Provisional Translation

Economic White Paper 2026

(Annual Report on the Japanese Economy and Public Finance)

"Challenges on full-scale transition towards growth-oriented economy"

Summary

July 2026

Cabinet Office, Government of Japan

Contents

1-1: Impacts of elevated oil prices and developments in prices and wages (1)

- Crude oil and naphtha prices rose sharply, due to the heightened tensions in the Middle East in spring 2026. Though the prices has gradually declined following the signing of memorandum towards cessation of hostilities between the U.S. and Iran, developments in the region continue to warrant close attention.
- Japan has secured the necessary amount of crude oil comparable to that of the previous year, by releasing stockpiles and procuring from alternative sources. Production of petroleum-related products bottomed out in April. While necessary amount has been secured, prices of petroleum-related goods remain elevated.

Figure 1. Market price on crude oil and petroleum-related goods

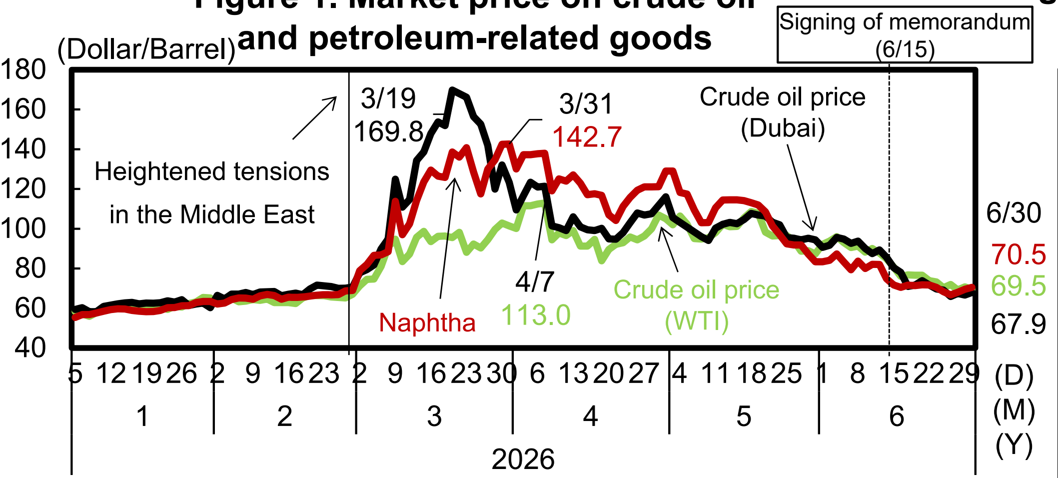


Figure 2. Procurement of crude oil from alternative sources and stockpiles

1. Procurement of crude oil from alternative sources

April	**Approx. 25% of the required volume** Procuring expanded to Latin America and the Asia-Pacific region in addition to the Middle East and the U.S.
May	**Approx. 60%** Procuring expanded to Central Asia
June	**Approx. 80%** Procuring expanded to Africa
July	**Approx. 100%** Procuring from the U.S. increased to more than ten times the previous year's monthly average

2.Stockpiles on crude oil

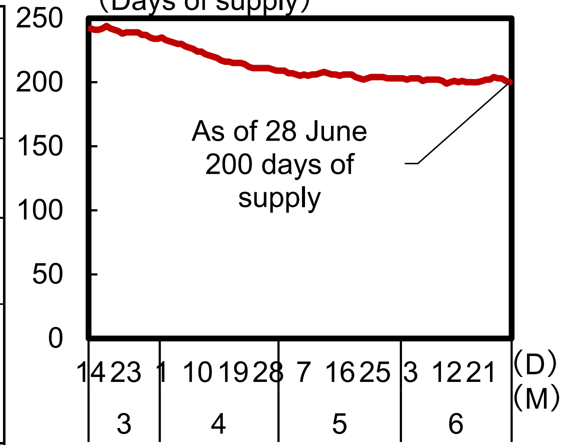


Figure 3. Production on petroleum-related goods

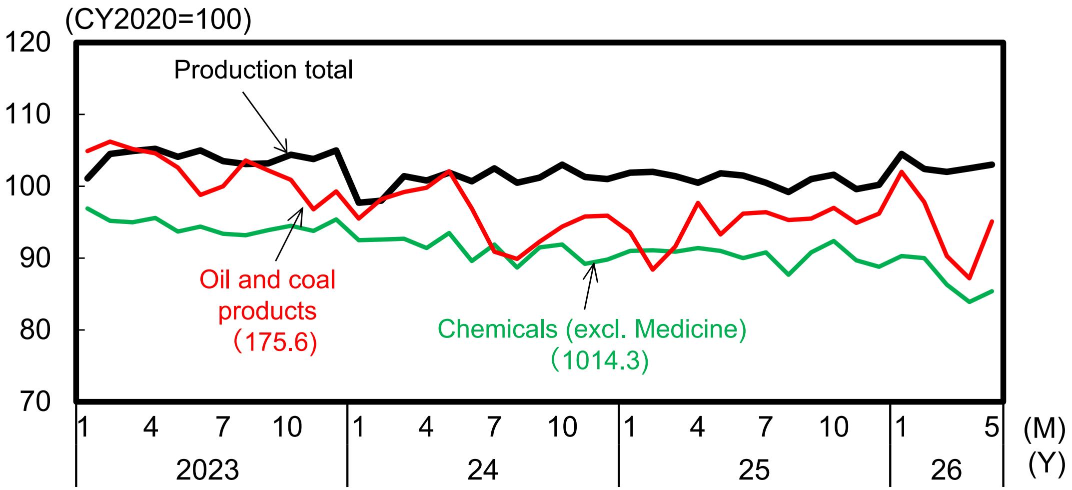
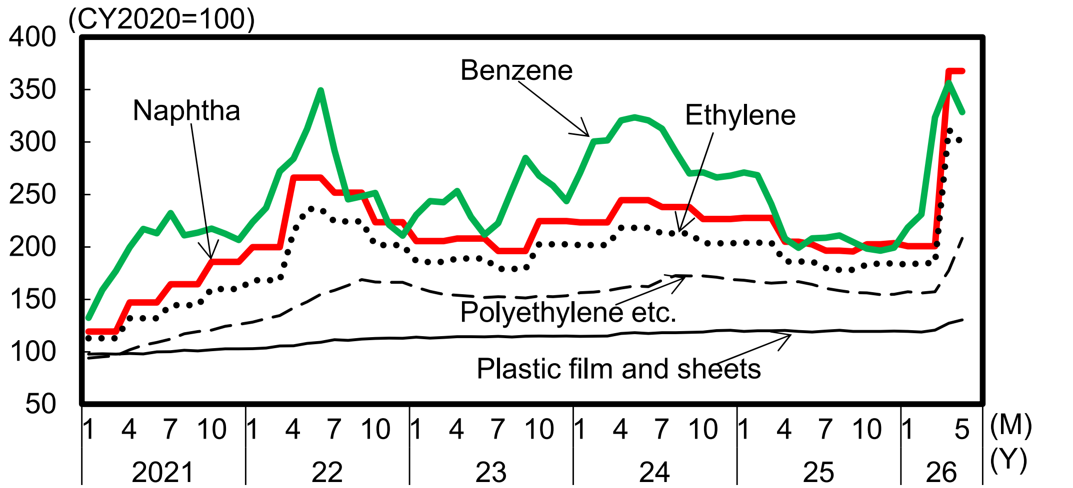


Figure 4. Price of petroleum-related goods



(Source): Ministry of Internal Affairs and Communications, Agency for Natural Resources and Energy, Cabinet Office, Ministry of Finance, Bank of Japan, Bloomberg

1-1: Impacts of elevated oil prices and developments in prices and wages (2)

- Price indices show the pronounced rise in import prices and signs of pass-through on business-to-business prices. Among firms planning to raise prices, the share citing rising costs for "packaging materials", many of which are made of petroleum-based materials, as the reason has risen.
- Meanwhile, the rate of increase in consumer price has remained in the 1% range, partly due to the emergency measures to curb gasoline and other fuel prices. Amid continued wage growth, real wages remain on an upward trend.

Figure 1. Import price and B to B price

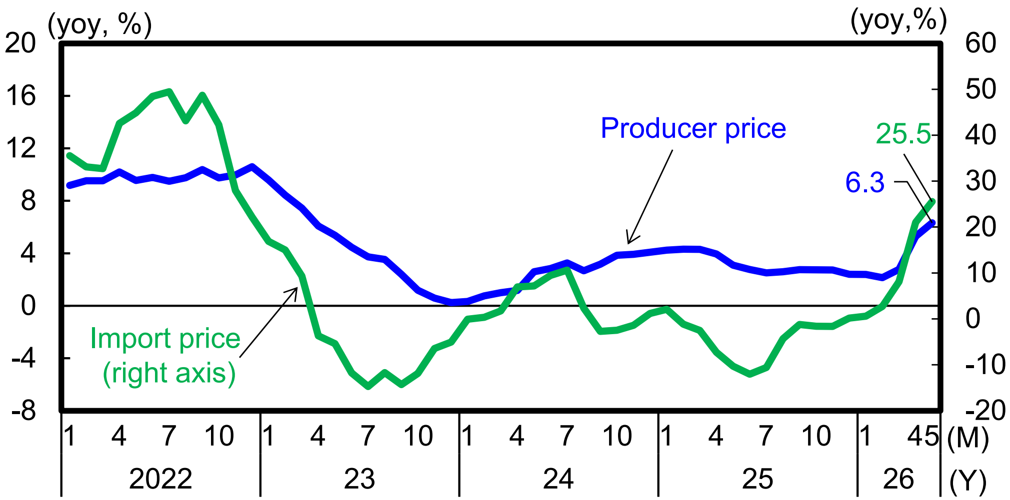


Figure 2. Number of planned price hike for foods

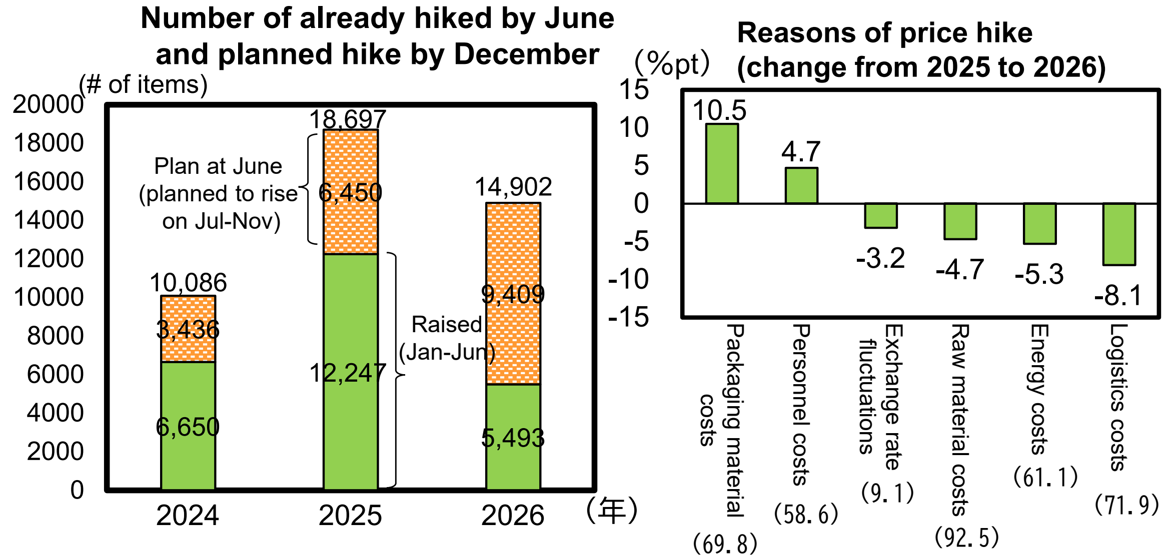


Figure 3. Consumer price

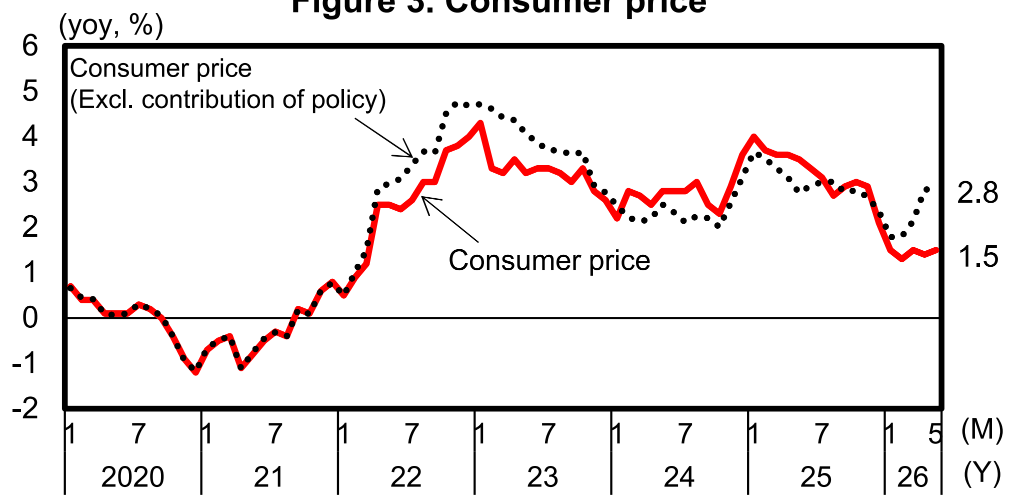
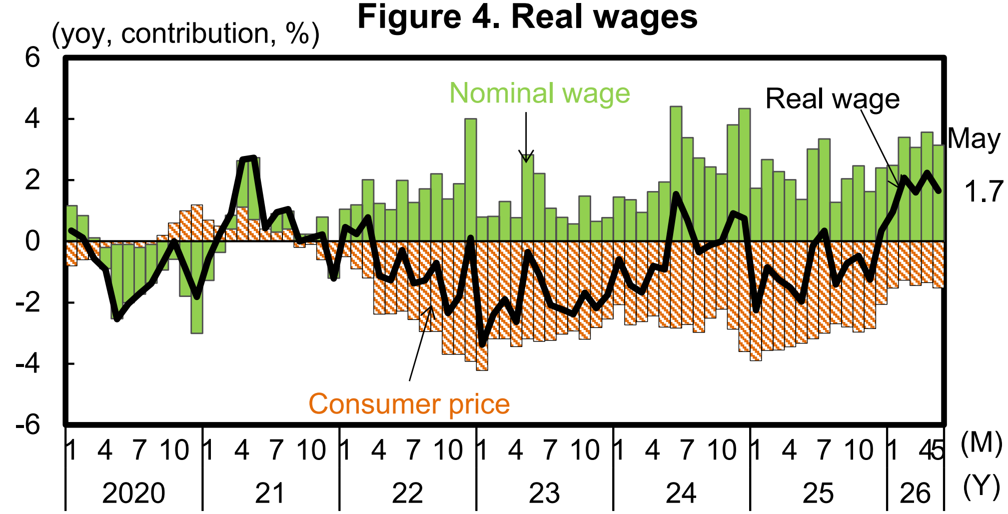


Figure 4. Real wages



(Source): Ministry of Internal Affairs and Communications, Agency for Natural Resources and Energy, Cabinet Office, Ministry of Finance, Bank of Japan, Bloomberg

1-1: Impacts of elevated oil prices and developments in prices and wages (3)

- Compared with the previous period of high inflation (around 2022), which was driven by rising crude oil prices, the pace of price pass-through may now be accelerating across a broader range of firms, including material producers and manufacturers, and various size of firms.
- Since spring 2026, inflation expectations among business and consumers have risen again amid heightened tensions in the Middle East. Medium- to long-term inflation expectations (based on firms' forecasts for the next 3 to 5 years and market-based measures derived from government bond yields) have remained on an upward trend since 2022.

