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Japan's Economy: Monthly Outlook (Apr 2026)

Rising Downside Risks From Escalating Middle East Tensions Are Likely to Postpone the April Rate Hike

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Summary

- Amid heightened tensions in the Middle East, energy prices, including crude oil, remain elevated. The effects are expected to gradually spill over to a broad range of goods and services beyond energy. On average, prices of crude oil, natural gas, and coal have risen by more than 30% since before the outbreak of the conflict. We have estimated the impact on domestic consumer prices based on input-output tables and taking gasoline subsidies into account. Under a full pass-through scenario, the CPI would rise by about 0.73%, while under a partial pass-through scenario, in which energy-related items are fully passed through and other items by 50%, the increase would be around 0.26%.
- Japan's ratio of crude oil imports to real GDP stood at 51 petajoules (PJ) per tril yen at the time of the first oil crisis (FY1973) but had declined to 9 PJ per tril yen by FY2024. This indicates that Japan's economic resilience to higher oil prices has improved substantially since the oil crisis. However, over the same period, Japan's dependence on the Middle East for crude oil imports increased from 78% to 96%, leaving the economy more vulnerable to tensions in the region. In preparation for the risk of prolonged tensions in the Middle East, the government should promptly clarify the conditions and timeline for scaling back gasoline subsidies, while encouraging households and firms to further promote energy conservation to make effective use of oil reserves.
- The March 2026 Tankan survey by the Bank of Japan (BOJ) indicates that firms have become increasingly cautious about the outlook for business conditions. At the same time, the rise in medium- to long-term inflation expectations and the persistence of an accommodative financial environment also warrant attention. Meanwhile, an examination of the background to CPI inflation, using indicators such as the output

deflator for non-manufacturing industries, suggests that wage-driven inflationary pressures have intensified since around 2024 and are likely to persist through 2026. Against this backdrop, there remains a strong case for the BOJ to continue raising interest rates to adjust the degree of monetary accommodation. However, a disruption in crude oil supply would pose a significant downside risk to Japan's economy. As such, the BOJ is expected to leave policy unchanged at the April Monetary Policy Meeting while closely monitoring developments in the Middle East. Should conditions improve, an additional rate hike could take place as early as June.
