

Monthly Report of Prospects for Japan's Economy

January 2021

Macro Economic Research Center
Economics Department



The Japan Research Institute, Limited

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

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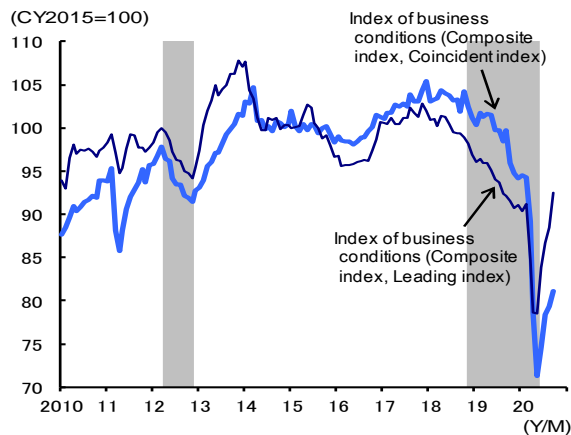
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The General Situation – While Signs of Economic Recovery Remain, Level of Economic Activity Has Been Sluggish

Figure 1-1 Economic Activity

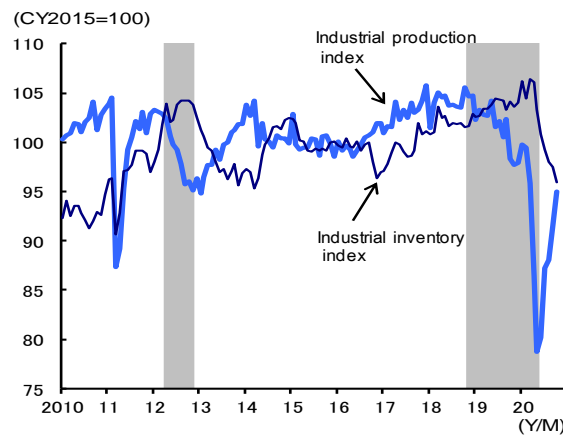
Indices of business conditions continued to rise both in terms of the CI coincident index and the CI leading index.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

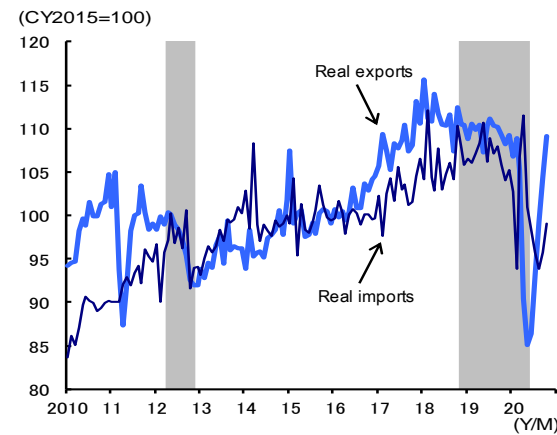
The industrial production index saw a rise in a wide range of industries, including machinery for general and business purposes and automobiles.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

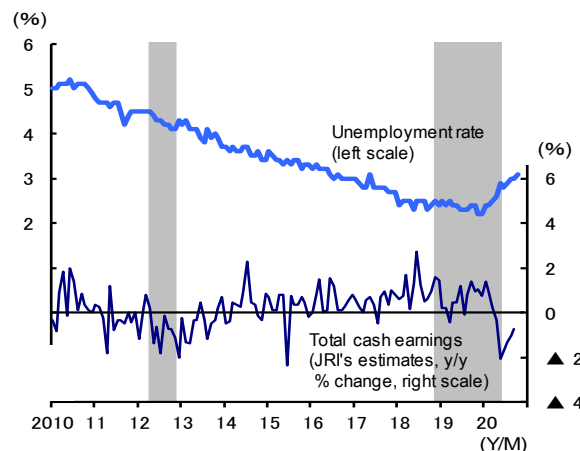
Exports increased, mainly to the United States. Imports remained at a low level amid sluggish economic activities.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate rose to the 3% range. Nominal wages declined mainly for non-scheduled salaries (overtime pay).

