

Monthly Report of Prospects for Japan's Economy

April 2018

Macro Economic Research Centre
Economics Department



The Japan Research Institute, Limited

<http://www.jri.co.jp/english/periodical/>

This report is the revised English version of the March 2018 issue of the original Japanese version.

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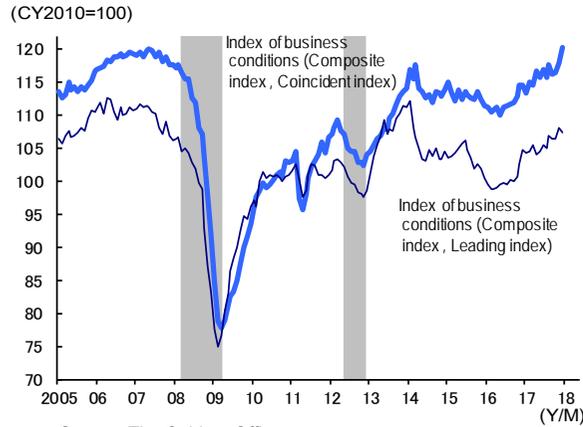
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The general situation of Japan's economy – Economic activity continues its recovery trend

Figure 1-1 Economic Activity

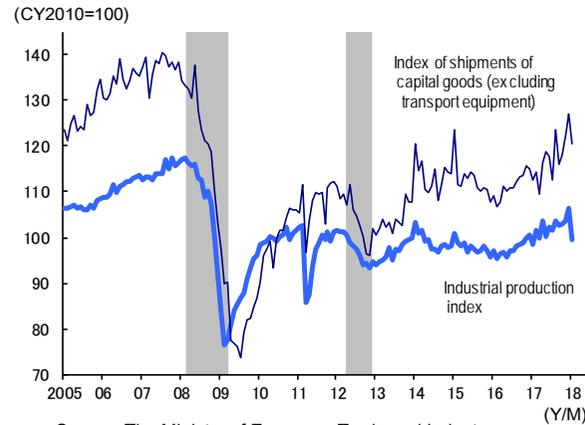
The coincident index rose to the highest level since October 1990, reflecting an increase in shipments of investment goods.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

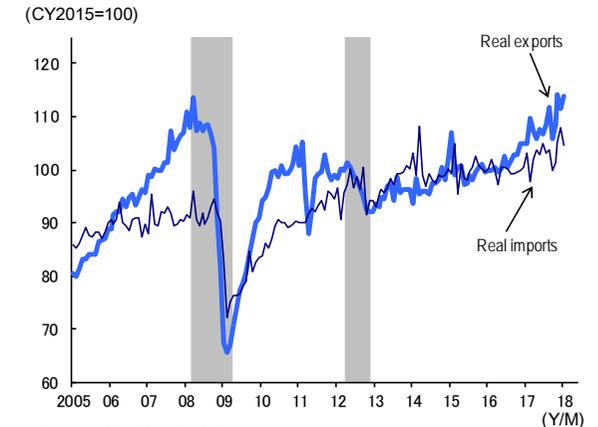
Both the production index and the index of shipments of capital goods have maintained the increasing trend on the whole, albeit with some ups and downs.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

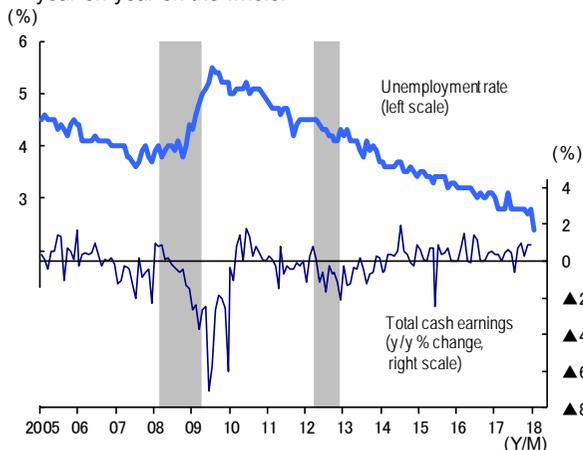
Real exports to destinations such as China and other Asian countries are on the rise. Real imports decreased for the first time in 4 months.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate fell to the lowest level since April 1993. Total cash earnings continue a slight rise year-on-year on the whole.

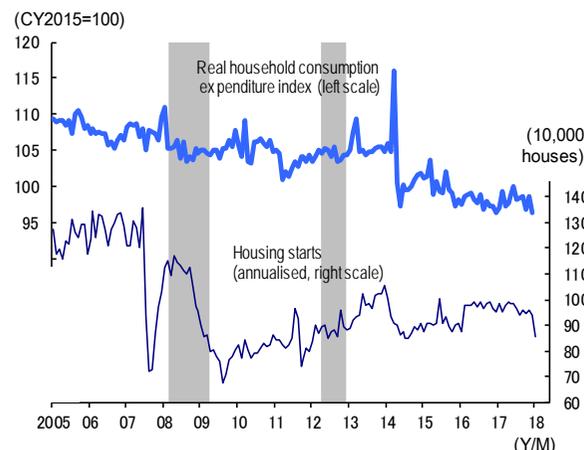


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labour and Welfare.

* The shaded area indicates the phase of recession.

Figure 1-5 The Household Sector

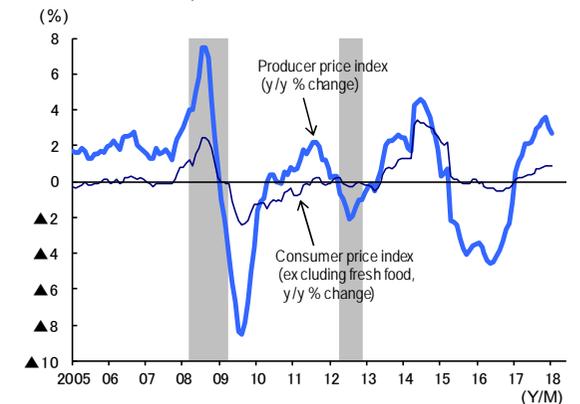
Household consumption expenditure has seesawed. Regarding housing starts, those for condominiums fell noticeably.



