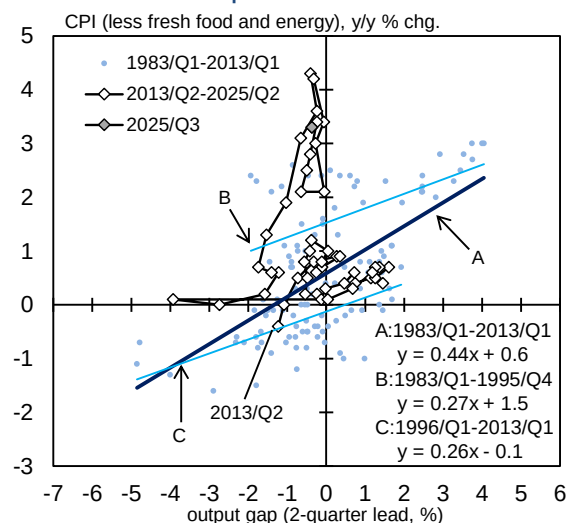


Source: Bank of Japan.

Notes: 1. Figures exclude the effects of the consumption tax hike.

2. Figures for "beverages and foods, etc." include agriculture, forestry and fishery products.

**Chart 44: Phillips Curve**



Sources: Ministry of Internal Affairs and Communications; Bank of Japan.

Notes: 1. The CPI figures are staff estimates and exclude mobile phone charges and the effects of the consumption tax hikes, policies concerning the provision of free education, and travel subsidy programs.

2. Figures for the output gap are staff estimates.

profits going forward due to the impact of trade and other policies in each jurisdiction, this could lead firms to strengthen their stance toward cutting costs, including personnel expenses. As a result, moves to reflect price rises in wages could weaken. On the other hand, going forward, with continuing tight labor market conditions and the minimum wage increases, upward pressure on wages could intensify to a greater extent than expected, and moves to reflect wage increases in selling prices could also strengthen.

### III. Financial Developments in Japan

#### Financial Conditions

Financial conditions have been accommodative.

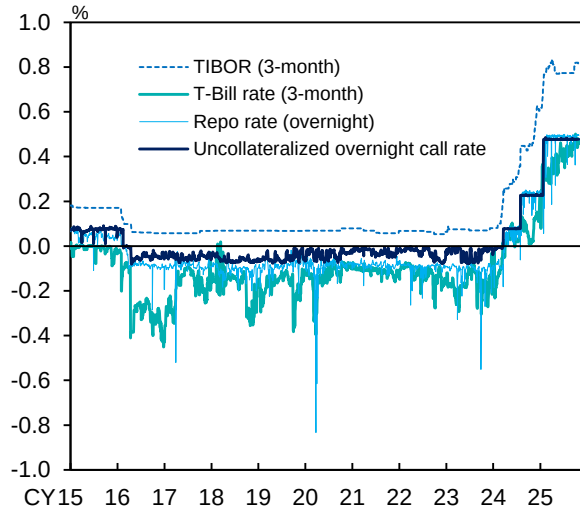
Looking at short-term interest rates, the uncollateralized overnight call rate has been at around 0.5 percent (Chart 45). Regarding interest rates on term instruments, both the 3-month TIBOR and the 3-month treasury discount bill (T-Bill) rate have risen slightly.

Real interest rates have been negative (Chart 46).<sup>18</sup>

Firms' funding costs have increased (Chart 47). As for lending rates (the average interest rates on new loans and discounts), both long-term and short-term ones have risen, due to rises in market interest rates and short-term prime rates, both of which serve as base rates. Issuance rates for CP have been more or less flat. The rise in issuance rates for corporate bonds has come to a halt.

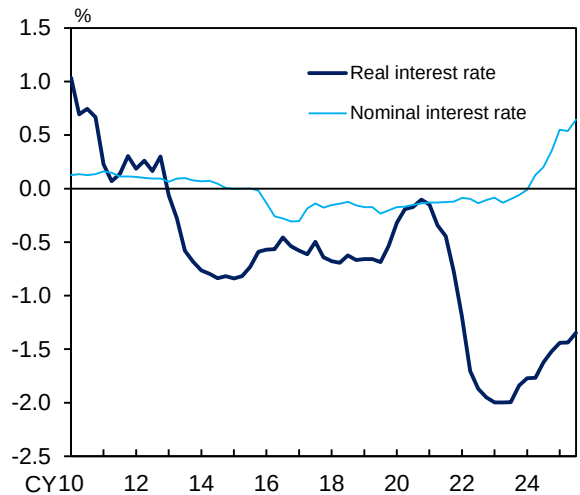
The DI in the *Tankan* for financial institutions' lending attitudes as perceived by firms suggests that such attitudes have remained accommodative on the whole (Chart 48). The DI for issuance conditions for CP has continued to show net "easy" conditions. As suggested by the latter, issuance conditions for CP and corporate bonds have been favorable. Meanwhile, the DI for firms' financial positions in the *Tankan* suggests

Chart 45: Short-term Interest Rates



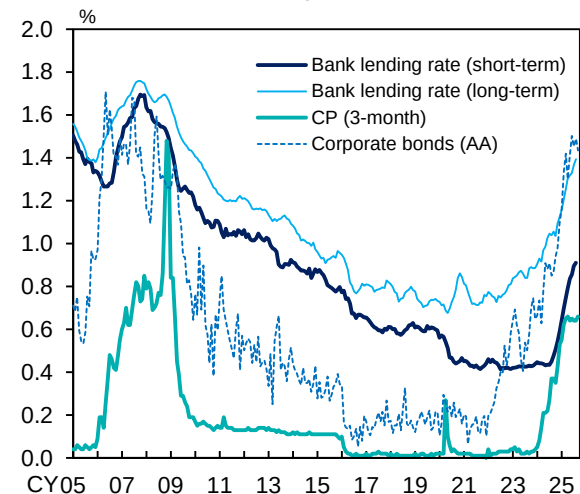
Sources: Bank of Japan; JBA TIBOR Administration; Bloomberg.  
Note: Figures for repo rate are the Tokyo Repo Rate.

Chart 46: Real Interest Rate (1-Year)



Sources: Bank of Japan; QUICK, "QUICK Monthly Market Survey <Bonds>"; Consensus Economics Inc., "Consensus Forecasts"; Bloomberg.  
Note: Figures for the real interest rate are calculated as government bond yields (1-year) minus the composite index of inflation expectations (staff estimates).

Chart 47: Bank Lending Rates and Issuance Yields for CP and Corporate Bonds



Sources: Bank of Japan; Japan Securities Depository Center; Capital Eye; I-N Information Systems; Bloomberg.

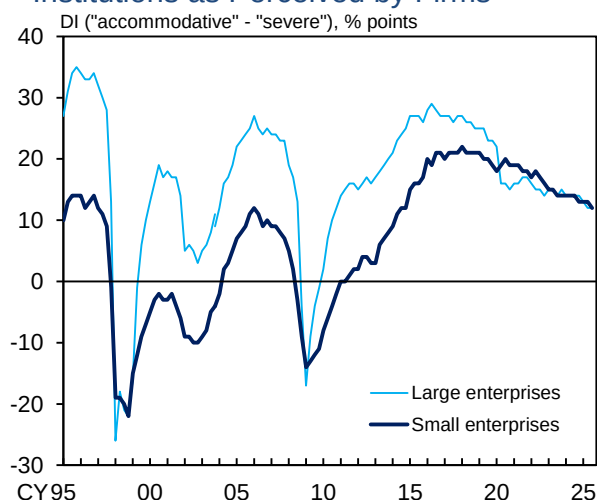
Notes: 1. Figures for issuance yields for CP up through September 2009 are the averages for CP (3-month, rated a-1 or higher). Those from October 2009 onward are the averages for CP (3-month, rated a-1).  
2. Figures for issuance yields for corporate bonds are the averages for domestically issued bonds launched on a particular date. Bonds issued by banks and securities companies, etc. are excluded.  
3. Figures for bank lending rates are 6-month backward moving averages.

<sup>18</sup> See Box 5 of the April 2024 Outlook Report for an assessment of financial conditions in terms of real interest rates.

that they have been at favorable levels on the back of the recovery in economic activity and progress in the pass-through of cost increases to selling prices (Chart 49).

Firms' demand for funds has increased moderately on the back of, for example, the recovery in economic activity as well as mergers and acquisitions of firms. In this situation, the year-on-year rate of increase in the amount outstanding of bank lending has been in the range of 4.0-4.5 percent (Chart 50). The year-on-year rate of increase in the aggregate amount outstanding of CP and corporate bonds has been at around 7 percent, partly due to large-scale issuances.

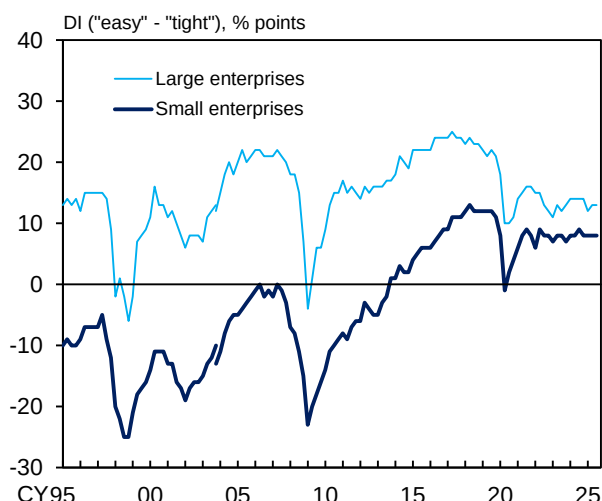
**Chart 48: Lending Attitudes of Financial Institutions as Perceived by Firms**



Source: Bank of Japan.

Note: Based on the *Tankan*. All industries. There is a discontinuity in the data for December 2003 due to a change in the survey framework.