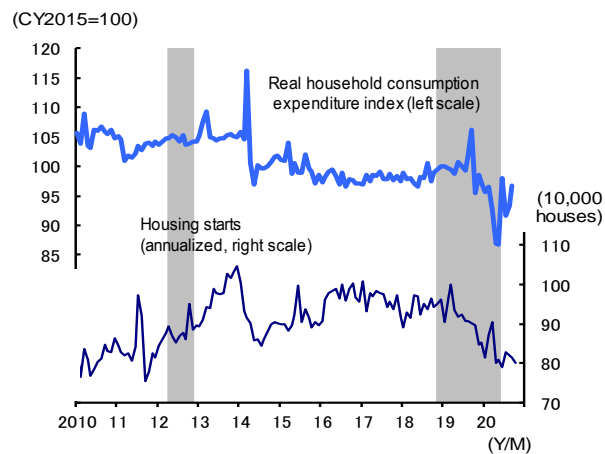


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

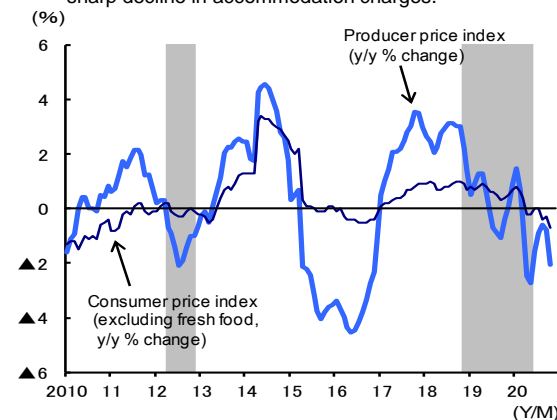
Stagnant service expenditure has been weighing on real household consumption. Housing starts were sluggish.



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

Figure 1-6 Prices

Producer prices declined, mainly for petroleum and coal products. Consumer prices were sluggish, reflecting a sharp decline in accommodation charges.



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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While Overseas Demand Continued to Pick up, the Recovery of Private Consumption Slowed

◆ The July-September Period Saw Significant Positive Growth

Japan's real GDP (second preliminary report) for the July-September 2020 period increased 22.9% on an annualized quarter-on-quarter basis, recording significant positive growth. In terms of domestic demand, personal consumption increased 22.1% on an annualized quarter-on-quarter basis on the back of a rise in the number of people out on the street as a result of the cancellation of the state of emergency declaration. Looking at external demand, exports also saw a significant surge of 31.2% on an annualized quarter-on-quarter basis, due to the recovery in exports to the United States mainly for automobiles in addition to a rise in exports to China.

◆ Production and Exports Continued to Pick Up

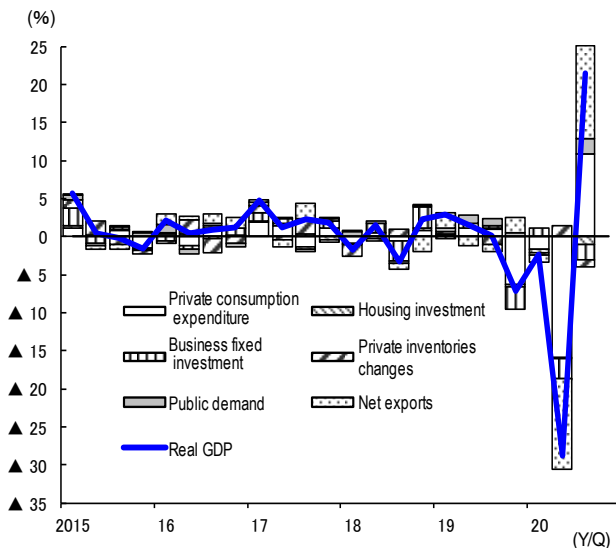
Currently, external demand is continuing to rebound. Real exports in October increased for the fifth consecutive month, rising 5.3% from the previous month. While exports to China, whose economy is continuing to pick up, remained strong, exports to other Asian countries and the United States mostly recovered to the levels prior to the outbreak of the novel coronavirus.

In response to the increase in exports, production activities continued to recover. The industrial production index for October rose 4.0% from the previous month, resulting in five months of consecutive gains. Production saw an increase across a wide range of industries including general and production machinery. Looking at future production plans, however, the recovery of industrial production is expected to pause, up 2.7% month-over-month in November and down 2.4% month-over-month in December.

◆ Recovery of Personal Consumption Has Slowed

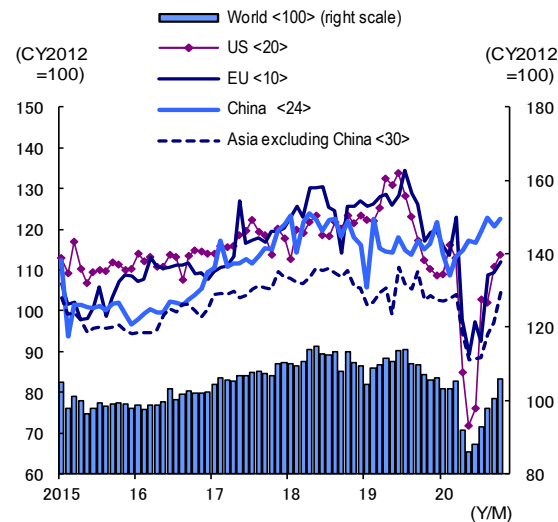
Meanwhile, looking at domestic demand, the pace of recovery in private spending has slowed, as a rise in the number of new coronavirus cases and the lingering tendency toward self-restraint weighed on consumption. The real consumption activity index was up a mere 0.5% month-over-month in September. It only recovered to the level of slightly over 60% of the decline following the outbreak of the novel coronavirus.

