

Outlook for Economic Activity and Prices (January 2026)

The Bank's View¹

Summary

- Japan's economy is likely to continue growing moderately, with overseas economies returning to a growth path, and as a virtuous cycle from income to spending gradually intensifies, supported by factors such as the government's economic measures and accommodative financial conditions, while the economy is projected to be affected by trade and other policies in each jurisdiction.
- 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 in the first half of this year, with the waning of the effects of the rise in food prices, such as rice prices, and partly due to the effects of government measures to address rising prices. However, it is likely that the mechanism in which wages and prices rise moderately in interaction with each other will be maintained, and that underlying CPI inflation will continue rising moderately. Thereafter, since it is projected that a sense of labor shortage will grow as the economy continues to improve 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 for fiscal 2025 and 2026 are somewhat higher, mainly due to the effects of the government's economic measures; on the other hand, the projected growth rate for fiscal 2027 is somewhat lower. The projected year-on-year rates of increase in the CPI (all items less fresh food) are more or less unchanged.
- Risks to the outlook include developments in overseas economic activity and prices under the impact of trade and other policies in each jurisdiction, wage- and price-setting behavior of firms, and developments in financial and foreign exchange markets, and it is necessary to pay due attention to the impact of these risks on Japan's economic activity and prices.
- With regard to the risk balance, risks to both economic activity and prices are generally balanced.

¹ "The Bank's View" was decided by the Policy Board at the Monetary Policy Meeting held on January 22 and 23, 2026.

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, while they have been affected by 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 been 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 2.5 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 Japan²

A. Baseline Scenario of the Outlook for Economic Activity

Japan's economy is likely to continue growing moderately, with overseas economies returning to a growth path, and as a virtuous cycle from income to spending gradually intensifies, supported by factors such as the government's economic measures and accommodative financial conditions, while the economy is projected to be affected by trade and other policies in each jurisdiction.

In the corporate sector, although downward pressure stemming from the impact of tariff increases is expected to remain for the time being, exports and production are likely to recover moderately as overseas economies return to a growth path, partly supported by global AI-related demand. Corporate profits for the time being are likely to remain at high levels on the whole, although downward effects due to tariffs are expected to continue to be seen in manufacturing; thereafter, the uptrend in corporate profits is likely to become more pronounced due to an increase in domestic and external demand. In this situation, supported in part by the government's economic measures and accommodative financial conditions, business fixed investment is likely to remain on an increasing trend, including labor-saving and digital-related investment to address labor shortages, as well as research and development (R&D) investment.

² 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.

In the household sector, regarding the employment situation, labor market conditions are likely to tighten further as the economy improves, with it becoming more difficult for labor supply of women and seniors to increase. Against this backdrop, it is likely that a wide range of firms will continue to raise wages steadily in this year's annual spring labor-management wage negotiations, following the solid wage increases last year, and the growth in nominal wages is projected to remain relatively high. 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 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 2026. Housing investment is expected to continue recovering for the time being; thereafter, however, it is likely to follow a moderate declining trend, mainly reflecting a rise in housing prices and demographic developments. Public investment is expected to be more or less flat, and government consumption is expected to increase moderately reflecting factors such as an uptrend in healthcare and nursing care expenditures and a rise in defense-related spending.

Comparing the projections with those presented in the previous Outlook Report, the projected real GDP growth rate for fiscal 2025 is somewhat higher due to higher-than-expected growth in overseas economies and the impact of the statistical revision to the GDP figures. The projected growth rate for fiscal 2026 is also somewhat higher, mainly reflecting the effects of the government's economic measures. The rate for fiscal 2027 is somewhat lower due to the dissipation of the effects of these economic measures.