Source: The Japan Research Institute, Ltd. based on the data of The Cabinet Office, The Ministry of Land, Infrastructure and Transport.

Figure 1-6 Prices

Both producer prices and core consumer prices continue to rise year-on-year, affected by the rise in the crude oil price.



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications, The Bank of Japan.

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Production increases in the corporate sector, as the household sector also recovers mildly

◆ Economic activity continues its recovery trend

Japan's real GDP in the October-December period 2017 grew by 1.6 per cent on an annualised quarter-on-quarter change basis (national accounts, the second preliminary estimates), a rise in 8 quarters running.

The main reason for the deceleration in the growth rate from Q3 was a considerable increase in imports. Viewed by item, contribution of imports of telecommunication equipment was large due to sales of new models of smartphones. Therefore, the sharp rise in imports is judged to be temporary.

As for domestic demand, private consumption expenditure and business fixed investment stayed firm. Besides, an increase in exports was at a relatively high pace, reflecting solid economic growth in overseas economies and worldwide improvement in willingness towards business fixed investment.

◆ Production holds its rising track

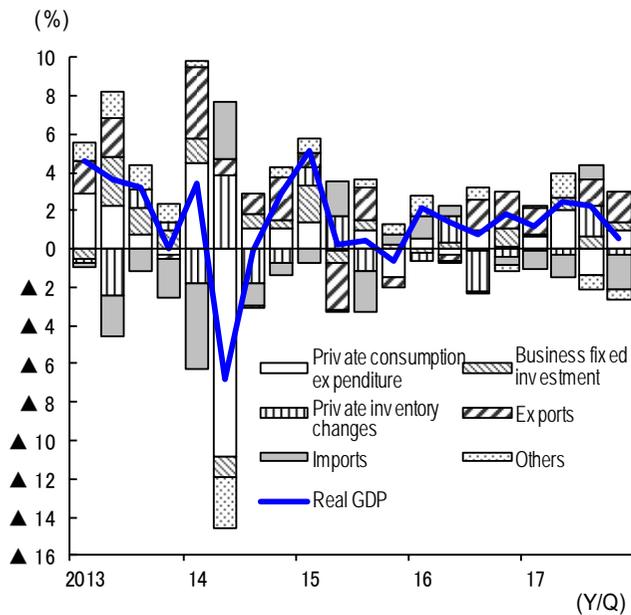
As for corporate activity, although the industrial production index declined by a noticeable 6.8 per cent month-on-month in January, the situation is not worrisome. This is because 1) a seasonal adjustment tends to be unstable early every year due to the Lunar New Year in China, 2) the production forecast index shows a considerable 4.7 per cent rise in February, etc.

On the whole, it is considered that industrial production will continue its rising trend, against the background of an increase in exports.

◆ The household sector also shows a pickup

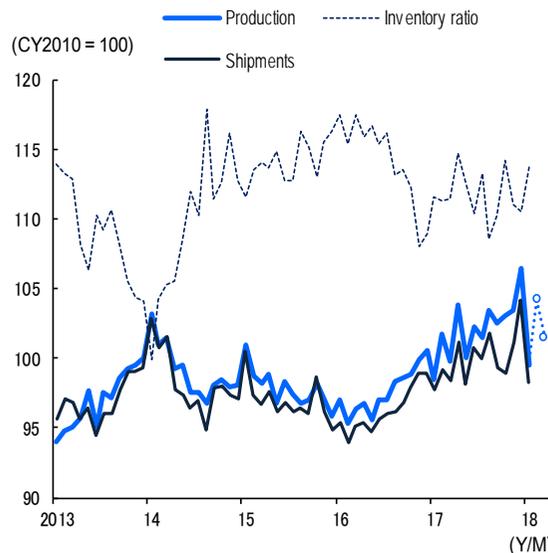
As an improvement in employment and income environments continues, retail sales value increased by 1.6 per cent year-on-year in January, a rise in 3 months in a row. Nevertheless, it is necessary to keep an eye on unfavourable factors such as 1) a lowering of the purchasing power caused by the rise in the prices of fresh food and gasoline, 2) possible negative influences of heavy snow late January.

Figure 2-1 Real GDP Change Rate by Demand Item
<the second preliminary estimates, on an annualised q/q change basis, seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on the data of The Cabinet Office.

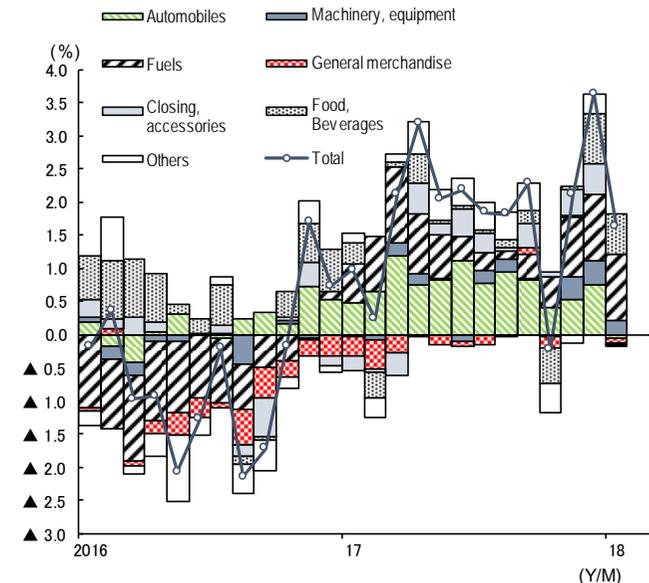
Figure 2-2 Indices of Industrial Production
<seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Economy, Trade and Industry.

Note: The latest two figures in production are based on the production forecast index.

Figure 2-3 Retail Sales Value by Item
<year-on-year % change>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Economy, Trade and Industry.