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



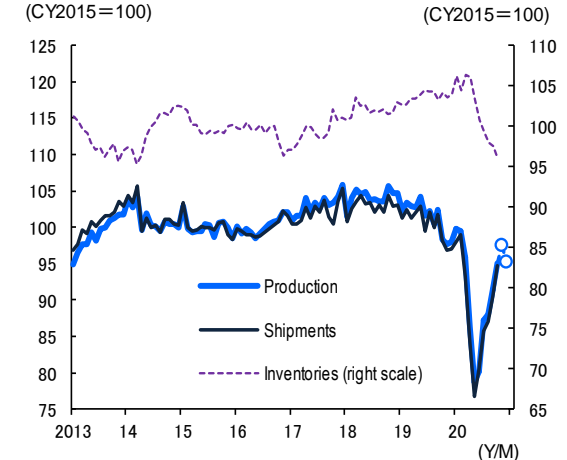
Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office.

Figure 2-2 Real Exports by Destination <seasonally adjusted>



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 CY2019.

Figure 2-3 Industrial Production Index <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 the industrial production index are forecasts for November and December 2020 based on the production forecast index.

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Exports of Goods Rebounded to the Level Prior to the Outbreak of the Novel Coronavirus

◆ Goods Exports Have Picked up, Mainly for Transportation Machinery

Goods exports in October 2020 increased month-over-month for the fifth consecutive month, rebounding to the level prior to the outbreak of the novel coronavirus. By item, shipments of transportation machinery continued to recover sharply on the back of a recovery in global automobile sales, while those of capital goods and electronic parts and devices remained on a rising trend.

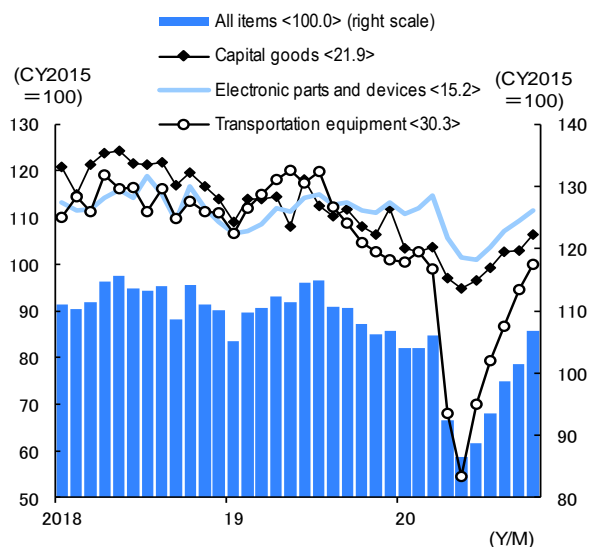
As for future prospects, exports are expected to remain on a recovery trajectory, with goods exports having moved out of the worst period as the economy has started to pick up around the world. However, since there is an absence of a strong global economic engine, such as that provided by China after the collapse of Lehman Brothers, and an increase in the number of new coronavirus cases, mainly in developed countries, will likely weigh on the economy, the pace of increase in exports is expected to gradually slow down going forward.

◆ Demand Related to Inbound Tourism Was Almost Zero

Amid restrictions on overseas travel around the world, the number of tourists that visited Japan in October fell 98.9% on a year-on-year basis.

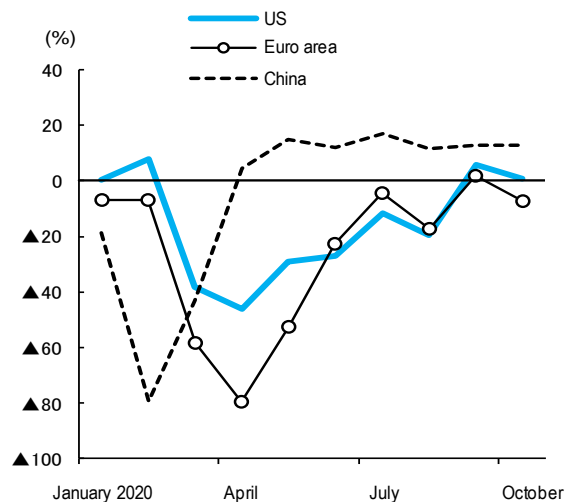
While the Japanese government has been easing immigration restrictions by permitting the entry of business travelers and international students from around the world since October, it will not allow tourists to enter the country for the time being. Therefore, demand related to inbound tourism is expected to remain virtually nonexistent even after this winter. In addition, the pace of recovery is anticipated to be moderate, as people will likely continue to refrain from overseas travel due to concerns over infection risks even if the restrictions on tourists are relaxed. In fact, the International Civil Aviation Organization (ICAO) predicted that the number of international passengers will only recover to around 40% of the level prior to the outbreak of the novel coronavirus even in June 2021.

Figure 3-1 Real Exports by Item
<seasonally adjusted>



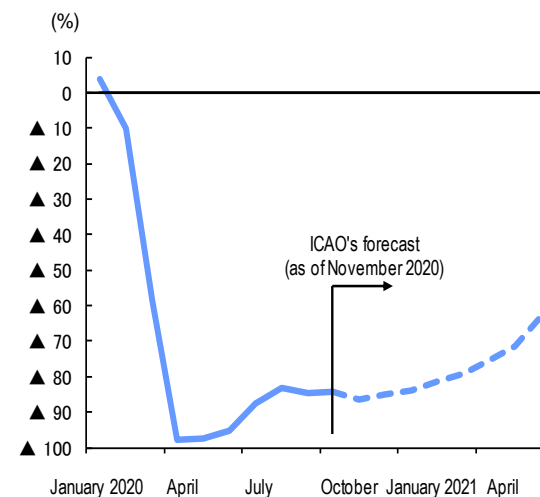
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, The Bank of Japan.
Note: Figures in the angled brackets show the shares in total nominal exports in CY2019.