Meanwhile, the potential growth rate is expected to rise moderately.³ 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 in the first half of this year, with the waning of the effects of the rise in food prices, such as rice prices, and partly due to the effects of government measures to address rising prices. However, it is likely that the mechanism in

³ 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.

which wages and prices rise moderately in interaction with each other will be maintained, and that underlying CPI inflation will continue rising moderately. Thereafter, since it is projected that a sense of labor shortage will grow as the economy continues to improve 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 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. Regarding the government's measures, the abolition of the former provisional gasoline tax rate, measures to reduce the household burden of higher electricity and gas charges, and measures to make high school tuition and elementary school lunches effectively free, among other measures, will push down the year-on-year rate of increase in the CPI (all items less fresh food), particularly in fiscal 2025 and 2026.

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 decelerate to around 2 percent, mainly due to the waning of the effects of the rise in food prices, such as rice prices. Thereafter, with moves to pass on wage increases to selling prices continuing, the rate of increase in this CPI is likely to remain at around the same level.

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 output gap will widen moderately within positive territory. 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, as the economy continues to improve and labor market conditions tighten further, firms' active wage- and price-setting behavior is expected to become more widespread, and it is therefore likely that inflation expectations will continue to rise moderately and be at around 2 percent in the second half of the projection period.

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. Although uncertainties regarding trade policies have declined, attention continues to be warranted on the possibility that the trade policies announced so far could push down the global economy through, for example, their impact on global trade activity and on global financial and capital markets. On this point, with regard to the U.S. economy, attention is warranted on factors such as the impact of tariffs on employment and income formation through a deterioration in corporate profits, as well as the impact on private consumption through the pass-through to consumer prices of increased costs due to tariffs. Regarding AI, amid the continued increase in global demand, strong business fixed investment could push up the global economy; on the other hand, if profits do not expand in line with such investment, adjustment pressure could arise, accompanied by, for example, changes in asset prices. Meanwhile, attention also 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 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 for some goods -- coupled with the effects of trade policies -- will affect global economic activity and prices. Moreover, attention continues to be warranted on developments in geopolitical risks.

The second risk is developments in import prices. Reflecting the effects of trade and other policies in each jurisdiction, if disruptions arise on the supply side, such as in logistics, or moves to restructure supply chains take place, this could incur considerable costs. In addition, attention continues to be warranted on the risk that prices of grains and other commodities will fluctuate significantly, particularly due to geopolitical factors and weather conditions. If import prices were to rise significantly, households' defensive attitude 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. In the medium to long term, there are extremely high uncertainties surrounding, for example, efforts by countries around the world toward addressing climate change.

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. Intensifying labor shortages -- which are partly due to structural demographic changes -- could accelerate labor-saving investment, such as for digitalization and the use of AI, and this, together

with the government's efforts, could push up growth expectations and the potential growth rate. On the other hand, if such a substitution of labor with capital does not sufficiently progress, there is a risk that supply-side constraints will push down the growth rate. Moreover, 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 highly likely that the mechanism in which wages and prices rise moderately in interaction with each other will be maintained. On this basis, moves to reflect wages in selling prices could strengthen to a greater extent than expected, and there could be growing expectations that labor market conditions will tighten further; these developments could heighten upward pressure on wages. 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. On the other hand, if the impact of tariffs on corporate profits, for example, becomes prolonged, this could lead firms to focus more on cost cutting. As a result, moves to reflect price rises in wages could also weaken. 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, if new temporary factors, such as irregular weather events, 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. Uncertainties remain over the outlook for the global economy, such as the impact of trade policies, 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, attention should be paid to the point that, with firms' behavior shifting more toward raising wages and prices recently,

exchange rate developments are, compared to the past, more likely to affect prices, and that such moves could affect underlying CPI inflation through changes in inflation expectations.

