5 June 2026 (No. of pages: 15)

Japanese report:27 May 2026

# Japan's Economy: Monthly Outlook (May 2026)

In response to the situation in the Middle East, the forecast for real GDP growth in FY2026 has been revised downward to +0.6%

Economic Research Dept. **Keiji Kanda**
**Hirohito Hatanaka**
**Kanako Nakamura**
**Kachidoki Yokota**

**Summary**

- In light of the announcement of the Jan-Mar 2026 GDP 1st preliminary results, we have revised our economic outlook. We now see growth in Japan's real GDP according to our main scenario at +0.6% in FY2026, and +0.8% in FY2027. (On a calendar year basis, we expect +0.6% in 2026 and +0.7% in 2027). In response to the situation in the Middle East, we have revised our growth forecast downward, particularly for FY2026, compared to our previous announcement on March 10.

- According to our main scenario we assume that the situation in the Middle East will come to an end in a short period of time, and that a downward trend in the price of crude oil and recovery in supply will continue. However, things remain highly uncertain. If a shortage of crude oil and other supplies occurs in Asia, including Japan, and crude oil prices rise again from the fourth quarter of 2026 to the first quarter of 2027, it is estimated that Japan's real GDP growth rate for FY2026 will fall by 0.4%pt.

- Due to rising inflationary pressures stemming from the situation in the Middle East, core CPI is projected to rise by +2.6% y/y in FY2026 and +2.2% in FY2027. We anticipate that the Bank of Japan will raise short-term interest rates to 1.00% as early as June 2026, and then raise them by 0.25%pt approximately once every six months thereafter.

## 1. Moderate Positive Growth Expected, but Downside Risks Linger Due to Situation in Middle East

***Despite the deteriorating situation in the Middle East, the impact on GDP was limited in the Jan-Mar period, resulting in positive growth for the second consecutive quarter***

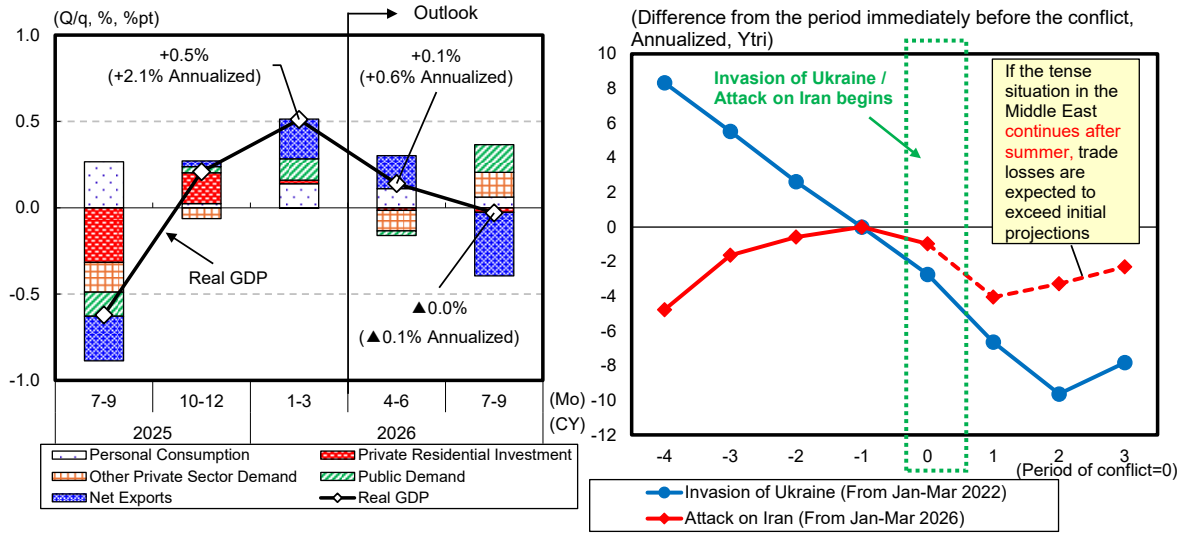
The real GDP growth rate for Jan-Mar 2026 (1st preliminary) was up by +2.1% q/q annualized (+0.5% q/q)[1]. This was the second consecutive quarter of positive growth.

Although the US-Israel strikes on Iran that began in the end of February caused some turmoil, including a surge in crude oil prices, they did not have a significant impact on Japan's GDP. Personal consumption increased, partly due to rising real wages, and exports of goods – which had been declining, centering on motor vehicles, due to the Trump administration's high tariff policy (the "Trump tariffs") – rose for the first time in three quarters. With other demand components, excluding private sector inventory, also showing an overall increase, the results can be described as robust.

Looking at performance by demand component (Chart 1, left), in the area of private sector demand, personal consumption, capital expenditure and housing investment achieved growth, but private sector inventories contributed to pushing down the real GDP growth rate by 0.1%pt q/q. As for public sector demand, both government consumption and public investment achieved growth. Meanwhile, in the area of external demand, growth in exports exceeding that of imports, hence net exports pushed the real GDP growth rate up.

**Real GDP Growth Rate Results & Outlook (Left); Trends in Goods Exports, Capital Expenditure, and Personal Consumption (Right)**

**Chart 1**




Source: Cabinet Office; compiled by DIR.
Notes: Figures are seasonally adjusted. Outlook produced by DIR. The chart on the right shows the difference in trade gains and losses from the period immediately preceding the outbreak of the conflict (the increase or decrease in real income due to changes in terms of trade from the base year, CY2020, which is an annualized rate of -6.6 tril yen for the first quarter of 2026).

[1] See the DIR report by Keiji Kanda and Hirohito Hatanaka dated 19 May 2026, *Jan-Mar 2026 1st Preliminary GDP* (Japanese only).

The GDP deflator rose +3.4% y/y, achieving its 17th consecutive quarter of growth. Unit labor costs (nominal employee compensation divided by real GDP) also increased by +2.8% y/y, the 12th consecutive quarter of growth, indicating that wage-driven inflationary pressures have been continuing recently.

***Positive growth is expected to continue in the Apr-Jun Period, but exports and other components are expected to decline, with trading losses also seen***

Real GDP growth for the Apr-Jun period of 2026 is expected to grow by +0.6% q/q annualized (+0.1% q/q), representing three consecutive quarters of growth. Although supply chain disruptions have occurred in some areas due to the deteriorating situation in the Middle East, the impact on overall economic activity is expected to be limited, and growth in personal consumption and capital expenditure is likely to continue. On the other hand, exports are expected to decline.

Trade gains (or trade losses if negative) amounted to -6.6 tril yen (annualized) in the Jan-Mar period[2]. Due to worsening terms of trade caused by rising crude oil prices, income flowed overseas, and trade losses expanded by 1.0 tril yen from the previous quarter. However, they are projected to expand by a further 3.1 tril yen in the Apr-Jun period (Chart 1, right).