Figure 3-2 New Car Sales by Country or Area
<year-on-year % change>



Source: The Japan Research Institute, Ltd. based on data of European Automobile Manufacturers' Association and so on.

Figure 3-3 Number of International Air Travelers
<% change from the same month in 2019>



Source: The Japan Research Institute, Ltd. based on data of the International Civil Aviation Organization (ICAO).

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Business Fixed Investment Will Likely Start to Recover as Corporate Earnings Pick Up

◆ Corporate Earnings Saw a Moderate Recovery

In the July-September 2020 period, sales on an industry-wide basis increased 3.8% from the previous quarter, up for the first time in five quarters. In the manufacturing industry, sales increased across a wide range of industries including transportation machinery on the back of the recovery in consumption of durable goods both in Japan and overseas. The nonmanufacturing industry also recorded higher sales thanks to the resumption of sales operations and an increase in the number of people out on the street following the cancellation of the state of emergency declaration. In addition, current profits on an industry-wide basis were up 33.7% from the previous quarter, recording increased profit for the first time in six quarters. Having said that, as people continued to refrain from going out and avoid the “Three Cs” (closed spaces, crowded places and close contacts) due to the effect of the second wave of coronavirus during the summer, industries including transportation services, accommodation and food services as well as living-related services continued to record losses.

Corporate earnings for the October-December period are expected to remain on a recovery path, mainly for the manufacturing industry, on the back of a rise in goods exports, among other factors. The pace of recovery in the nonmanufacturing industry, however, will likely be moderate due to the lingering effects of self-restraint on outings amid the third wave of coronavirus.

◆ Recovery of Business Fixed Investment Is Anticipated in the Future

In the July-September period, capital investment on an industry-wide basis was down for the second consecutive quarter, falling 1.3% from the previous period. Amid continuing uncertainty over the future, investment restraint has been occurring, particularly in industries that have been significantly affected by the coronavirus pandemic. However, since the amount of investment is tracked on a progress basis, this could have reflected the delayed impact of the decline in orders received in early spring of year 2020.

As for future prospects, business fixed investment is expected to shift toward a moderate recovery, though lagging the recovery in corporate earnings.

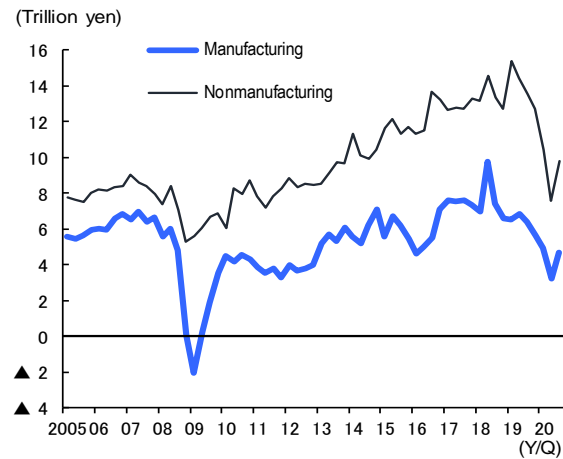
Figure 4-1 Sales Value of Japanese Corporations by Type
<seasonally adjusted>



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

Note: All industries except for financial services and insurance.

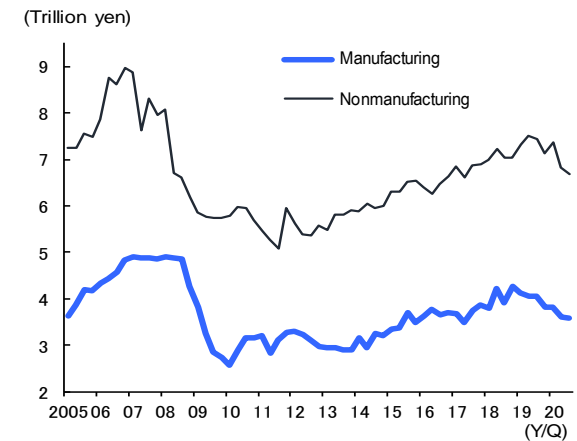
Figure 4-2 Current Profits of Japanese Corporations by Type
<seasonally adjusted>



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

Note: All industries except for financial services and insurance.

Figure 4-3 Business Fixed Investment of Japanese Corporations by Type
<seasonally adjusted>



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

Note: 1. All industries except for financial services and insurance.

2. Excluding software investment.

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The Unemployment Rate Is Expected to Rise to Nearly 4% in the Future

◆ The Sense of a Bloated Workforce Among Enterprises Has Remained at a High Level

The ratio of active job openings to applicants is still above the 1.0 level, but has declined 0.45 points since the beginning of year 2020 and is hovering around its lowest level since December 2013. Although the number of active job openings started to rise moderately after bottoming out in May, workers who had lost their jobs in the wake of the outbreak of the novel coronavirus recently resumed their job-hunting activities, contributing to the decline in the ratio of active job openings to applicants.