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Overseas demand is on the rise

◆ Real imports increased remarkably in Q4 2017

Looking at real net exports as overseas demand, real imports of goods made a visible negative contribution to the total in Q4 2017. The main reason for this was a considerable increase in imports of telecommunication equipment due to sales of new models of smartphones. Thus, as this boosting effect comes to an end, the pace of increase in real imports is expected to slow down sooner or later.

Nonetheless, the mild rising trend of real imports will likely continue. This trend is against the background that 1) a recovery in domestic economic activity will go on, 2) Japan's enterprises will carry on with imports of their products manufactured by their overseas facilities, rather than returning their overseas facilities to Japan, etc.

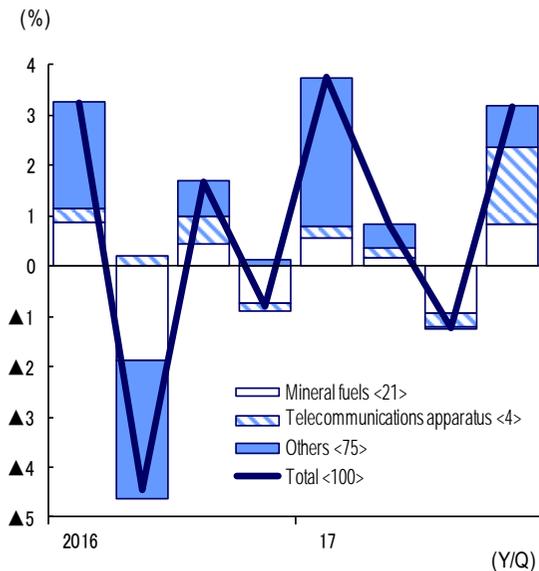
◆ Japan's real exports of goods will likely continue their rising trend

Regarding real exports, the rising trend has been maintained, as global trade

volume expands. Viewed by item, exports of electronic parts and devices, of which worldwide demand has expanded visibly, continue to be a driving force. It is expected also in the future that exports of electronic parts and devices will keep their high pace. They will be driven by heightened demand for smartphones with higher quality, increased demand for data centres for cloud computing services, expanding demand for IoT (Internet of Things) and an incorporation into automobiles, and so on.

However, there is a risk that the recent unstable financial market situation could have negative effects on exports. It is true that manufacturing PMIs both in advanced and emerging economies stay over 50, the diverging point. Yet, for example, if the unstable situation in the financial markets reduces willingness of enterprises towards business fixed investment, Japan's real exports of capital goods could peak.

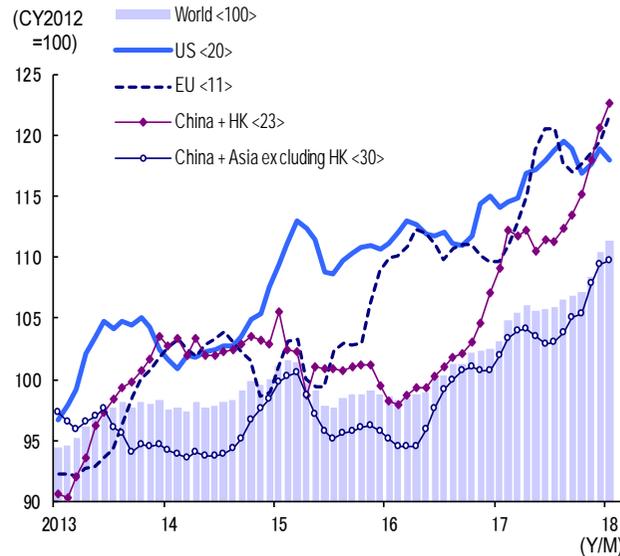
Figure 3-1 Contributions of Each item to Total Real Imports of Goods <quarter-on-quarter % change>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, The Bank of Japan.

Note: Figures in the angle brackets show the shares in the total nominal imports in FY2017.

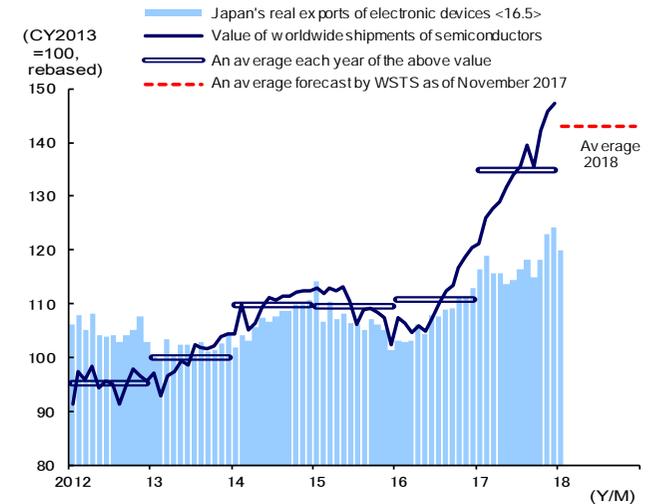
Figure 3-2 Real Exports by Destination <seasonally adjusted, 3-month moving averages>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance, The Bank of Japan.

Note: Figures in the angle brackets show the shares in the total nominal exports in FY2016.

Figure 3-3 Value of Worldwide Shipments of Semiconductors and Japan's Real Exports of Electronic Devices



Source: The Japan Research Institute, Ltd. based on the data of World Semiconductor Trade Statistics (WSTS), Semiconductor Industry Association (SIA), The Ministry of Finance of Japan, The Bank of Japan.

Note: The figure in the angle brackets shows the share in the total nominal exports in FY2017.

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With profits continuing to improve, business fixed investment is on a rising trend

◆ Corporate profits continue to be firm

Corporate profits continue their firm trend. Based on Financial Statements Statistics of Corporations by Industry, sales value increased in the October-December period 2017 by 2.3 per cent from the previous quarter, the sixth consecutive quarterly rise. Yet, current profits declined by 1.7 per cent, the second successive fall.