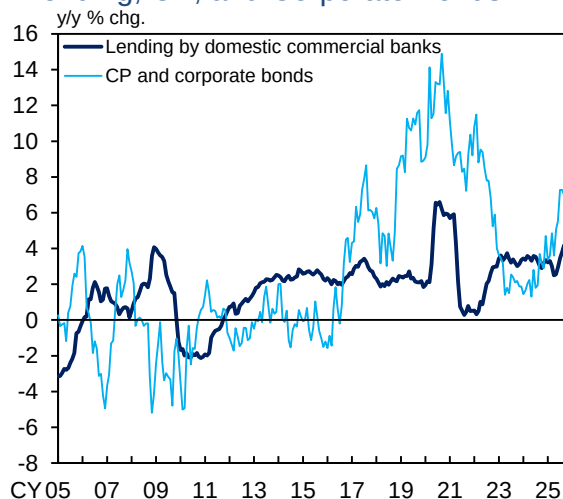
**Chart 49: Firms' Financial Positions**



Source: Bank of Japan.

Note: Based on the *Tankan*. All industries. There is a discontinuity in the data for December 2003 due to a change in the survey framework.

**Chart 50: Amounts Outstanding of Bank Lending, CP, and Corporate Bonds**



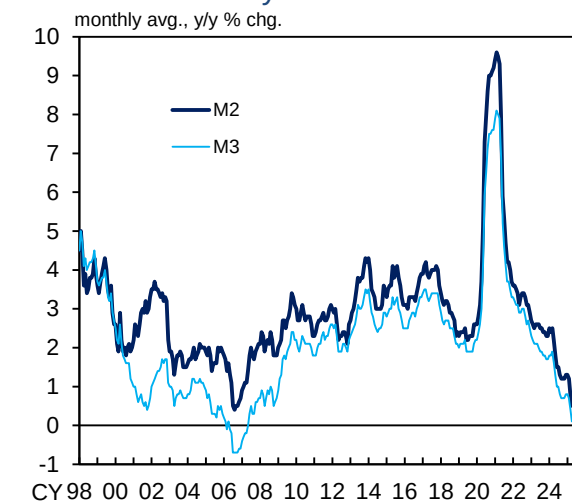
Sources: Bank of Japan; Japan Securities Depository Center;

Japan Securities Dealers Association; I-N Information Systems.

Note: Figures for lending by domestic commercial banks are monthly averages. Figures for CP and corporate bonds are those at the end of the period.

The year-on-year rate of change in the money stock (M2) has been at around 1.5 percent, as an increase in the amount outstanding of bank lending has continued to push up the rate (Chart 51).

**Chart 51: Money Stock**



Source: Bank of Japan.

## Developments in Financial Markets

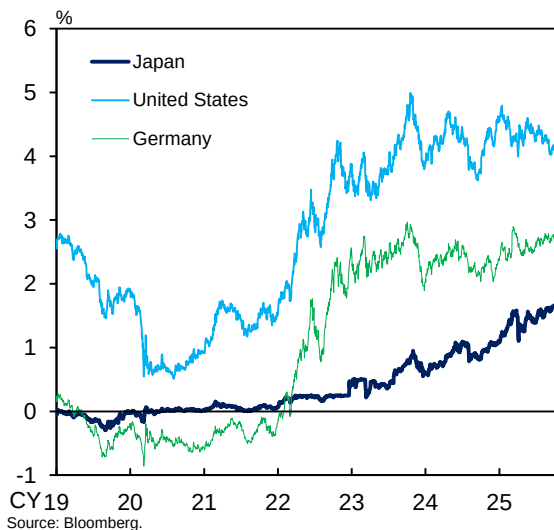
In global financial markets, despite continued attention to uncertainties over the outlook for the global economy, market sentiment has improved, reflecting factors such as progress in trade policy negotiations.

Yields on 10-year government bonds in the United States have declined, mainly reflecting lower employment-related indicators and the increase in market expectations for policy interest rate cuts by the Federal Reserve (Chart 52). Yields on 10-year government bonds in Europe have generally been more or less flat: while 10-year yields in Europe declined at times in line with those in the United States, there were also times when the yields in Europe rose due to vigilance against an easing of supply and demand conditions in sovereign bonds. In Japan, yields on 10-year government bonds rose through late September, mainly reflecting solid economic indicators and the resultant market views on future monetary policy. Since then, 10-year yields in Japan have been more or less flat, albeit with fluctuations.

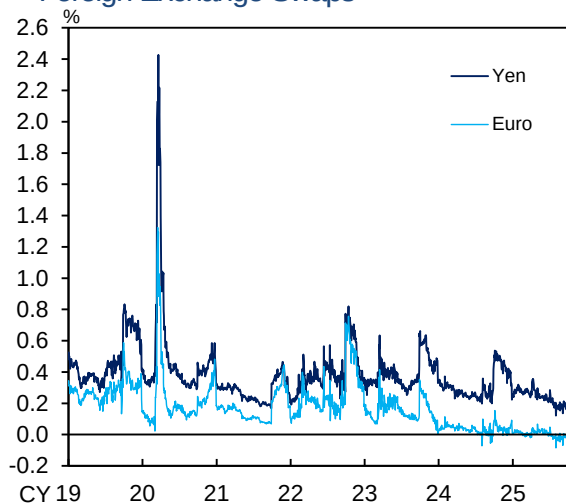
Premiums for U.S. dollar funding through the dollar/yen foreign exchange swap market have generally been at low levels, although they have expanded somewhat since the end of September, mainly due to transactions conducted in view of the year-end (Chart 53).

With the improvement in market sentiment, stock prices in the United States have risen significantly, reflecting the solid business performance of major

**Chart 52: 10-Year Government Bond Yields in Selected Advanced Economies**



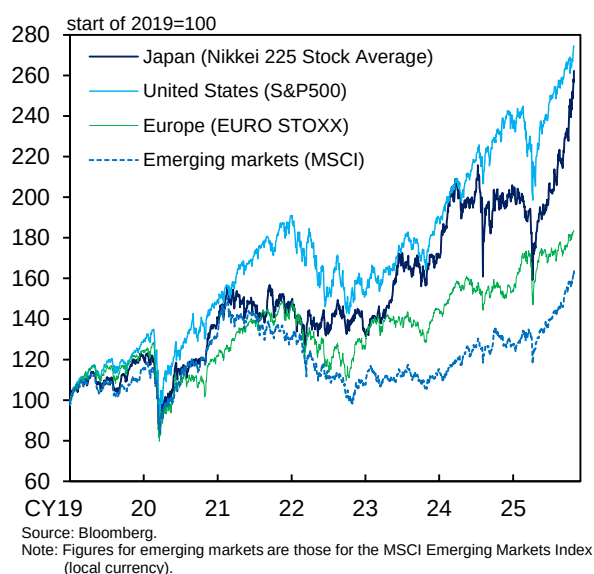
**Chart 53: Dollar Funding Premiums through Foreign Exchange Swaps**



Notes: 1. U.S. dollar funding premiums are calculated as the difference between U.S. dollar fundings rates (3-month) in the dollar/yen or euro/dollar foreign exchange swap market and those in the money market.  
2. The interest rates used for the calculation are as follows: for the yen, the OIS rate; for the euro, the EONIA-referencing OIS rate before October 4, 2019, and the €STR-referencing OIS rate thereafter; for the U.S. dollar, the OIS rate before January 3, 2019, and the SOFR thereafter.

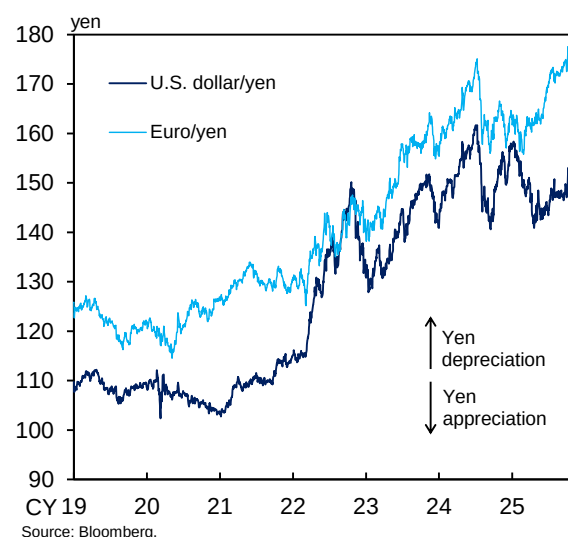
high-tech firms and the policy interest rate cuts by the Federal Reserve (Chart 54). Stock prices in Europe have risen, moving in line with those in the United States. Stock prices in Japan have risen significantly, moving in tandem with the rise in U.S. stock prices, and as the determination of tariff rates for automobiles and other items as a result of the Japan-U.S. tariff negotiations, for example, has been perceived as favorable. Meanwhile, stock prices in emerging economies have also risen, like those in advanced economies.

**Chart 54: Selected Stock Price Indices**



In foreign exchange markets, the yen had been more or less flat against the U.S. dollar but recently has depreciated (Chart 55). The yen has depreciated against the euro, as market expectations for policy interest rate cuts by the European Central Bank have subsided.

**Chart 55: U.S. Dollar/Yen and Euro/Yen**

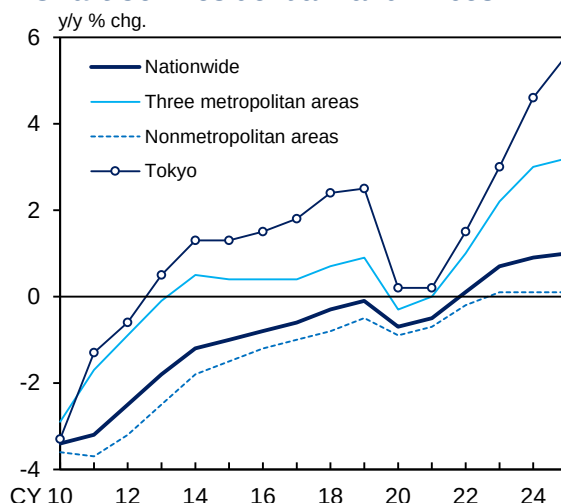




## Land Prices

Land prices have increased in reflection of the economic recovery. According to the *Land Price Research by Prefectural Governments* for 2025 (as of July 1), the year-on-year rates of increase in both residential and commercial land prices have accelerated (Charts 56 and 57). In the three major metropolitan areas (Tokyo, Osaka, and Nagoya), the year-on-year rates of increase in both residential and commercial land prices have accelerated. In nonmetropolitan areas, the rate of increase in residential land prices has been flat, while the rate of increase in commercial land prices has accelerated.