Figure 1. Price pass-through in larger firms

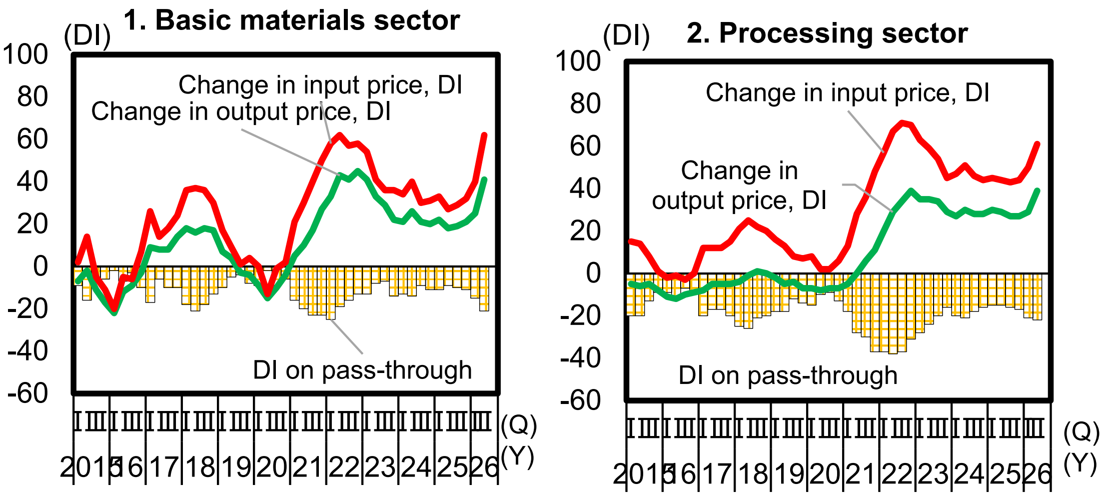


Figure 2. Price pass-through in SMEs

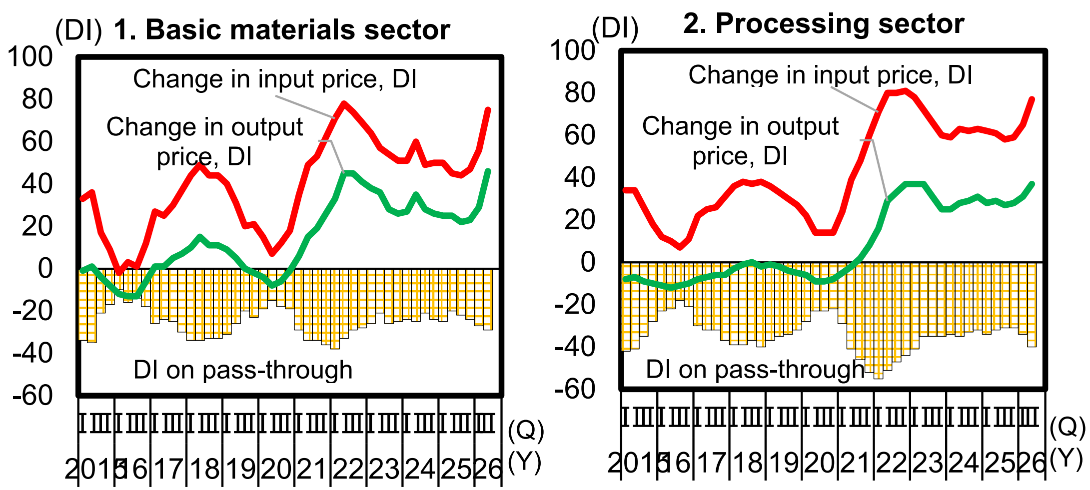


Figure 3. Inflation expectations of firms

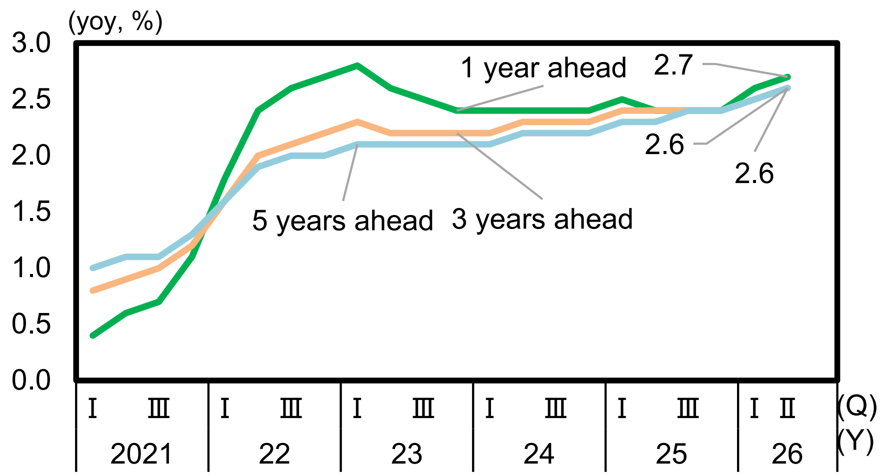
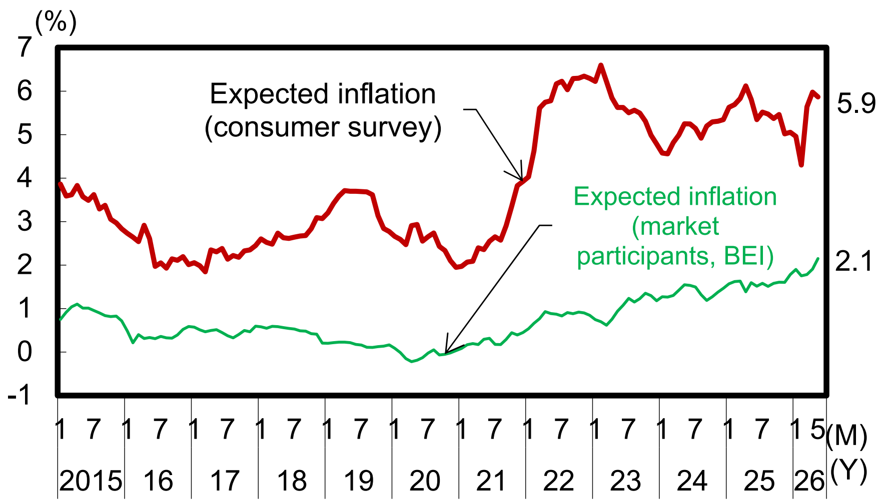


Figure 4. Inflation expectations of consumers and market participants



(Sources): Bank of Japan, Cabinet Office, Ministry of Internal Affairs and Communications, Ministry of Health, Labour and Welfare, Japanese Trade Union Confederation, Bloomberg

1-1: Impacts of elevated oil prices and developments in prices and wages (4)

- In determining whether the economy has overcome deflation, it is necessary to "comprehensively assess the underlying trend and economic context of prices" and to confirm that "the economy has overcome the situation of persistent price declines and is unlikely to return to such a situation."
- With regard to the following four indicators shown in the document, the trend in prices can be regarded as an upward trend, judging from both the CPI and the GDP deflator. Regarding indicators of the underlying conditions affecting prices, while GDP gap has reached around zero, unit labor costs, indicator of inflationary pressure stemming from wage growth, have remained on an upward trend.
- It is necessary to assess the extent to which the impact of the tensions in the Middle East will weigh on the economic activity.

Figure 1. Consumer price index

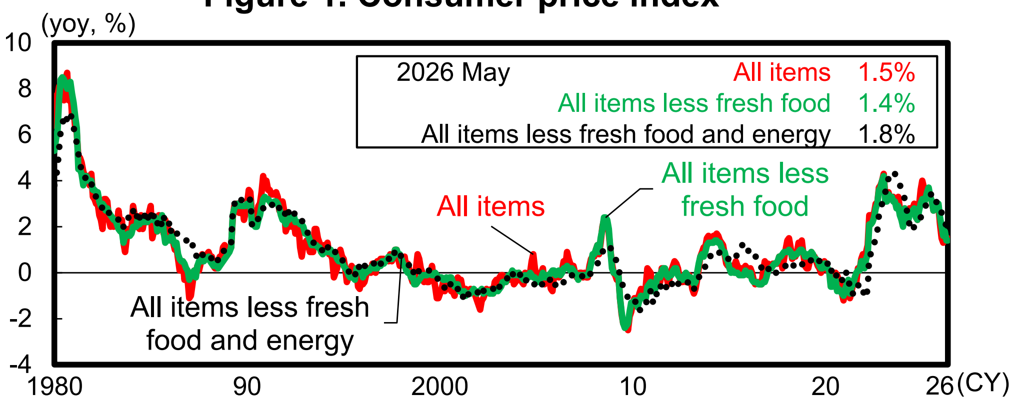


Figure 2. GDP deflator

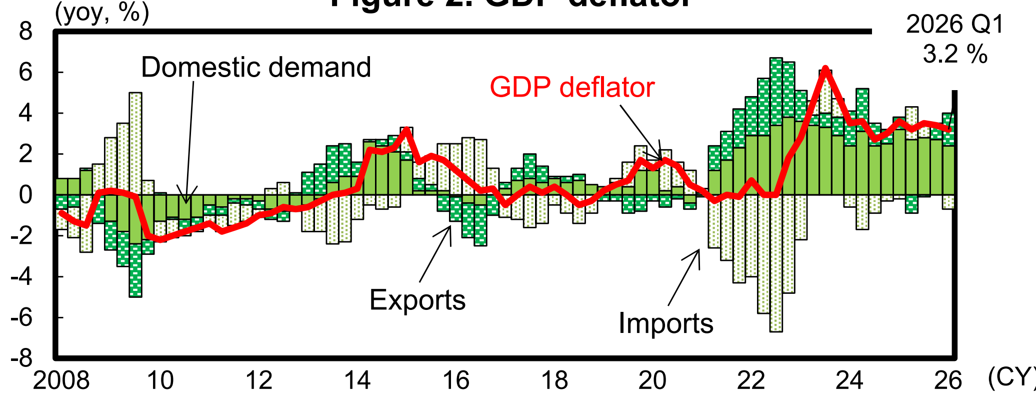


Figure 3. Output gap

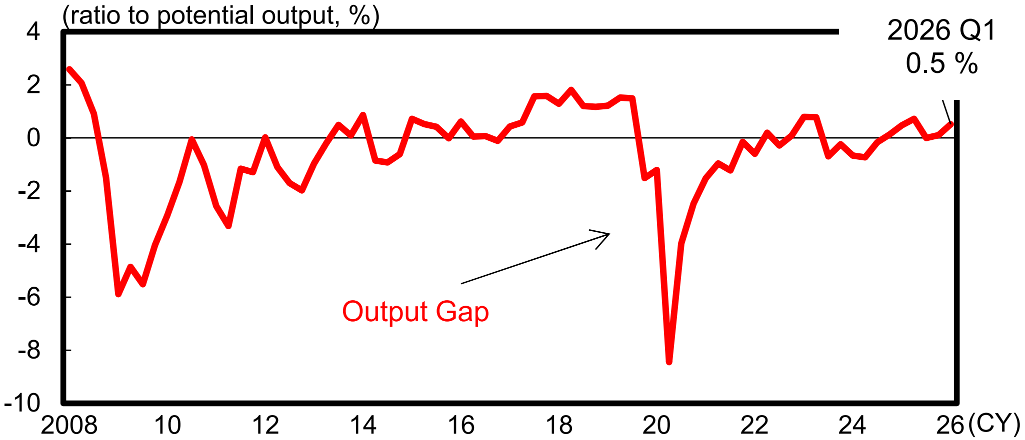
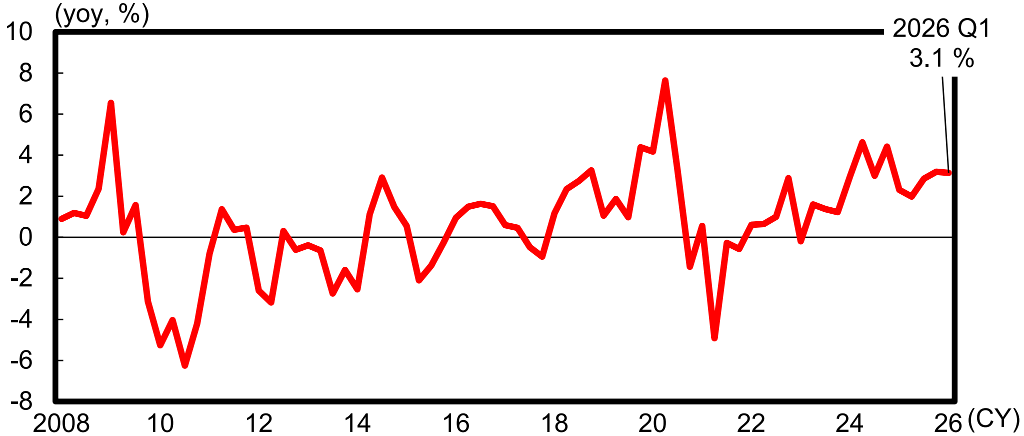


Figure 4. Unit labor cost



(Sources): Cabinet Office and Ministry of Internal Affairs and Communications

1-2: Trends in economic activity(1)

- The Japanese economy has continued to recover gradually, despite some fluctuations since the downturn caused by the COVID-19 pandemic. Real GDP grew for the second consecutive year in 2025, supported by private consumption and business investment. Continued wage growth has raised disposable income and underpinned steady consumption.
- Tensions in the Middle East initially weighed on the production of petroleum-related products, but production bottomed out and rose in May. Corporate profitability is improving. Firms maintain a strong appetite for investment, with planned capital spending exceeding the historical average for the second consecutive year.

