

High-pressure economy is no solution for Japan today

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Executive Summary

With demographics constraining the Japanese economy's supply capacity, Japan may not be able to capitalize on growth opportunities. The Takaichi Government's plan to run a "high-pressure economy" by boosting demand through fiscal expansion poses a risk of merely exacerbating cost-push inflation and financial market volatility.

Why former Fed chair Yellen revived "high-pressure economy" narrative

Upon assuming power last October, Prime Minister Sanae Takaichi's government pivoted to expansionary fiscal policy under the banner of "responsible fiscal activism." Takaichi favors accommodative monetary policy as well. Her macroeconomic policy stance reflects a high-pressure economy concept advocated by certain thought leaders in Japanese policy circles.

According to briefing materials prepared by private-sector advisors to the Council on Economic and Fiscal Policy, a high-pressure economy is characterized by strong growth, buoyant employment and high aggregate demand. During high-pressure economic phases, investment growth, rising wages and increased labor mobility are supposed to drive productivity gains and expansion of the economy's supply capacity. These advisors apparently believe that if the government can boost demand through fiscal policy, even today's Japanese economy would embark on a more robust growth trajectory. However, it is questionable whether such a high-pressure approach is really the right remedy for what currently ails the Japanese economy.

NOTE

¹⁾ For example, see Arthur M. Okun, "Upward Mobility in a High-pressure Economy," *Brookings Papers on Economic Activity*, 1973(1), 207-261.

²⁾ Janet L. Yellen, "Macroeconomic Research After the Crisis," 60th annual economic conference sponsored by the Federal Reserve Bank of Boston, Boston, Massachusetts, October 14, 2025.

The idea of running a high-pressure economy dates back to the late 1950s and was discussed through the early 1970s¹. Nearly a half century later, it regained currency after then Fed Chair Janet Yellen used the term in an October 2016 speech². What prompted Yellen to revisit the idea at that time? Back then, a full eight years after the 2008 GFC, Yellen presumably felt that the GFC's repercussions were still weighing heavily on not only aggregate demand but also the supply side of the US economy, with the labor market mired in a sluggish recovery and businesses scrimping on capex and R&D spending. Given such an economic backdrop, Yellen likely thought that artificially boosting demand

temporarily could catalyze a rebound in supply capacity and, in turn, sustainably revitalize the US economy.

In Japan today, however, the economy and, more specifically, the labor market differ from the US circa 2016 and even from Japan in the late 1990s. The supply side of the Japanese economy is now heavily constrained by a severe, protracted labor shortage rooted in adverse demographic trends.

In the BOJ's December 2025 Tankan business survey, the Employment Conditions Diffusion Index (ECDI) for companies of all sizes across all sectors came in at negative 38, with 41% of total respondents reporting they were understaffed versus a mere 3% reporting they were overstaffed. Labor shortages are more acute in nonmanufacturing sectors, which collectively had a December ECDI of -46. The nonmanufacturing sector experiencing the most severe labor shortages is construction with a December ECDI reading of -63 (1% overstaffed minus 64% understaffed).

A half century ago, when the high-pressure economy narrative was in vogue, population in developed economies was still growing. The consensus back then did not envision that labor supply would be constrained by population shrinkage to the extent it now is. Given how drastically supply-side conditions are different, it doesn't make sense to embrace the same narrative in today's Japan.

Supply constraints are weighing on aggregate demand growth

If the government were to apply pressure to aggregate demand through policy stimulus despite the different supply-side conditions that now prevail, companies would be forced to intensify recruitment efforts to secure scarce labor, likely leading to more intercompany poaching of employees. In such an event, job vacancies would become even harder to fill and most companies' sales growth would fall short of actual demand growth. Macroeconomically, GDP growth would likewise underperform demand growth. Meanwhile, preexisting supply constraints would spur cost inflation, particularly wage inflation.

The idea of running a high-pressure economy is premised on demand growth being the solution to the economy's ills. If Japan were to recklessly adopt such a policy approach today, the most likely outcome would be exacerbation of the

ongoing vicious cycle where demand generation is inhibited by supply constraints stemming mostly from the labor market.

Such dynamics are evident in recent order bookings data. While 50 largest Japanese contractors' collective backlog of construction contracts in yen terms is currently in the vicinity of its all-time high reached in the early 1990s, the backlog in months-of-work terms³ has been on the rise since 2010s (see graph). Machinery orders, including machine tool orders, exhibit a similar pattern. Even if there is substantial pent-up demand for construction or machinery, suppliers in such sectors do not have enough manpower to meet additional demand. The result is perpetually growing order backlogs.

3) The backlog in months was calculated by dividing each month's backlog (uncompleted construction contracts) by the trailing 12-month average of monthly construction work completed.

Top 50 contractors' construction contract backlog



Note: Backlog in yen was seasonally adjusted by NRI.

Source: NRI, based on data from Ministry of Land, Infrastructure, Transport and Tourism's Current Survey on Orders Received for Construction

To maintain or expand the Japanese economy's supply capacity as the population continues to shrink, companies must increase their productivity and efficiency by investing in labor-saving automation. However, if labor supply constraints are currently weighing on aggregate demand growth in Japan as discussed above, the objective of expanding supply capacity will not be achieved through demand stimulus policies aimed at running a high-pressure economy.

Crucial first steps to alleviate labor supply bottlenecks include proceeding with labor market reforms such as promoting more flexible employment modalities and rectifying tax disincentives that keep part-time workers from working more hours. Equally important are steady efforts to improve efficiency with automation and workload reduction and to expand the STEM workforce through education and training. Next steps include expanding investment in strategic sectors while continuing to build as much spare capacity as possible into the labor supply.

Meanwhile, the BOJ is under pressure from financial markets, more specifically from rising long-term rates and yen depreciation, to unwind its unconventional monetary accommodation dating back to the Abenomics era and the high-pressure economy era that preceded it. Given such a market environment, if the government attempts to stimulate demand growth by simply running a high-pressure economy again, the bond and forex markets may revolt. If so, the resultant market volatility would likely weigh heavily on the real economy, ultimately weakening both supply and demand. The Takaichi Government should step back, recognize that conditions have changed and then move forward with policies geared toward the current reality.

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