### Chart 56: Residential Land Prices

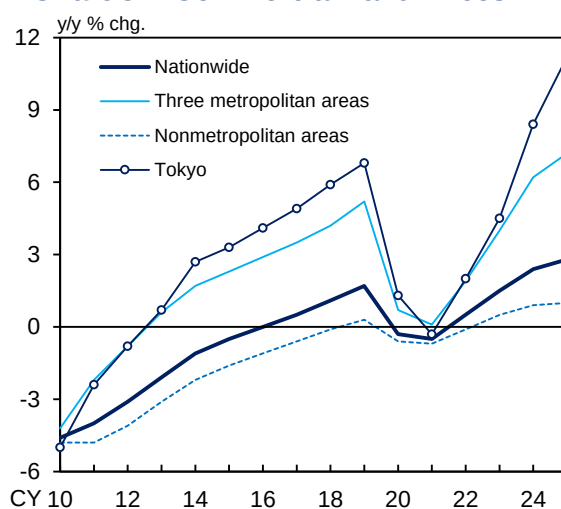


Source: Ministry of Land, Infrastructure, Transport and Tourism.

Notes: 1. Based on the *Land Price Research by Prefectural Governments*. Figures are as of July 1.

2. The three metropolitan areas are the Tokyo area (Tokyo, Kanagawa, Saitama, Chiba, and Ibaraki prefectures), the Osaka area (Osaka, Hyogo, Kyoto, and Nara prefectures), and the Nagoya area (Aichi and Mie prefectures). Nonmetropolitan areas are areas other than the three metropolitan areas.

### Chart 57: Commercial Land Prices



Source: Ministry of Land, Infrastructure, Transport and Tourism.

Notes: 1. Based on the *Land Price Research by Prefectural Governments*. Figures are as of July 1.

2. The three metropolitan areas are the Tokyo area (Tokyo, Kanagawa, Saitama, Chiba, and Ibaraki prefectures), the Osaka area (Osaka, Hyogo, Kyoto, and Nara prefectures), and the Nagoya area (Aichi and Mie prefectures). Nonmetropolitan areas are areas other than the three metropolitan areas.

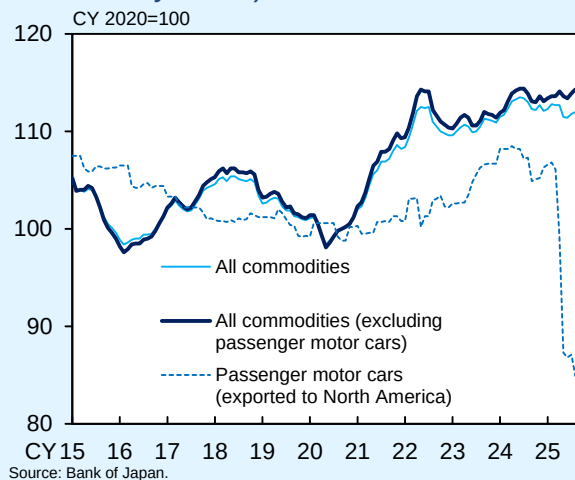
## (Box 1) Impact of U.S. Tariff Policies and Outlook for Exports

This box examines the impact of tariff hikes on Japan's economy thus far. On this basis, it outlines the outlook for Japan's export by goods.

On July 23, 2025 (Japan Standard Time), tariff negotiations between Japan and the United States concluded with an agreement, and U.S. tariffs on Japan were set at 15 percent for both "reciprocal" tariffs and those on automobiles, replacing existing rates that were below 15 percent. Thereafter, in an executive order issued by the President of the United States in early September, it was announced that the new "reciprocal" tariff rate would be applied retroactively from August 7 onward, and any excess tariffs collected prior to the executive order would be refunded. Tariffs on automobiles were lowered from September 16. Meanwhile, the U.S. administration has suggested the possibility of introducing sectoral tariffs on semiconductors and pharmaceuticals; however, no specific executive orders have been issued thus far.

Analysis in the April and July 2025 Outlook Reports suggested that U.S. tariff hikes would affect Japan's economy through three major channels: (1) the direct effects of bearing the burden of costs arising from tariff increases, (2) the indirect effects through a decrease in global trade activity, and (3) heightened uncertainty. Regarding (1), direct effects, contract currency-based export prices show that export prices of automobiles from Japan to the United States have remained about 20 percent lower

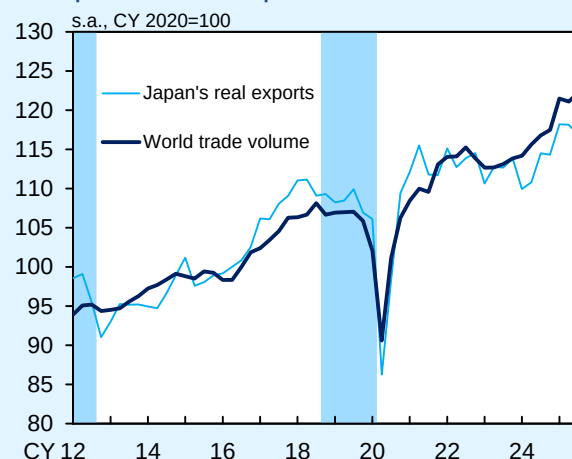
**Chart B1-1: Export Prices (Contract Currency Basis)**



since April 2025; export prices of other items have been more or less flat (Chart B1-1). This suggests the possibility that, while Japanese automobile exporters are likely absorbing most of the tariff costs to maintain competitiveness, the burden of costs arising from tariff increases for other items is highly likely being borne by U.S. consumers and firms, including U.S.-based subsidiaries of Japanese firms. As for (2), indirect effects, world trade volume increased in the January-March quarter of 2025 due to a front-loaded increase in demand ahead of tariff hikes, and it has remained at a high level (Chart B1-2). The high level of world trade volume is likely to have been supported by the front-loading of production to prepare for the possible introduction of sectoral tariffs on semiconductors, and by a rise in the trade volume of IT-related goods, which has in turn been supported by firm demand driven by robust growth in AI-related industries. With regard to (3), uncertainty, while uncertainties remain, mainly over developments in U.S.-China trade negotiations and sectoral tariffs on semiconductors, the abovementioned Japan-U.S. trade agreement appears to have eased some of the uncertainty faced by firms in Japan. In particular, the fact that the effective tariff rate on goods exported from Japan to the United States has been set at a level that would not be particularly disadvantageous compared with other regions is likely to have helped ease Japanese manufacturers' concerns over export competitiveness and to provide some degree of reassurance to exporting firms (Chart B1-3).

Taking into account the abovementioned impact of tariff hikes, Japan's exports are likely to be negatively affected by the reactionary decline

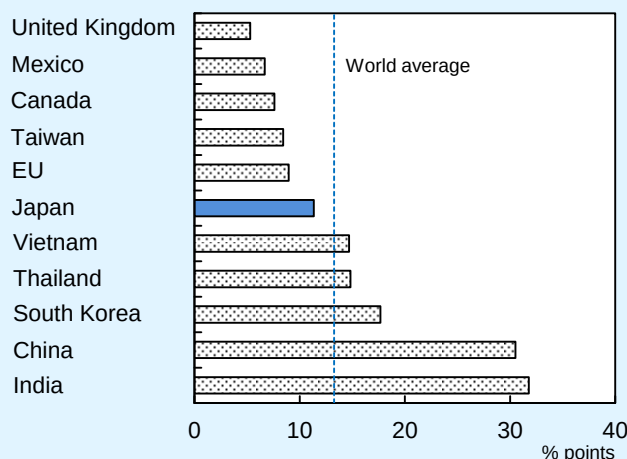
**Chart B1-2: World Trade Volume and Japan's Real Exports**



Sources: Bank of Japan; Ministry of Finance; CPB Netherlands Bureau for Economic Policy Analysis.

Notes: 1. Figures for the trade volume are those for real imports. The figure for the trade volume for 2025/Q3 is the July-August average.  
2. Shaded areas denote recession periods.

**Chart B1-3: U.S. Additional Effective Tariff Rates**



Sources: USITC; USTR; The White House; Federal Register; BEA.

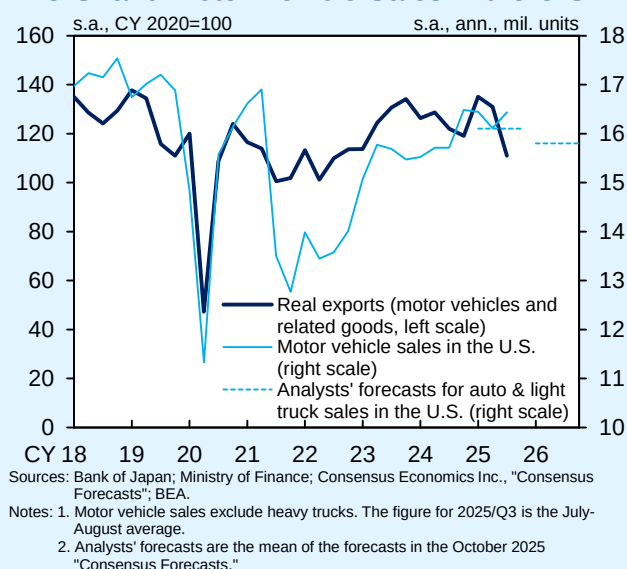
Note: Figures are additional tariff rates after January 2025. Based on staff calculations using the share of each country and region in U.S. total imports in 2024 and tariffs implemented as of October 24, 2025 (the USMCA tariff exemptions for Mexico and Canada are estimated based on certain assumptions).

following the front-loading due to the increase in U.S. tariffs and to be under gradually increasing downward pressure stemming from the slowdown in overseas economies (Chart B1-4). By goods, automobile-related exports -- which account for about one third of Japan's exports to the United States -- have been declining recently, partly due to the suspension of production lines at some automakers. They have, however, remained at a relatively high level, with new motor vehicle sales in the United States surpassing projections by analysts and maintaining resilience (Chart B1-5). Resilient automobile sales in the United States are likely to be on the back of, (1) a front-loaded increase in demand before the ending of subsidies for purchases of electric vehicles; and (2) most of the reactionary decline in automobile sales following the front-loading that has not yet taken place, owing to the slower pace of passing on of increased costs -- due to tariff hikes -- to selling prices, in comparison with other goods (Chart B1-6[1]). Indeed, automakers of other countries -- not just Japan -- have been containing the pass-through to selling prices of cost increases due to tariff hikes by bringing down the price of vehicles exported to the United States. This suggests that demand for automobiles in the United States has been underpinned by lower prices (Chart B1-6[2]). As for the outlook, automobile-related exports are highly likely to be sluggish, as increased costs due to tariff hikes are slowly passed on to selling prices in the U.S. automobile market and downward pressure on final demand grows, together with the reactionary decline in demand, mainly in the United States, following the front-loading.