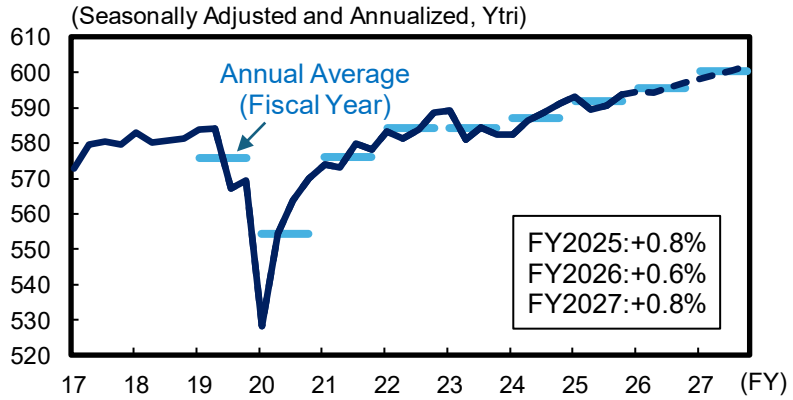
Based on the U.S. Energy Information Administration's (EIA) crude oil price forecast (Chart 3, left), trade losses are projected to begin shrinking in the Jul-Sep period of 2026, avoiding a sharp expansion like that seen during the invasion of Ukraine that broke out in February 2022. However, if the situation in the Middle East worsens further and becomes prolonged, crude oil prices will rise again, leading to continued trade losses and a deterioration in household and corporate income conditions that are even more pronounced than reflected in GDP.

***Assumptions regarding overseas economy and Middle East situation: our main scenario assumes that the situation in the Middle East will come to an end in a short period of time***

Chart 2 illustrates our main scenario for the trend in real GDP, based on our outlook for overseas economies. Our latest outlook for overseas economies dated May 20 is provided by our in-house experts on the overseas economy.

[2] Changes in real income resulting from shifts in the terms of trade (i.e., the export deflator divided by the import deflator) are referred to as “trade gains” when positive and “trade losses” when negative. Since the published figures are calculated using the CY2020 chained price deflator (with trade gains and losses for the base year set to zero), it is important to note that these figures reflect solely the impact of changes in the terms of trade relative to the base year.

**Outlook for Japan's Real GDP and Assumptions Regarding Overseas Economies** **Chart 2**




US, Eurozone & China Real GDP Growth Rate

| | | |
|---|---|---|
| US | 2025: | +2.1% |
| | 2026: | +2.0% |
| | 2027: | +2.1% |
| Eurozone | 2025: | +1.4% |
| | 2026: | +0.8% |
| | 2027: | +1.3% |
| China | 2025: | +5.0% |
| | 2026: | +4.5% |
| | 2027: | +4.2% |

Source: Produced by DIR based on data from the Cabinet Office and statistics by various countries.
Note: CY2020 chained prices. The dashed line in the chart represents predicted values estimated by DIR. Real GDP growth rates are actual for FY&CY2025 and estimated values for FY&CY2026 and beyond. Outlooks for the US, Eurozone and China are based on predictions by DIR's in-house experts.

We expect growth in real GDP in 2026 to be up by +2.0% y/y for the US, +0.8% for the Eurozone, and +4.5% for China. Our outlooks for both the US and the Eurozone economies were revised downwards by 0.5%pt, while the outlook for China was revised upwards by 0.1%pt in comparison to our report of March 10, 2026 (*Japan's Economic Outlook No. 228 Update* (Japanese only), hereafter "our previous outlook"). For details please refer to the outlooks for each individual country (Japanese only).

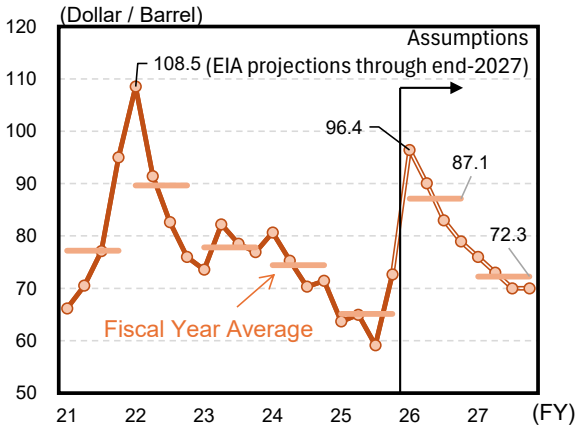
Although the United States and Iran are currently in a state of ceasefire as of this writing, it remains unclear whether this will lead to an end to hostilities. The Strait of Hormuz is in the state of effective blockade, and crude oil prices remain high. Therefore, our main scenario is based on the EIA's latest energy outlook[3] (released on May 12) (Chart 3).

According to the EIA's projections, the blockade of the Strait of Hormuz will be lifted between late May and early June 2026, allowing shipping traffic to gradually resume. Crude oil production and exports are expected to largely recover to pre-attack levels between late 2026 and early 2027. Reflecting these developments, crude oil prices (WTI) are expected to peak at 96.4 USD/bbl in the Apr-Jun 2026 period and continue to decline, reaching 70.0 USD/bbl in the Oct-Dec 2027 period[4]. Even at that time, the risk premium is expected to remain elevated, exceeding pre-attack levels (which stood at 67 USD/bbl on February 27).

[3] EIA "Short-Term Energy Outlook" (May 12, 2026)
[4] However, the EIA notes that if the lifting of the effective blockade of the Strait of Hormuz is delayed until the end of June, crude oil prices could rise by more than 20 USD/bbl in the short term (see Footnote 3).

**Assumptions in Main Scenario Regarding Crude Oil Prices and Middle East Situation (Based on EIA Projections)**

**Chart 3**




**EIA's Latest Short-Term Energy Projections**

- The conflict between the United States–Israel and Iran moves toward de-escalation, with the effective blockade of the Strait of Hormuz lifted between late May and early June 2026, leading to a gradual recovery in oil exports.
- Except for some Persian Gulf countries, oil production and exports largely recover to pre-attack levels from late 2026 to early 2027. Accordingly, crude oil prices (WTI) decline.
- Even after the ceasefire, the risk premium remains elevated, and WTI prices stay above pre-strike levels throughout the forecast period.

Source: Haver Analytics, EIA ""Short-Term Energy Outlook" (May 12, 2026); compiled by DIR.
Note: Since the EIA's Short-Term Energy Outlook covers only the period through Oct–Dec 2027, crude oil prices for Jan–Mar 2028 are assumed to remain at the same level as in Oct–Dec 2027.