Figure 1. GDP

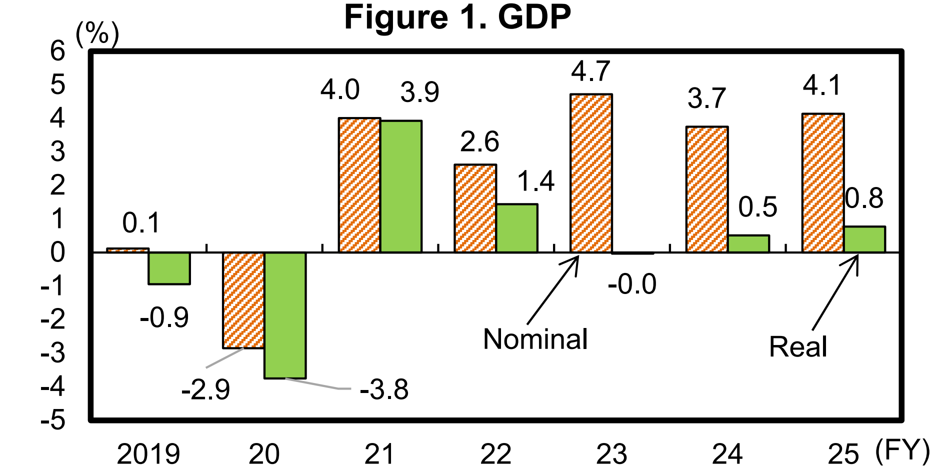


Figure 2. Household's Consumption and disposable income

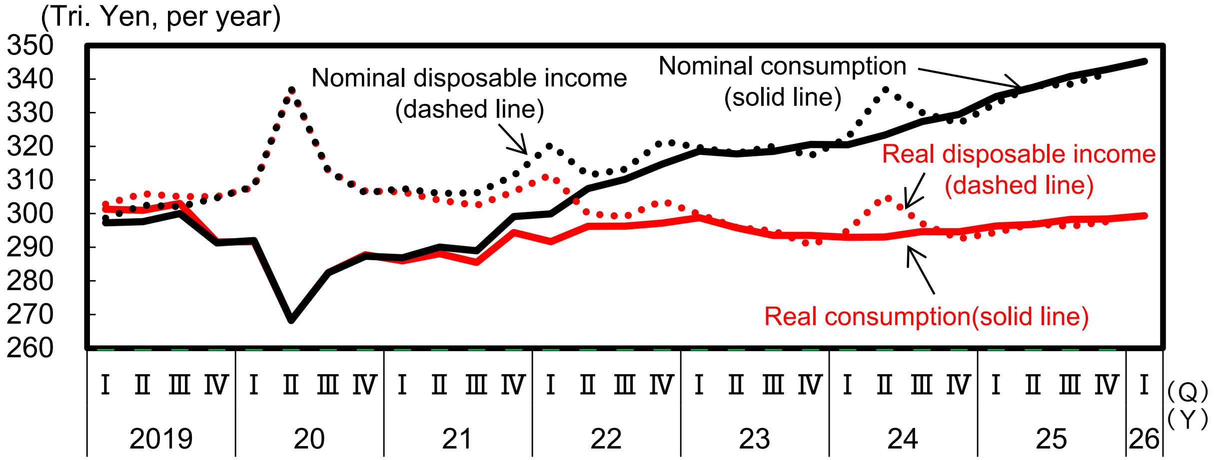


Figure 3. Production and corporate profit

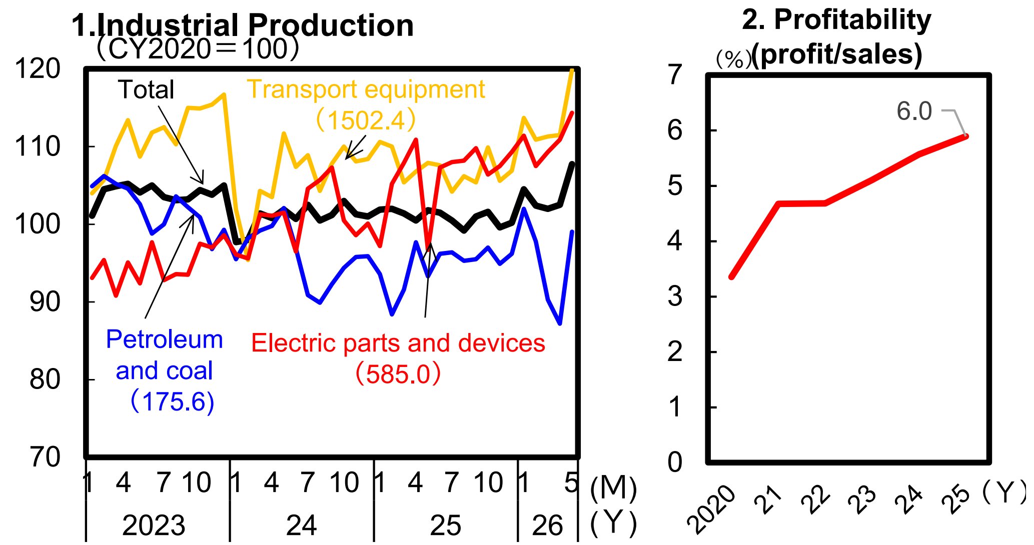
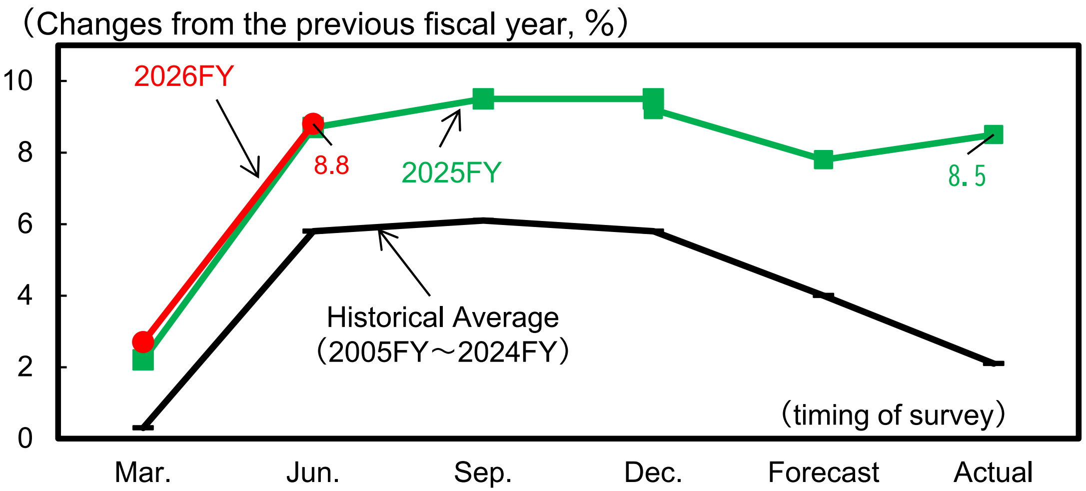


Figure 4. Planned investment



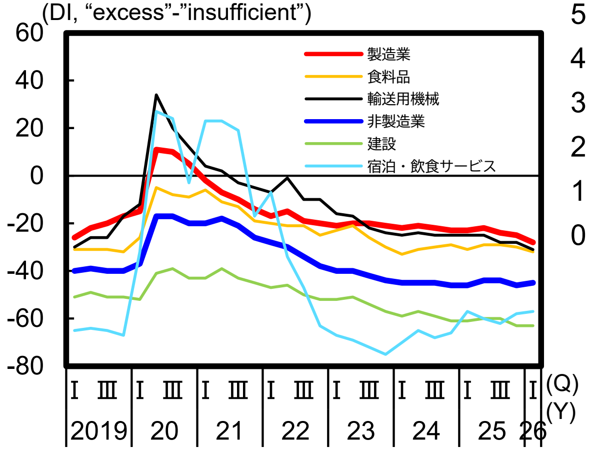
(Source) Cabinet Office, Ministry of Economy, Trade and Industry, Ministry of Finance, Bank of Japan

1-2: Trends in economic activity(2)

- The employment conditions DI indicates a continued labor shortage. While sectors such as construction and nursing care face severe labor shortages, with job openings exceeding the number of job seekers, job seekers outnumber vacancies in clerical occupations, pointing to a mismatch between labor supply and demand.
- Imports of crude oil and related goods from the Middle East have declined significantly, while procurement from alternative sources, including the U.S., is progressing. Despite weaker trade with the Middle East, trade with Asia, the U.S., and other regions remains steady. Demand for AI-related goods continues to support robust trade, leading to the stock prices on an upward trend.

Figure 1. Labor shortage

1. DI for labor shortage (by sector)



2. Job openings ratio (by job type)

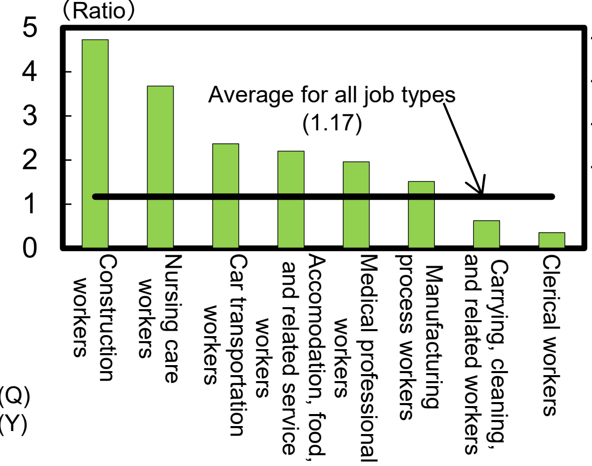
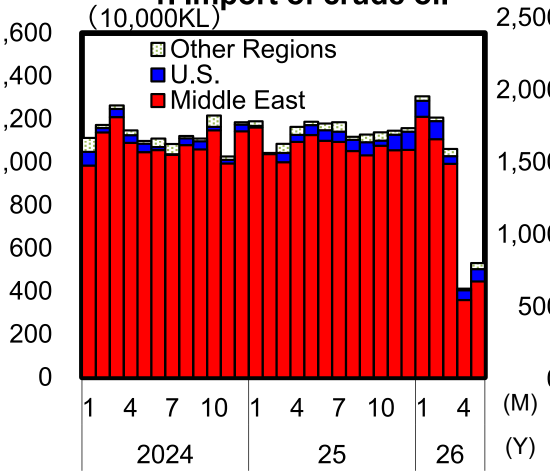


Figure 2. Procurement for crude oil and related products (by country)

1. Import of crude oil



2. Import of naphtha

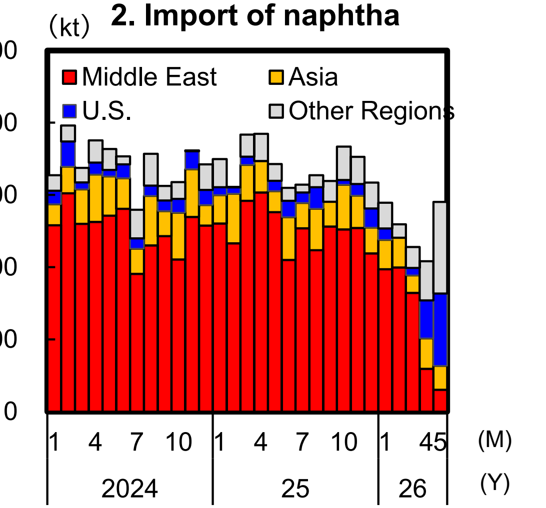
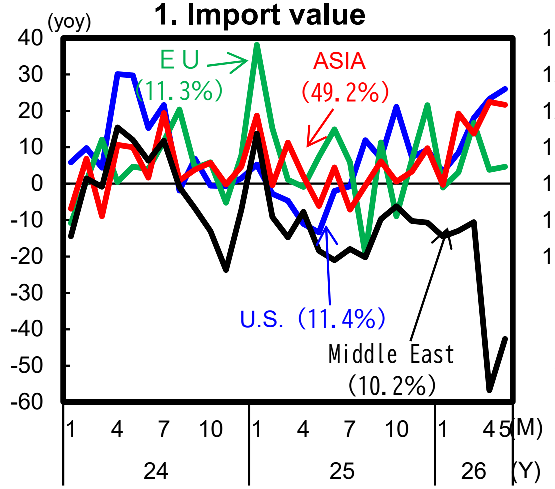


Figure 3. Export and Import by region

1. Import value



2. Export volume

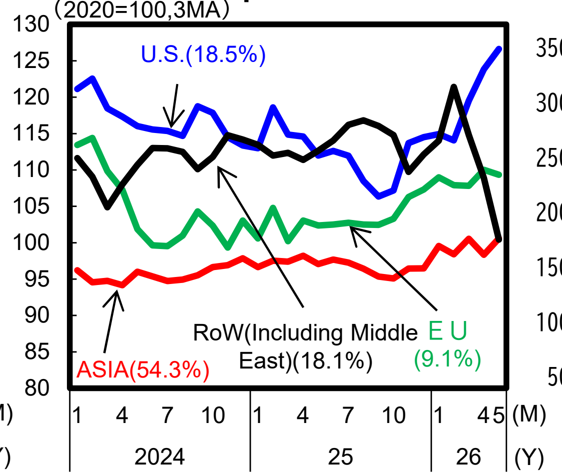
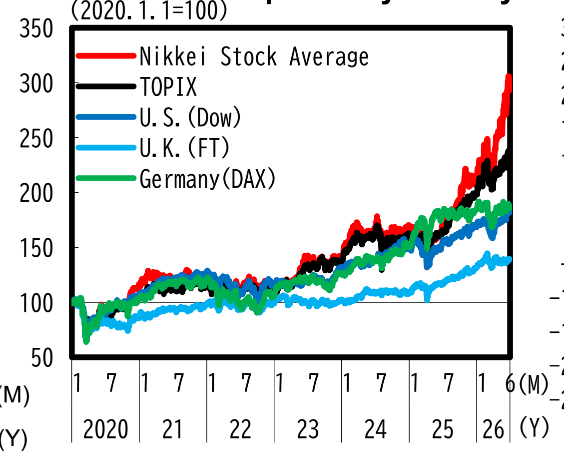
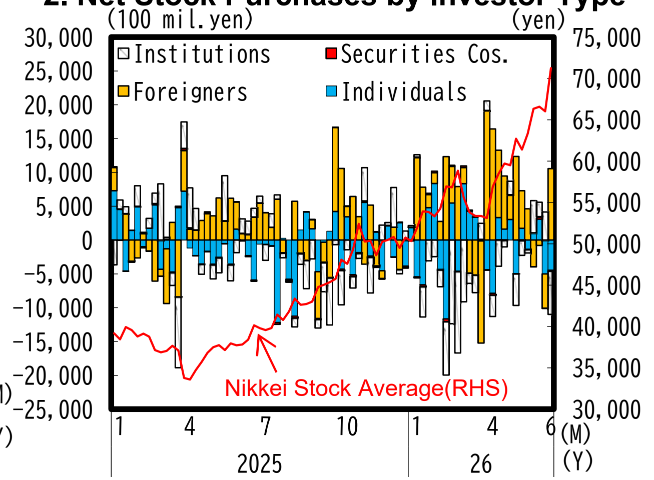


Figure 4. Stock market

1. Stock prices by country



2. Net Stock Purchases by Investor Type



(Source) Bank of Japan, Ministry of Health, Labour and Welfare, Ministry of Finance, Ministry of Economy, Trade, and Industry, Bloomberg

2-1: Effects on households by economic structure with responsive wages, prices, and interest rates

- As the economy transitions toward a structure with responsive wages, prices, and interest rates, the share of equities and investment funds in household financial assets continues to rise, driven primarily by valuation gains. Income from financial assets as a share of disposable income has also been increasing.
- Estimates based on historical deposit-lending rate spreads suggest that rising interest rates adversely affect households in their 40s or younger on net, but benefit those in their 50s or older. The difference largely reflects age-related differences in mortgage holdings and outstanding loan balances.