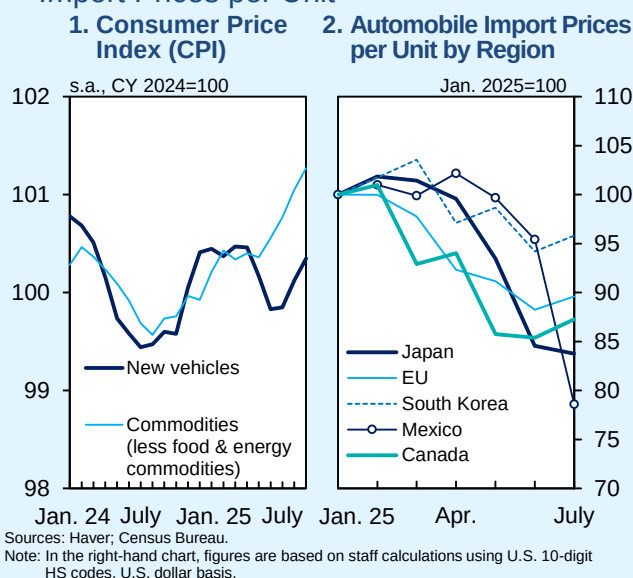
**Chart B1-4: PMI**



**Chart B1-5: Motor Vehicle Exports to the U.S. and Motor Vehicle Sales in the U.S.**

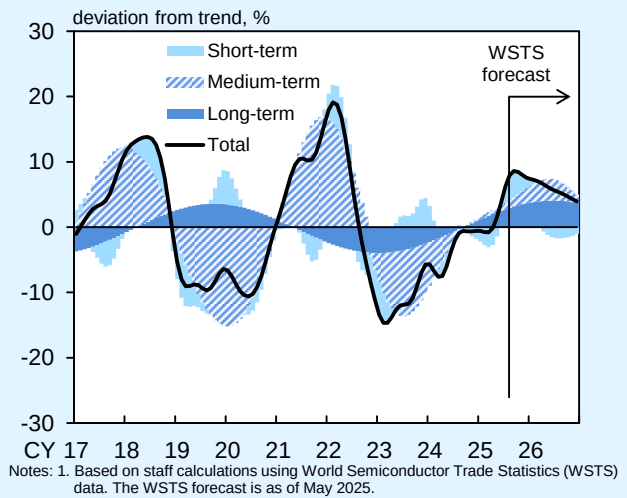


**Chart B1-6: U.S. CPI and Automobile Import Prices per Unit**

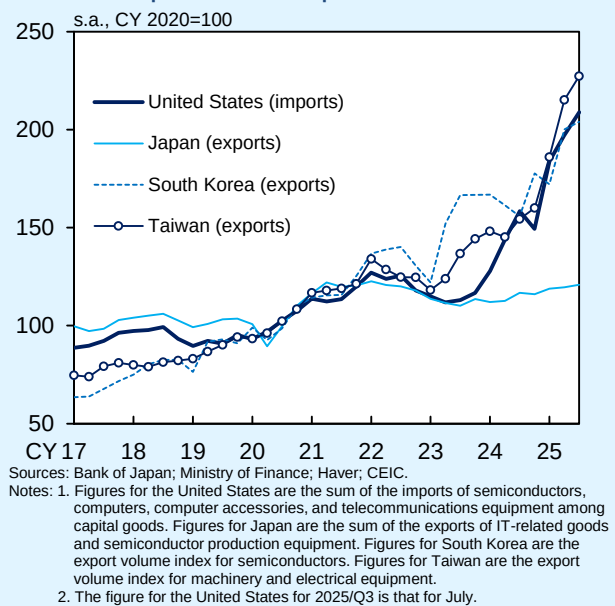


IT-related exports have continued to be on an uptrend, supported not only by front-loaded demand in preparation for the possible introduction of sectoral tariffs on semiconductors but also by robust underlying strength in AI-related demand. A decomposition of global semiconductor shipments, including the latest forecasts for the industry -- by applying frequency spectrum decomposition -- suggests that the global IT cycle may have entered an expansionary phase recently due to the following: (1) the medium-term replacement cycle for computers and smartphones has been approaching, as devices purchased when demand was boosted for stay-at-home consumption of goods during the COVID-19 pandemic reach their replacement date; and (2) AI-related demand has been on a long-term increasing trend (Chart B1-7). The growth in AI-related demand has been led mainly by investment demand for generative AI and data centers in the United States. However, shipments by Japanese IT-related firms are mainly items related to computers, smartphones, and automotive semiconductors; these firms have not been able to fully benefit from the surge in AI-related demand since last year. Consequently, the increase in Japan's IT-related exports has been limited when compared with that of manufacturers in Taiwan and South Korea, where the shares of graphic processing units (GPUs) and products for data centers are larger (Chart B1-8). As for the outlook, downward pressure is highly likely to be exerted temporarily on IT-related exports, once demand for replacing computers and smartphones peaks out, although certain sectors and firms may continue to benefit from AI-related demand.

**Chart B1-7: Global Cycle for IT-Related Goods**

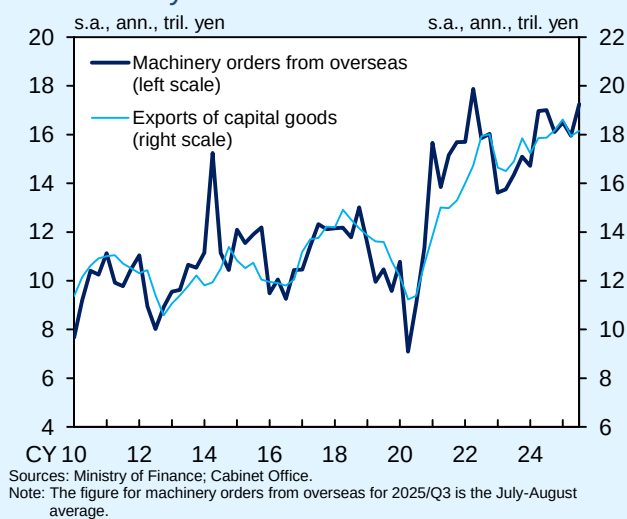


**Chart B1-8: Semiconductor-Related Real Exports and Imports**



Finally, a pick-up in capital goods exports has paused due to a leveling-off of demand for semiconductor production equipment for China (Chart B1-9). As uncertainty surrounding trade policies remains, postponement of business fixed investment seems to have been materializing in some sectors globally, and machinery orders from overseas have been more or less flat after having increased.<sup>19</sup> Japan's capital goods exports are therefore also highly likely to decelerate.

**Chart B1-9: Exports of Capital Goods and Machinery Orders from Overseas**



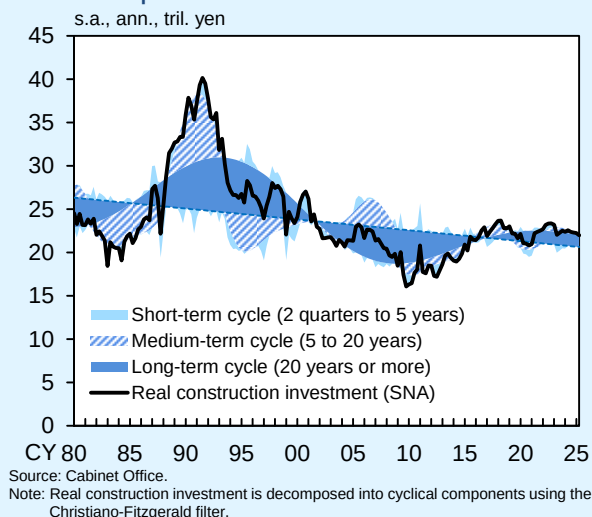
<sup>19</sup> Recently, machinery orders from overseas have increased temporarily owing to a surge in large-scale projects in telecommunication machinery.

## (Box 2) Background to Resilient Business Fixed Investment

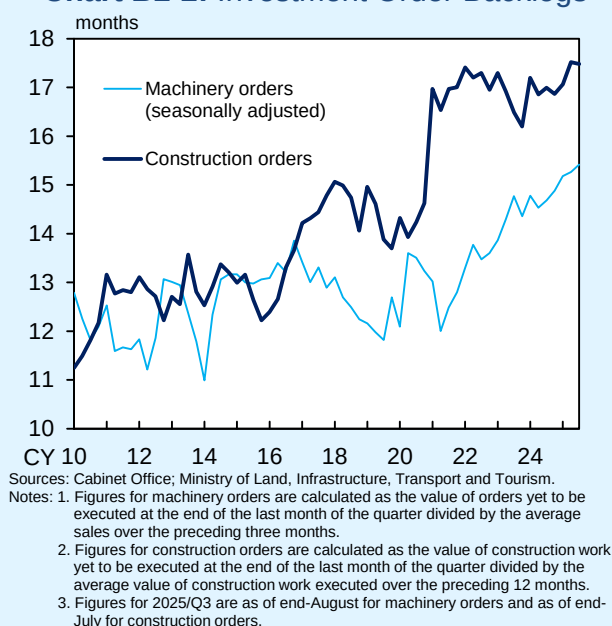
As confirmed in the September 2025 *Tankan*, firms have maintained an active stance toward business fixed investment thus far (Chart 19). However, considering, (1) that their profits are projected to decline to some extent for fiscal 2025, mainly among manufacturers (Chart 15); and (2) that uncertainties surrounding trade policies remain, although alleviated by the Japan-U.S. trade agreement, firms' business fixed investment plans may be revised downward toward the second half of fiscal 2025.<sup>20</sup> Despite this, business fixed investment is likely to be supported to a certain degree by, (1) resilient construction investment, mainly in nonmanufacturing sectors; and (2) an increase in intangible asset investment (R&D and software investment), which is not susceptible to fluctuations in profits, as a proportion of overall business fixed investment.