The decline in current profits is for the following reasons: 1) an increase in personnel expenses reflecting labour shortages, which has in turn led to a rise in labour's share in aggregate income. Also, 2) a climb in variable costs affected by the rise in the crude oil price, and 3) a decrease in value of receipt of dividends, etc. from overseas facilities owing to the appreciation of the yen.

Looking ahead, it is highly likely that the burden of personnel expenses will continue to weigh on corporate profits. However, reflecting elements such as 1) a slowdown in the pace of rise in the crude oil price and 2) an expectation that a further strong yen will be avoidable for expanding interest rate differentials, corporate profits

will likely gain momentum again, as demand at home and abroad stays solid.

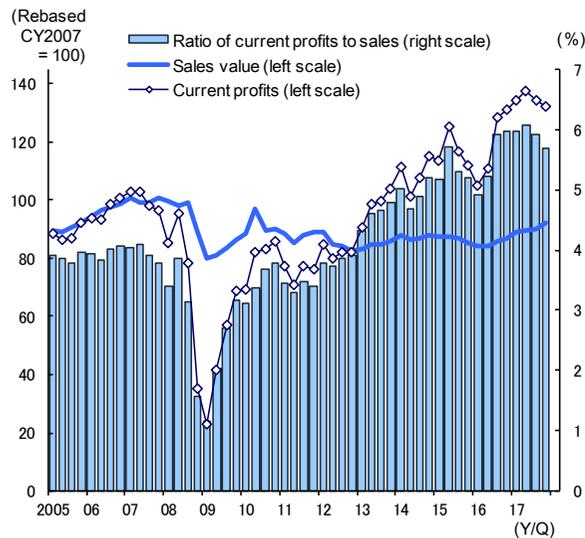
◆ Business fixed investment is on a rising trend

As for business fixed investment, as cash held by enterprises per se is abundant, it is projected that investment in plants and equipment, mainly investment for rationalisation and saving reflecting labour shortages, will increase.

Also, in certain fields where rapid growth of some products and services is expected, strategic investment has increased. For instance, construction investment continues to be buoyant, such as in 1) accommodations in response to a climb in inbound (foreign tourist) demand, 2) logistics facilities with sophisticated functions to meet increasing demand due to an expansion in internet shopping, and 3) redevelopment projects in core cities such as metropolitan areas.

Nonetheless, it is necessary to keep an eye on whether the unstable situation in the financial markets would reduce willingness of enterprises to expand business fixed investment, as volatility in the stock markets has heightened.

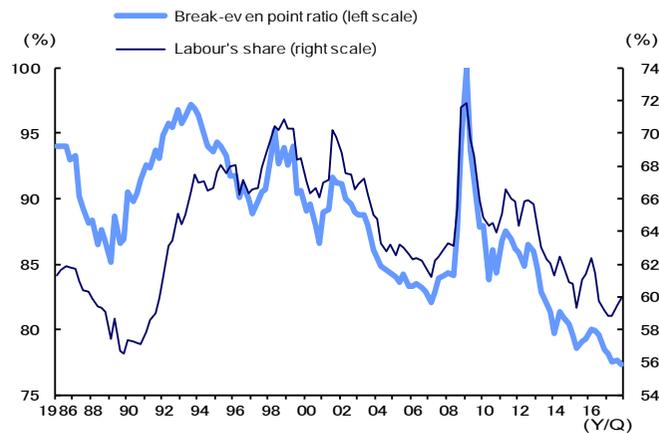
Figure 4-1 Sales Value and Ratio of Current Profits to Sales <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.

Note: All industries except for financial institutions.

Figure 4-2 Sales and Break-even Point Ratio and Labour's Share in Aggregate Income



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.

Note: The break-even point ratio =

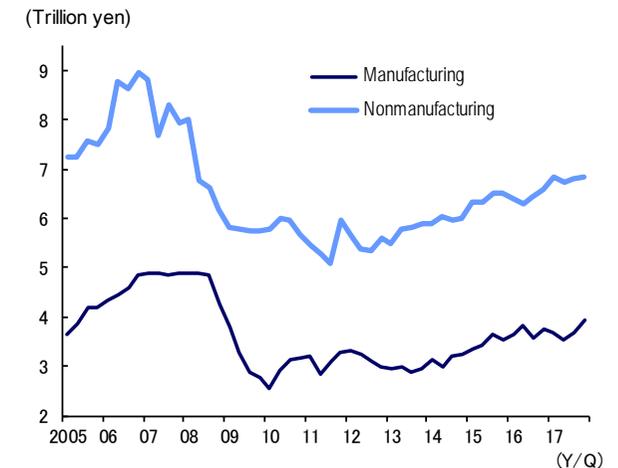
$$\frac{\text{break-even point sales value}}{\text{sales value}}$$

$$\text{Break-even point sales value} = \frac{\text{fixed costs}}{1 - (\text{variable costs} / \text{sales value})}$$

$$\text{Fixed costs} = \text{personnel expenses} + \text{depreciation expenses} + \text{interest payment}$$

$$\text{Variable costs} = \text{cost of goods sold} + \text{selling and administration expenses} - \text{personnel expenses} - \text{depreciation expenses}$$

Figure 4-3 Value of Business Fixed Investment based on Financial Statements Statistics of Corporations by Industry <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.

Note: All industries excluding financial institutions.

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The pace of recovery in income is likely to continue to be slow

◆ Employment conditions continue to improve

Employment environments are on an improving trend. In the current economic expanding phase since November 2012, notably, the number of regular employees has increased steadily since the middle of 2015. In 2017, most of increase in the number of persons holding jobs on a year earlier during each quarter has stemmed from regular employees. Thus, the employment situation has improved not only in quantity but also in quality.