### *Japan's real GDP expected to grow at a moderate pace of +0.6% in FY2026*

Based on the above overseas economic outlook, Japan's real GDP growth rate according to our main scenario is expected to be +0.6% in FY2026 and +0.8% in FY2027 (Chart 2, +0.6% in 2026 and +0.7% in 2027 on a calendar year basis).

The outlook for the FY2026 growth rate was revised downwards by -0.4%pt from our previous outlook. Personal consumption was revised downward to account for the impact of rising prices caused by soaring raw materials costs, which are reducing household real disposable income. Exports were also revised downward in light of factors such as a decline in exports to the Middle East and a contraction in external demand due to high crude oil prices. Furthermore, imports and changes in private and public sector inventories were revised downward to reflect the decline in imports of Middle Eastern crude oil resulting from the blockade of the Strait of Hormuz, as well as the release of oil reserves to cover the shortfall. While the downward revision of imports – a deduction in GDP – pushes up real GDP, the downward revision of changes in private and public inventories pushes down real GDP.

The growth rate for FY2027 has been revised downwards by -0.1%pt from our previous outlook. This is largely due to an increase in imports associated with a reaction to FY2026. If we ignore carryover (real GDP growth rate that can be achieved with zero q/q growth in each quarter), the y/y growth rate would be +0.5% (+0.3% in FY2026). Though in terms of momentum it is only a small amount, growth is expected to accelerate.

The main factors expected to underpin and boost the Japanese economy are "improvements in household income driven by wage increases and other factors," "government economic measures," "the continuation of accommodative monetary conditions," and "high levels of household savings." Wage increases in the spring labor negotiations are highly likely to remain at high levels in 2026 as well[5], and household income environment is expected to

[5] According to the fifth round of survey results for the 2026 spring labor negotiations released by the Japanese Trade Union Confederation (RENGO) on May 12, the weighted average wage increase rate, including regular

continue improving, partly because government measures to address high energy costs are helping to curb inflation. As discussed below, although the Bank of Japan (BOJ) is expected to continue raising interest rates, real short-term interest rates remain well into negative territory, and the accommodative monetary environment is likely to be maintained for the time being. Household financial assets, which stood at 2,351 tril yen as of the end of December 2025, are equivalent to 6.9 years' worth of nominal consumption, exceeding the pre-pandemic level (an average of 6.3 years' worth in 2019). Even if household income falls short of expectations, there appears to be ample room to stabilize living standards by drawing down savings.

Looking at the GDP outlook by demand component, while private consumption faces downward pressure from rising prices, we expect it to continue on a moderate growth trajectory due to ongoing improvements in the income environment – driven by sustained high wage increases, as mentioned earlier, and measures to address high energy costs (FY2026: +0.7% y/y, FY2027: +0.7% y/y).

Capital investment is expected to continue its upward trend, driven by investments in labor-saving measures to address labor shortages, information-related investments such as AI-related ones, and research and development (FY2026: +1.7% y/y, FY2027: +1.5% y/y). However, construction investment is likely to be weighed down by delays in project timelines resulting from labor shortages, and soaring raw material costs. Furthermore, caution is warranted regarding the possibility that rising uncertainty in the business environment – driven by the worsening and protracted situation in the Middle East – could exert downward pressure on capital investment.

Government consumption is expected to remain steady (FY2026: +1.3% y/y, FY2027: +1.6% y/y). In addition to an increase in medical and nursing care benefits due to the aging population, active wage increases by private companies are also expected to be reflected in public sector wages.

Exports are expected to slow through FY2026 but accelerate in FY2027 (FY2026: +0.5%, FY2027: +2.5%). By goods and services, exports of goods are expected to remain weak through the Jul–Sep period of 2026, partly due to a decline in motor vehicle exports to the Middle East and a contraction in external demand caused by high crude oil prices. However, they are likely to recover gradually thereafter as the Strait of Hormuz reopens and the global economy recovers. Exports of services are expected to be weighed down by the Chinese government's request to its citizens to refrain from traveling to Japan, increases in fuel surcharges, and reduced flight frequencies via the Middle East, but are expected to gradually recover starting in the Jul–Sep period of 2026.

***In light of the situation in the Middle East, the inflation outlook has been revised upward, particularly for FY2026***

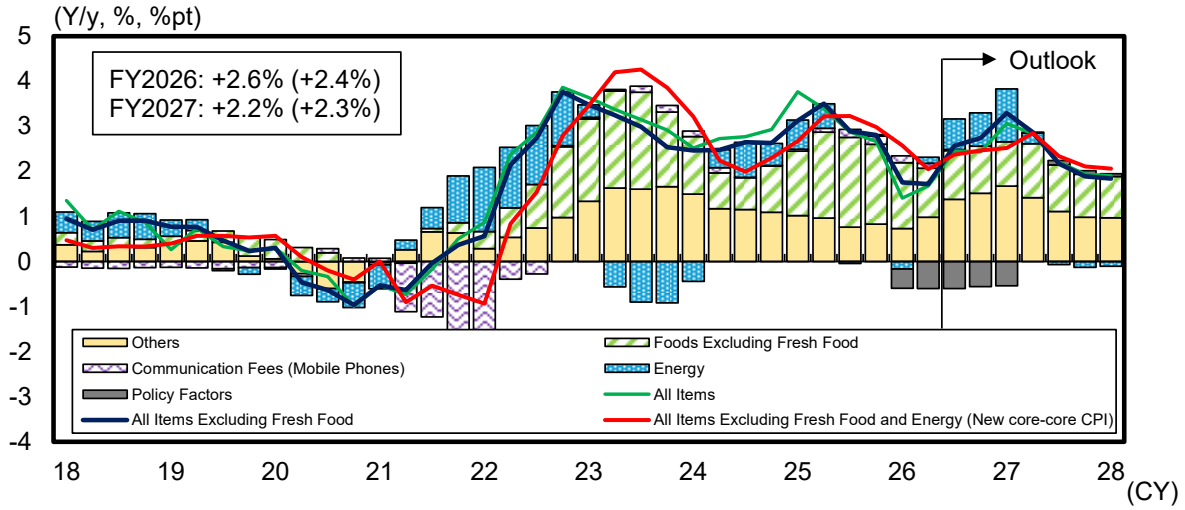
The Consumer Price Index (CPI) is projected to rise by 2.6% y/y in FY2026 and by 2.2% in FY2027 on a core CPI basis (excluding fresh food). For the index of all items excluding fresh

raises, was 5.05%, while for small and medium-sized enterprises (SMEs) with fewer than 300 employees, it was 4.81%. Although both figures declined slightly from the same period last year, overall wage increases remained in the 5% range for the third consecutive year, and the gap in wage increase rates between large and SMEs narrowed.

food and energy (new core-core CPI), the outlook is for a y/y increase of 2.4% in FY2026 and 2.3% in FY2027 (Chart 4).
In response to rising inflationary pressures stemming from the escalating tensions in the Middle East, we have revised our outlook upward for both FY2026 and FY2027 compared to our previous outlook. High crude oil prices are likely to affect prices in non-energy sectors not only through higher energy costs such as gasoline and kerosene but also through increases in raw material and transportation costs[6].