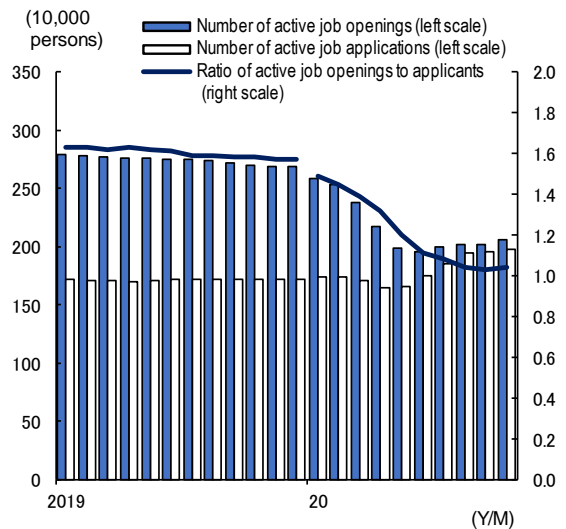
Meanwhile, the number of non-regular workers has been on a declining trend, but the overall decline has been limited to around 1% on a year-on-year basis. The corporate sector's move to cut back on employment has been rather restrained, and the sense of a bloated workforce among enterprises has remained at a high level.

The employment conditions DI in the BOJ September 2020 Tankan Survey was minus six percentage points, remaining at its highest level since September 2013 as in the previous survey. Judging from the correlation with the DI, the unemployment rate will likely rise to nearly 4% between the end of 2020 and the beginning of 2021.

◆ Total Cash Earnings Saw a Decline

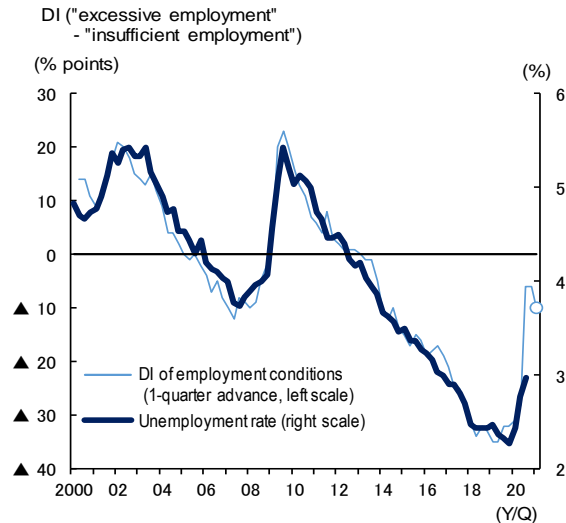
The novel coronavirus has also had ripple effects on wages. Total cash earnings in September plunged 0.7% year-on-year, recording a year-on-year decline for the sixth consecutive month. Against the backdrop of a decline in overtime due to sluggish economic activity, non-scheduled salaries (overtime pay) declined significantly. As for future prospects, it is anticipated that special salaries, mainly winter bonuses, will decrease, and that downward pressure on scheduled salaries will increase going forward. As a result, the fall in wages is expected to accelerate once again.

Figure 5-1 Ratio of Active Job Openings to Applicants
<seasonally adjusted>



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

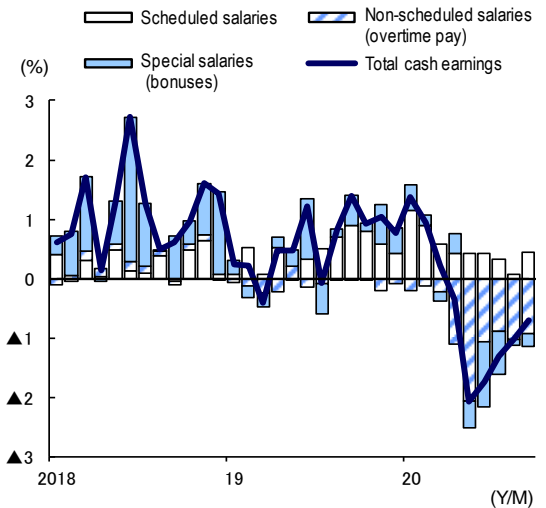
Figure 5-2 Tankan DI of Employment Conditions and Unemployment Rate



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

Note: The latest figure of the DI is a forecast.

Figure 5-3 Contributions to Change Rate of Nominal Wages
<year-on-year % change>



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

Private Consumption Will Likely Remain Sluggish for a Long Period of Time

◆ Recovery of Consumption Has Remained at a Standstill

Private consumption has remained virtually flat. Retail sales in October 2020 increased slightly, up 0.4% from the previous month. Meanwhile, the recovery of service consumption has been limited amid the lingering tendency toward self-restraint, despite the commencement of the government's "Go To Eat" campaign in October. Sales of food services in October were down 10% compared with the same month in 2018, when there was no impact of the consumption tax hike, indicating the continuing declining trend.

