

# Monthly Report of Prospects for Japan's Economy

June 2018

Macro Economic Research Center  
Economics Department



The Japan Research Institute, Limited

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

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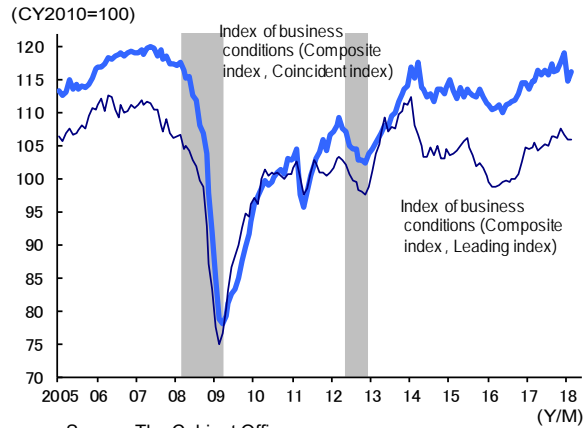
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# The General Situation of Japan's Economy – Except for a Decline in Q1, the Economic Recovery Trend will Continue

**Figure 1-1 Economic Activity**

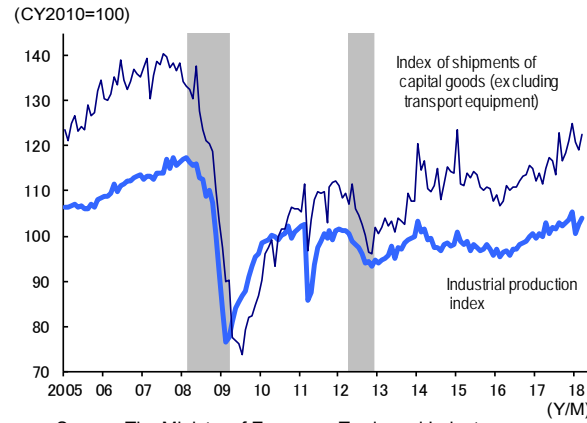
The coincident index rose slightly after the fall last month, reflecting an improvement in production and shipments.



Source: The Cabinet Office.

**Figure 1-2 The Corporate Sector**

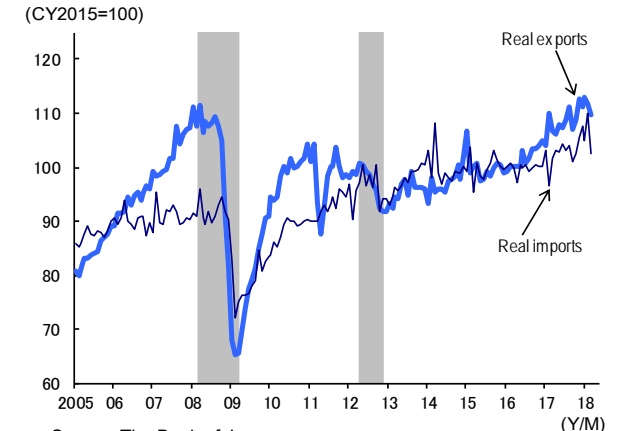
The production index increased for 2 months running. The index of shipments of capital goods also climbed for the first time in 3 months.



Source: The Ministry of Economy, Trade and Industry.

**Figure 1-3 Overseas Demand**

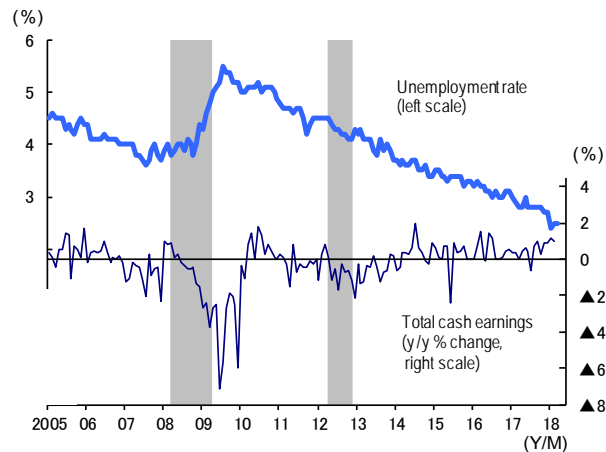
Real exports to the US and EU declined. Real imports fell considerably due to the effect of the Lunar New Year in China.



Source: The Bank of Japan.

**Figure 1-4 Employment and Income**

The unemployment rate stayed at a low level. Total cash earnings continued a slight rise year-on-year, on the whole.

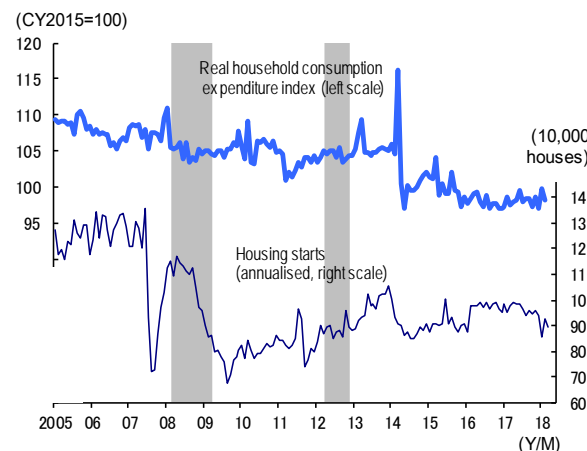


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

\* The shaded area indicates the recession phase.