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.⁴

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 in the first half of this year. However, it is likely that the mechanism in which wages and prices rise moderately in interaction with each other will be maintained, and that underlying CPI inflation will continue rising moderately. Thereafter, since it is projected that a sense of labor shortage will grow as the economy continues to improve 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. Risks surrounding Japan's economic activity and prices include developments in overseas economic activity and prices under the impact of trade and other policies in each jurisdiction, wage- and price-setting behavior of firms, and developments in financial and foreign exchange markets, and it is necessary to pay due attention to the impact of these risks on Japan's economic activity and prices. With regard to the risk balance, risks to both economic activity and prices are generally balanced.

Examining risks on the financial side, financial intermediation activities, such as lending, have operated smoothly, and no major financial imbalances have been seen in current financial activities, although attention continues to be warranted on developments in asset prices, such as real estate and stock prices. Japan's financial system has maintained stability on the whole. 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, it is necessary to carefully monitor the impact that factors such as the trade policy in each jurisdiction, geopolitical risks, and developments in the foreign

⁴ 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."

non-bank financial intermediary (NBFI) sector have on the financial system through various channels.

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. With the price stability target of 2 percent, it 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.

(Appendix)

Forecasts of the Majority of the Policy Board Members

y/y % chg.

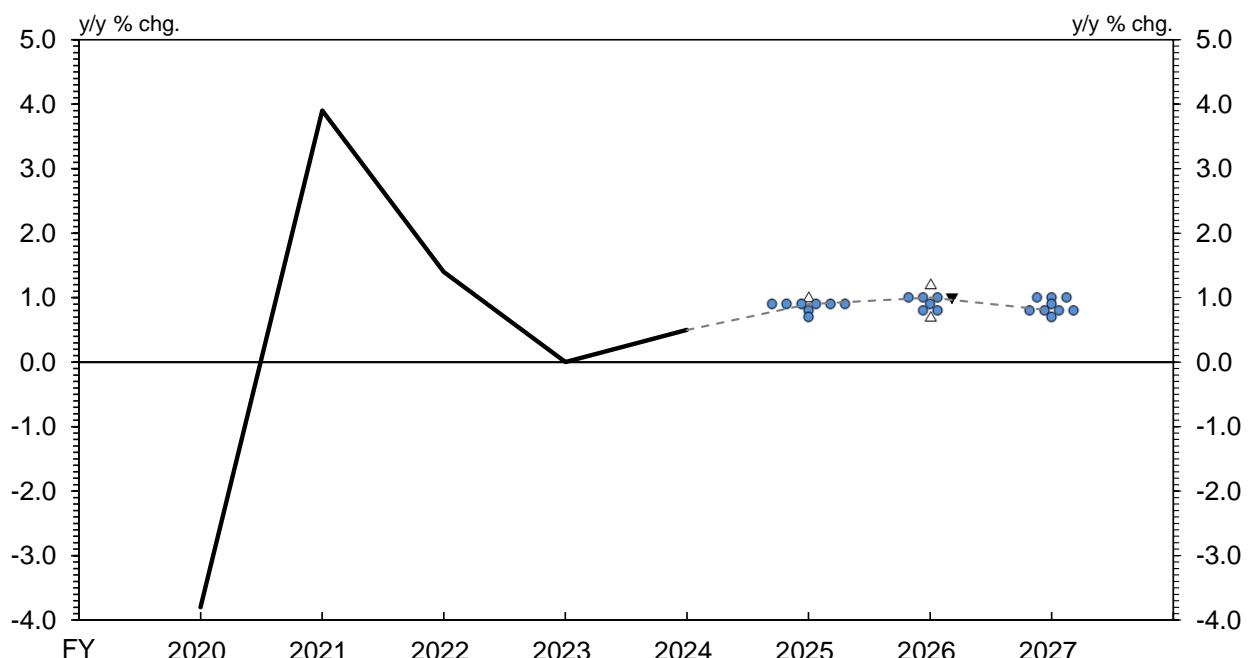
	Real GDP	CPI (all items less fresh food)	(Reference) CPI (all items less fresh food and energy)
Fiscal 2025	+0.8 to +0.9 [+0.9]	+2.7 to +2.8 [+2.7]	+2.9 to +3.1 [+3.0]
Forecasts made in October 2025	+0.6 to +0.8 [+0.7]	+2.7 to +2.9 [+2.7]	+2.8 to +3.0 [+2.8]
Fiscal 2026	+0.8 to +1.0 [+1.0]	+1.9 to +2.0 [+1.9]	+2.0 to +2.3 [+2.2]
Forecasts made in October 2025	+0.6 to +0.8 [+0.7]	+1.6 to +2.0 [+1.8]	+1.8 to +2.2 [+2.0]
Fiscal 2027	+0.8 to +1.0 [+0.8]	+1.9 to +2.2 [+2.0]	+2.0 to +2.3 [+2.1]
Forecasts made in October 2025	+0.7 to +1.1 [+1.0]	+1.8 to +2.0 [+2.0]	+2.0 to +2.2 [+2.0]