**Chart 4 Outlook for Core CPI (New Core-Core CPI in Parenthesis)**

Chart 4




Source: Ministry of Internal Affairs and Communications, U.S. Energy Information Administration (EIA); compiled by DIR.
Note: This price outlook is based on resource prices (excluding crude oil) and exchange rates prevailing at the time of preparation. Crude oil prices (WTI) are based on the EIA's Short-Term Energy Outlook. "Policy factors" include electricity and gas bill subsidies implemented from January to March 2026, emergency measures to mitigate sudden price shocks for fuel oil (assumed to continue throughout the forecast period), the effective elimination of tuition fees at private high schools, and the elimination of school lunch fees at public elementary schools.

Meanwhile, various government policies are helping to mitigate the current rise in prices. In addition to the emergency measures to mitigate sudden price shocks for fuel oil that began on March 19[7], measures to effectively make private high school tuition free and public elementary school lunch fees free began in April. Furthermore, although details have not been finalized at the time of writing, the government plans to resume subsidies for electricity and gas bills in the summer of 2026[8], which is likely to curb the rate of inflation to some extent.

We expect the rate of increase in food prices to gradually slow down through the second half of FY2027. However, at present, cost pressures are becoming apparent in some sectors due to the situation in the Middle East. According to TEIKOKU DATABANK, cost increases have been noted in food packaging materials and other areas due to a shortage of naphtha[9].

[6] The impact of the tense situation in the Middle East on prices and other factors was examined in the DIR Report dated 27 April 2026, *Japan's Economy: Monthly Outlook (Apr 2026)*.
[7] Agency for Natural Resources and Energy, "Regarding Emergency Measures to Mitigate Sudden Price Shocks in Light of the Situation in Iran" (March 11, 2026) (Japanese only).
[8] "Government to Finalize Supplementary Budget of Around 3 Trillion Yen; Electricity and Gas Subsidies to Total 500 Billion Yen" (Kyodo News, May 21, 2026) (Japanese only)
[9] See TEIKOKU DATABANK, "Survey on Price Revision Trends at 195 Major Food Companies – May 2026" (April 30, 2026) (Japanese only).

Given these developments, while the underlying trend in food price increases is expected to slow, the pace of that slowdown is likely to remain modest.

As mentioned earlier, wage increases in the spring labor negotiations are likely to remain at a high level in 2026, and the momentum for wage hikes has been sustained even after the deterioration of the situation in the Middle East. Furthermore, the environment for passing on price increases to consumers is improving for small and medium-sized enterprises (SMEs) and other businesses[10]. As the increased costs resulting from wage hikes are passed on to sales prices, leading to rising consumer prices, which in turn leads to further wage increases, the upward trend in prices is expected to continue.

***We assume the Bank of Japan will raise the short-term interest rate to 1.00% in June 2026 at the earliest***

At a press conference following the G20 summit in April 2026, the BOJ Governor Kazuo Ueda noted the difficulty of responding to negative supply shocks through monetary policy. He stated, "Real interest rates are very low in the medium term; in that sense, financial conditions are highly accommodative[11]," and reiterated his intention to take low real interest rates into account in future policy decisions.

Looking back at the two oil crises of the 1970s, the BOJ sought to stabilize prices in both instances by raising the official discount rate and other measures. In particular, during the second oil shock that occurred in October 1978, the BOJ began tightening monetary policy at a relatively early stage, drawing on its experience from the first oil shock (October 1973 to August 1974), which had led to "runaway inflation." As a result, the official discount rate reached a record high of 9.0% in March 1980. Subsequently, as inflation clearly began to slow, easing measures – such as lowering the official discount rate – were implemented starting in August of that year.

Currently, crude oil prices remain high, and the cyclical rise in wages and prices continues. Against this backdrop, there is a strong need for interest rate hikes to adjust the "highly accommodative" monetary environment – as described by Governor Ueda – in order to stabilize the inflation rate and medium- to long-term inflation expectations at around 2% y/y.

For this reason, we expect the BOJ to raise short-term interest rates to 1.00% at its next meeting in June (or July) 2026, and to implement additional rate hikes of 0.25%pt approximately every six months thereafter (Chart 5).

On the other hand, long-term interest rates, which have been rising at a markedly accelerated pace recently, are projected to reach around 3.1% in the second half of FY2027 (Chart 5). In addition to the BOJ's gradual increases in short-term interest rates acting as a factor pushing up long-term rates, upward pressure from supply and demand is also expected to intensify as the BOJ gradually reduces its purchases of long-term government bonds.

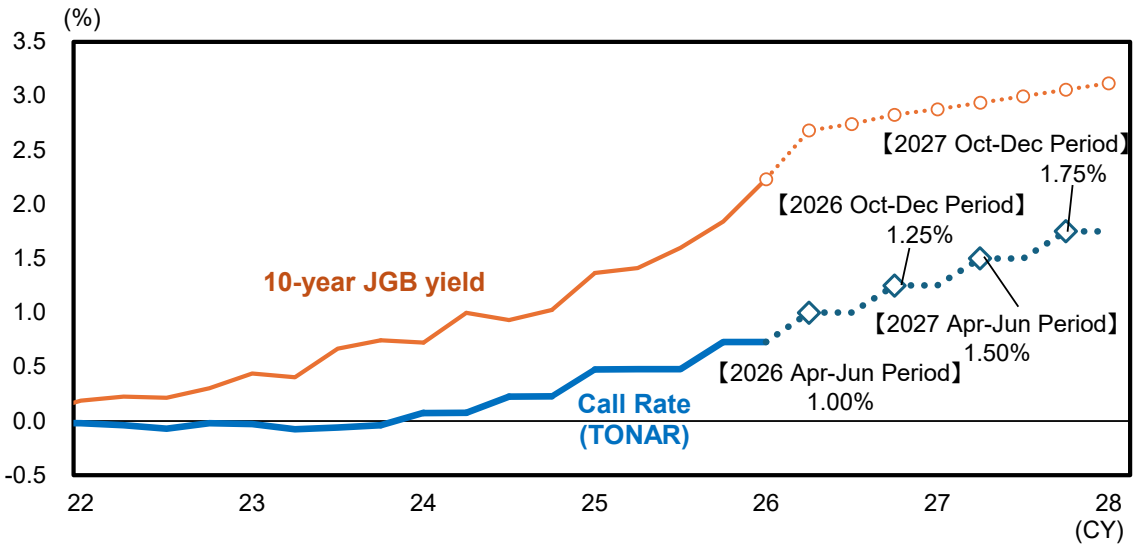
---

[10] According to the Small and Medium Enterprise Agency's "Implementation of Price Negotiation Promotion Month and Follow-up Survey Results (Japanese only)," the rate at which SMEs are passing on costs has been rising gradually since around 2024, and the proportion of companies unable to pass on costs at all has continued to decline. This trend is even more evident in labor costs.