**Figure 1-5 The Household Sector**

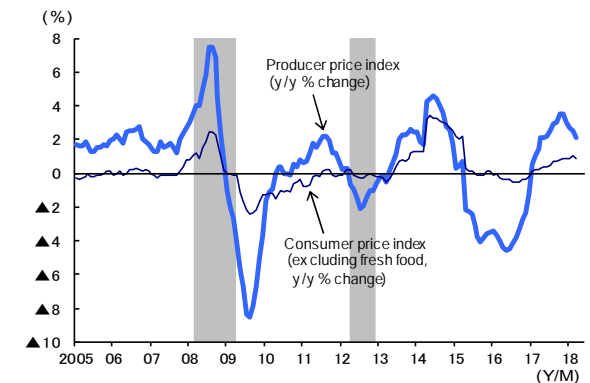
Real household consumption expenditure seesawed. Housing starts, mainly those for rental houses, weakened.



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

**Figure 1-6 Prices**

The extent of year-on-year increases both in producer prices and in core consumer prices narrowed, due to a pause in the rise of crude oil prices and the stronger yen.



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

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# Industrial Production in the Corporate Sector were at a Standstill during Q1

## ◆ Despite a Decline in Q1, the Economic Recovery Trend will Likely Continue

Japan's real GDP in the January-March period 2018 declined by 0.6 percent on an annualized quarter-on-quarter change basis (national accounts, the first preliminary estimates), a fall for the first time in 9 quarters. However, despite the decline, Japan's economic activity will likely continue its recovery trend, against the background of firm demand at home and abroad.

Meanwhile, in The All Industry Activity Index, a trend toward leveling off was observed from the perspective of the three-month moving average.

## ◆ Industrial Production were at a Standstill during Q1

The Industrial Production Index increased 1.4 percent month on month for the second consecutive month in March. Industrial production saw increases in a broad range of fields including semiconductor manufacturing equipment, electronic parts and automobiles. However, as the level prior to a significant drop that occurred in January could not be recovered, industrial production for the period from January to

March decreased 1.4 percent quarter on quarter for the first time in eight quarters.

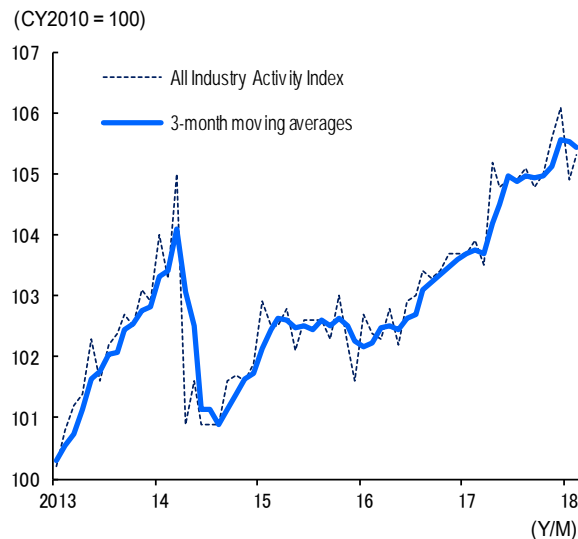
While industrial production is anticipated to rise 3.1 percent month on month in April and decline 1.6 percent in May according to the Indices of Industrial Production Forecast, it is judged that industrial production has been stagnant since the beginning of 2018 in light of potential downward revisions.

## ◆ Improvement in the Household Sector was Seen

The Synthetic Consumption Index rose 0.5% from the previous month in February. Despite negative factors, including the cold weather and heavy snowfall in January and February and the deterioration in consumer sentiment due to a sharp fall in stock prices at the beginning of February, consumer spending remained resilient on the back of improved employment and income conditions.

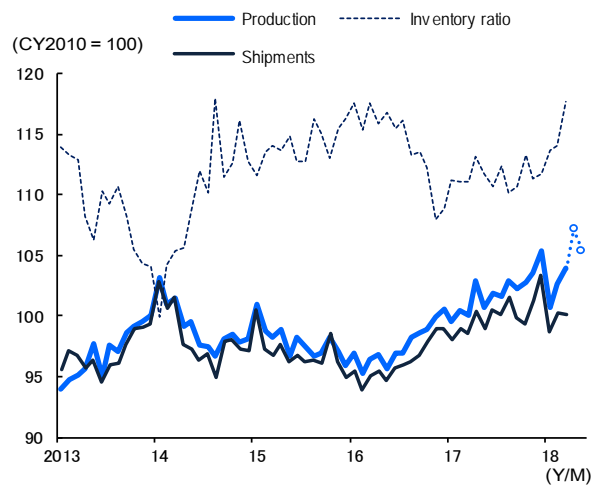
In terms of outlook, consumer spending is expected to remain on a moderate recovery trend given the fact that scheduled salaries are likely to increase, reflecting pay raises exceeding those in normal years as a result of the spring labor offensive and the expected waning of the negative wealth effect on the back of a rebound in stock prices.