Construction investment has been on an increasing trend in recent years due to accelerating urban redevelopment, mainly in major metropolitan areas. This increase in investment in urban redevelopment may be attributed to the aging stock of urban infrastructure entering a medium- to long-term rebuilding cycle, and is partly supported by accommodative financial conditions. Indeed, a simple frequency spectrum decomposition of construction investment in GDP shows that, in recent years, (1) a long-term cycle (20 years or

**Chart B2-1: Frequency Spectrum Decomposition of Construction Investment**



**Chart B2-2: Investment Order Backlogs**



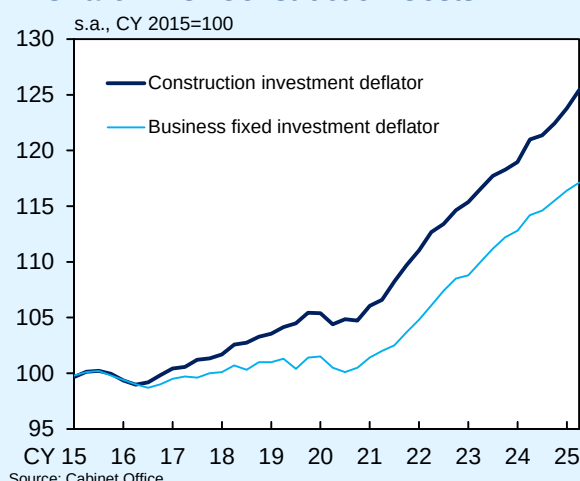
<sup>20</sup> Regarding the impact of uncertainty on business fixed investment in the current phase, see Box 2 of the July 2025 Outlook Report.



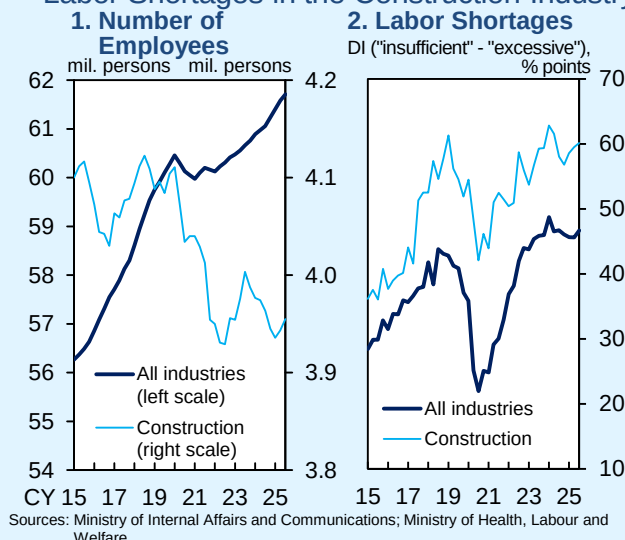
more) with the bottom in the second half of the 2000s has entered an expansionary phase; and (2) since the second half of the 2010s, a medium-term cycle (5 to 20 years) has also played a role in pushing up construction investment (Chart B2-1). This suggests that the long-term cycle represents buildings constructed during the bubble period entering a rebuilding phase, while the medium-term cycle represents an expansionary phase during the financial cycle. The long-term cycle is likely to continue exerting positive effects on construction investment, on the back of rebuilding demand, and the resilience in construction investment is highly likely to be maintained. Moreover, project timelines have been getting longer and order backlogs increasing markedly in recent years, as the scale of construction projects has become larger and labor shortages have been evident in the construction industry (Chart B2-2). This suggests that construction investment may continue to be underpinned by moves to clear order backlogs.

This robust demand for construction investment has brought about a significant increase in construction costs, together with a considerable rise in building material costs and severe labor shortages in the industry (Charts B2-3 and B2-4). The increase in construction costs seems to have been leading to a decrease in the size of investment, and to the postponement or cancellation of investment projects. It is therefore necessary to pay attention to the fact that there is a certain degree of downside risk stemming from supply constraints.

**Chart B2-3: Construction Costs**



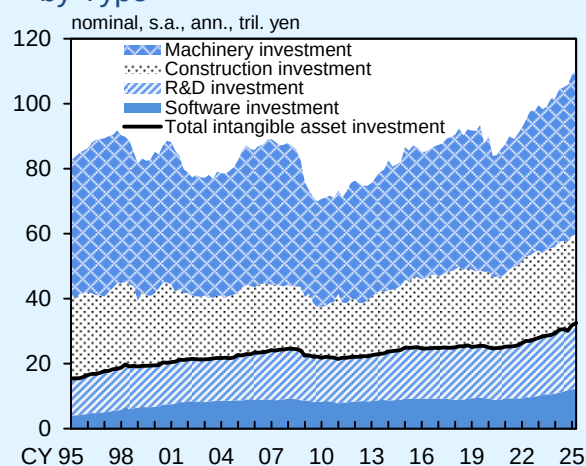
**Chart B2-4: Number of Employees and Labor Shortages in the Construction Industry**





The share of intangible asset investments (R&D and software investment) in overall business fixed investment has been rising, and this is likely to have been contributing to the stable growth of business fixed investment (Chart B2-5). The increase in intangible asset investments in recent years has been led by R&D investment in medium-to-long-term growth areas such as AI, electric vehicles, and semiconductor materials, and in labor-saving software investment. The correlation with profits by type of investment shows that intangible asset investments and profits are less correlated than machinery and construction investment (Chart B2-6). Intangible asset investments are likely to be carried out from a medium- to long-term perspective, without being significantly affected by short-term decreases in profits due to global tariff policies.

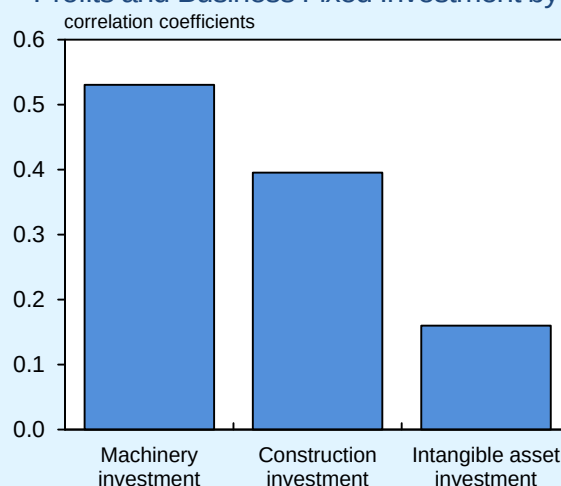
**Chart B2-5: Business Fixed Investment by Type**



Sources: Cabinet Office, etc.

Note: Calculated based mainly on "Gross Fixed Capital Formation by Type" and "Gross Fixed Capital Formation of Assets classified by Institutional Sectors and Economic Activities."

**Chart B2-6: Correlation between Operating Profits and Business Fixed Investment by Type**



Sources: Cabinet Office; Ministry of Finance, etc.

Note: The correlation coefficients are calculated between the quarter-on-quarter changes in real business fixed investment by type and the quarter-on-quarter changes in operating profits adjusted to real terms using the GDP deflator, for the period from 1994/Q1 to 2025/Q2. Calculations are based on 8-quarter backward moving averages.

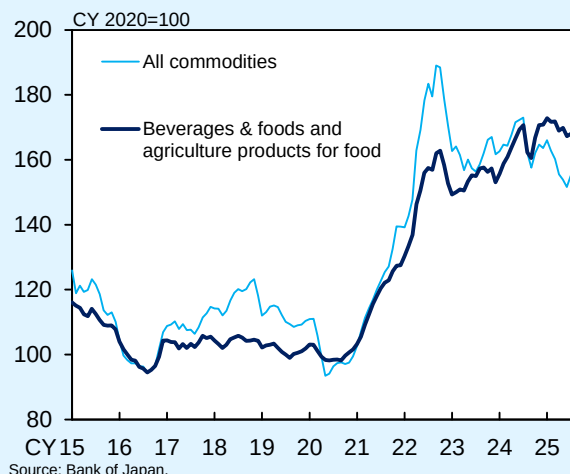
### (Box 3) Increase in Food Prices and Its Impact on Private Consumption

The increase in food prices since summer 2024 has been affected by (1) a rise in rice prices and their impact on related items and (2) an increase in import food prices, as summarized in the previous Outlook Report. This box examines the background to the increase in import food prices and analyzes the impact of increased food prices on recent private consumption, using various data, including high-frequency data.

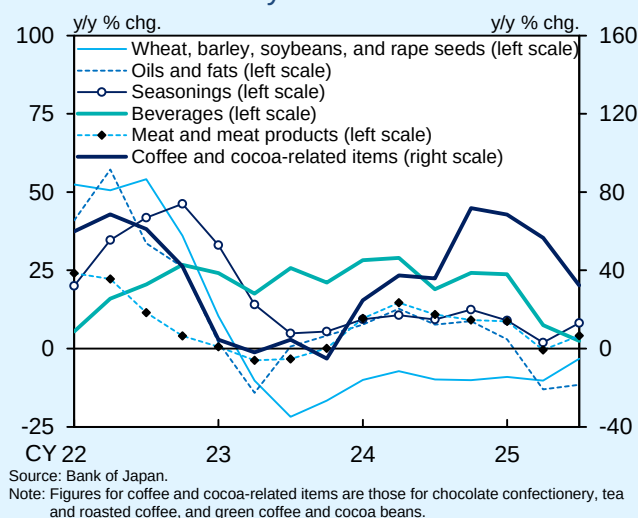
Looking back on developments in import food prices from a somewhat long-term perspective, they continued to be more or less flat in the second half of the 2010s. Around 2022, however, they surged significantly and acutely, in a similar manner to import prices of other items, due to a global resumption of economic activity following the COVID-19 pandemic and to Russia's invasion of Ukraine (Chart B3-1). Import food prices have since continued to be on an uptrend; this differs from developments in overall import prices, which have followed a downtrend, albeit with fluctuations.