Figure 1. Share in household's financial asset

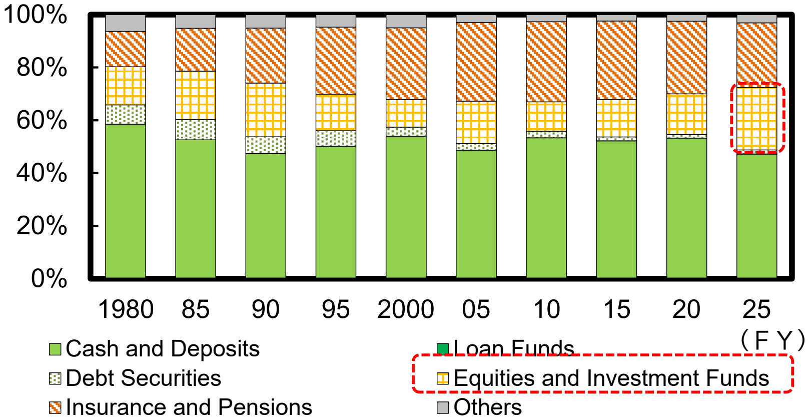


Figure 2. Value of stock in household

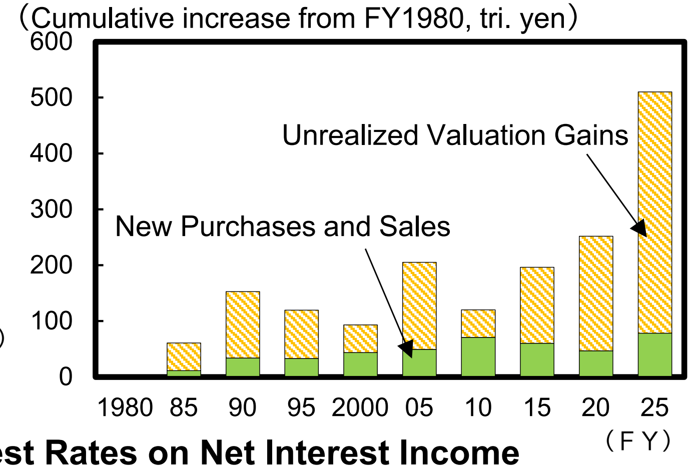


Figure 3. Income from financial asset and disposable income

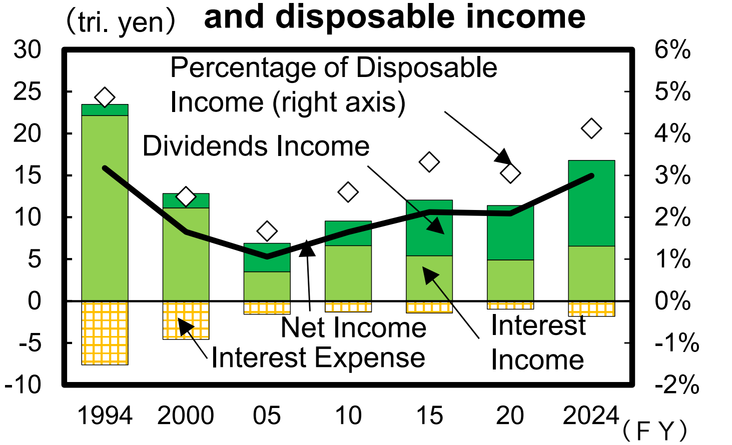
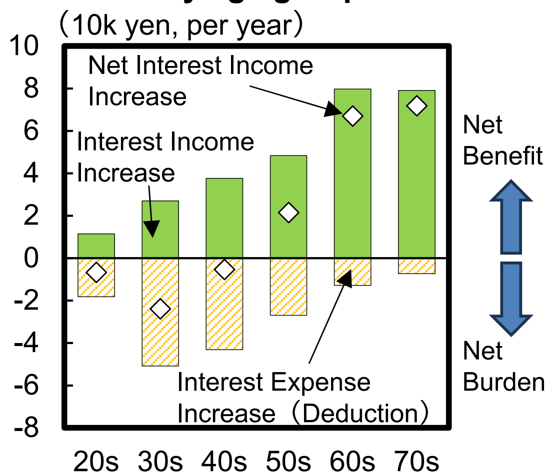


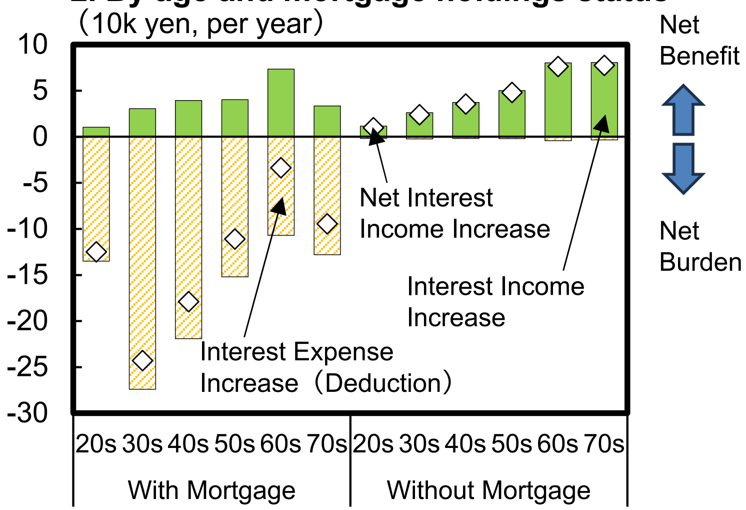
Figure 4. Impact of Higher Interest Rates on Net Interest Income

Assumption: Lending rates rise by 1.0 %pt and deposit rates by 0.6 %pt.

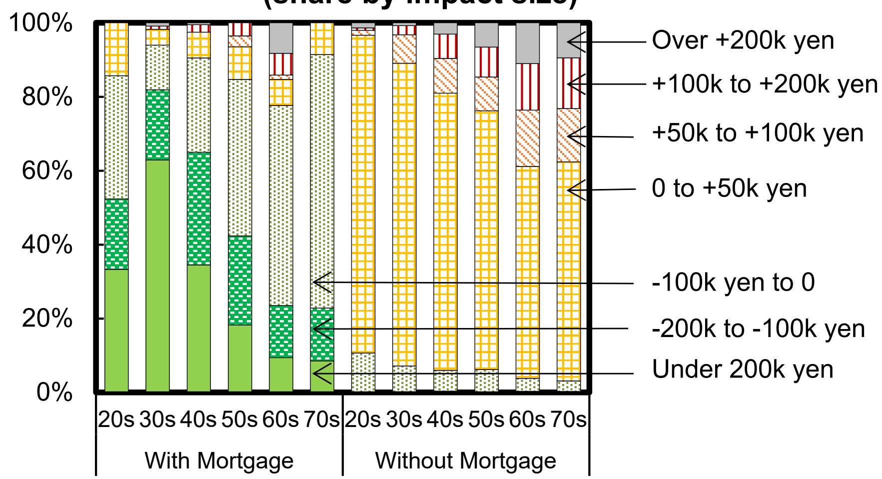
1. By age group



2. By age and mortgage holdings status



3. By age and mortgage holdings status (share by impact size)



(Sources): Cabinet Office, Bank of Japan, J-FLEC

2-2: Changes in labor demand and effects on labor markets(1)

- Demand for clerical workers has long remained relatively stable, but there are signs that AI is beginning to substitute for some of their tasks, particularly routine work. Many firms, especially in the financial and information technology sectors, report benefits from AI adoption, including improved operational efficiency.
- A key challenge for Japan's labor market is weak wage growth in nonclerical workers, particularly in the service sector where labor shortages are severe. Flatter wage profiles provide limited incentives for workers to remain in these occupations. Making their wage structures more attractive, especially to younger workers, is a key task.

Figure 1. Changes of share in employees, by job type

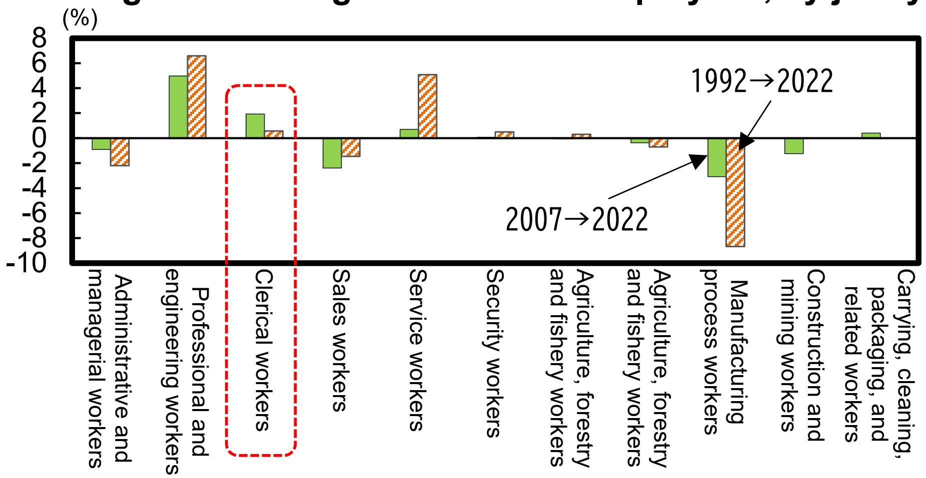


Figure 2. Tasks for introducing/planning to introduce AI (2026)

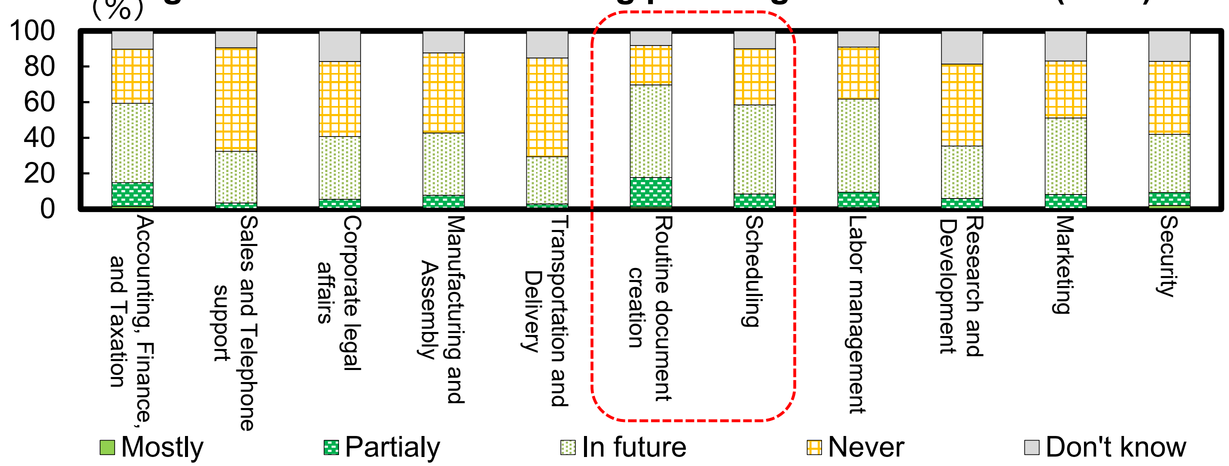
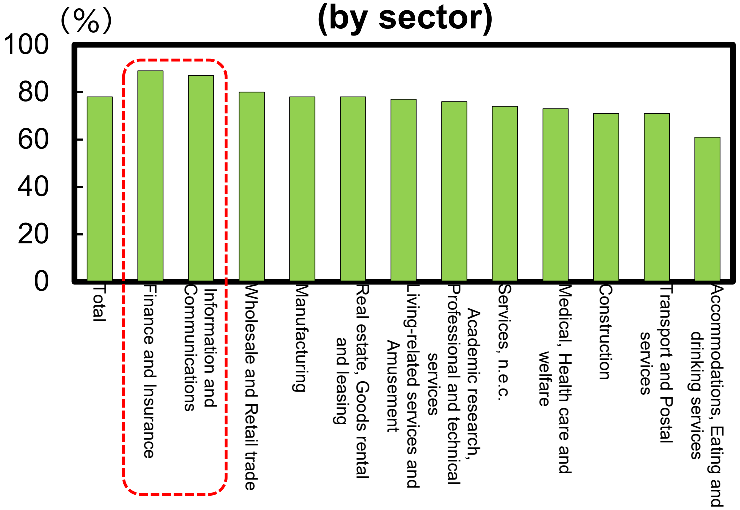


Figure 3. Share of firms reporting benefits from AI (by sector)



4. Wage profiles by job type

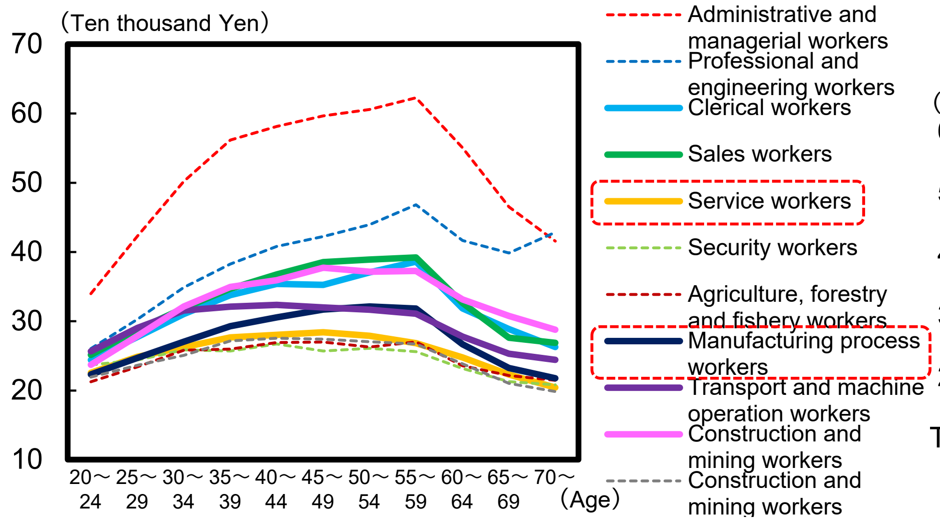
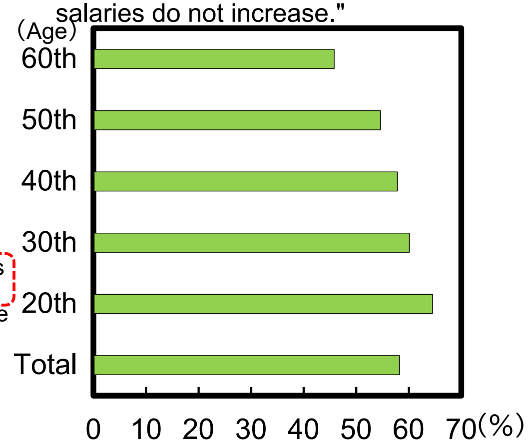


Figure 5. Future wage and choice for jobs

The percentage of respondents who answered "No" to the question, "Do you want to stay long at a company where salaries do not increase."