Figure 2-1 All Industry Activity Index



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

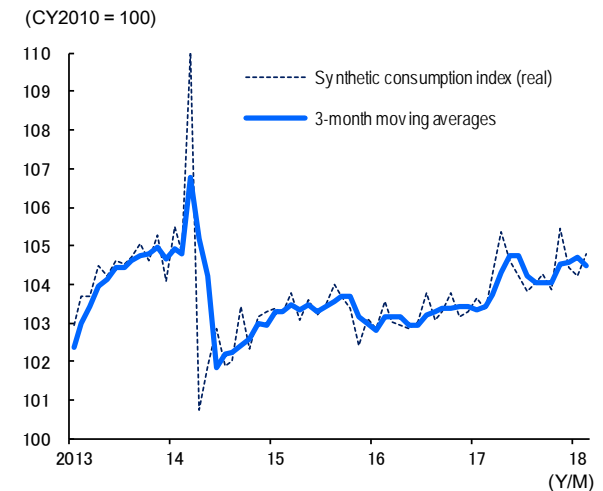
Figure 2-2 Indices of Industrial Production <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on 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 Real Synthetic Consumption Index



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

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# Exports will Likely Follow a Mild Rising Path

## ◆ Exports will Likely Slow Down and then Follow a Mild Rising Trend

Exports have been weak lately. Despite the expansion of global IT demand, Japan's exports of electronic parts and devices reached a plateau due to growing in-house production in emerging Asian countries and sluggish sales of iPhone X. In addition, the momentum of transportation equipment exports has slowed down amid the weakening of overall automobile sales in the U.S.

However, we have judged that the trend toward increasing exports has not shifted. China has continued to demonstrate solid growth, and a high growth rate will also likely be seen in the U.S. thanks to tax reductions and greater fiscal expenditures. Against the backdrop of global recovery in demand for capital investment, it is expected that exports of capital goods such as semiconductor manufacturing

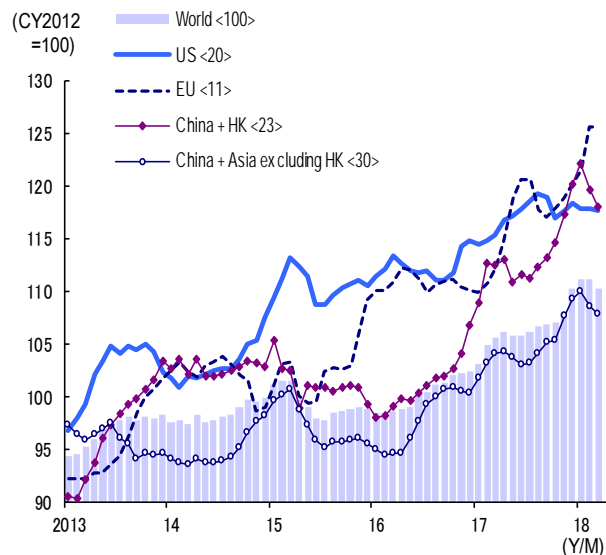
equipment and industrial robots will continue to grow.

## ◆ Protectionist Trade Policies of the Trump Administration are Worrisome

Nevertheless, concerns remain about the export environment. The Trump administration's stance on the U.S. trade policy has shifted toward protectionism. If increased trade frictions result in global stagnation of trade and subsequent decline in capital investment, Japan's exports centered on capital goods may also plunge.

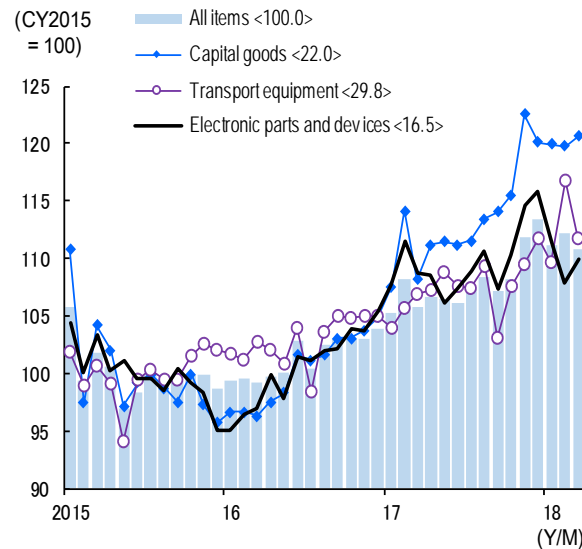
Meanwhile, the direct impact of a hike in tariffs on steel and aluminum products is likely to be minimal, largely because (i) Japan's exports of such products to the U.S. are relatively small and (ii) it is not easy to replace high value-added products exported from Japan.

Figure 3-1 Real Exports by Destination  
<seasonally adjusted,  
3-month moving averages>



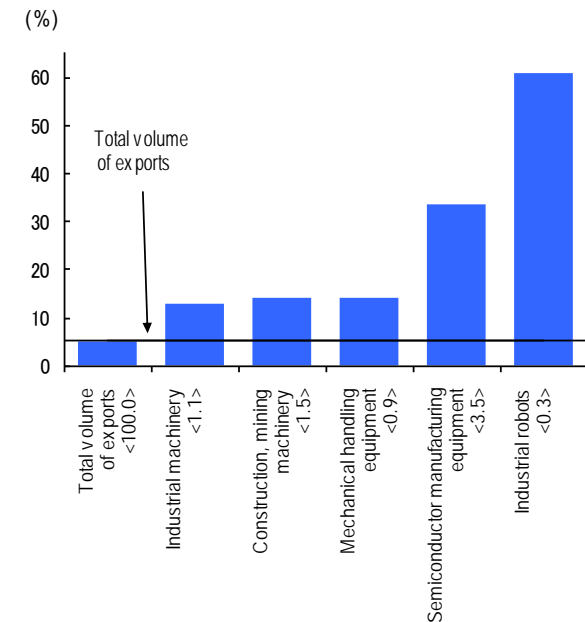
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, The Bank of Japan.  
Note: Figures in the angled brackets show the shares in total nominal exports in FY2016.

Figure 3-2 Real Exports by Item



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance.  
Note: Figures in the angled brackets show the shares in total nominal exports in FY2017.

Figure 3-3 Change in Export Volume of Major Capital Goods  
<year-on-year, % change>



Source and Note: The same as Figure 3-2.