The decomposition of Japan's import food prices since 2022 shows that the overall uptrend is not due to a simultaneous and uniform increase across many food categories. Rather, certain items have shown price spikes at different times, influenced by changes in international commodity prices, contributing collectively to the overall upward trend (Chart B3-2). During this period, the output deflator of Japan's food manufacturers has also been rising steadily by firms passing on the

**Chart B3-1: Import Prices (Yen Basis)**



**Chart B3-2: Developments in the Import Prices of Food by Item**

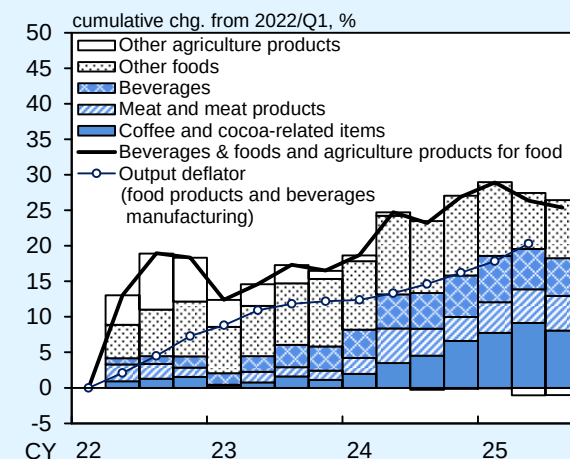


increase in import costs. It is likely that this has contributed to pushing up the CPI for food (Chart B3-3).

The increase in import food prices has been affected by, (1) a growing uptrend due to a global rise in population and demand for food, which is a structural factor; and (2) global supply shocks that have been induced continuously over the past few years by unusual weather events. In this situation, the rise in food prices is not specific to Japan but seems increasingly to be a global phenomenon.<sup>21</sup> Indeed, increasing food prices in advanced economies has been a clear trend over the past few years, regardless of country and region, with some variations reflecting differences in consumption baskets (Chart B3-4). In Japan, the rate of increase has accelerated somewhat since the middle of 2024, mainly due to a rise in the price of rice. That being said, part of this rise can be interpreted as a catch-up adjustment in response to the earlier price increase of food items overall.

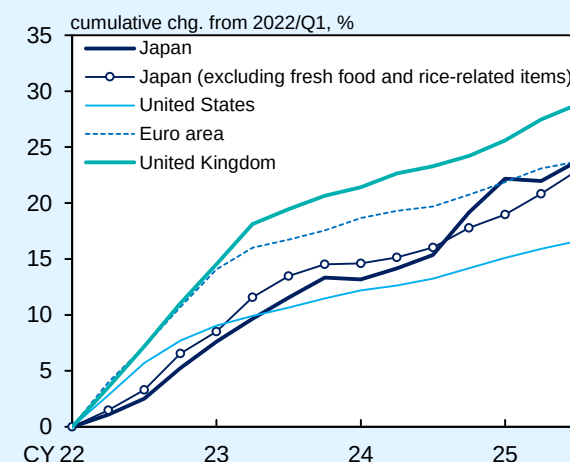
Prices have continued to rise, mainly led by food prices, which are daily necessities, and this has had a clear impact on households' consumption activity. On this point, nominal private consumption has been on a clear increasing trend since 2022, when prices started to rise. In real terms, however, private consumption has been more or less flat recently (Chart B3-5). By type of consumption, the consumption of nondurable

**Chart B3-3: Import Prices and Output Prices of Food**



Sources: Cabinet Office; Bank of Japan.  
Note: Figures for import prices are on a yen basis.

**Chart B3-4: International Comparison of Food Prices**



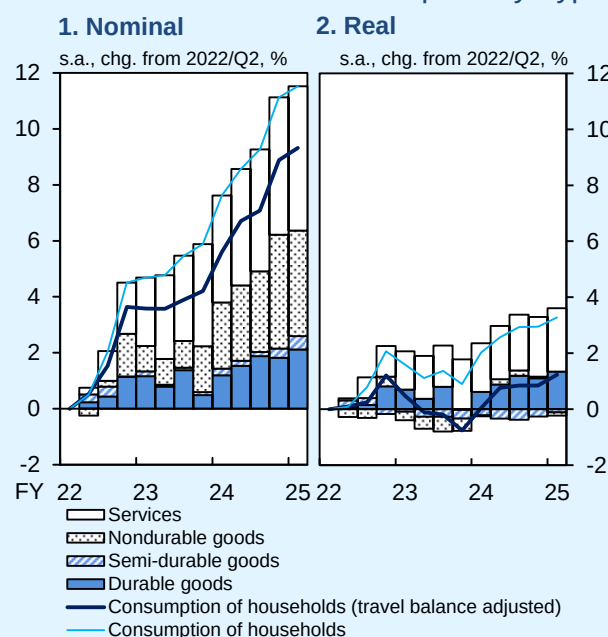
Sources: Ministry of Internal Affairs and Communications; Haver.  
Notes: 1. Figures are for food including fresh food and eating out, and excluding alcoholic beverages and tobacco.  
2. Figures for Japan (excluding fresh food and rice-related items) exclude fresh food, rice, rice-related food products, and eating out.  
3. Figures for the United States are the PCE deflator. The figure for 2025/Q3 is the July-August average.

<sup>21</sup> For example, see the following report by the Bank of England:  
Bank of England, "Box E: The Outlook for Food Price Inflation,"  
*Monetary Policy Report*, August 2025.

goods, including food items, has been showing clear sluggishness. Moreover, a look at services consumption in detail shows that growth momentum has recently slowed somewhat, except for services related to healthcare and nursing care and for financial services. Meanwhile, the financial surplus and deficit of households in the *Flow of Funds* data shows that overall excess savings have been on a decreasing trend, mainly in currency and deposits (Chart B3-6). These developments suggest the possibility that, despite households' growing thriftiness reflecting price increases, it has become difficult to constrain nominal expenditure because current inflation has been led mainly by food -- daily necessities with low price elasticity.

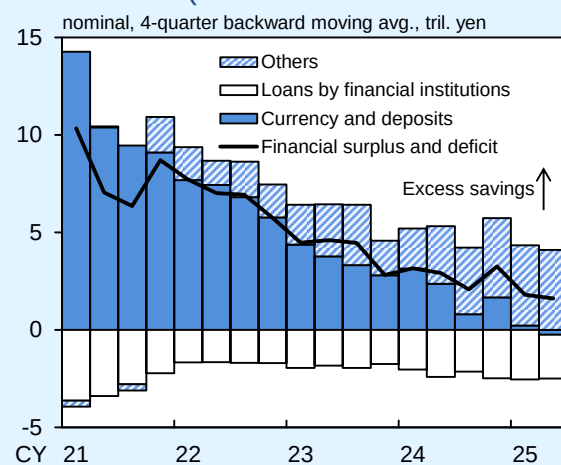
A detailed look at high-frequency consumption data of retail stores shows that households' thriftiness has clearly increased since early 2025, when the rise in food prices intensified. Specifically, as shown in the Hitotsubashi Consumer-purchase Quantity Index, the quantity of goods purchased by households has been clearly on a declining trend in the recent inflationary phase. This contrasts with the inflationary period between 2022 and 2023, when savings accumulated during the COVID-19 pandemic served as a buffer (Chart B3-7[1]). In this situation, a shift in demand to cheaper products and an increase in short-term discount sales have caused the rate of increase in the Nikkei CPINow and the Hitotsubashi Unit Value Price Index to increasingly deviate downward from the CPI released by the Ministry of Internal Affairs and Communications, which remains unaffected by such factors (Chart B3-8). Indeed, the substitution effects of items in the

**Chart B3-5: Private Consumption by Type**



Source: Cabinet Office.  
Note: Based on the SNA.

**Chart B3-6: Financial Surplus and Deficit of Households (Flow of Funds Accounts Statistics)**



Source: Bank of Japan.

Note: Figures for loans by financial institutions are the sum of the transaction flow of loans by private financial institutions and loans by public financial institutions on the borrowing side. Figures for "others" include equity, investment trusts, debt securities, liabilities less loans by financial institutions, etc.

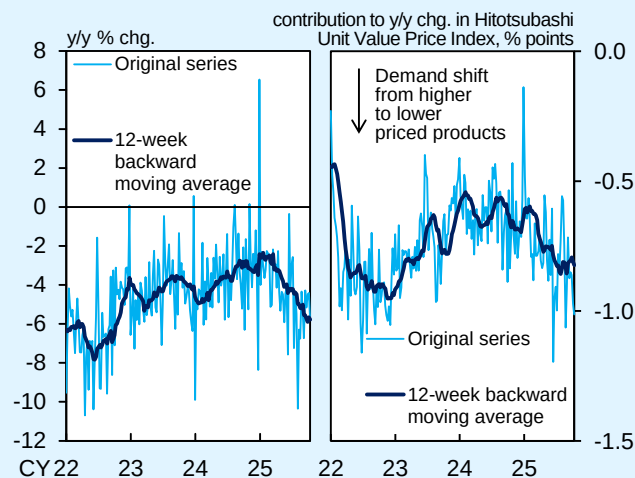
Hitotsubashi Unit Value Price Index have recently increased their downward contribution to the index, suggesting a growing tendency for households to replace more expensive products with cheaper alternatives (Chart B3-7[2]).

As for consumption activity, there are notable differences depending on the age group. Credit card spending, which is considered to capture consumption of high-value items, including dining out, travel, and durable goods, shows a clear decrease in expenditure by those aged 60 and over, as opposed to firm expenditure by the younger population (Chart B3-9). Weak consumption among age groups of 60 and over is likely to be because they are less affected by wage increases and their consumption baskets have a higher share of food (a higher Engel's coefficient), meaning that higher inflation affects them more than other age groups and it affects their consumption directly.