(Sources): Cabinet Office, Ministry of Internal Affairs and Communications, Ministry of Health, Labour, and Welfare, PERSOL RESEARCH AND CONSULTING Co

2-2: Changes in labor demand and effects on labor markets(2)

- The share of elderly job seekers among "hello-work" users has been rising. The trend of younger people turning away from Hello Work is driven not only by relatively low wages offered in posted jobs but also by a low share of IT-related job openings, which are mainly posted in online advertisements managed by private sector.
- Estimation results suggest that vacancies offering higher wages or benefits, such as childcare leave and training opportunities, are more likely to be filled. As labor demand changes, wage adjustments should facilitate labor mobility toward the occupations with strong demand.

Figure 1. Job seekers in hello-work (share by age)

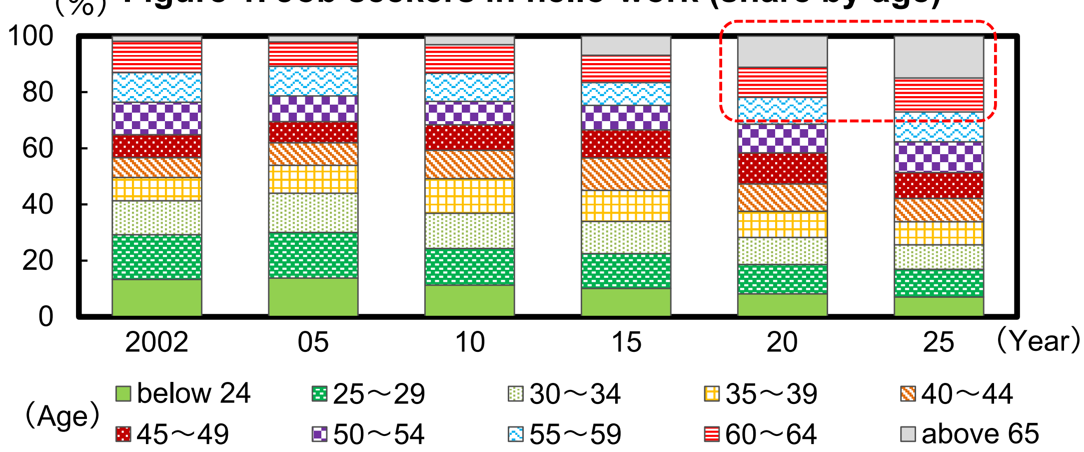


Figure 2. Offered wages in posted jobs (regular worker, 2025)

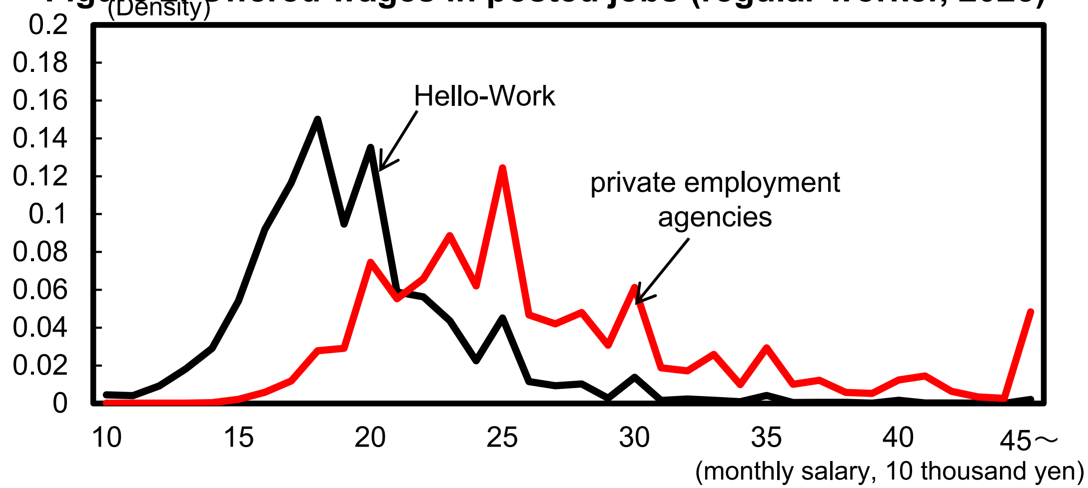


Figure 3. IT related job openings
(share of jobs including related words in job description)

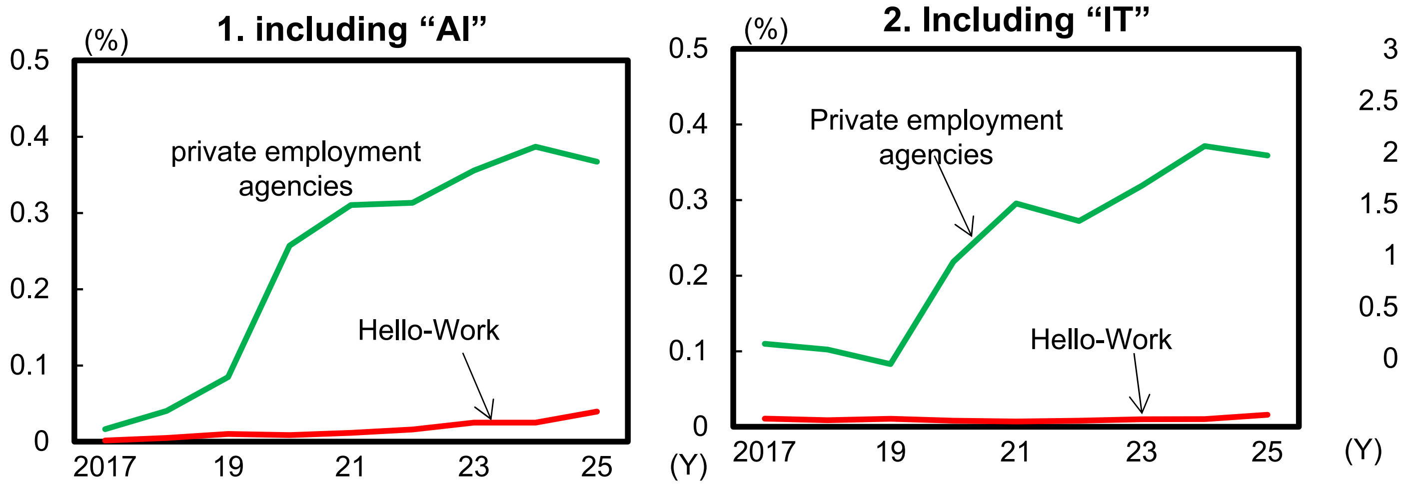
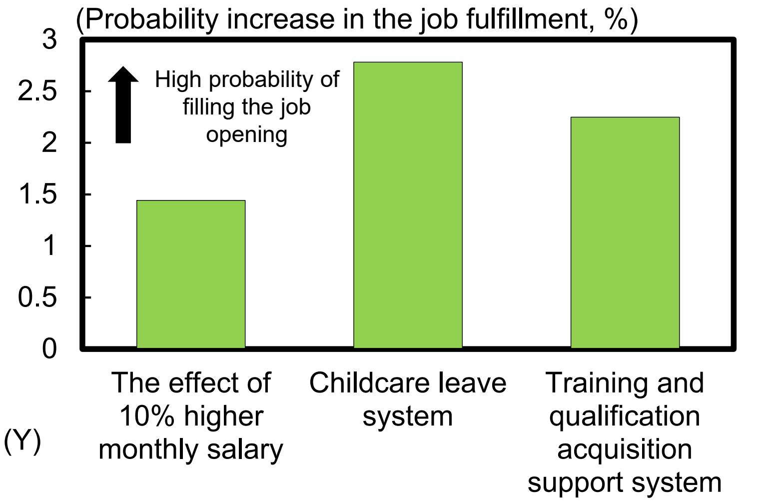


Figure 4. Elements on filling job openings



(Sources): Ministry of Health, Labour, and Welfare, HRog Co., Ltd.

2-3: Worker's choice of time allocation and labor markets(1)

- While scheduled working hours for full-time employees are concentrated around certain lengths, particularly eight hours per day, ideal working hours vary considerably. If more flexible working arrangements, including reduced-hours schedules, become widely available, more workers may be willing to take regular full-time positions.
- Longer working hours are associated with lower satisfaction with one's health and less perceived free time. However, estimation results suggest that their direct impact on overall happiness is limited. Flexible working-time arrangements should therefore be designed with due consideration to both workers' health and individual preferences.

Figure 1. Scheduled working hours for full-time employees

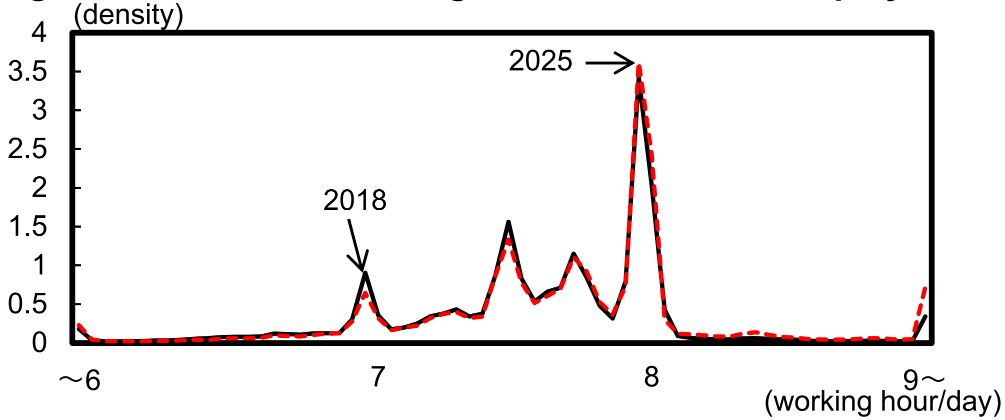


Figure 2. Distribution of ideal working hours

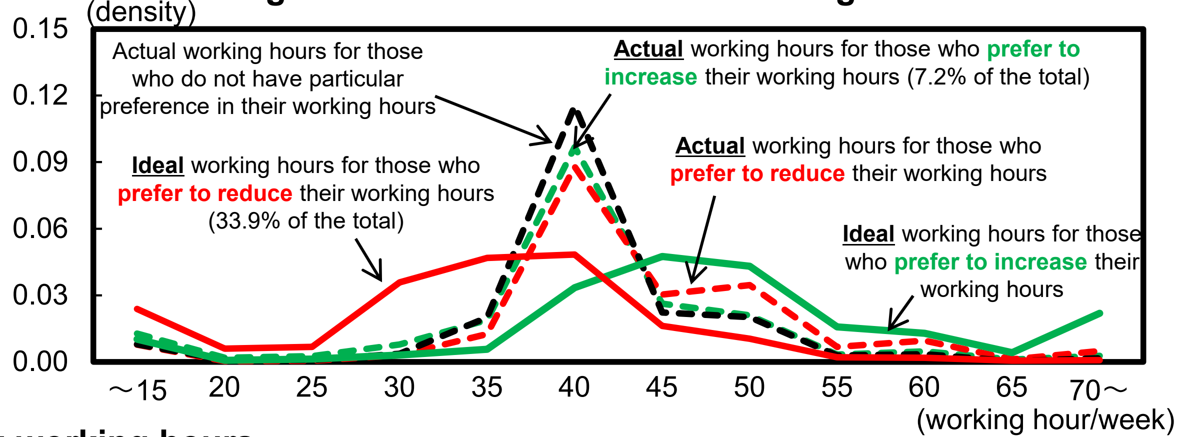
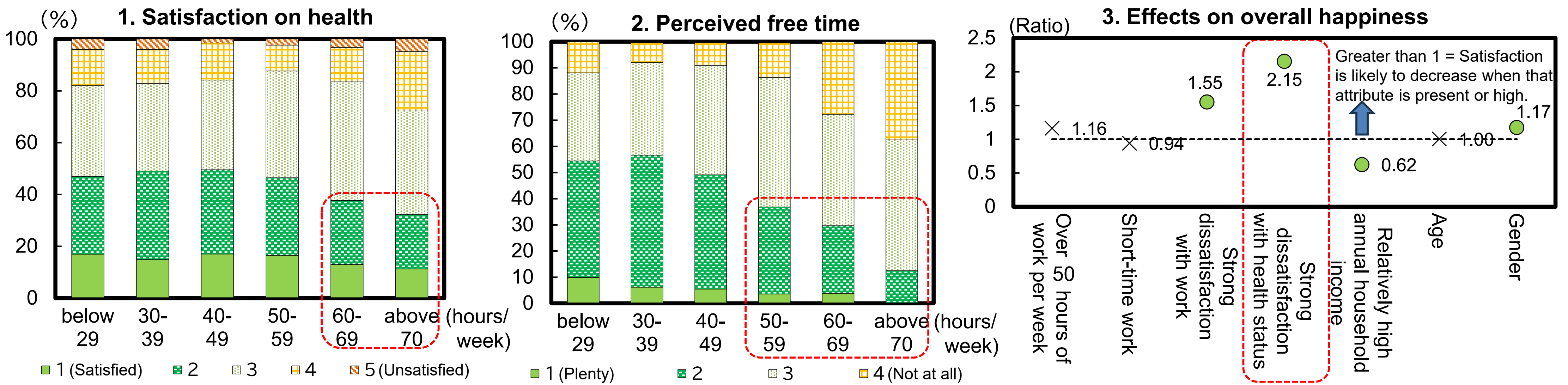


Figure 3. Impact of long working hours



(Sources): Ministry of Health, Labour, and Welfare, RECRUIT Works Institute, Japanese General Social Surveys (JGSS)

2-3: Worker's choice of time allocation and labor markets(2)

- Part-time workers tend to seek jobs closer to home than regular employees. Preferences for the combined total of commuting and working hours vary less than preferences for working hours alone, suggesting that commuting time also plays an important role in labor supply decisions.
- Labor market concentration, measured by geographic commuting zones based on actual commuting patterns and defined separately by occupation, tends to be higher in rural areas. Particularly for part-time workers, offered wages tend to be lower in more concentrated labor markets. Minimum wage increases may help mitigate the adverse effects of labor market concentration, especially in rural areas.