# With Profits Continuing to Improve, Business Fixed Investment is on a Rising Trend

## ◆ Corporate Profits Continue to be Firm

Corporate earnings have remained strong. Despite increases in labor cost and variable expense due to the growing seriousness of labor shortages and a rise in raw material prices, ordinary income margin remained at a high level, reflecting the labor share and the ratio of variable expense to sales which has remained at a historically low level thanks mainly to restructuring efforts for existing businesses.

Looking at the Nikkei Japan Manufacturing PMI, economic sentiment in the corporate sector remained brisk overall, as seen in a rise in new export orders in April on the back of improved production and employment, despite a reactionary decline in new export orders that followed a significant increase in orders in the latter half of the previous year.

In terms of outlook, significant growth in corporate earnings is not likely due to an increase in labor cost and a decline in dividend income from overseas, in line with appreciation of the yen. Yet, it is anticipated that corporate earnings will remain brisk

amid solid expansion of domestic and international demand unless appreciation of the yen accelerates at a level that significantly exceeds the presumed exchange rate.

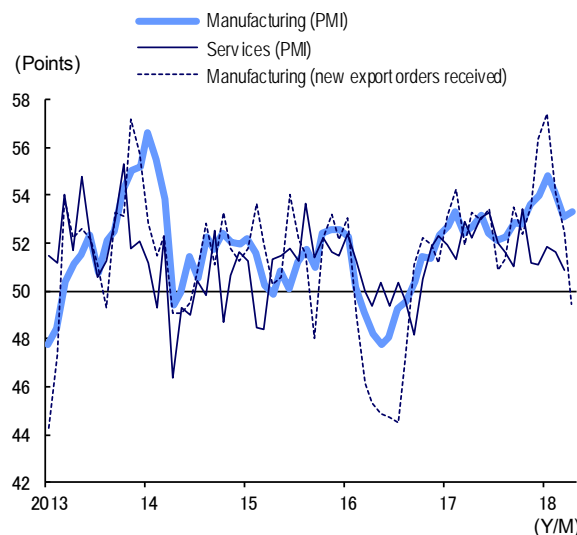
## ◆ Business Fixed Investment is on a Rising Trend

Reflecting abundant cash flow, capital investment has remained on an upward trend mainly in the fields of rationalization and labor saving against the backdrop of labor shortages.

According to the Bank of Japan's quarterly Tankan Survey, the capital investment plan by small and medium-sized manufacturers for FY2018 turned out to be -0.1 percent year on year which was slightly higher for the initial forecast, indicating that the upward trend for capital investment will likely continue in the future.

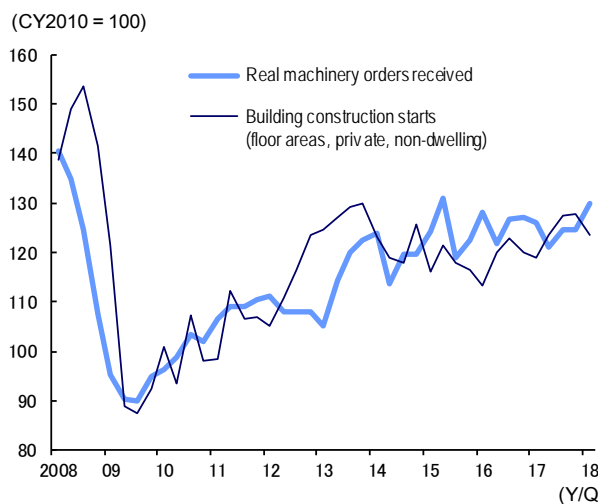
However, there is a risk that appetite for capital investment may wane if concerns over the outlook of corporate earnings increase due to the intensification of trade friction between the U.S. and China and subsequent acceleration of the appreciation of the yen.

Figure 4-1 PMI by Type of Industry



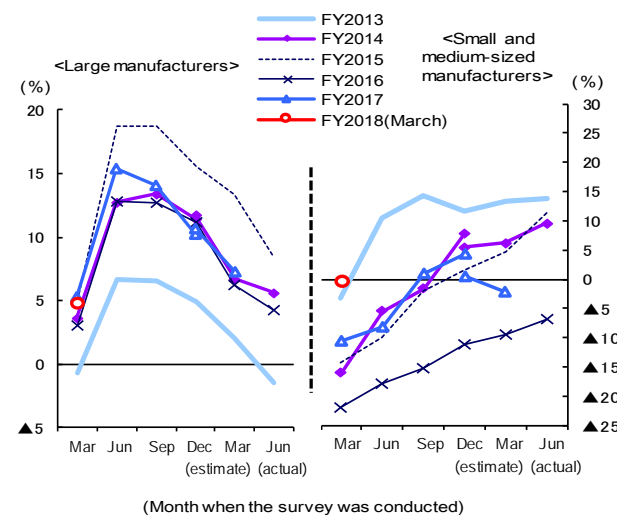
Source: The Japan Research Institute, Ltd. based on data of the Nikkei / IHS Markit.

Figure 4-2 Leading Indicators for Business Fixed Investment <seasonally adjusted>



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

Figure 4-3 Change over Time in Planned Business Fixed Investment for Each Fiscal Year <year-on-year, %>



Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan, "The Tankan Surveys".

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# The Pace of Recovery in Income is Likely to Continue to be Slow

## ◆ Employment Conditions Continue to Improve

The employment situation continued to improve. In addition to an incremental increase in the number of workers since the inception of Abenomics, there has been a trend toward growing regular employment opportunities since mid-2015. Against the backdrop of labor shortages, regular employment accounted for the majority of employment expansion in 2017. This indicates that the employment situation has been improving in terms of both the number and quality of jobs.