[11] Bank of Japan, "Press Conference by Governor Ueda (April 16)" (April 20, 2026) (Japanese only)

If inflationary pressures intensify further against the backdrop of the Takaichi administration's expansionary fiscal policy, or if concerns grow over a deterioration in supply-demand conditions due to increased government bond issuance, long-term interest rates could be pushed up even further as investors demand higher risk premiums to hedge against future uncertainty.

**Outlook for Japan's Long-Term Interest Rate** **Chart 5**




Source: Ministry of Finance, Bank of Japan; compiled by DIR.
Note: Long-term interest rates are based on the average for the period, while short-term interest rates are based on end-of-period values. The dotted line indicates DIR estimates.

## 2. Impact of Middle East Situation and Risk of Economic Downturn

As mentioned earlier, our main scenario is based on the assumption that the situation in the Middle East will stabilize in the short term, leading to a decline in crude oil prices and a recovery in crude oil supply. While there have been recent reports that negotiations between the United States and Iran aimed at ending the fighting are nearing a conclusion[12], there remains significant uncertainty regarding the situation in the Middle East. If the effective blockade of the Strait of Hormuz were to persist for an extended period[13], it is conceivable that crude oil prices could rise further or that a crude oil shortage could lead to massive disruptions in supply chains.

In this chapter, we will examine the impact of recent developments in the Middle East on the Japanese economy in terms of both prices and volumes, and estimate the potential impact on Japan's real GDP should crude oil prices rise or a supply shortage occur.

[12] "Reports of a Framework Agreement on U.S.-Iran Talks: Ending Hostilities Contingent on a Pledge to Dispose of Highly Enriched Uranium and Reopening the Strait of Hormuz" (Yomiuri Shimbun Online, May 25, 2026) (Japanese only)
[13] Even if the Strait of Hormuz is reopened soon, it may take time for crude oil supplies to return to normal. This is because, in addition to the removal of mines reportedly laid in the Strait of Hormuz, repairs are needed for heavily damaged energy facilities in the Middle East. In a speech on April 13, Fatih Birol, Executive Director of the International Energy Agency (IEA), stated that restoring these facilities could take "up to two years."

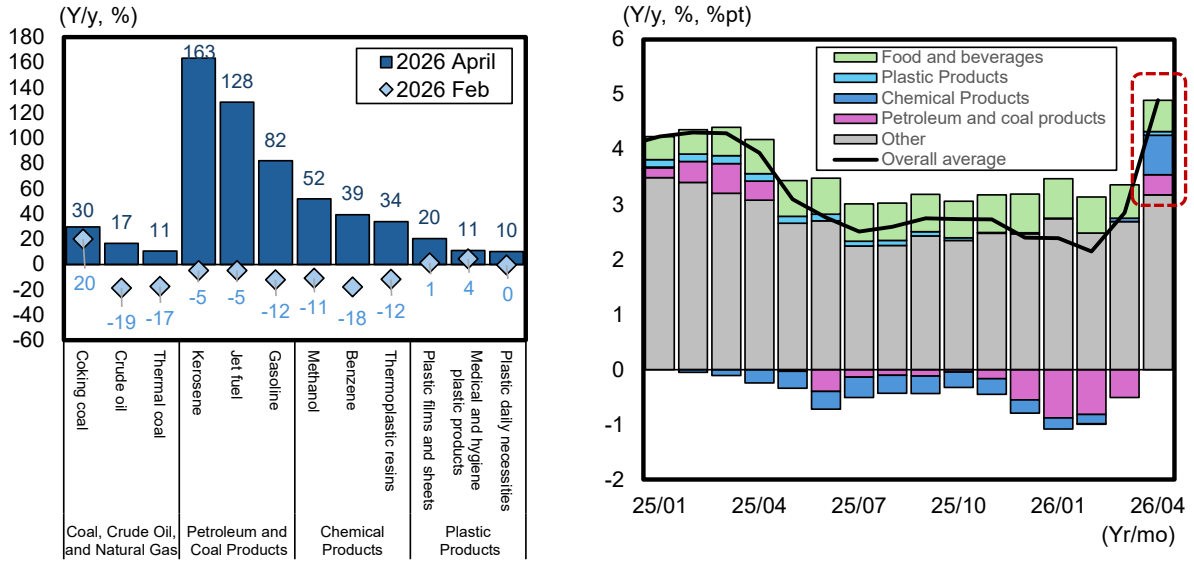
### *(1) The Impact of Recent Developments in the Middle East on the Japanese Economy*

***Prices: Driven by rising import prices, corporate prices have begun to rise again, particularly for petroleum and coal products and chemical products***

Chart 6 (left) summarizes trends in import prices for crude oil-related items. It compares February 2026 – just before the situation in the Middle East deteriorated – with April of this year, and identifies items with high y/y increase rates across four categories: "Coal, Crude Oil, and Natural Gas"; "Petroleum and Coal Products"; "Chemical Products"; and "Plastic Products." Note that "Coal, Crude Oil, and Natural Gas" and "Petroleum and Coal Products" generally correspond to the upstream segment of the supply chain, "Chemical Products" to the midstream, and "Plastic Products" to the downstream segment.

**Trends in Import Prices for Crude Oil-Related Items (Left); Breakdown of Domestic Corporate Prices (Right)**

**Chart 6**




Source: Bank of Japan; compiled by DIR.
Note: The chart on the left shows the top three items in each category by y/y growth rate as of April 2026.

Upward pressure on import prices is spreading throughout the supply chain. Looking first at price trends for coal, crude oil, and natural gas in the upstream sector, y/y increases accelerated for coking coal (+30%), crude oil (+17%), and thermal coal (+11%). In response to these trends, petroleum and coal products also saw extremely sharp increases in fuel-related items such as kerosene (+163% y/y), jet fuel (+128%), and gasoline (+82%). While all of these were in negative territory y/y as of February, they have experienced rapid price surges in a short period, suggesting that rising raw material prices are spreading to processed products. Furthermore, the fact that the rate of increase for petroleum and coal products has exceeded that of crude oil is believed to be due to the combination of high crude oil prices, reduced refinery operating rates, and a shift to alternative crude oils, which has led to a tightening of supply for middle distillates such as kerosene and an expansion of refining margins[14].

[14] According to the IEA, against the backdrop of supply constraints stemming from the deterioration of the situation in the Middle East, refinery utilization rates have declined, particularly in Asia and the Middle East.