Regarding the outlook in the baseline scenario, as the rate of increase in the price of food decelerates, private consumption is projected to return to a moderate increasing trend. Food prices, however, remain highly sensitive, depending on weather conditions, global commodity prices, and developments in foreign exchange markets. It is therefore necessary to carefully monitor developments in food prices and private consumption.

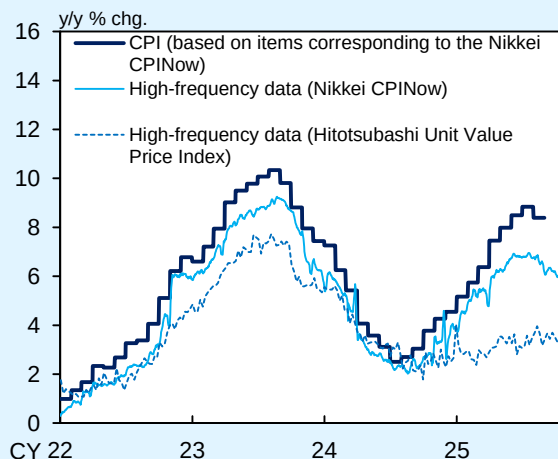
**Chart B3-7: Purchase Quantity and Substitution Effect**

1. Purchase Quantity 2. Substitution Effect



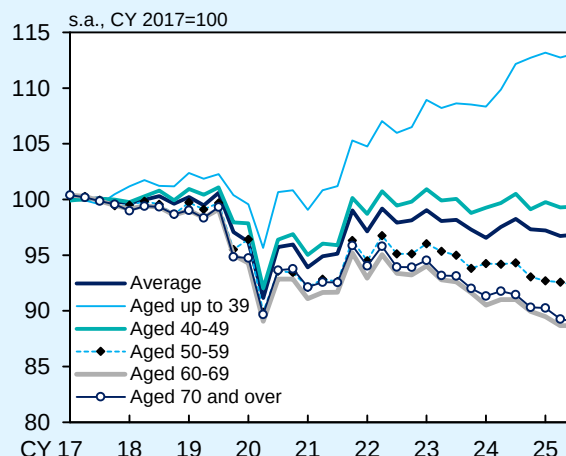
Source: Research Center for Economic and Social Risks, Hitotsubashi University.  
Notes: 1. The substitution effect refers to the effect whereby a shift in demand from higher to lower priced products reduces the price per unit.  
2. The latest figures are for the week of October 13 to 19.

**Chart B3-8: High-Frequency Data and CPI**



Sources: Nowcast Inc., "Nikkei CPINow"; Research Center for Economic and Social Risks, Hitotsubashi University.  
Notes: 1. High-frequency data (Nikkei CPINow) are the Nikkei CPINow T-index (7-day backward moving average).  
2. The latest figure for the CPI (based on items corresponding to the Nikkei CPINow) is for August 2025, that for high-frequency data (Nikkei CPINow) is as of October 27, and that for high-frequency data (Hitotsubashi Unit Value Price Index) is for the week of October 13 to 19.

**Chart B3-9: Real Consumption by Age**



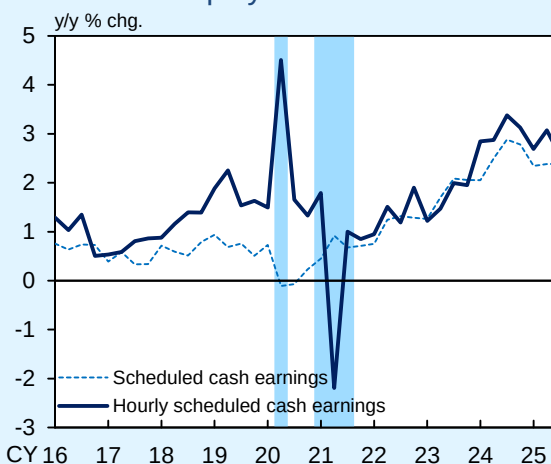
Sources: Ministry of Internal Affairs and Communications; Nowcast Inc./ JCB, Co., Ltd., "JCB Consumption NOW."  
Notes: 1. Figures show the expenditures per person. Figures are the averages for the corresponding age groups in five-year increments.  
2. Figures are based on staff calculations using the CPI (less imputed rent).

## (Box 4) Impact of Wage Increases on Prices

This box examines recent wage developments separately for full-time and part-time employees and analyzes the relationship between wages and prices.

First, scheduled cash earnings per full-time employee have been rising steadily, reflecting the base pay increases agreed at the annual spring labor-management wage negotiations. However, the rate of increase has decelerated recently (Chart 25). This is partly attributable to, (1) weakness in certain industries,<sup>22</sup> possibly due to sampling bias in the *Monthly Labour Survey*; and (2) a continuing decline in working hours per employee. When comparing the rate of change in scheduled cash earnings per employee and per hour for full-time employees, it is clear that, even when excluding the changes during the COVID-19 pandemic, the rate of increase in scheduled cash earnings per hour has often exceeded that of scheduled cash earnings per employee since the middle of the 2010s (Chart B4-1).<sup>23</sup> Reflecting "work style reforms" that have been progressing since the middle of the 2010s and the consequent increase in the amount of paid leave used by employees, a declining trend

**Chart B4-1: Scheduled Cash Earnings of Full-Time Employees**



Source: Ministry of Health, Labour and Welfare.

Notes: 1. Hourly scheduled cash earnings = Scheduled cash earnings / Scheduled hours worked. Figures are based on continuing observations following the sample revisions of the *Monthly Labour Survey*. Figures for 2025/Q3 are July-August averages.

2. Figures for hourly scheduled cash earnings are seasonally adjusted.

3. Shaded areas denote the periods of the state of emergency during the COVID-19 pandemic.

<sup>22</sup> Wages in wholesale and retail have been weaker than those in other industries since the beginning of 2025. This is likely to have been affected by the possibility that, within these industries, some samples, which were added to the "continuing observations" of the *Monthly Labour Survey* in 2024 and remain in the sample in 2025, may exhibit relatively lower wage increase rates.

<sup>23</sup> There are a certain number of full-time employees, mainly in retail and services industries, who work for hourly and daily wages. When working hours of these employees decline, wages per employee decrease, even if hourly wages are unchanged.

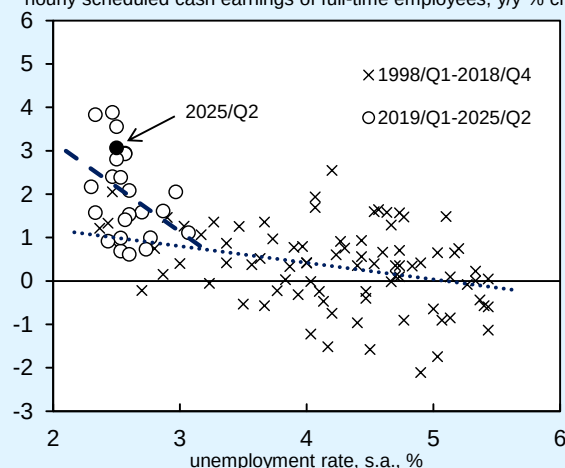


in working hours per full-time employee has strengthened. Against this backdrop, firms have to increase their number of employees more than before, to meet growing demand for goods and services and to secure adequate labor input (number of employees  $\times$  working hours per employee), when labor productivity remains constant.

Taking the above points into account, the "wage Phillips curve" -- which shows the relationship between labor market conditions and the rate of change in scheduled cash earnings per hour of full-time employees -- indicates that the year-on-year rate of hourly wage increase has been rising steadily to around 3 to 4 percent, following a decline in the unemployment rate in the past few years (Chart B4-2). This is attributable to the fact that, since the end of the 2010s, the wage Phillips curve has been steeper than in the preceding low inflation period, as confirmed by previous studies.<sup>24</sup> The steepening of the wage Phillips curve may also reflect that, (1) tightening labor market conditions are becoming more likely to lead to an increase in nominal wages through growth in the labor market for job changers;<sup>25</sup> and (2) the decrease in working hours due to work style reforms is increasingly likely to lead to a rise in hourly wages and growth in demand for employees, thereby further lowering the unemployment rate.

**Chart B4-2: Wage Phillips Curve**

hourly scheduled cash earnings of full-time employees, y/y % chg.



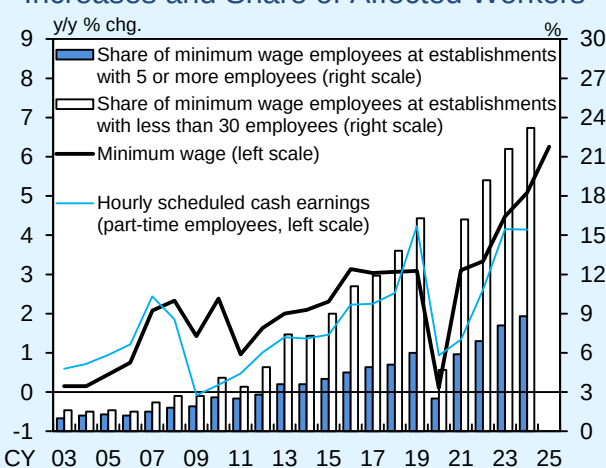
#### Estimation Results

| Hourly scheduled cash earnings of full-time employees (y/y % chg.) |                 |                 |                 |
|--------------------------------------------------------------------|-----------------|-----------------|-----------------|
| Unemployment rate (two-period lag, %)                              | -0.8 ***        | -0.5 ***        | -3.3 **         |
| Constant                                                           | 4.0 ***         | 2.4 ***         | 10.7 ***        |
| Estimation period                                                  | 1998/Q1-2025/Q2 | 1998/Q1-2018/Q4 | 2019/Q1-2025/Q2 |

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

Notes: 1. Hourly scheduled cash earnings = Scheduled cash earnings / Scheduled hours worked. Figures from 2016/Q1 onward are based on continuing observations following the sample revisions of the *Monthly Labour Survey*.  
2. In the chart, the thin broken line represents the fitted regression line for the period from 1998 to 2018, while the thick broken line represents that for the period from 2019 onward. 2020/Q2 and 2021/Q2, when working hours fluctuated significantly due to self-restraint from going outside, are excluded.  
3. The table shows the estimation results of a second-order autoregressive model. \*\*\* and \*\* denote statistical significance at the 1 percent and 5 percent levels, respectively. Dummy variables for the impact of COVID-19 are included as control variables.