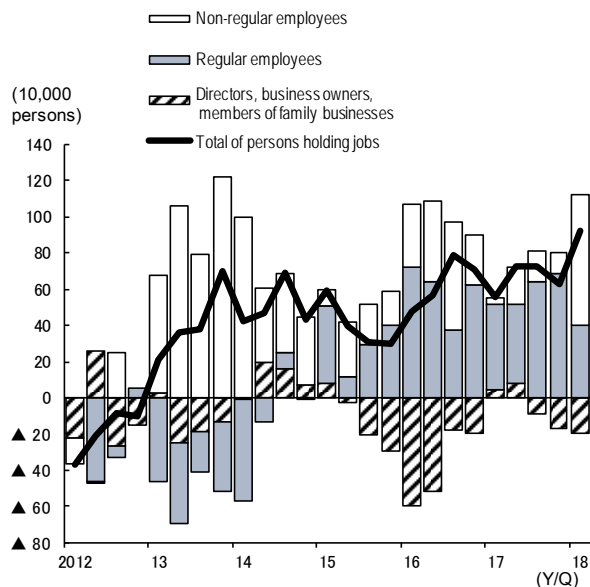
Looking at wages, scheduled salaries have been steadily increasing mainly among full-time workers, particularly in transportation, postal service, wholesale and retail businesses, which face a serious labor shortage problem. This indicates a movement toward securing the workforce through an increase in wages.

## ◆ The Slow Pace of Pickup in Real Income will Likely Continue

As for the future outlook, the employment situation is expected to continue to improve on the back of the economic recovery. Amid the expansion of regular employment by companies against the backdrop of labor shortages and favorable corporate earnings, scheduled salaries are expected to remain on the rise as seen from wage increases for the FY2018 spring labor offensive, which have exceeded levels recorded from the past two years.

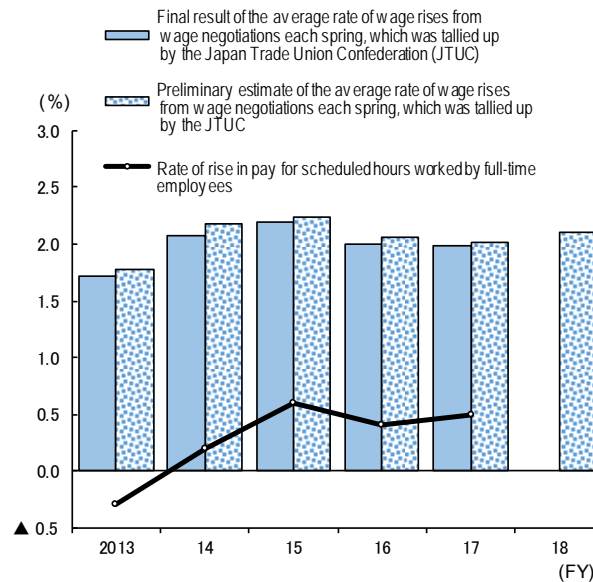
Nonetheless, the majority of companies are not likely to offer wage increases at the 3 percent target stated by the Japanese government, reflecting their persistent stance toward curtailing labor cost. On the other hand, considering a rise in consumer prices, real income is anticipated to remain on a modest recovery path.

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



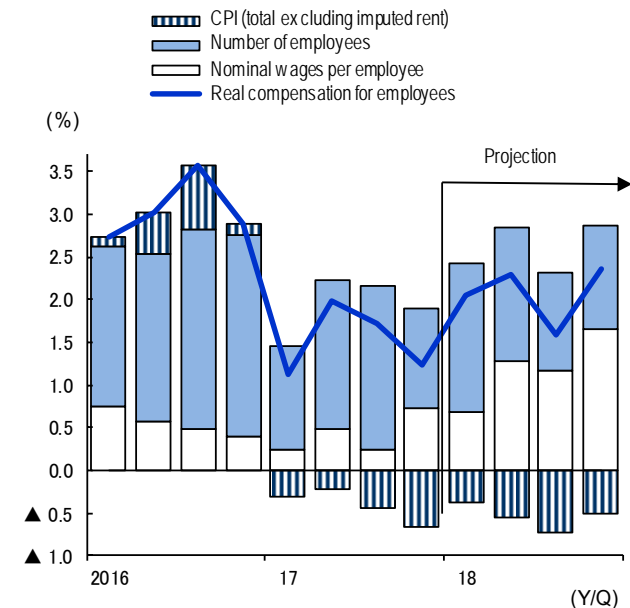
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Health, Labor and Welfare.  
Note: Regular employees are persons employed for an indefinite period.

Figure 5-2 Rate of Wage Rises Resulting from Wage Negotiations Each Spring



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Health, Labor and Welfare, Japan Trade Union Confederation (JTUC).

Figure 5-3 Earnings for Employees  
<year-on-year % change>



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

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# Signs of Moderate Recovery Have been Seen in Private Consumption Expenditure

## ◆ Signs of Gradual Recovery Have been Seen in Private Consumption

Consumer spending has been gradually recovering. Due to the impact of the cold weather and heavy snowfall, the Consumption Activity Index for the January-February period plunged for all durables, non-durables and services. In addition, with the effects of new vehicles coming to an end, the growth in automobile sales has slowed down.

However, leisure demand soared due to favorable weather in March. In the food service industry, both unit spending by customers and the volume of customer traffic grew on a year-on-year basis. Reflecting strong inbound demand, department store sales also turned positive year on year.