In future prospects, private consumption will unavoidably remain sluggish for a long period of time. As the number of new coronavirus cases has started to increase once again since the beginning of November, the number of people who visited retail and entertainment facilities, which had remained at a level lower than that prior to the outbreak of the novel coronavirus, has been declining further, mainly in the areas with increasing infections. In such areas, some local governments have requested restaurants and bars to shorten their operating hours once again. In addition, the

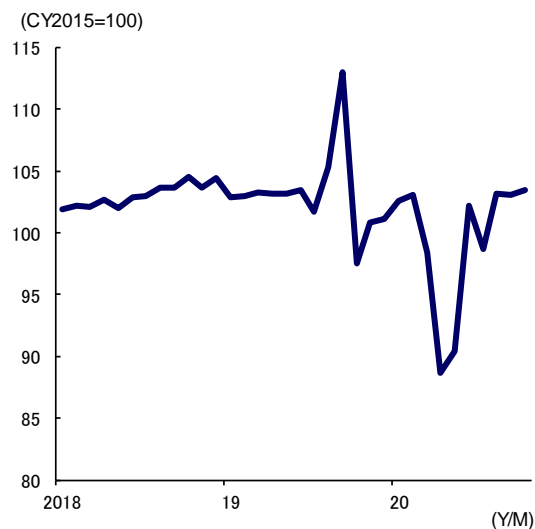
deterioration in employment and income conditions such as the rise in the unemployment rate and decline in winter bonuses is anticipated to exert downward pressure on the recovery of consumption going forward. Therefore, private spending is highly likely to remain at a level below that prior to the outbreak of the novel coronavirus even through fiscal 2021.

◆ Housing Investment is Expected to Remain Lackluster for the Foreseeable Future

The number of housing starts in October decreased 1.6% from the previous month, recording the third consecutive monthly fall. By type of housing, while the number of housing starts for owner-occupied housing and rental housing increased slightly, the decline in that for subdivision housing pushed down the overall housing starts.

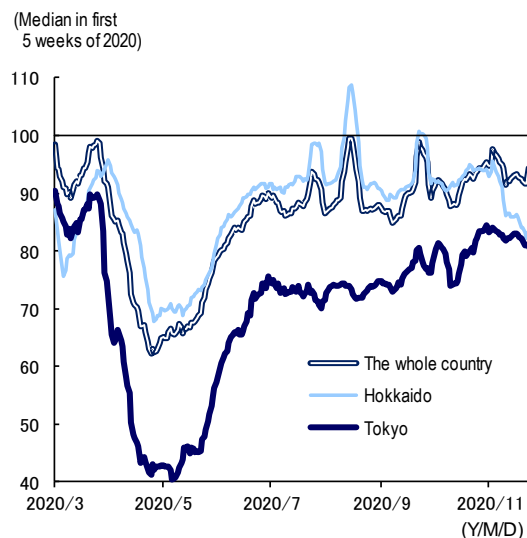
As for future prospects, against the backdrop of a more cautious lending approach by financial institutions toward apartment construction projects in addition to weak consumer confidence due to the worsening employment and income environment, housing investment will likely remain lackluster on the whole.

Figure 6-1 Retail Sales Value
<seasonally adjusted>



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

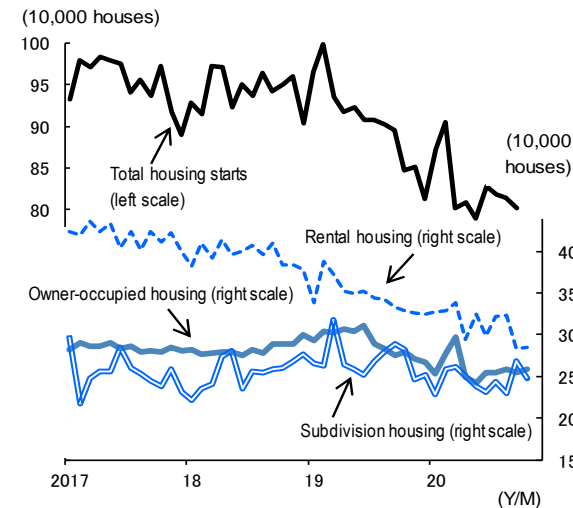
Figure 6-2 Number of People Who Visited Retail and Entertainment Facilities



Source: The Japan Research Institute, Ltd. based on data of Google "Covid-19 community mobility report".

Note: 7-day moving averages.

Figure 6-3 Housing Starts by Type
<annualized, seasonally adjusted>



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

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Topic: The Gap in Business Performance Has Been Increasing Due to Differences in Location and Sales Strategies

◆ Sales Have Been Affected by the Decrease in Human Traffic in Central Urban Areas

As lifestyles and consumption behaviors change dramatically due to the outbreak of the novel coronavirus, the gap in business performance among retailers has become clear.