**Chart B4-3: Rate of Minimum Wage Increases and Share of Affected Workers**



Source: Ministry of Health, Labour and Welfare.

Notes: 1. "Share of minimum wage employees" refers to the percentage of employees whose wages in a particular year fall below the new minimum wage level set later in that year. The share of minimum wage employees at establishments with less than 30 employees (less than 100 employees for manufacturing establishments) and the share of minimum wage employees at establishments with 5 or more employees are calculated based on the *Fact-finding Survey on Minimum Wages* and the *Basic Survey on Wage Structure (special tabulation)*, respectively.  
2. Hourly scheduled cash earnings (part-time employees) are the averages from October to the following September. The figure for 2024 is the average from October 2024 to August 2025.

<sup>24</sup> Hoshi, T. and A. Kashyap (2025), "The Normalization of Wage Dynamics," *Asian Economic Policy Review*, vol. 20, no. 2, pp. 237-246.

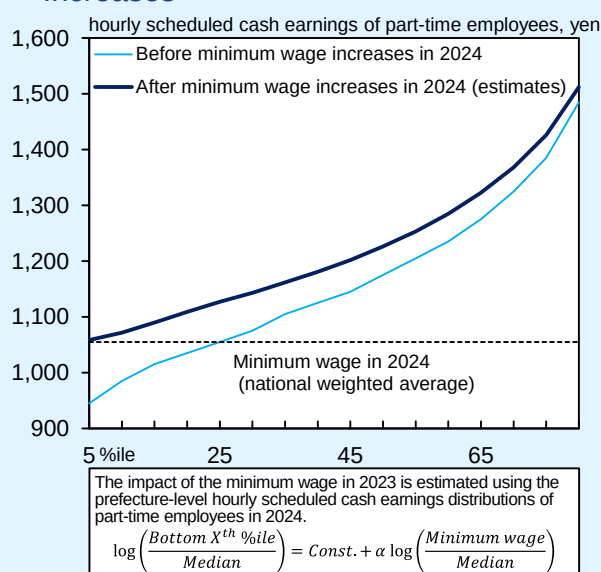
<sup>25</sup> See Box 3 of the April 2025 Outlook Report.

Next, wages of part-time employees have continued to rise at a relatively high pace, driven by tightening labor market conditions and minimum wage increases. The share of employees whose wages in a particular year were below the new minimum wage levels set later in that year (i.e., the influence ratio) has been increasing steadily, reflecting the upward revisions to minimum wages in recent years, and thus the degree of influence at which minimum wages directly affect the level of wages is likely to have become greater than in the past (Chart B4-3).

Minimum wage increases seem to push up to a certain extent the level of hourly cash earnings of part-time employees whose wages are above the minimum, in addition to hourly cash earnings of those who work at around minimum wage levels. The estimation of the impact of the increase in minimum wages on wage distributions, using the data on the distribution of hourly cash earnings of part-time employees by prefecture, suggests that minimum wage increases can have the indirect impact of lifting up hourly cash earnings for not only the bottom part of the distribution but also around the median, as shown empirically (Chart B4-4).

A rise in wages of part-time employees is likely to lead to higher selling prices through an increase in labor costs, mainly in sectors with a high proportion of part-time employees or sectors in which wages of full-time employees are relatively close to the level of the minimum wage. In fact, according to a recent study of firms in Japan, firms have been increasingly passing higher labor

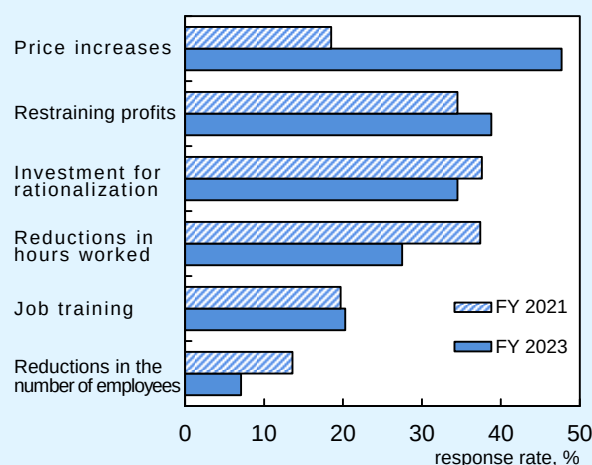
**Chart B4-4: Impact of Minimum Wage Increases**



Source: Ministry of Health, Labour and Welfare.

Note: The wage distribution after the minimum wage increases in 2024 is estimated based on the results of the estimation model above. The median after the minimum wage increases in 2024 is estimated using the relationship between the prefecture-level minimum wages in 2023 and the prefecture-level medians of part-time employees' hourly wages in June 2024.

**Chart B4-5: Responses to Minimum Wage Increases**



Source: Morikawa (2024), "Impact of Minimum Wage Increase on Businesses," *Japanese Journal of Labour Studies*.

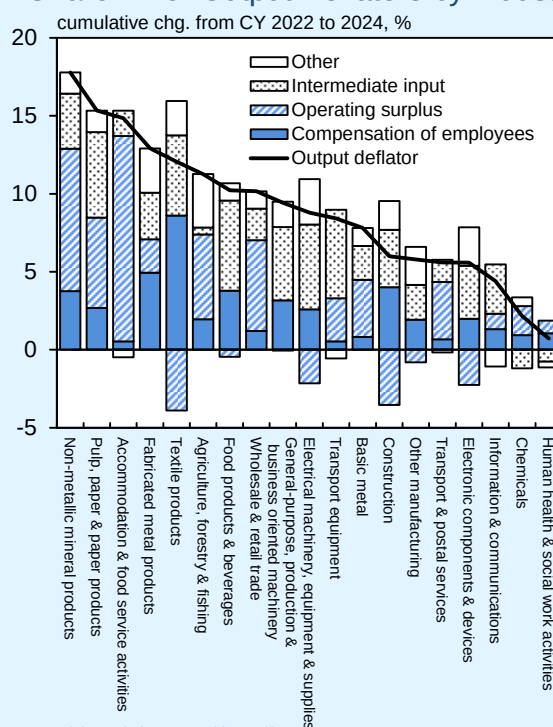
Note: Figures are for firms who responded that the minimum wage increases had an impact on their businesses. The number of responding firms for fiscal 2021 was 1,955 firms, and that for fiscal 2023 was 991 firms. Multiple answers were allowed.



costs stemming from minimum wage increases on to consumers by raising prices of goods and services, in addition to improving various types of margins by, for example, reducing non-wage labor costs, restraining profits, and boosting productivity (Chart B4-5).<sup>26</sup>

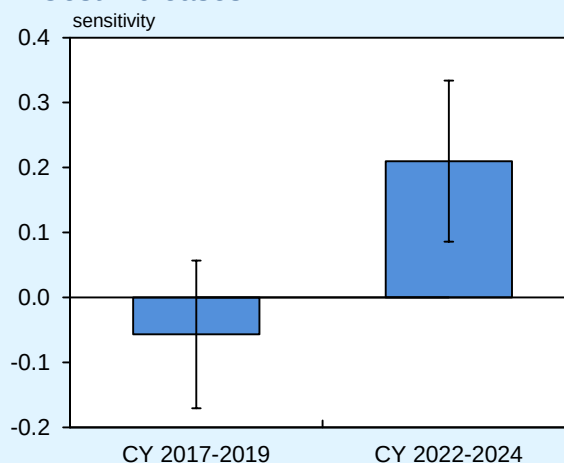
With regard to developments in moves to pass increased labor costs on to selling prices, decompositions from the distribution side of each industry-specific output deflator since 2022 show that a rise in labor costs has been pushing up output prices across a wide range of industries (Chart B4-6). Moreover, in a comparison with data for 2017-2019, empirical evidence has shown a significant rise recently in the pass-through rate to output prices of the increase in unit labor costs (ULCs), which shows labor costs per value added. This suggests that wage increases are passed on more easily to selling prices (Chart B4-7). However, a detailed look by industry shows that labor costs push up output prices relatively significantly in manufacturing sectors (such as food and machinery), while output prices in nonmanufacturing sectors are not pushed up very much by labor costs. This may be attributed to active labor-saving investment in nonmanufacturing sectors, in which labor shortages are severe, leading to improved labor productivity and downward pressure on ULCs.<sup>27</sup>

**Chart B4-6: Output Deflators by Industry**



Sources: Ministry of Finance; Cabinet Office.  
Note: Figures up through 2023 are based on the *Annual Report on National Accounts*. Figures for 2024 are estimated using the *Quarterly National Accounts for Value Added by Economic Activity* and the *Financial Statements Statistics of Corporations by Industry, Quarterly*.

**Chart B4-7: Pass-Through of Unit Labor Cost Increases**



|                                        | Output deflator (y/y chg.) |           |
|----------------------------------------|----------------------------|-----------|
|                                        | 2017-2019                  | 2022-2024 |
| Constant                               | 0.001                      | 0.006     |
| Output deflator (y/y chg., 1-year lag) | -0.004                     | 0.002     |
| Unit labor costs (y/y chg.)            | -0.057                     | 0.210***  |
| Intermediate input (y/y chg.)          | 0.602***                   | 0.384***  |
| Other (y/y chg.)                       | -0.030                     | 0.096     |
| Number of observations                 | 87                         | 79        |
| Adjusted R-squared                     | 0.85                       | 0.73      |

Sources: Ministry of Finance; Cabinet Office.  
Note: Unit labor costs = Nominal compensation of employees / Real GDP  
Intermediate input = Nominal intermediate input / Real output  
Other = (Consumption of fixed capital + (Taxes - Subsidies)) / Real GDP  
The bands indicate the 90 percent confidence intervals. \*\*\* denotes statistical significance at the 1 percent level. Industry fixed effects and time fixed effects are controlled for.

<sup>26</sup> Morikawa, M (2024). "Impact of Minimum Wage Increase on Businesses," *Japanese Journal of Labour Studies*, No. 771.

<sup>27</sup> See Box 2 of the April 2025 Outlook Report for productivity trends by industry in recent years.