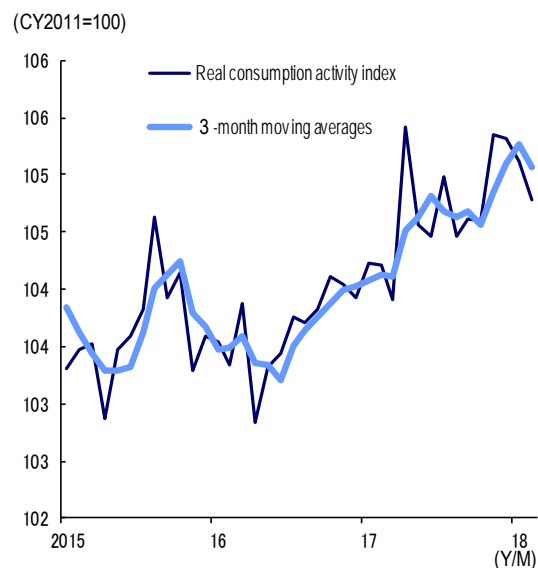
## ◆ The Moderate Pace of Pickup in Private Consumption will Likely

## Continue

As for the future outlook, consumer spending is expected to remain on a gradual recovery path due to an improved employment and income environment. As the prices of fresh foods have leveled off and stock prices have picked up, the deterioration in consumer sentiment turned out to be temporary, and the derailing of the recovery in consumption will likely be avoided.

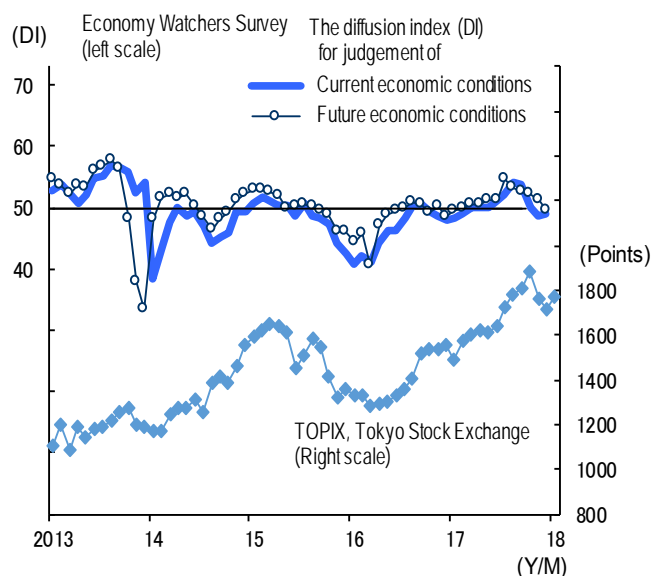
Meanwhile, housing investment is anticipated to weaken for the foreseeable future. In fact, the number of new housing loans turned negative from the previous year. Despite the low interest rate which had underpinned housing investment, the rental market is likely to stagnate against the backdrop of subleasing contract issues and concerns over excessive supply, as seen in a rise in vacancy rates.

Figure 6-1 The Consumption Activity Index



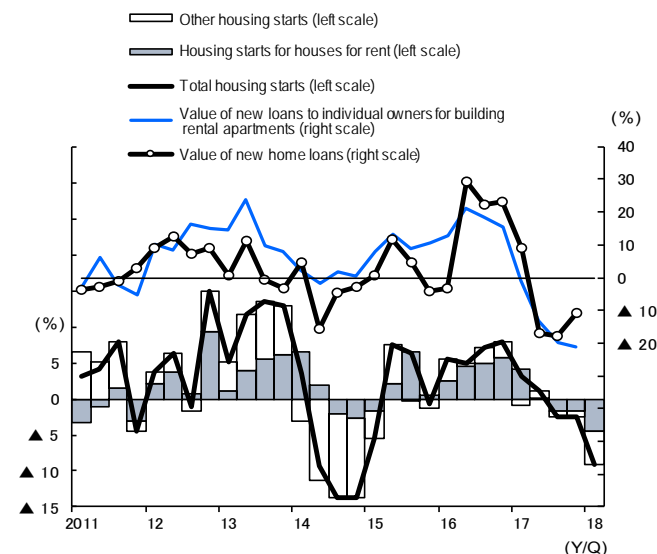
Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan.

Figure 6-2 Economy Watchers Survey and Stock Prices



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

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



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

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# Topics : Consumption Market Boosted by Older Workers of Baby Boomers

## ◆ Expansion of the Consumption Market Thanks to Elderly Workers

The employment rate for elderly workers aged between 65 and 69 years has been increasing. Consumption expenditures of workers' households tend to be higher than those of non-working households, which has become a factor in boosting the consumption market. It is estimated that consumption demand was boosted by 500 billion yen over the past five years mainly in the following areas.

The first area is consumption related to hobbies and social expenses involving families and friends. Compared with non-working elderly households, elderly workers' households tend to spend approximately 6,800-yen more pocket money and approximately 3,500-yen more on social expenses, including gifts to children and grandchildren, each month.