Turning to chemical products in the midstream sector, we saw significant increases in methanol (+52% y/y), benzene (+39%), and thermoplastic resins (+34%). Although these items were down on a y/y basis as of February, this indicates that cost increases originating in the upstream sector are now spreading to intermediate goods.

Furthermore, among plastic products in the downstream sector, increases were observed in plastic films and sheets (+20% y/y), medical and hygiene plastic products (+11%), and plastic daily necessities (+10%). Although the rate of increase is relatively modest compared to the upstream and midstream sectors, it is evident that the impact of rising prices is beginning to extend to the final product stage as well.

These trends are spilling over into domestic prices through business-to-business transactions. Chart 6 (right) summarizes trends in domestic corporate prices. In April 2026, domestic corporate prices rose 4.9% y/y, marking the highest rate of increase since May 2023. A breakdown of the data shows that the contribution of petroleum and coal products turned positive, while the contribution of chemical products also increased significantly, suggesting that rising import costs are beginning to be reflected in intermediate goods prices. On the other hand, the change in plastic products has remained relatively modest. However, compared to the period when prices hovered near zero, an upward trend is currently evident, indicating that the impact of rising prices is beginning to extend to sectors closer to the downstream end of the supply chain.

***Volume: Motor vehicle exports to the Middle East fell sharply in April; caution is advised regarding a potential downturn in exports to Asia in the near future***

Japanese motor vehicle makers are increasingly reducing production of vehicles destined for the Middle East at their domestic plants and redirecting shipments to other regions, as they adjust their supply chains. These measures appear to be driven by growing uncertainty regarding demand in the Middle East and logistical constraints resulting from heightened geopolitical risks. In particular, since motor vehicle exports rely heavily on maritime transport, they are highly vulnerable to disruptions in shipping routes and rising insurance costs.

Chart 7 (left) summarizes the characteristics of Japan's motor vehicle exports to the Middle East. Exports to the Middle East accounted for approximately 14% of the total in both value and volume in 2025, demonstrating a significant presence. Meanwhile, exports to the United States – which were hit hard by Trump tariffs in 2025 – accounted for about 23% of the total in terms of volume. However, due to relatively high export unit prices, they accounted for approximately 30% of the total in terms of value.

For this reason, while automobile exports to the Middle East are smaller in scale than those to the United States, given the recent decline, the impact of the drop in exports could exceed that seen in 2025 when Trump's tariffs were introduced.

Chart 7 (right) shows trends in motor vehicle exports to the Middle East (including used cars), exports of new passenger cars, and local new car sales by three Japanese motor vehicle makers. While new car exports and sales generally move in tandem, this is because local production

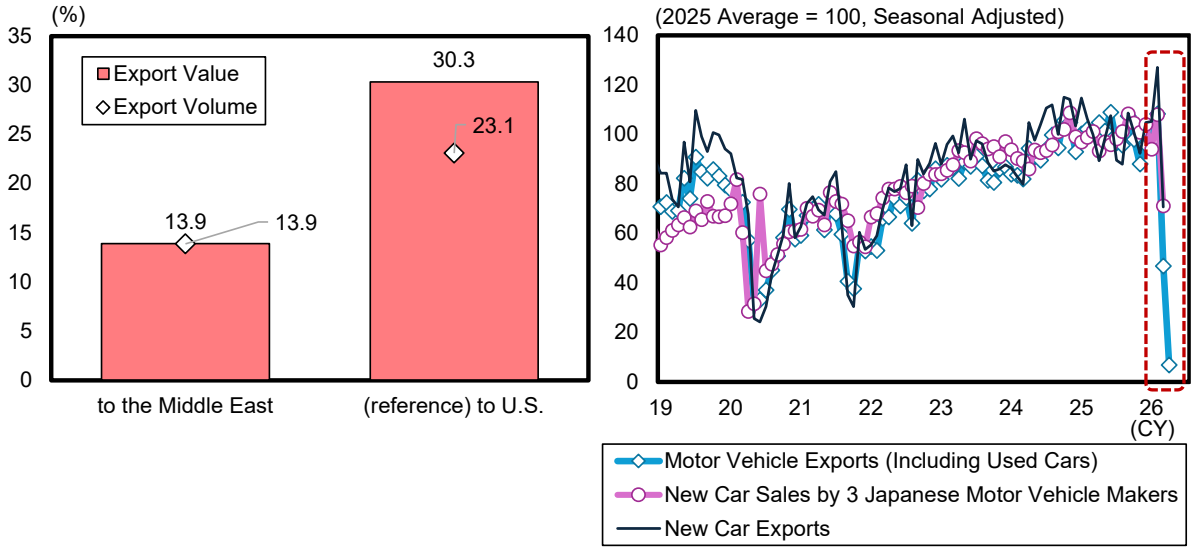
Consequently, the supply-demand balance for middle distillates (such as diesel and jet fuel) has become even tighter, and the crack spread (refining margin) has expanded to a record high.

in the Middle East is limited, and vehicles sold there are primarily supplied by imports from Japan and other countries[15].

Chart 7 (right) shows the trends following the deterioration of the situation in the Middle East. In March 2026, all indicators fell sharply, with both exports and local sales declining. Looking at the motor vehicle export figures (including used cars) released for April, the downward trend has intensified further. With 2025 levels set at 100, figures exceeded this level in February but fell below 50 in March and dropped into single digits in April. This is believed to be the result of a combination of factors, including declining demand, logistical constraints, and adjustments to shipments.

**Share of Motor Vehicle Exports to Middle East (left), Export Volume to Middle East and New Car Sales (right)**

**Chart 7**




Source: Ministry of Finance, companies' websites; compiled by DIR.
Note: The motor vehicle export share shown in the left chart is as of 2025. The new passenger car export volume shown in the right figure is calculated by summing the exports to countries in the Middle East from the total passenger car exports by country and then subtracting the volume of used cars. Both the new car sales and export figures in the right figure are seasonally adjusted values provided by DIR.

On the other hand, no significant impact has been observed on exports (overall) to countries and regions outside the Middle East. Before the situation in the Middle East deteriorated, much of the crude oil passing through the Strait of Hormuz was supplied to Asian countries and regions such as China, India, and South Korea[16]. Indeed, the export volume index for Asia in April exceeded the level recorded in February, just before the situation in the Middle East worsened (seasonally adjusted figures from the Cabinet Office). This is likely due to temporary measures such as the release of oil reserves and alternative procurement, which have mitigated the negative impact on economic activity. However, continued vigilance is

[15] See, for example, "Warnings of a Blow to Car Exports to the Middle East: 'It Will Be Troublesome If It Drags On Like the Ukraine Situation'… If Navigation Through the Strait of Hormuz Is Impossible, It Will Also Affect Used Cars Bound for Africa" (Yomiuri Shimbun Online, March 5, 2026) (Japanese only), and the Ministry of Economy, Trade and Industry's "Domestic and International Conditions Surrounding the Automobile Industry and the Direction of Automobile Policy" (March 12, 2025) (Japanese only).
[16] According to the EIA, in 2024, 86% of the crude oil supplied via the Strait of Hormuz was destined for Asia and Oceania (with China, India, South Korea, and Japan accounting for 71% of that total).

required regarding the possibility that the impact of the Middle East situation could spread to the Japanese economy through a decline in exports to Asia.