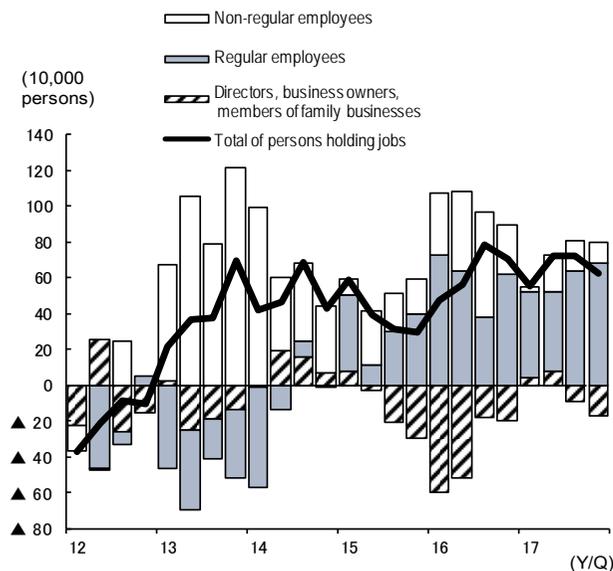
As for wages, favourably, pay for scheduled hours worked in full-time employees has steadily increased year-on-year. However, the situation continues where wage rises are hard to accelerate because 1) an attitude of enterprises maintains persistently their cautious attitude towards an increase in personnel expenses. Also, 2) it is mainly industries with relatively lower wages that have seen wage increases, such as i) eating and drinking places, and accommodations, ii) health care and welfare, and iii) wholesale and retail trade.

◆ Slow pace of recovery in real income will likely continue

Looking ahead, the improvement in employment environments will likely continue, against the background of the recovery in economic activity. Also, the pressure to raise wages is expected to strengthen gradually reflecting continued labour shortages and good corporate profits. Further, as an atmosphere that wage rise momentum is growing spreads, it is expected that the rate of wage rises in the wage negotiations spring this year (FY2018) will be 2.4 per cent, a rate more than that in the result last spring (FY2017).

However, it should not be relied on that the acceleration in the rate of rise in wages up to 3 per cent, which is the target of the government, will be materialised in the wage negotiations this spring. In addition, the year-on-year change rate in consumer prices will stay positive, albeit slightly, mainly due to the rise in energy prices. Unfavourably, this will likely add downward pressure on the real purchasing power of households.

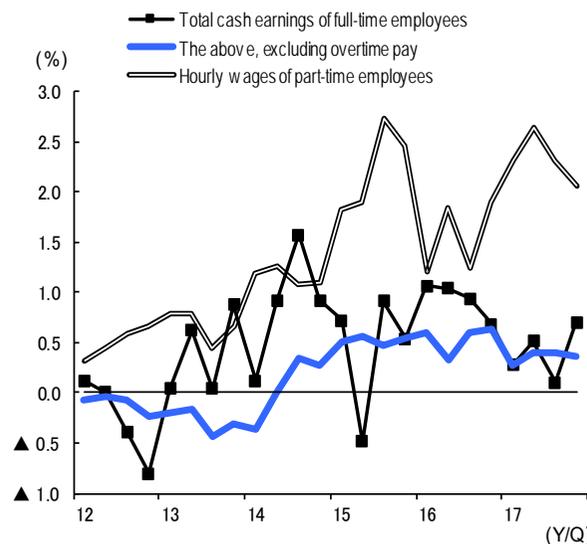
Figure 5-1 Number of Persons Holding Jobs <difference from a year earlier>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Health, Labour and Welfare.

Note: Regular employees are persons employed for an indefinite period.

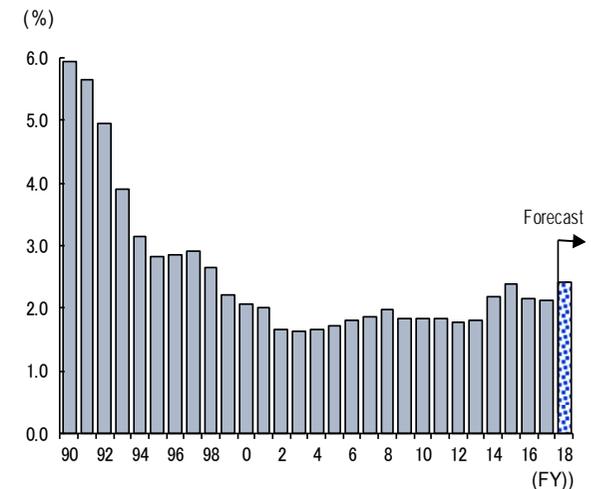
Figure 5-2 Year-on-year Change Rates of Wages by Type of Employees



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Health, Labour and Welfare.

Note: Full-time employees are persons who are regular employees, but are not part-time employees.

Figure 5-3 Rate of Wage Rise Resulting from Wage Negotiations Each Spring



Source: The wage negotiation results each spring (mainly in large enterprises) released by The Ministry of Health, Labour and Welfare. Forecast by the JRI.

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Private consumption expenditure is likely to recover mildly

◆ Private consumption is back to a mild picking up trend again

Based on the Consumption Activity Index by BoJ, expenditure on durable goods, which had weakened after last autumn, (mainly affected negatively by the improper pre-shipment inspection problem in automobiles), turned positive year-on-year again. Expenditure on services has accelerated, led by services such as communications, health care and welfare, eating out, etc. Further, in food, which is one of the non-durable goods, an active trend where enterprises try to secure sales increases through marketing new products has come to gain momentum again.

◆ Slow pace of recovery in private consumption will likely continue

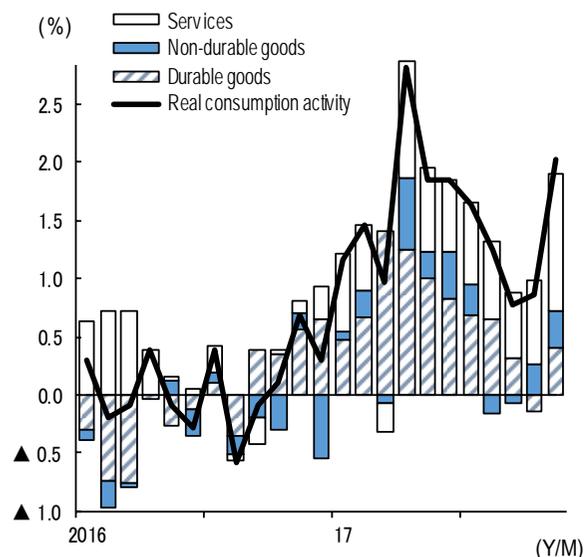
Looking ahead, the continued improvement in employment environments will likely go on bolstering the recovery in private consumption expenditure. With respect to consumer confidence, the Nikkei Stock Average fell from about 24,000 yen to about 21,000 yen in early February. Yet, even though the recent level, which is in the range

from 21,000 yen to 22,000 yen, continues, net unrealised gains on a year earlier will be maintained. Thus, if there is no further significant fall, it is unlikely that private consumption will wobble due to the worsening of consumer confidence.

