6 January 2026 (No. of pages: 2)

Japanese report:23 December 2025

Outlook for Japan's Economy in 2026

Growth of just under 1% expected, but caution is needed regarding downside risks in external demand, sharp yen depreciation, and rising interest rates, among others

Economic Research Dept.

Keiji Kanda
Shotaro Kugo
Munehisa Tamura
Koki Akimoto
Kanako Nakamura

Summary

- We expect real GDP growth in 2026 to be +0.8% y/y. While this represents a slowdown from 2025 (projected at +1.2%), it is influenced by the carryover effect (real GDP growth rate that can be achieved with zero q/q growth in each quarter) shrinking from +0.6%pt in 2025 to +0.0%pt in 2026. On an underlying basis, a moderate economic recovery similar to 2025 is anticipated, with increases expected in components including personal consumption and capital expenditure.

- In 2026, factors such as "improved household income conditions due to wage increases," "government economic measures," "continued accommodative financial conditions," and "a high level of household savings" are expected to underpin or boost the Japanese economy. On the other hand, there are numerous downside risks to the economy, including: "Trump tariffs," "deteriorating Japan-China relations," "escalating tensions in the Middle East and Ukraine (leading to soaring crude oil prices)," "a sharp depreciation of the yen," and "rising domestic interest rates."

- The fiscal management of the Sanae Takaichi administration, which advocates "responsible proactive fiscal policy," is also noteworthy. In recent years, the ratio of net debt to GDP for national and local governments has been declining even with a primary balance (PB) deficit. This is largely due to nominal GDP growth exceeding the nominal effective interest rate against a backdrop of high inflation. While this situation is expected to persist for the time being, the interest rate-growth rate differential is likely to narrow or reverse, with interest rates eventually surpassing growth. Without achieving a primary balance surplus, it will be difficult to reduce the net debt-to-GDP ratio. While the Takaichi administration is supporting growth through "crisis management investments," and other initiatives the outcomes depend on private

sector actions and remain unpredictable. It is essential to continuously monitor the primary balance and sustain market confidence in government bonds, preparing for scenarios where potential growth fails to accelerate.