### *(2) Impact on the Japanese economy in the event of a crude oil supply shortage*

#### *If high oil prices and supply constraints occur simultaneously, real GDP growth rate will decline by 0.4 percentage points*

In the future, if the impact of the situation in the Middle East becomes apparent not only in terms of crude oil prices but also in terms of supply, the Japanese economy could suffer a major blow due to large-scale disruptions in supply chains. Therefore, following the methodology of Tamura and Hatanaka (2026)[17], Chart 8 summarizes the real GDP growth rate projections for the main scenario and two risk scenarios for the fiscal year 2026.

According to our main scenario, we assume that starting in June 2026, tankers and other vessels will gradually be able to pass through the Strait of Hormuz, and that WTI prices will peak in the upper 90 USD/bbl range during the Apr–Jun period before declining (with an average of 87 USD/bbl for FY2026, Chart 3). No supply constraints are expected for crude oil or LNG, and real GDP growth rate for FY2026 is projected to be +0.6% y/y.

On the other hand, the "risk scenario" assumes that tensions in the Middle East will persist, with WTI trading at 100 USD/bbl starting in the Jul–Sep period of 2026 (averaging 99 USD/bbl for FY2026), but that no supply constraints will arise. In this case, taking into account both the direct impact of soaring crude oil prices on the domestic economy and the indirect impact via a global economic slowdown, real GDP growth rate for FY2026 is projected to decline by approximately 0.1%pt y/y to +0.6% (rounded to the second decimal place, this is +0.64% in the main scenario and +0.56% in the risk scenario).

In contrast, the "tail risk scenario" assumes that WTI will trade at 120 USD/bbl starting in the Jul–Sep period of 2026 (with an average of 114 USD/bbl for FY2026), and that crude oil and LNG imports from countries surrounding the Strait of Hormuz to Asian countries and regions, including Japan, will decline by 10%, leading to a gradual emergence of supply shortages in the second half of FY2026 (For details of the assumptions, see the notes in Chart 8). In this scenario, the combined impact of soaring crude oil prices and shortages of crude oil and LNG on the domestic and global economies is expected to cause real GDP growth rate in FY2026 to decline by approximately 0.4%pt y/y, resulting in a growth rate of +0.2%.

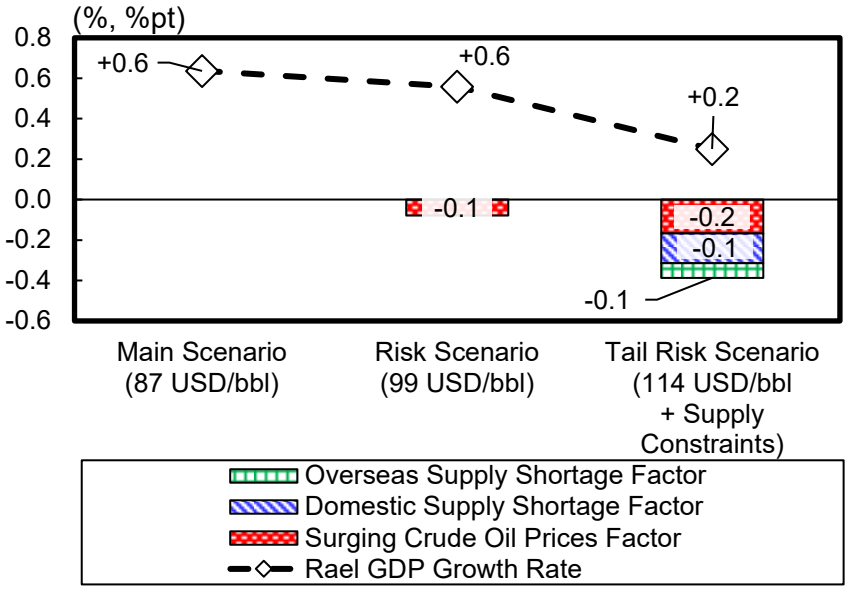
---

[17] Munehisa Tamura and Hirohito Hatanaka, "A 10% Reduction in Crude Oil and LNG Imports from the Middle East Would Push the Japanese Economy into Negative Growth" (DIR Report, March 26, 2026). In this analysis, we have revised the scope and timing of the supply shortage from that in Tamura and Hatanaka (2026), taking into account recent trends. Specifically, while Tamura and Hatanaka (2026) assumes a global supply shortage equivalent to a 10% reduction in imports from countries surrounding the Strait of Hormuz, this analysis limits that scope to Asian countries and regions. Furthermore, while Tamura and Hatanaka (2026) assumes that the supply shortage would persist throughout fiscal year 2026, the current estimates – taking into account crude oil stockpiles and other factors – assume that the shortage will occur in India and other countries starting in the Oct–Dec 2026 period, and in Japan and other countries starting in the Jan–Mar 2027 period. Furthermore, while Tamura and Hatanaka (2026) consider factors such as sluggish production in China, South Korea, Taiwan, and India as causes of supply shortages (overseas), the current estimates incorporate the impact of sluggish production in Southeast Asian countries in addition to these countries and regions.

As of May 23, Japan's domestic oil reserves stood at 203 days' worth[18], and given that alternative supplies are being secured from the US and other sources, the likelihood of a domestic crude oil shortage in the near term is low. However, considering the uncertainty surrounding the situation in the Middle East and the significant risk of an economic downturn, there is a strong need to encourage businesses and households to use petroleum-related products efficiently.

**Real GDP Growth Rates for FY2026 Under Each Scenario (In "Tail Risk Scenario," Supply Shortages Occur in Asia from Oct–Dec 2026 through Jan–Mar 2027)**

**Chart 8**




Source: Ministry of Finance, (Taiwan) Customs Administration, Ministry of Finance, EIA, OECD, United Nations Statistics Division; compiled by DIR.