Concerning housing investment, it is predicted that it will be on a weakening trend for the time being. It is notable that the value of new home loans has turned negative year-on-year. It is true that the situation of low interest rates continues as a supporting factor for housing investment. However, there are some daunting problems in housing investment for rental houses.

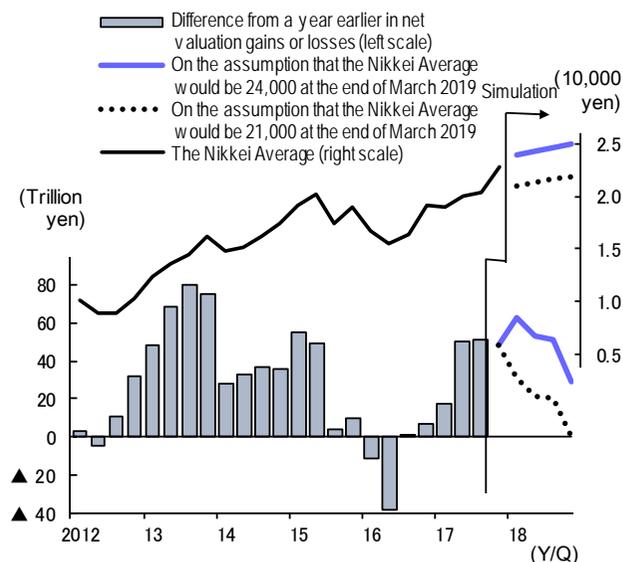
These include the issue that 1) sub-lease problems have risen, where some owners of rental houses put their rental houses for sub-lease to intermediate real estate agents and then become involved in quarrels over collecting the rent, and 2) rental houses have been oversupplied, which has led to a surge in the rate of vacant apartments.

Figure 6-1 The Consumption Activity Index by Bank of Japan <year-on-year % change>



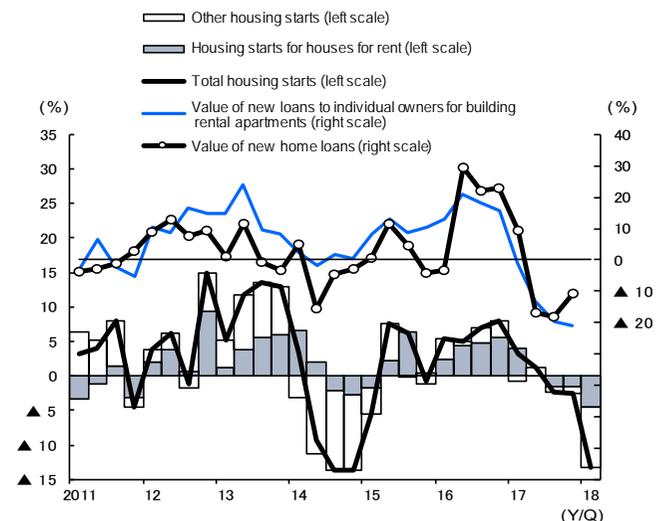
Source: The Japan Research Institute, Ltd. based on the data of The Bank of Japan.

Figure 6-2 Stock Prices and Change in Net Unrealised Gains or Losses <difference in value from a year earlier>



Source: The Japan Research Institute, Ltd. based on the data of The Bank of Japan, Nikkei.

Figure 6-3 Value of New Loans for Building of Rental Apartments <year-on-year % change>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Land, Infrastructure and Transport, The Bank of Japan.

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Topics : On the sharp fall of the Nikkei Stock Average in early February

◆ The fall of US stocks and the strong yen have been weighing factors

The Nikkei 225 Stock Average fell sharply in early February. It dropped by 592 yen and 1,072 yen on February 5 and 6, respectively. The stock prices started to recover after the period, yet have seesawed and been very slow to rise. Even pessimistic views have loomed over the future prospects of stock prices.

Examining the reasons for the fall this time, it is estimated that the main one was an adjustment in US stock prices which had been overheated by excessively optimistic views of investors, not a change in tone of Japan's economic activity.

The overseas investors, whose risk tolerance had been lowered by the fall of US stocks, have sold Japan's stocks in large volume. Also, due to an anxiety that the strong yen would reduce exports and profits received from overseas facilities, the stock prices of Japan's exporters have fallen.

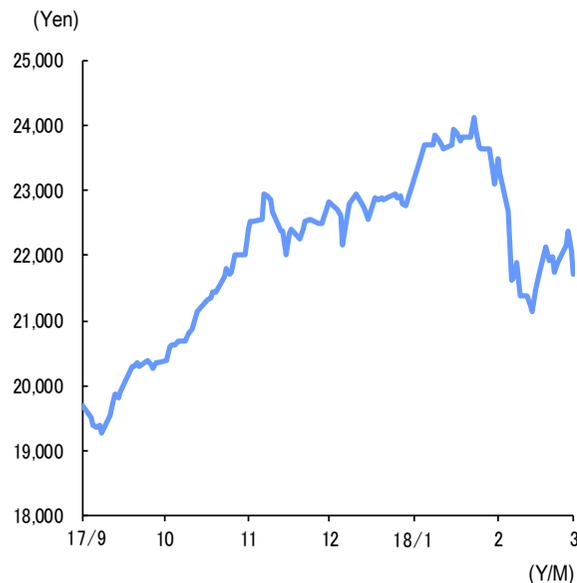
◆ It is expected that Japan's stock prices will rise gradually

Looking ahead, although stock prices are likely to be volatile for the time being, they are predicted to recover to a mild rising trend gradually. As for US stock prices, they are expected to move around at the level late last year for a moment, then they will pick up moderately against the background of good corporate profits.