Figure 1. Working place by sector and employment type

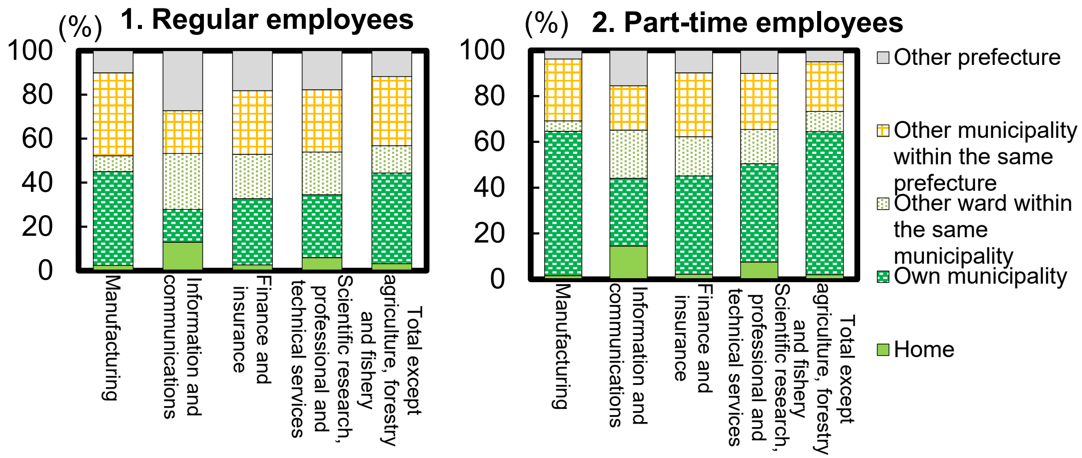
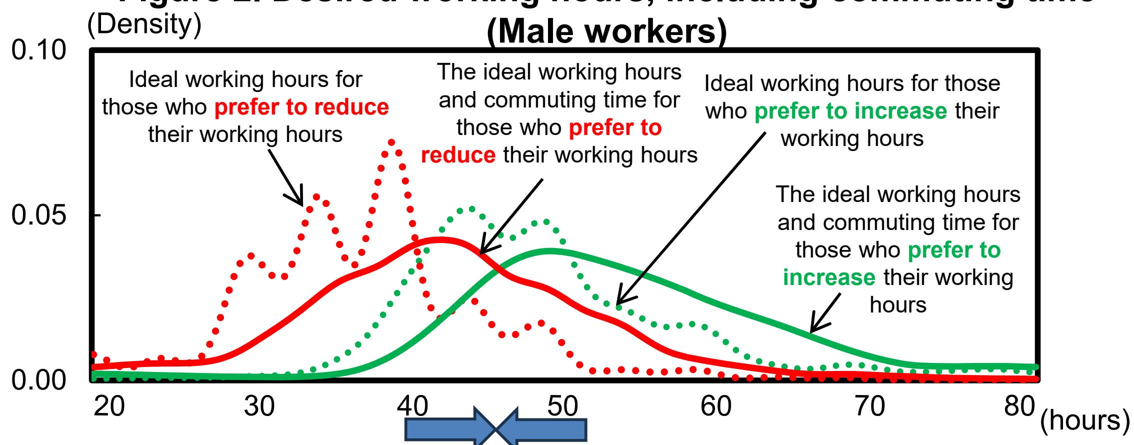


Figure 2. Desired working hours, including commuting time



The distribution represented by the solid line (including commuting time) is more centrally concentrated than that of the dotted line (working hours only). This suggests the possibility that workers view their commuting time as part of their working hours and the preference for working hours includes commuting hours.

Figure 3. Labor market concentration by prefecture

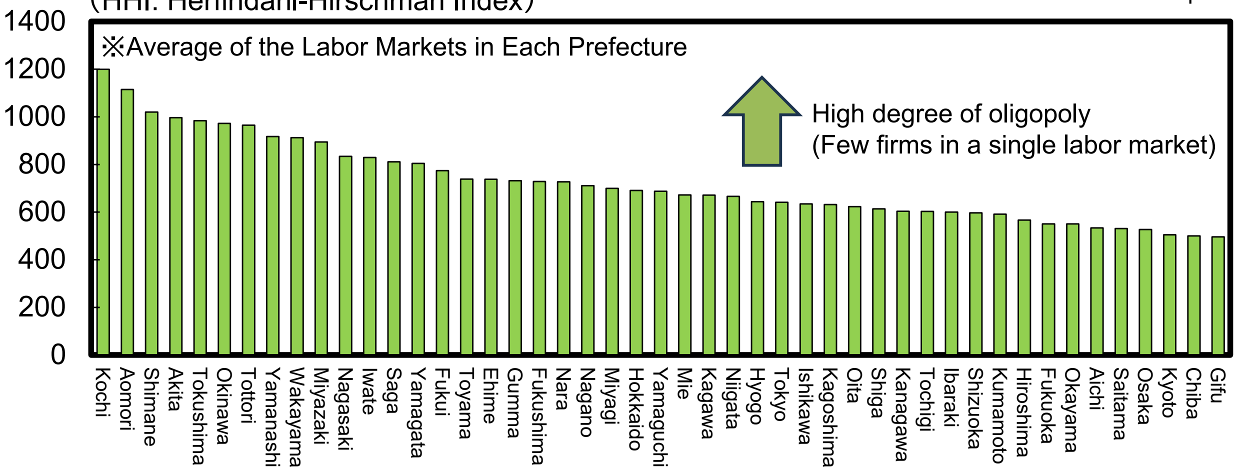
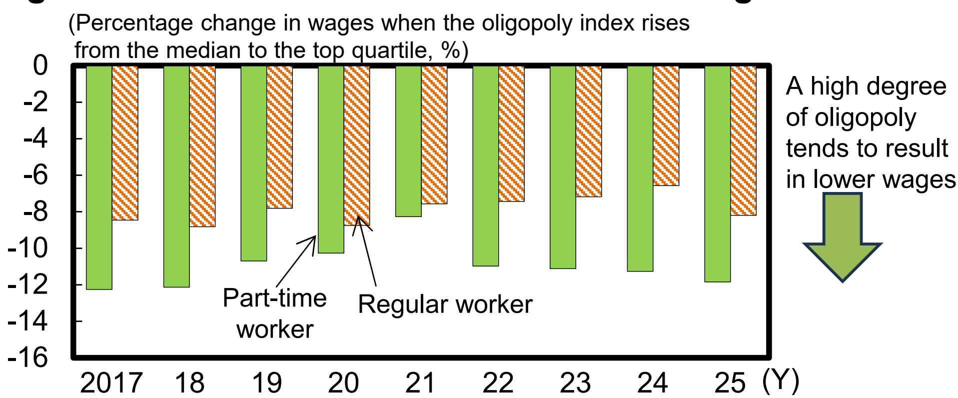


Figure 4. Labor market concentration and wage level



(SourcesMinistry of Internal Affairs and Communications, RECRUIT Works Institute, HRog Co., Ltd.

3-1: Signs of changes in corporate behavior

- Japan has experienced persistently low economic growth since the collapse of the bubble economy. This partly reflects intensified competition from China and other countries, as well as limited competitiveness in cutting-edge technologies.
- Corporate behavior also became more cautious, contributing to a prolonged period of deflation and economic stagnation. As inflation rate began to rise around 2022, business sentiment improved. A key challenge is whether these signs of change will translate into more proactive corporate behavior, including capital investment.

Figure 1. International comparison of GDP

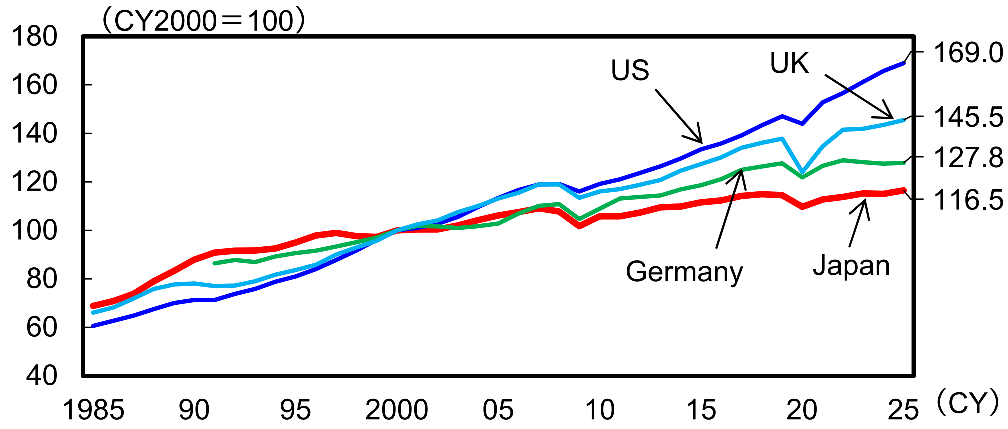


Figure 2. Exports by major countries

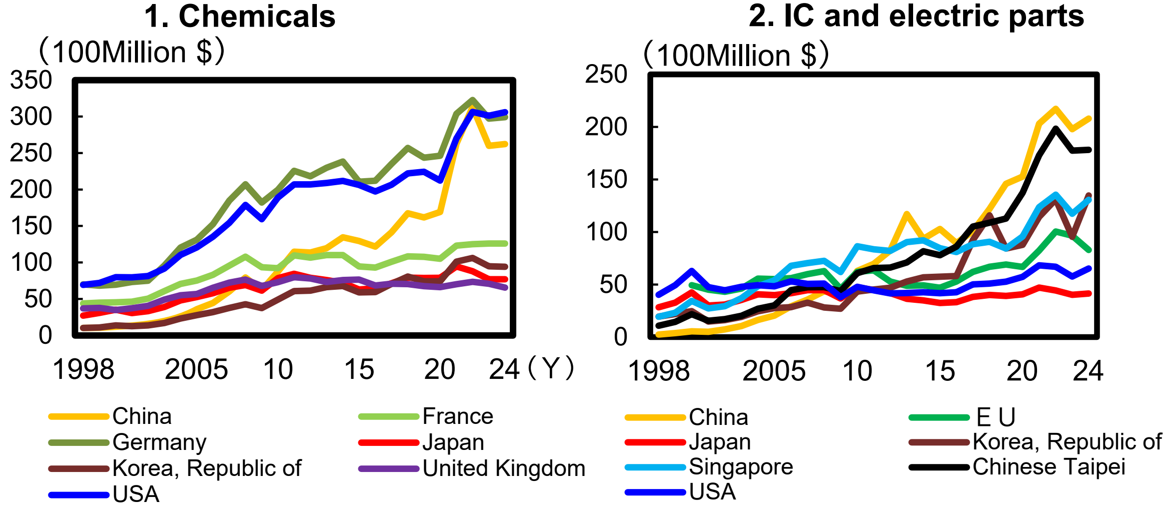


Figure 3. Expenditure of firms

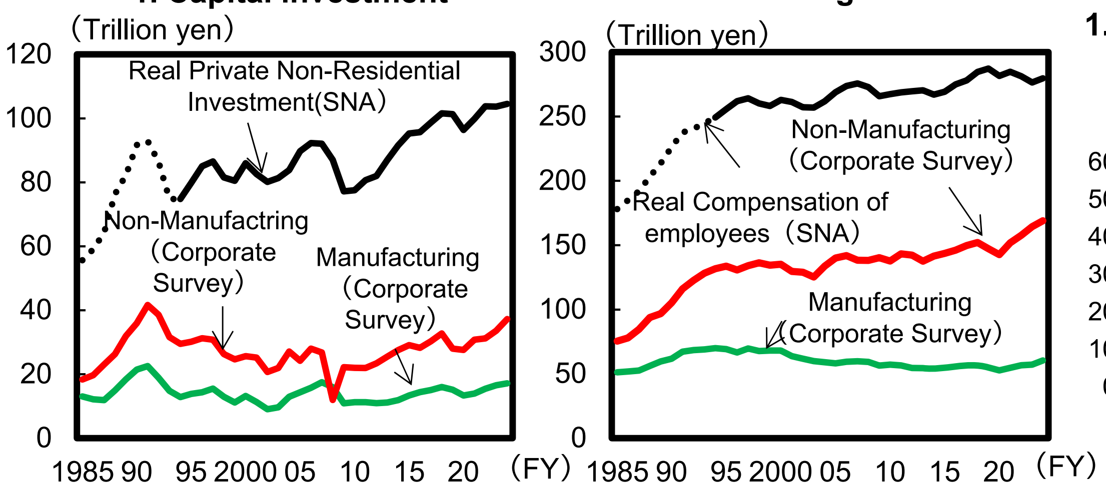
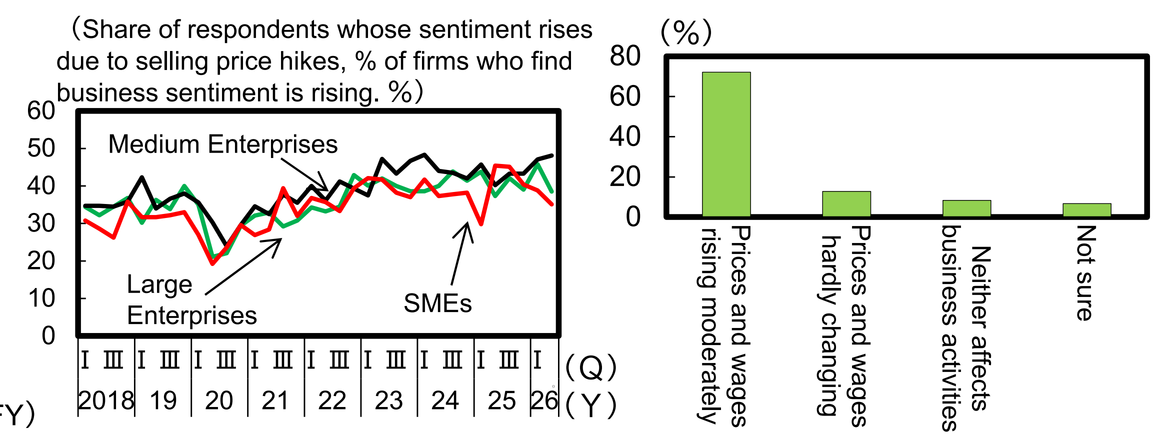


Figure 4. Firm's sentiment and trend in price



(Source) OECD, Ministry of Finance, WTO, Cabinet Office, Bank of Japan.