The number of people staying in their residential areas has increased due to the spread of telework, while human traffic in central urban areas, where stations and workplaces are located, has decreased significantly. As a result, sales of companies that had been operating their businesses in central urban areas have been hit hard. For example, looking at sales of shopping centers by location, while sales of stores in the central urban areas of major cities decreased significantly, sales of stores in surrounding areas increased from the previous year. Disparities in business performance due to location can be observed in many types of businesses, including

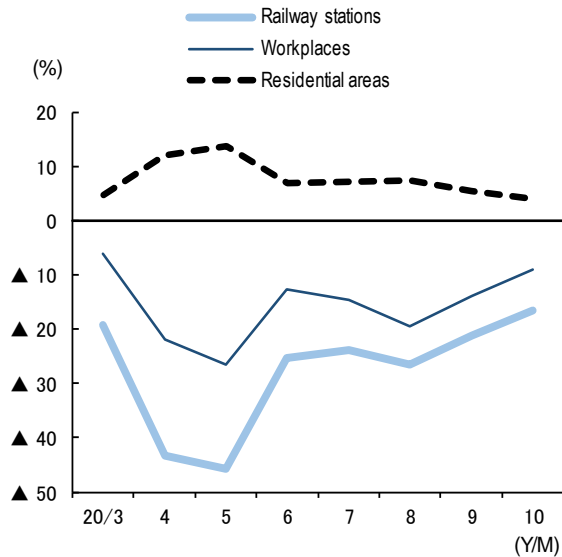
convenience stores, drugstores and consumer electronics retail stores.

Moreover, the outbreak of the novel coronavirus has accelerated the shift from brick-and-mortar stores to e-commerce. As a result, there is a widening gap in business performance between companies that have already expanded into the online space and those that have not.

◆ Sales Strategy Must Be Reviewed

Changes in lifestyles and consumption behaviors, such as the shift of people from central urban areas to residential areas and the expansion of consumption based on e-commerce, are likely to take root to a certain extent even after the spread of the novel coronavirus settles down. This indicates that sales composition in the retail industry will likely change considerably as a result of the outbreak of this pandemic. In order to boost sales amid such changes, companies will need to review the allocation of stores and employees and strengthen online sales.

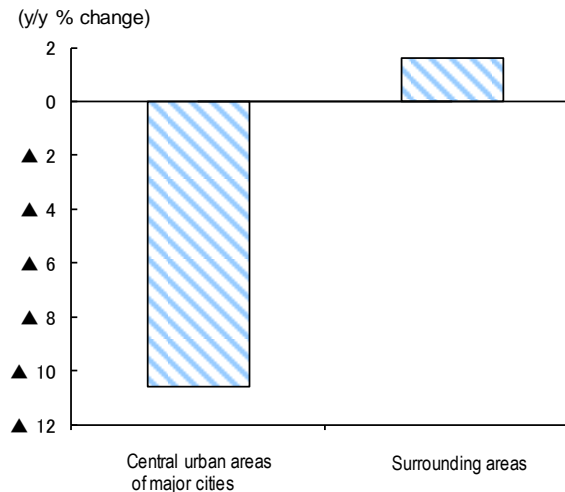
Figure 7-1 Change in Human Traffic by Place



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

Note: Change from the median in the first 5 weeks of 2020.

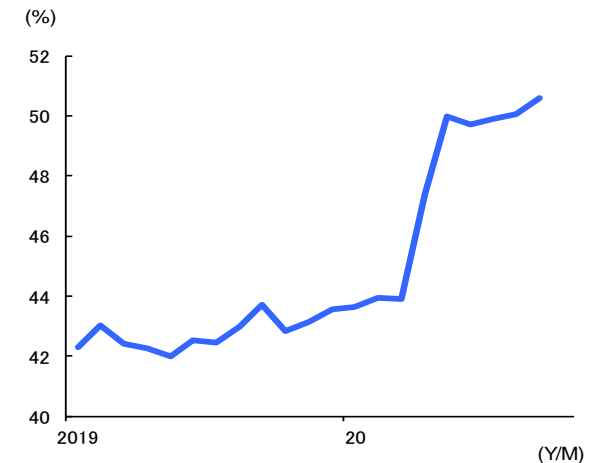
Figure 7-2 Sales of Shopping Centers by Location <October 2020>



Source: The Japan Research Institute, Ltd. based on data of Japan Council of Shopping Centers.

Note: Major city indicates a city with a population of 150,000 or more.

Figure 7-3 Ratio of Households Which Use E-commerce <seasonally adjusted>



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

Note: Households with 2 or more members.

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Prospects for Japan's Economy - Projected Real GDP Change; -5.1% for FY2020 and 3.5% for FY2021

◆ Japan Will See a Negative Growth Rate of Minus 5.1% for FY2020 and Will Not Return to Its Pre-coronavirus Growth Level Until FY2023

(1) According to the Second Preliminary Quarterly Estimates of GDP (2nd QE), Japan's real GDP for the July-September 2020 period increased 22.9% on an annualized quarter-on-quarter change basis (up 5.3% from the preceding quarter), with a slight upward revision from the First Preliminary Quarterly Estimates of GDP (1st QE) (21.4% on an annualized quarter-on-quarter change basis; up 5.0% from the preceding quarter). Looking at the revisions by demand item, however, while personal consumption and capital investment have been revised upward, the range of revision from the First Preliminary Quarterly Estimates was limited. As the level of GDP for the July-September period has remained significantly below that prior to the outbreak of the novel coronavirus, there is no change in the perception that Japan's economy remains in a very severe situation.