Japan's stock prices are also likely to recover gradually. This is due to the forecast that 1) it is projected that the exchange rate of the yen will become weaker mildly, pricing in the increasing differences in interest rates between Japan and the US, as the risk-off attitude of investors eases, 2) economies at home and abroad will likely continue to improve, and so on.

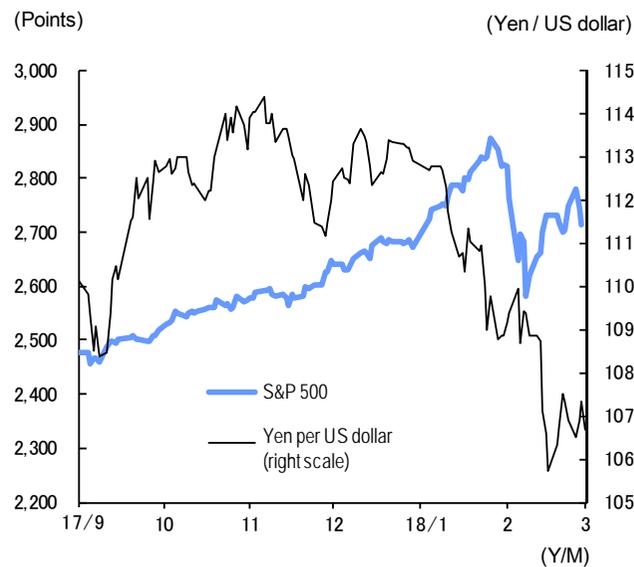
However, it should be carefully watched how negative factors will affect the financial markets, such as uncertainties over the policies taken by the Trump administration seen in the planned import tariffs, and geopolitical risks surrounding the DPRK and the Middle East.

Figure 7-1 Nikkei 225 Stock Average



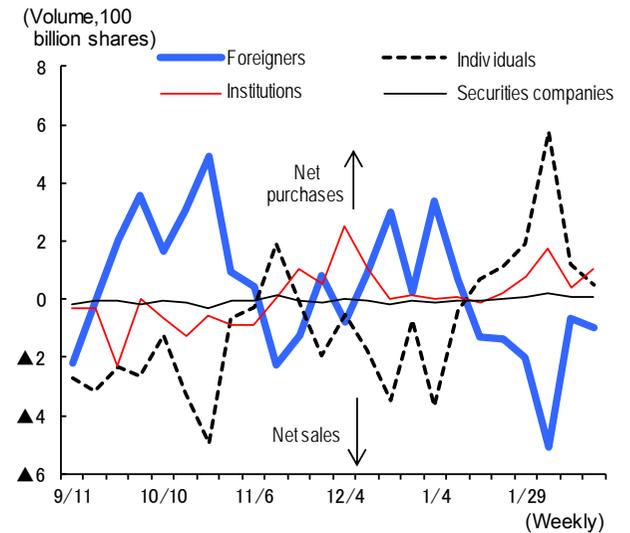
Source: The Japan Research Institute, Ltd. based on the data of Nikkei NEEDS.

Figure 7-2 Stock Prices in the US and Yen / US Dollar Exchange Rate



Source: The Japan Research Institute, Ltd. based on the data of Nikkei NEEDS.

Figure 7-3 Volume of Investment in Japanese Stocks by Type of Investor



Source: The Japan Research Institute, Ltd. based on the data of Japan Exchange Group, Inc..

Note: The figures are for the first section stocks in Tokyo Stock Exchange, and on a volume basis.

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Prospects for Japan's economy - Projected real GDP change; 1.8% in FY2017 and 1.2% in FY2018

◆ Japan's economic activity will likely continue its recovery trend, against the background of firm demand at home and abroad

(1) Japan's real GDP in the October-December period 2017 grew by 1.6 per cent on an annualised quarter-on-quarter change basis (national accounts, the second preliminary estimates), a rise in 8 quarters running. The figure 1.6 per cent was revised upwards from 0.5 per cent in the first preliminary estimates.

Viewed by demand item, the revision seems to have been a positive one. The main reason was an upwards revision in business fixed investment, in addition to private inventory changes. Therefore, there is no alteration in the JRI view on current economic conditions that Japan's economic activity continues its recovery trend.

(2) Looking ahead, it is projected that the pace of economic recovery will slow down slightly, due to 1) the appreciation of the yen and a fall in stock prices after February, and 2) a production adjustment related to new models of smartphones.

Yet Japan's exports will likely maintain their rising trend against the background of solid economic growth of overseas economies. Further, it is predicted that business fixed investment will be affected positively by the following factors. These are 1) an increase in construction investment driven by redevelopment projects in metropolitan areas as well as by new building of accommodations and business logistics facilities, and 2) an improvement in willingness for business fixed investment in manufacturers encouraged by a rise in exports. Thus, economic activity will continue to pick up, mainly led by the corporate sector.

(3) In the household sector, a tone of corrections has been felt in the stock market since early February. Therefore, a further push to private consumption expenditure through the wealth effect cannot be relied on.

On the other hand, as a favourable aspect, income environments in the middle to lower income brackets have improved, reflecting factors such as a pause in the rise in the ratio of non-regular employees to the total and wage increases in medium and small-sized enterprises. Taking these elements into consideration, it is highly unlikely that private consumption expenditure will falter.

(4) As a result, it is projected that real GDP in FY2017 and FY 2018 will grow at a pace over Japan's potential output growth rate, which is currently estimated to be about 1.0 per cent, as demand at home and abroad stays solid. Namely, it is forecast that the annual real GDP growth rate will be 1.8 per cent in FY2017 and 1.2 per cent in FY2018.