3-2: Analysis on corporate balance sheets(1)

- Japanese firms have accumulated cash at a faster pace than debt, while remained reluctant to invest because of debt aversion and uncertainty about the economic outlook. This cautious stance may have constrained capital accumulation.
- Moreover, since the onset of the COVID-19 pandemic, a growing number of firms have increased both their cash holdings and borrowing. This suggests that substantial inefficiencies remain in the allocation of financial resources, both within individual firms and across the economy. Ensuring the effective use of these funds remains a key challenge.

Figure 1. Financial assets in firm's balance sheets

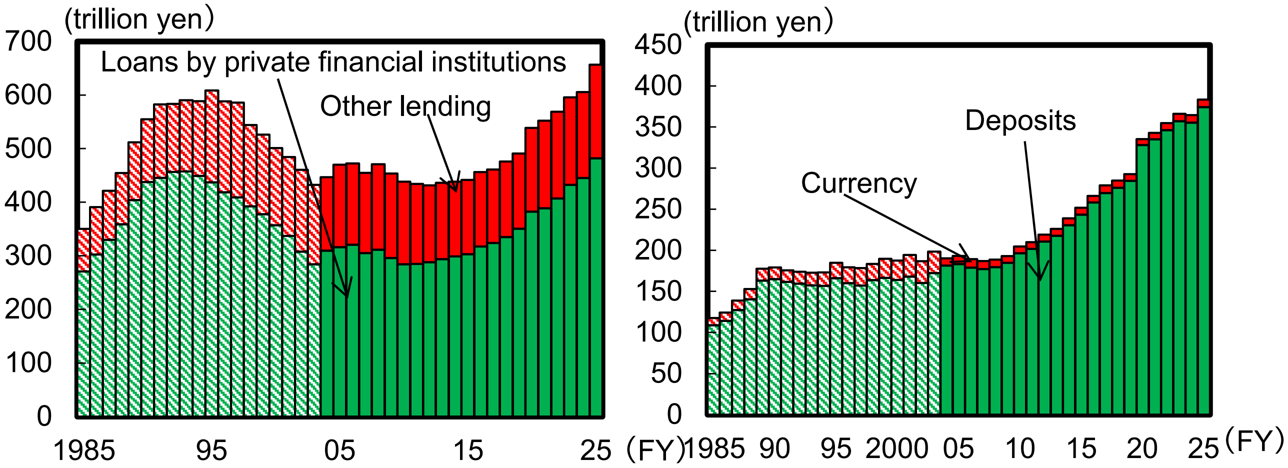


Figure 2. Fixed assets (share in firm's total asset)

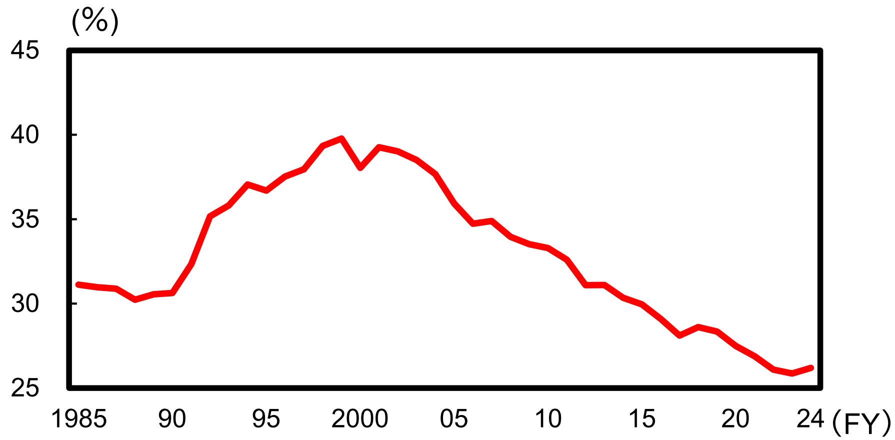


Figure 3. Motivation for holding cash

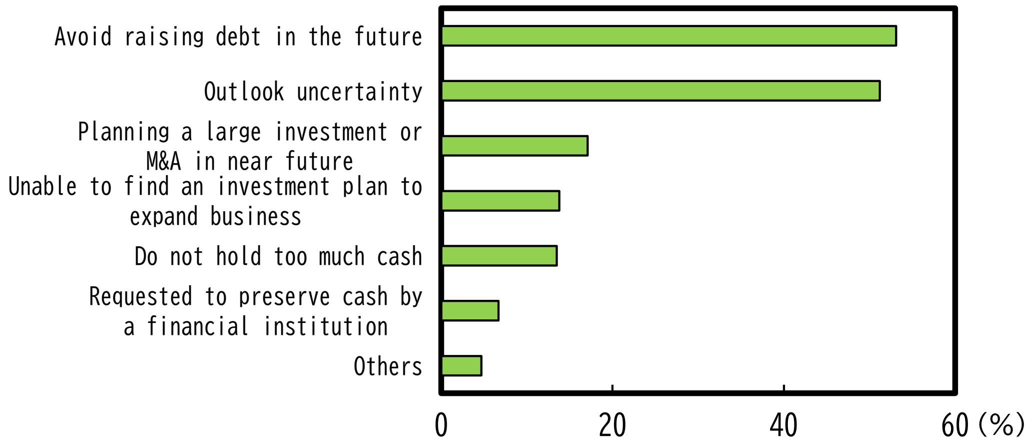


Figure 4. Cross-tabulation for cash and borrowing (per sales value)

1. Change from FY 2019 to 2021

Cash → ; Loan liabilities ↓ (%)

	0-10	11-20	21-30	31-40	41-50	51-60	61-70	71-80	81-90	91-100	Over100
0-10	-5.00	-2.37	-0.63	-0.54	0.00	0.05	0.15	0.12	0.17	0.17	0.82
11-20	-1.18	0.03	0.49	0.12	0.30	0.09	0.11	0.09	0.05	0.03	0.19
21-30	-0.96	[illegible]	0.40	0.51	0.30	0.26	0.12	0.11	0.05	0.03	0.25
31-40	-0.98	-0.15	0.12	0.44	0.13	0.14	0.10	0.08	0.06	0.03	0.16
41-50	-0.50	-0.07	0.05	0.27	0.30	0.13	0.15	0.08	0.04	0.07	0.11
51-60	-0.47	[illegible]	0.24	0.22	0.16	0.19	0.09	0.06	0.06	0.04	0.11
61-70	-0.24	-0.03	0.17	0.19	0.15	0.05	[illegible]	0.08	0.04	0.03	0.07
71-80	-0.21	0.03	0.04	0.13	0.05	0.08	0.04	0.04	0.07	0.04	0.08
81-90	-0.17	0.03	0.16	0.05	0.08	0.09	0.03	0.04	0.04	0.02	0.10
91-100	-0.14	0.01	0.01	0.07	0.08	0.03	0.04	0.05	0.05	0.03	0.05
Over100	-0.18	-0.04	0.23	0.27	0.37	0.37	0.28	0.19	0.17	0.10	0.74

2. Change from FY 2019 to 2023

Cash → ; Loan liabilities ↓ (%)

	0-10	11-20	21-30	31-40	41-50	51-60	61-70	71-80	81-90	91-100	Over100
0-10	-3.49	-1.32	-0.24	-0.27	0.28	-0.08	0.09	0.36	0.11	0.05	1.31
11-20	-0.78	-0.02	0.42	0.15	0.17	0.12	0.10	0.02	0.03	0.05	0.20
21-30	-0.66	-0.21	0.18	0.33	0.14	0.18	0.07	0.06	0.01	0.03	0.08
31-40	-0.61	-0.12	0.18	0.20	0.08	0.11	0.02	0.08	-0.01	0.03	0.11
41-50	-0.33	0.03	0.15	0.21	0.10	0.00	0.08	0.06	0.02	0.03	0.07
51-60	-0.28	-0.03	0.03	0.19	0.07	0.09	0.05	0.02	0.04	0.03	0.03
61-70	-0.14	0.00	0.13	0.07	0.16	-0.01	[illegible]	0.05	0.01	0.01	0.06
71-80	-0.12	0.02	0.02	0.02	0.12	-0.02	0.01	0.01	0.04	0.01	0.01
81-90	-0.03	-0.02	0.06	0.01	0.01	0.05	0.03	0.02	0.03	0.02	0.03
91-100	-0.13	-0.03	0.01	-0.05	0.01	0.04	0.01	0.01	0.02	0.02	0.02
Over100	-0.08	0.00	0.06	0.12	0.28	0.07	0.18	0.05	0.02	0.05	0.45

(Source) Bank of Japan, Ministry of Finance, The Small and Medium Enterprise Agency.

3-2: Analysis on corporate balance sheets(2)

- Although long term interest rates faced by Japanese firms are rising, real interest rates remain negative, partly reflecting higher inflation expectations. Financial institutions also continue to take a more accommodative stance toward lending.
- The recent rise in interest rates has so far had only a limited impact on corporate earnings in total. However, it is important to closely monitor whether firms can maintain their strong investment appetite.

Figure 1. Interest rates faced by Japanese firms

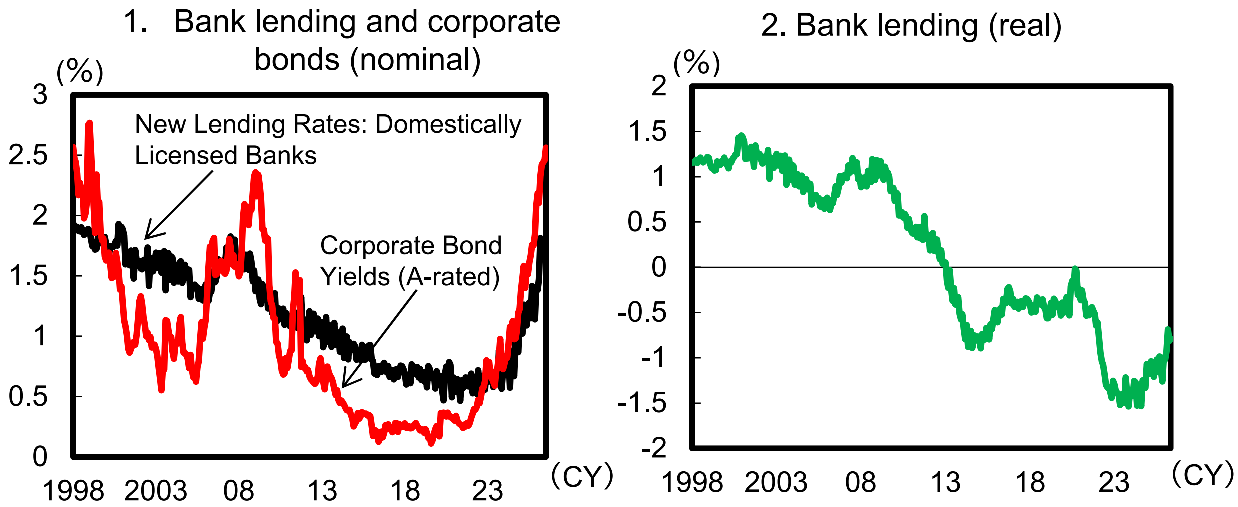


Figure 2. Financial institutes' stance towards lending

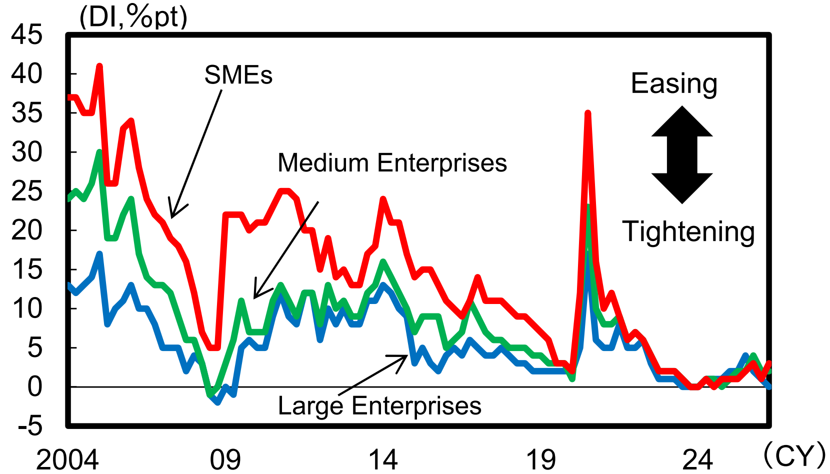


Figure 3. Impact on SMEs' earnings by interest rate rise

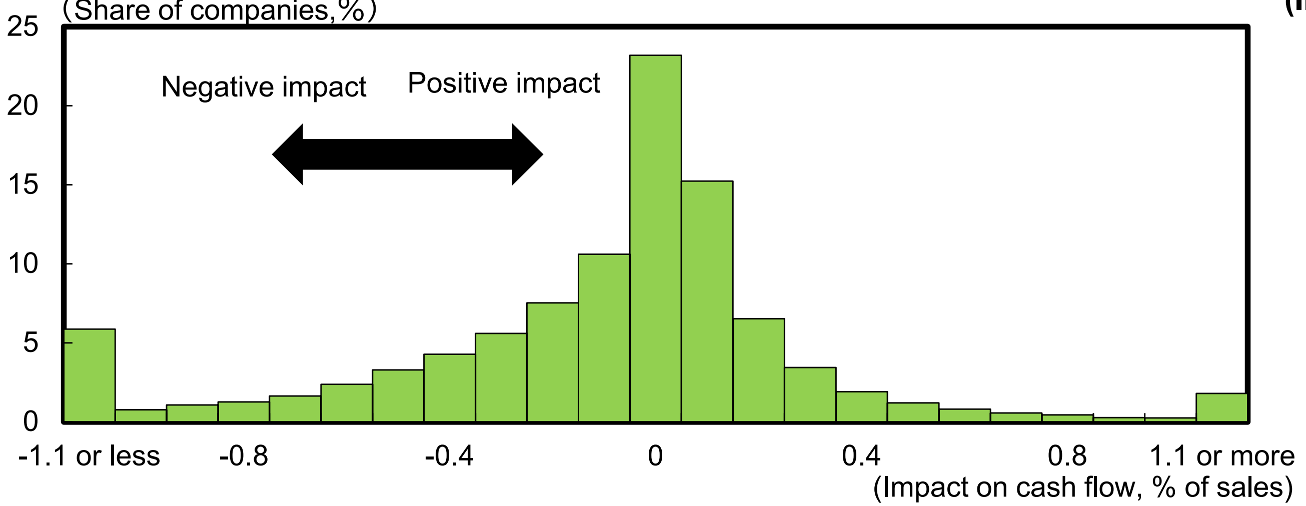
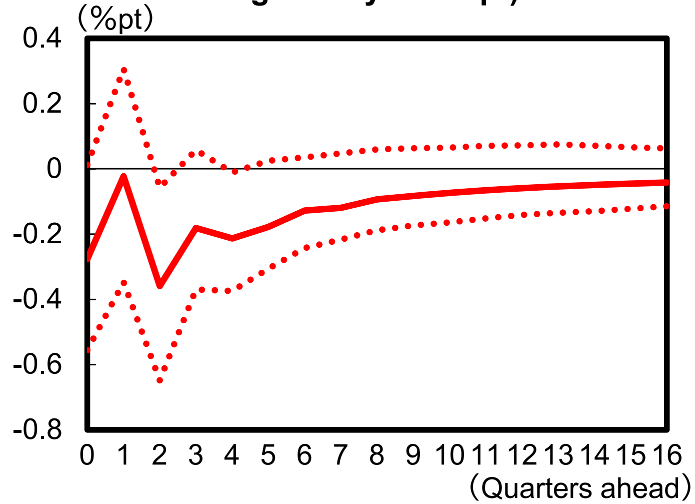


Figure 4. Impact on investment by interest rate rise (Impulse response of investment, for the shock of rising real lending rate by 0.25%pt)



(Source) Bank of Japan, The Small and Medium Enterprise Agency, Nakajima(2025), Bloomberg.