The second area is work-related consumption. Elderly workers' households tend to spend approximately 2,900-yen more on clothing and shoes such as suits and leather shoes, approximately 1,800-yen more on eating out, and approximately 1,200-yen more on transportation each month. In addition, they tend to spend

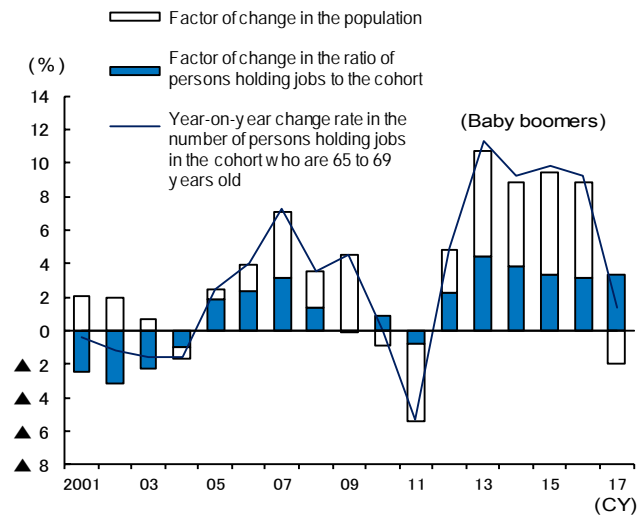
approximately 900-yen more per month on prepared meals in order to save time needed for cooking.

On the other hand, expenditures for time-consuming pastimes in the households of elderly workers have been decreasing. Such households tend to spend approximately 1,400-yen less per month in expenditures related to travel such as expenses for package tours, accommodations, etc. Although elderly workers have surplus funds, there may be few opportunities for leisure consumption, as it is more difficult for them to take long leaves of absence.

## ◆ Consumption-boosting Effects are Likely to Decline

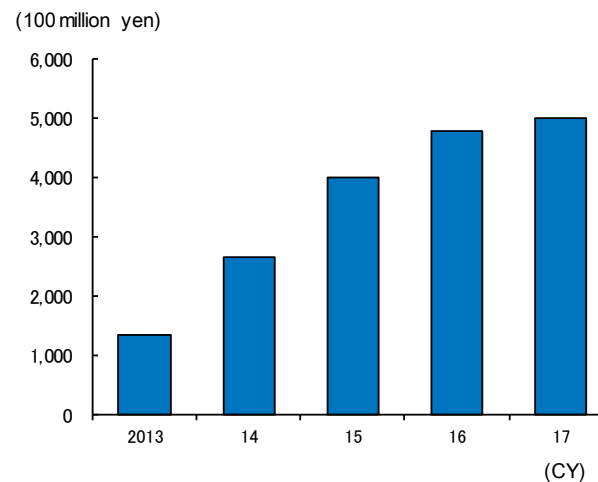
The consumption boost over the past five years is due partly to the effect of the population increase from baby boomers. As for the future outlook, while the employment rate is likely to rise continuously, growth in the number of workers aged between 65 and 69 years is anticipated to decline due to a decrease in the population in that age group. This will also result in diminishment of the consumption-boosting effects of elderly workers.

Figure 7-1 Change in the Number of Persons Holding Jobs in the Age Group of 65 to 69 Years Old  
<year-on-year % change>



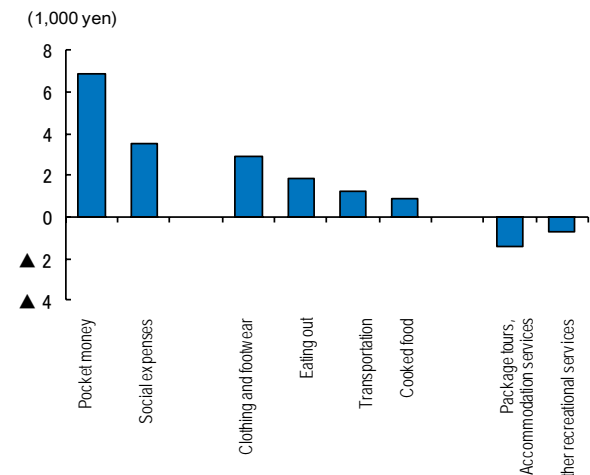
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.

Figure 7-2 Accumulated Effect of Consumption Expenditure of the 65 to 69 Year Old Age Group who are Holding Jobs



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.  
Note: Accumulated value with base year 2012.

Figure 7-3 Difference between those in the 65 to 69 Year Old Age Group who Hold Jobs and don't Hold Jobs



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

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## Prospects for Japan's Economy - Projected Real GDP Change; 1.1% in FY2018 and 0.9% in FY2019

### ◆ 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 January-March period 2018 declined by 0.6 percent on an annualized quarter-on-quarter change basis (national accounts, the first preliminary estimates), a fall for the first time in 9 quarters.

Viewed by demand item, it is notable that some negative factors were concentrated in this period. First, private consumption expenditure decreased slightly. The reasons for the decline were that 1) the purchasing power of consumers lowered due to the rise in fresh food price, etc., and 2) expenditure on durable consumer goods such as household appliances had a reactionary fall from the previous quarter when replacement buying was buoyant towards the end of last year. Second, Exports slowed down because 1) demand for electronic parts and devices in Asia had a downswing, and 2) consumption expenditure of foreign tourists in Japan was slow to increase due to bad weather.

(2) Looking ahead, it is predicted that inventory adjustment, mainly in the electronic parts and devices industry, will weigh down production activity. However, it can be judged that it is unlikely that production activity will falter. This is because a rising trend in exports will likely continue, against the backdrop of solid growth in overseas economies and a recovery in demand for business fixed investment mainly in China.

With respect to domestic capital investment, positive factors will contribute to its growth. These include: 1) construction investment will stay solid, driven by redevelopment projects in metropolitan areas as well as by new building of accommodations and business logistics facilities, 2) willingness for business fixed investment in manufacturers is likely to improve, encouraged by a rise in exports, and 3) labor saving and rationalization investment will be buoyed by a shortage of workers.

Thus, it is projected that Japan's economic activity will continue its recovery trend, led by the corporate sector.

(3) In the household sector, it is predicted that private consumption expenditure will return to its moderate rising trend. This is mainly because income environments continue to improve, reflecting the fact that 1) the pace of the increase in cash earnings for scheduled time has accelerated, and 2) income in the middle to lower

income brackets has visibly improved due the rise in the ratio of regular employees to the total.