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

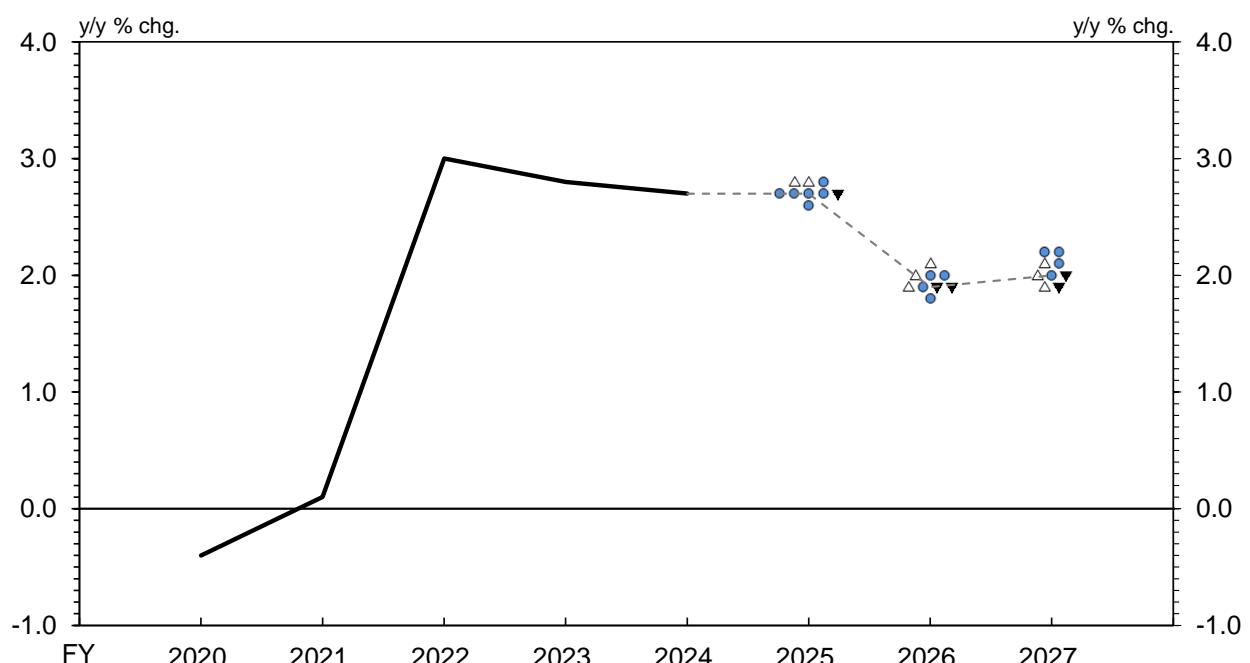
2. The forecasts of the majority of the Policy Board members are constructed as follows: each Policy Board member's forecast takes the form of a point estimate -- namely, the figure to which they attach the highest probability of realization. These forecasts are then shown as a range, with the highest 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.

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."