3-3: Moderate wage and price growth and expansion of capital investment(1)

- Firms expecting stronger economic growth or moderate inflation tend to be more proactive in capital investment. Greater progress in cost pass-through is also associated with more active investment.
- To expand investment and stimulate economic growth, it is important to foster expectations of moderate inflation and create an environment in which firms can pass on higher costs. In particular, the survey finds a positive relationship between the ability to pass on higher labor costs and proactive capital investment.

Figure 1. Expected growth and capital investment

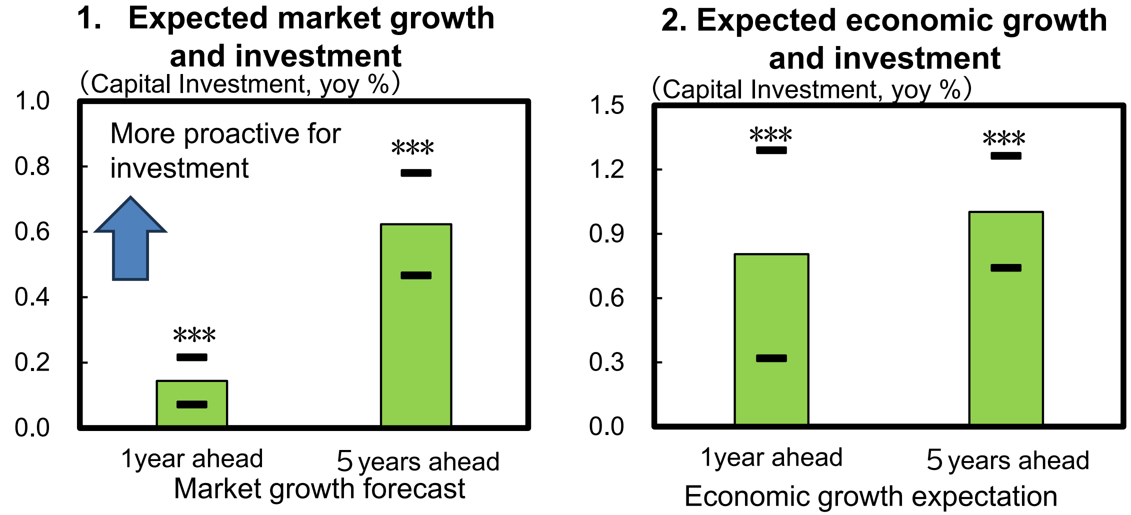


Figure 2. Expected inflation and capital investment

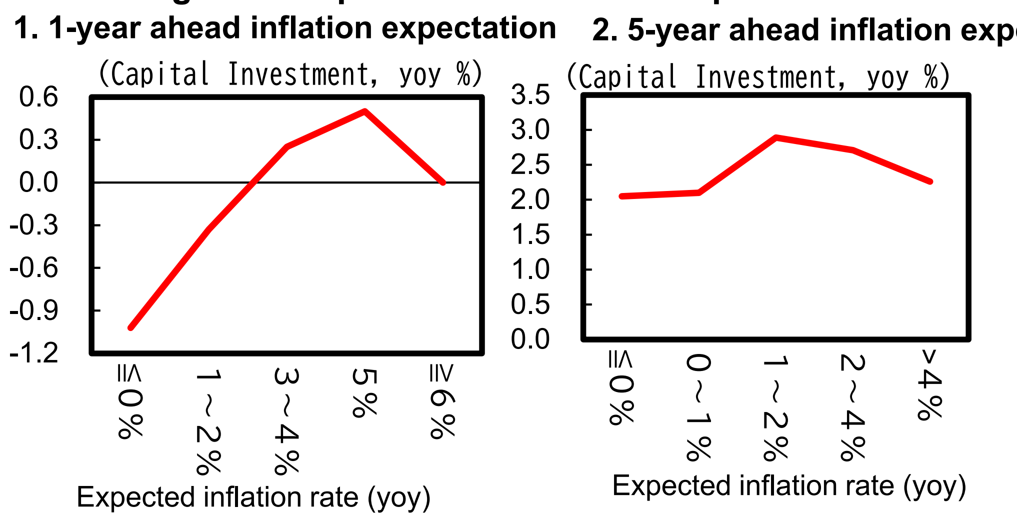
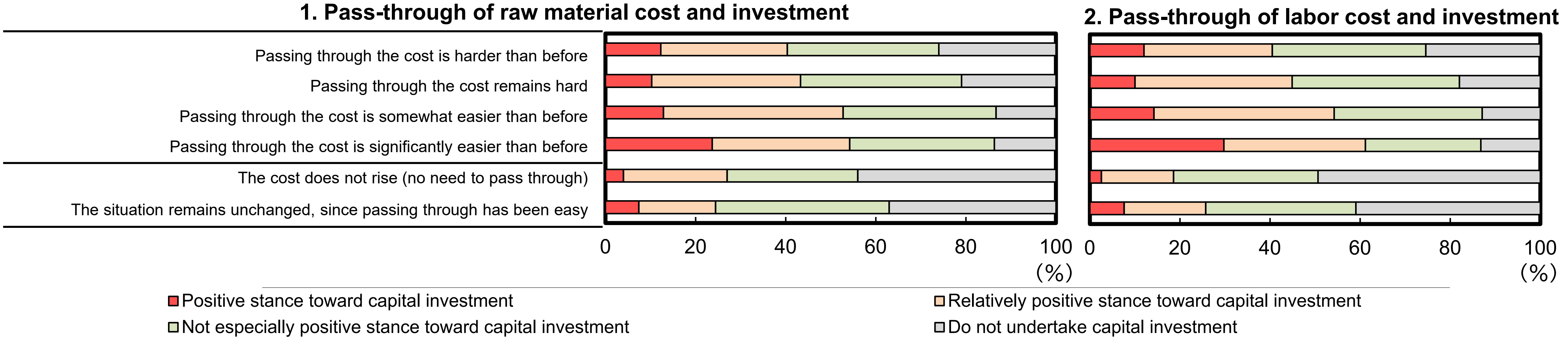


Figure 3. difficulty in cost pass-through and investment



(Source) Cabinet Office.

3-3: Moderate wage and price growth and expansion of capital investment(2)

- Many firms have inactive equipment because of labor shortages. As employee compensation often takes priority over capital investment, Firms should strengthen profitability for pushing up wage and investment. Further innovation among firms is expected to improve national productivity.
- Innovation should be promoted to secure a position in promising markets by making use of strong research capability in natural science in Japan.

Figure 1. Equipment that cannot fully utilized because of labor shortages

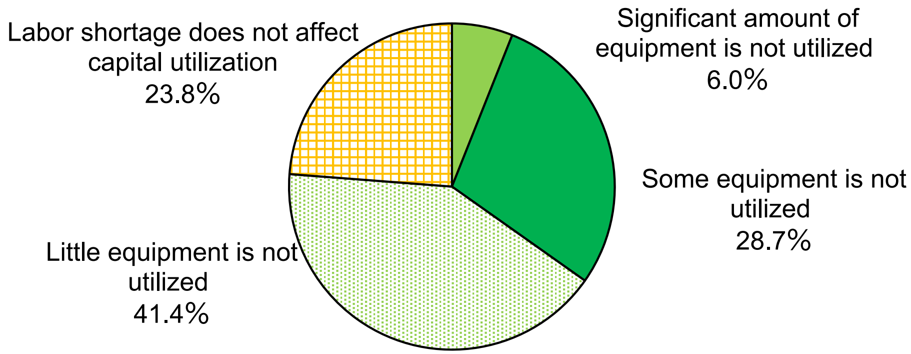


Figure 2. Factors with higher priority over capital investment

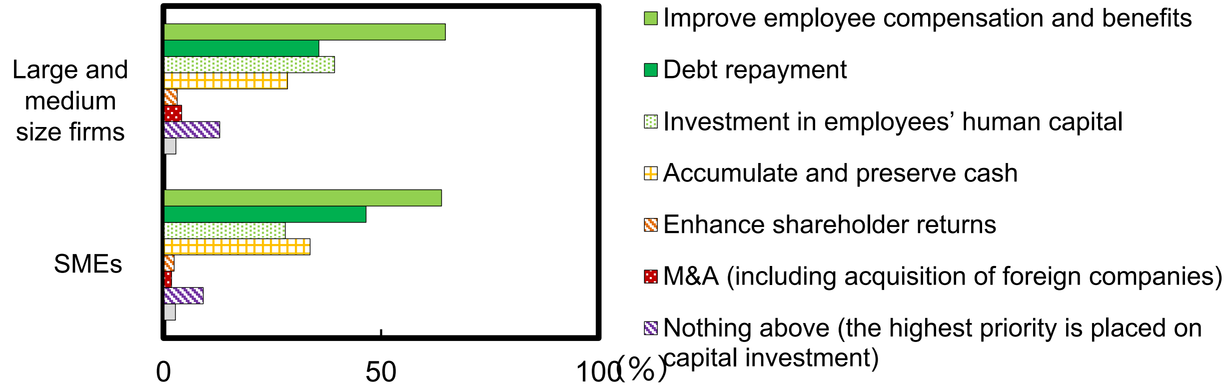


Figure 3. Strength in research activity (international ranks, by fields)

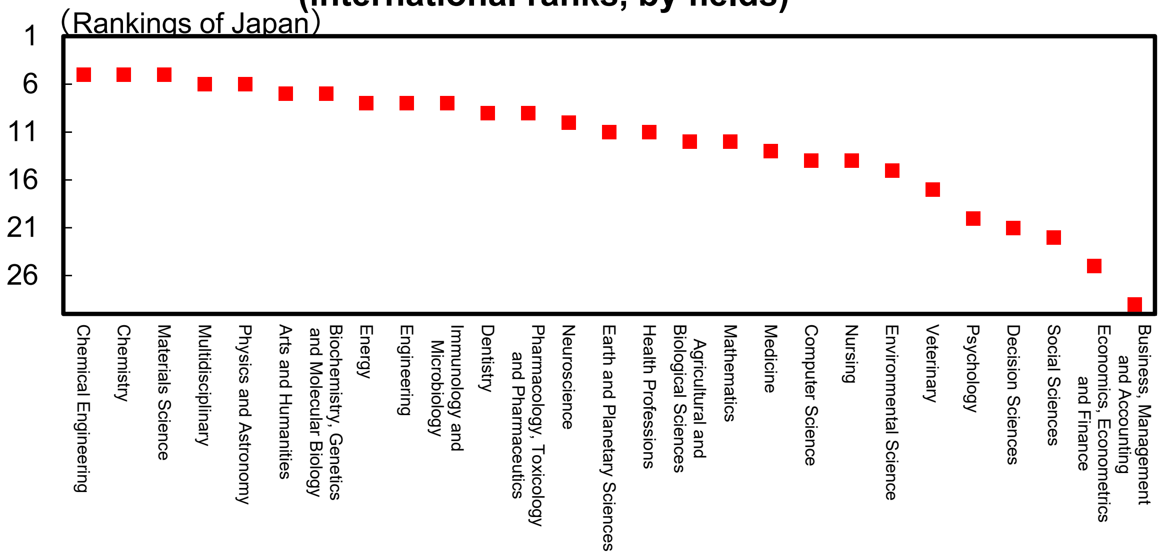
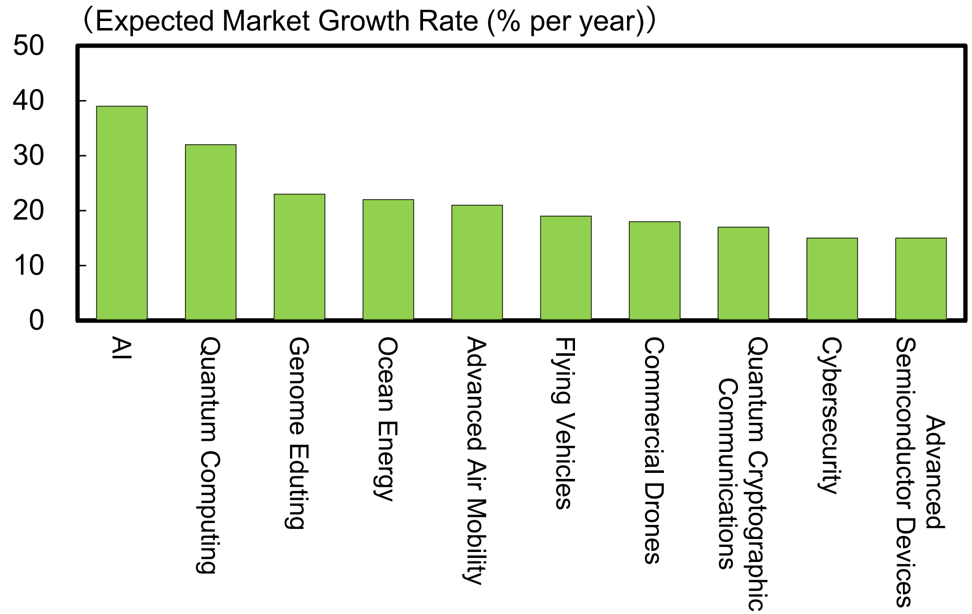


Figure 4. Sectors expected to have market growth in the future



（Source）Cabinet Office, Scientific Journal Rankings.