Note: The "Risk Scenario" assumes that WTI will trade at 100 USD/bbl from the Jul–Sep 2026 period onward. The "Tail Risk Scenario" assumes that WTI will trade at 120 USD/bbl from the Jul–Sep period of 2026 onward, and that starting from the Oct–Dec period of 2026 in India, Indonesia, Thailand, the Philippines, and Malaysia, and from the Jan–Mar period of 2027 in Japan, China, South Korea, and Taiwan, there will be a supply shortage of crude oil and LNG equivalent to 10% of imports from countries surrounding the Strait of Hormuz (Saudi Arabia, the United Arab Emirates, Iran, Iraq, Qatar, Kuwait, and Bahrain). The estimates for "Surging Crude Oil Prices Factor" are based on our short-term macroeconomic model. The "Overseas Supply Shortage Factor" represents the impact on Japan's real GDP of the decline in real GDP in China, South Korea, Taiwan, India, Indonesia, Thailand, the Philippines, and Malaysia resulting from a supply shortage of crude oil and LNG equivalent to 10% of imports from countries surrounding the Strait of Hormuz. The figures in parentheses on the horizontal axis indicate the average WTI price for FY2026 under each scenario.

[18] Agency for Natural Resources and Energy, "Status of Oil Reserves (Preliminary Estimates)" (Last accessed: May 26, 2026) (Japanese only).

## Japan's Economic Outlook No. 229 (May 25, 2026)

**Chart 9**

| | | 2025 | | | 2026 | | | | 2027 | | | | 2028 | FY2024 (CY) | FY2025 (CY) | FY2026 (CY) | FY2027 (CY) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Apr-Jun | Jul-Sep | Oct-Dec | Jan-Mar | Apr-Jun | Jul-Sep | Oct-Dec | Jan-Mar | Apr-Jun | Jul-Sep | Oct-Dec | Jan-Mar | | | | |
| Real GDP | Y tril; annualized | 593.1 | 589.4 | 590.7 | 593.7 | 594.5 | 594.4 | 595.7 | 597.0 | 598.2 | 599.5 | 600.6 | 601.9 | 587.1 | 591.9 | 595.7 | 600.4 |
| | Q/q % | 0.3 | −0.6 | 0.2 | 0.5 | 0.1 | 0.0 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | | | | |
| | Q/q %; annualized | 1.4 | −2.5 | 0.8 | 2.1 | 0.6 | −0.1 | 0.9 | 0.9 | 0.8 | 0.9 | 0.8 | 0.8 | | | | |
| | Y/y % | 2.0 | 0.5 | 0.2 | 0.6 | 0.3 | 0.8 | 0.8 | 0.6 | 0.6 | 0.9 | 0.8 | 0.9 | 0.5 | 0.8 | 0.6 | 0.8 |
| | | | | | | | | | | | | | | (−0.2) | ( 1.1) | ( 0.6) | ( 0.7) |
| Private Consumption | Q/q % | 0.2 | 0.5 | 0.0 | 0.3 | 0.2 | 0.1 | 0.1 | 0.1 | 0.2 | 0.2 | 0.2 | 0.2 | 0.1 | 1.2 | 0.7 | 0.7 |
| Private Residential Investment | Q/q % | 0.0 | −8.1 | 5.0 | 0.5 | −0.4 | −0.7 | −0.8 | −0.9 | −1.0 | −1.0 | −1.0 | −1.0 | −0.7 | −3.5 | −0.8 | −3.7 |
| Private Non-Resi. Investment | Q/q % | 1.2 | −0.1 | 1.4 | 0.3 | 0.3 | 0.3 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 0.8 | 2.4 | 1.7 | 1.5 |
| Government Consumption | Q/q % | 0.7 | 0.1 | 0.4 | 0.1 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 2.3 | 0.8 | 1.3 | 1.6 |
| Public Investment | Q/q % | 0.4 | −1.1 | −0.2 | 1.4 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.1 | −0.6 | 1.2 | 0.8 |
| Exports | Q/q % | 1.6 | −1.6 | 0.2 | 1.7 | −1.2 | 0.1 | 0.7 | 0.8 | 0.6 | 0.6 | 0.5 | 0.6 | 2.7 | 1.9 | 0.5 | 2.5 |
| Imports | Q/q % | 1.1 | −0.2 | 0.0 | 0.5 | −2.4 | 2.3 | 1.1 | 1.0 | 0.9 | 0.8 | 0.8 | 0.7 | 4.0 | 2.6 | 0.4 | 3.9 |
| Nominal GDP | Q/q %; annualized | 8.2 | 0.3 | 3.8 | 3.4 | −0.1 | 2.6 | 3.5 | 3.4 | 2.5 | 2.9 | 2.7 | 2.7 | 3.7 | 4.2 | 2.2 | 2.9 |
| GDP Deflator | Y/y | 3.2 | 3.5 | 3.4 | 3.4 | 1.6 | 1.6 | 1.5 | 1.8 | 2.4 | 2.2 | 2.0 | 1.9 | 3.2 | 3.4 | 1.6 | 2.1 |
| Industrial Production | Q/q % | −0.5 | −1.0 | 0.2 | 2.5 | −1.5 | 0.6 | 0.4 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 | −1.5 | −0.2 | 1.0 | 1.5 |
| Core CPI | Y/y % | 3.5 | 2.9 | 2.8 | 1.8 | 1.7 | 2.6 | 2.7 | 3.3 | 2.9 | 2.2 | 1.9 | 1.8 | 2.7 | 2.7 | 2.6 | 2.2 |
| Unemployment Rate | % | 2.5 | 2.5 | 2.6 | 2.7 | 2.6 | 2.6 | 2.6 | 2.5 | 2.5 | 2.5 | 2.5 | 2.4 | 2.5 | 2.6 | 2.6 | 2.5 |
| Call Rate | % | 0.48 | 0.48 | 0.73 | 0.73 | 1.00 | 1.00 | 1.25 | 1.25 | 1.50 | 1.50 | 1.75 | 1.75 | 0.48 | 0.73 | 1.25 | 1.75 |
| 10-Year JGB Yield | % | 1.41 | 1.60 | 1.84 | 2.23 | 2.68 | 2.74 | 2.83 | 2.88 | 2.94 | 3.00 | 3.06 | 3.12 | 1.08 | 1.77 | 2.78 | 3.03 |
| Major assumptions | | | | | | | | | | | | | | | | | |
| Crude Oil Price (WTI futures) | $/bbl | 63.7 | 65.0 | 59.1 | 72.7 | 96.4 | 90.1 | 83.0 | 79.0 | 76.0 | 73.0 | 70.0 | 70.0 | 74.4 | 65.1 | 87.1 | 72.3 |
| Exchange Rate | Yen/$ | 144.6 | 147.5 | 154.1 | 156.9 | 158.8 | 159.0 | 159.0 | 159.0 | 159.0 | 159.0 | 159.0 | 159.0 | 152.5 | 150.7 | 158.9 | 159.0 |

Source: Various statistics, EIA; Compiled by DIR.
Notes: GDP through Jul-Sep 2024: actual; thereafter: DIR estimates.