(4) As a result, it is projected that real GDP in FY 2018 will grow at a pace over Japan's potential output growth rate, which is currently estimated to be about 1.0 percent, as demand at home and abroad stays solid. Specifically, it is forecast that the annual real GDP growth rate will be 1.1 percent in FY2018.

(5) With respect to economic activity in FY2019, it is predicted that the pace of real GDP growth will decelerate, since private consumption expenditure will likely be pushed down in total by 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 falter. This is because 1) the extent of the rise in the consumption tax rate in 2019 will be less than that in April 2014 (from 5 to 8 percent), 2) the degree of burden such as an increase in income tax and social insurance premiums is estimated to be less than that in 2014, and 3) a reduced tax rate is planned to be introduced. As a result, real GDP will likely grow by almost 1 percent in FY2019.

### ◆ The year-on-year Change Rate in the Core CPI will Likely Stay at about 1 Percent

(6) The core CPI, which excludes fresh food, expanded the extent of its year-on-year increase gradually, albeit slightly, after having turned into positive territory in January 2017. A rise in food prices (excluding fresh food) pushed up the total rate of the year-on-year increase. Then, it flattened, reflecting a slowdown in the pace of the rise in energy prices.

Looking ahead, it is predicted that the year-on-year increase rate in the core CPI will stay at about 1 percent, which is below the BoJ's target of 2 percent. This is because, while upward pressure will likely strengthen due to an improvement in supply-demand conditions on an aggregate basis, the pace of the year-on-year rise in energy prices will likely slow down.

Figure 9 Projections for GDP Growth and Main Indicators of Japan ( as of May 16, 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)	(Actual)	(Projection)	(Projection)
	(Actual)		(Actual)	(Projection)			(Projection)				(Projection)	(Actual)	(Actual)	(Projection)	(Projection)
Real GDP	2.0	0.6	▲ 0.6	1.6	1.6	1.3	1.4	1.4	2.4	▲ 3.6	1.3	1.2	1.5	1.1	0.9
Private Consumption Expenditure	▲ 2.6	0.9	▲ 0.0	1.3	1.0	1.0	1.1	1.8	5.2	▲ 9.1	1.3	0.3	0.8	0.7	0.7
Housing Investment	▲ 6.4	▲ 10.3	▲ 8.2	▲ 6.7	0.7	3.3	6.5	1.9	▲ 2.4	▲ 9.8	▲ 7.2	6.2	▲ 0.3	▲ 4.1	▲ 0.1
Business Fixed Investment	4.0	2.6	▲ 0.3	4.1	3.6	3.6	2.8	2.4	2.4	2.3	2.3	1.2	3.0	2.9	2.7
Private Inventories (percentage points contribution)	( 1.5)	( 0.4)	(▲ 0.6)	(▲ 0.1)	(▲ 0.1)	( 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	0.1	0.9	0.9	0.9	0.8	0.8	0.8	0.8	0.8	0.5	0.4	0.6	0.8
Public Investment	▲ 10.0	▲ 1.5	0.1	3.5	4.2	▲ 6.9	▲ 1.5	0.0	1.0	0.5	0.3	0.9	1.5	▲ 0.1	▲ 0.6
Net Exports (percentage points contribution)	( 2.2)	(▲ 0.4)	( 0.3)	( 0.2)	( 0.2)	( 0.3)	( 0.1)	(▲ 0.0)	(▲ 0.5)	( 1.1)	( 0.0)	( 0.8)	( 0.4)	( 0.3)	( 0.1)
Exports of Goods and Services	8.2	9.2	2.6	3.1	3.2	3.5	3.6	3.6	3.5	2.8	2.8	3.6	6.2	4.1	3.4
Imports of Goods and Services	▲ 5.2	12.9	1.2	1.9	2.0	2.0	3.0	3.9	6.3	▲ 3.3	2.9	▲ 0.8	4.0	2.7	2.8
(Ref.) Domestic Private Demand (percentage points contribution)	( 0.4)	( 1.0)	(▲ 0.9)	( 1.1)	( 1.1)	( 1.2)	( 1.2)	( 1.3)	( 2.7)	(▲ 4.7)	( 1.2)	( 0.3)	( 1.0)	( 0.7)	( 0.7)
(Ref.) Public Demand (percentage points contribution)	(▲ 0.5)	(▲ 0.1)	( 0.0)	( 0.4)	( 0.4)	(▲ 0.2)	( 0.1)	( 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	2.0	1.9	1.4	0.7	0.6	1.1	2.1	2.2	2.5	1.6	1.7	1.0	1.6	1.1	2.0
GDP deflator	0.1	0.1	0.5	▲ 0.3	▲ 0.2	0.1	0.6	0.8	0.9	1.2	1.2	▲ 0.2	0.1	0.1	1.0
Consumer Price Index (excluding fresh food)	0.6	0.9	0.8	0.9	1.1	1.0	1.1	0.9	0.8	1.8	1.9	▲ 0.2	0.7	1.0	1.3
(excluding fresh food, consumption tax)	0.6	0.9	0.8	0.9	1.1	1.0	1.1	0.9	0.8	0.8	0.9	▲ 0.2	0.7	1.0	0.8
Unemployment Rate (%)	2.8	2.7	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 (JY/US\$)	111	113	108	109	109	110	111	111	110	110	109	108	111	110	110
Import Price of Crude Oil (US\$/barrel)	50	58	67	71	70	68	68	68	68	68	68	47	57	69	68

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.