(5) With respect to economic activity in FY2019, it is predicted that the pace of real GDP growth will decelerate, because private consumption expenditure will likely be pushed down in total by the lowering purchasing power due to the rise in the consumption tax rate from 8 to 10 per cent scheduled for October 2019.

However, it is unlikely that private consumption expenditure will wobble. This is because 1) the extent of the rise in the consumption tax rate in 2019 is less than that in April 2014 (from 5 to 8 per cent), 2) reduced tax rates are planned to be introduced, and 3) the degree of burden such as an increase in income tax and social insurance premiums is estimated to be less than that in 2014. As a result, real GDP will likely grow by almost 1 per cent in FY2019.

◆ The year-on-year change rate in the core CPI will likely stay at about 1 per cent

(6) The core CPI, which excludes fresh food, has enlarged the extent of its year-on-year increase, albeit slightly, since having turned into positive territory in January 2017. A rise in energy prices and food prices has pushed up the total rate of year-on-year increase.

Looking ahead, it is predicted that the year-on-year increase rate in the core CPI will stay at about 1 per cent, against the background of an improvement in supply-demand conditions on an aggregate basis, albeit with the pace of the rise in energy prices slowing down.

Figure 9 Projections for GDP Growth and Main Indicators of Japan (as of March 8, 2018)

	(seasonally adjusted, annualised % changes from the previous quarter)											(% changes from the previous fiscal year)			
	CY2017		CY2018				CY2019				CY2020	FY2016	FY2017	FY2018	FY2019
	7~9	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Actual)	(Projection)	(Projection)	(Projection)
	(Actual)	(Actual)	(Projection)				(Projection)				(Projection)	(Actual)	(Projection)	(Projection)	
Real GDP	2.4	1.6	0.7	1.2	1.2	1.0	1.3	1.4	2.5	▲ 3.6	1.3	1.2	1.8	1.2	0.9
Private Consumption Expenditure	▲ 2.6	2.1	0.5	0.9	1.0	1.0	1.1	1.6	5.2	▲ 9.1	1.3	0.3	1.1	0.8	0.6
Housing Investment	▲ 6.6	▲ 10.1	▲ 7.2	▲ 2.4	0.7	3.2	6.5	1.9	▲ 3.1	▲ 9.8	▲ 7.2	6.2	▲ 0.3	▲ 2.8	▲ 0.2
Business Fixed Investment	4.2	4.2	1.7	2.4	2.7	2.7	2.6	2.4	2.4	2.3	2.3	1.2	3.5	2.7	2.5
Private Inventories (percentage points contribution)	(1.7)	(0.3)	(▲ 0.4)	(▲ 0.2)	(0.0)	(0.0)	(0.0)	(▲ 0.1)	(▲ 0.5)	(0.3)	(0.3)	(▲ 0.3)	(0.1)	(0.0)	(▲ 0.1)
Government Consumption Expenditure	0.2	▲ 0.0	0.8	0.8	0.7	0.7	0.8	0.8	0.8	0.8	0.8	0.5	0.4	0.6	0.8
Public Investment	▲ 9.8	▲ 0.8	▲ 4.1	6.0	2.0	▲ 6.9	▲ 3.1	0.0	1.2	0.5	0.3	0.9	1.3	▲ 0.7	▲ 0.9
Net Exports (percentage points contribution)	(2.2)	(▲ 0.1)	(0.9)	(0.2)	(0.0)	(0.2)	(0.1)	(0.0)	(▲ 0.4)	(1.1)	(0.0)	(0.8)	(0.4)	(0.4)	(0.1)
Exports of Goods and Services	8.8	10.1	1.4	3.1	3.3	3.5	3.5	3.3	3.2	2.8	2.8	3.4	6.4	4.0	3.2
Imports of Goods and Services	▲ 4.7	12.0	▲ 3.5	2.2	3.3	2.7	3.0	3.2	5.4	▲ 3.3	2.9	▲ 1.0	3.9	2.1	2.6
(Ref.) Domestic Private Demand (percentage points contribution)	(0.7)	(1.8)	(▲ 0.0)	(0.6)	(1.0)	(1.1)	(1.2)	(1.2)	(2.7)	(▲ 4.7)	(1.1)	(0.3)	(1.2)	(0.8)	(0.7)
(Ref.) Public Demand (percentage points contribution)	(▲ 0.5)	(▲ 0.0)	(▲ 0.0)	(0.4)	(0.2)	(▲ 0.2)	(0.0)	(0.2)	(0.2)	(0.2)	(0.2)	(0.1)	(0.2)	(0.1)	(0.1)

	(% changes from the same quarter of the previous year)											(% changes from the previous fiscal year)			
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2016	2017	2018	2019
Nominal GDP	2.1	2.1	1.9	1.5	1.4	1.5	2.2	2.0	2.4	1.6	1.7	1.0	1.8	1.7	1.9
GDP deflator	0.2	0.1	0.1	▲ 0.0	0.2	0.5	1.0	0.7	0.8	1.3	1.3	▲ 0.2	0.0	0.4	1.0
Consumer Price Index (excluding fresh food)	0.6	0.9	0.8	0.9	0.9	0.8	0.7	0.7	0.9	2.0	2.1	▲ 0.2	0.7	0.8	1.5
(excluding fresh food, consumption tax)	0.6	0.9	0.8	0.9	0.9	0.8	0.7	0.7	0.9	1.1	1.1	▲ 0.2	0.7	0.8	1.0
Unemployment Rate (%)	2.8	2.8	2.5	2.5	2.5	2.5	2.4	2.4	2.4	2.4	2.4	3.0	2.7	2.5	2.4
Exchange Rates (¥/US\$)	111	113	108	109	110	111	111	110	110	109	109	108	111	110	110
Import Price of Crude Oil (US\$/barrel)	50	58	67	63	61	62	62	63	63	63	63	47	57	62	63

Source: The Cabinet Office; The Ministry of Internal Affairs and Communications; The Ministry of Economy, Trade and Industry; The Ministry of Finance.

The projection figures are based on those of The Japan Research Institute, Ltd.

Note : "▲" indicates minus.