(2) The high growth rate for the July-September period was due largely to the recovery from the excessive decline in economic activities as a result of the Japanese government's declaration of a state of emergency and lockdown measures taken in other countries. As there are no prospects that the spread of the novel coronavirus will settle down any time soon, the growth rate for the October-December period will likely be diminished considerably.

(3) As for exports, trade in goods has almost recovered from the decline following the outbreak of the novel coronavirus, and the sharp recovery appears to have largely come to an end. The pace of growth in exports is expected to slow significantly in 2021, as some countries have recently resumed restrictions on economic activities following the rise in the number of new coronavirus cases once again.

(4) Meanwhile, in terms of domestic demand, while capital investment is expected to pick up on the back of demand for investment related to digitization, personal consumption will likely be hampered by the lingering tendency toward self-restraint, depending on the number of new coronavirus cases. Furthermore, deteriorating employment and income conditions are anticipated to weigh on the recovery as companies are increasingly feeling employment surpluses and a further increase in

the unemployment rate will be unavoidable in the future. It is projected that personal consumption will remain below the level before the outbreak of the novel coronavirus for a long period of time, given the strong downward pressure on wages, especially bonuses.

(5) Due to the foregoing, the pace of economic recovery will remain modest, and Japan will likely see negative growth for FY2020 at a rate of minus 5.1%. While the growth rate is expected to turn positive at +3.5% in FY2021 and +1.7% in FY2022, the recovery will be weak compared with the decline in FY2020. Consequently, it is forecast that the recovery of Japan's GDP to the peak level recorded for the July-September 2019 period before the outbreak of the novel coronavirus will be delayed until FY2023.

◆ Prices Have Been Declining

(6) In October 2020, core CPI (excluding the impact of the increase in the consumption tax rate and the provision of free education) declined further from the previous month, down 0.8% year-on-year. While accommodation charges decreased further as travel to and from Tokyo, which had been excluded until last month, has been added to the scope of the government's "Go To Travel" campaign, energy prices also kept on falling, reflecting the year-on-year decline in crude oil prices.

As for the future outlook, downward pressure on prices from the viewpoint of supply and demand will likely intensify, and the trend of falling energy prices will likely continue. Consequently, core CPI is expected to diminish further, recording a year-on-year decline of about 1% toward the beginning of 2021.

Figure 9 Projections for GDP Growth and Main Indicators of Japan (as of December 8, 2020)

	(seasonally adjusted, annualised % changes from the previous quarter)											(% changes from the previous fiscal year)		
	CY2020		CY2021				CY2022				CY2023	FY2020	FY2021	FY2022
	7~9	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Projection)	(Projection)	(Projection)
	(Actual)	(Projection)	(Projection)				(Projection)				(Projection)	(Projection)	(Projection)	(Projection)
Real GDP	22.9	5.6	1.0	2.2	3.1	0.6	2.0	2.0	1.6	1.5	1.4	▲ 5.1	3.5	1.7
Private Consumption Expenditure	22.1	4.2	1.0	2.2	2.9	1.2	2.0	2.0	1.6	1.6	1.4	▲ 6.0	3.3	1.8
Housing Investment	▲ 21.2	2.8	10.4	5.8	4.5	▲ 2.5	▲ 0.3	1.8	2.7	1.4	0.2	▲ 6.6	2.7	1.0
Business Fixed Investment	▲ 9.3	10.4	5.9	3.7	2.4	2.6	3.6	3.6	2.8	2.6	2.4	▲ 6.8	3.7	3.0
Private Inventories (percentage points contribution)	(▲ 0.7)	(0.1)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.0)	(0.0)
Government Consumption Expenditure	11.6	1.8	▲ 3.5	1.1	3.8	▲ 2.6	1.0	0.7	0.7	0.7	0.7	2.6	1.0	0.5
Public Investment	1.9	3.0	2.1	▲ 3.3	▲ 0.6	0.6	0.8	0.4	▲ 1.6	▲ 1.4	0.8	3.7	0.0	▲ 0.2
Net Exports (percentage points contribution)	(11.5)	(1.2)	(▲ 0.1)	(0.2)	(0.3)	(0.2)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(▲ 1.2)	(0.8)	(0.1)
Exports of Goods and Services	31.2	31.0	3.8	4.9	6.2	2.8	3.9	3.9	3.4	3.4	3.0	▲ 13.1	8.8	3.7
Imports of Goods and Services	▲ 30.8	23.4	4.3	3.5	4.6	1.9	3.1	3.1	2.8	2.8	2.6	▲ 6.1	3.3	2.9
(Ref.) Domestic Private Demand (percentage points contribution)	(7.8)	(4.1)	(1.8)	(2.0)	(2.1)	(1.0)	(1.6)	(1.7)	(1.4)	(1.3)	(1.1)	(▲ 4.6)	(2.4)	(1.5)
(Ref.) Public Demand (percentage points contribution)	(2.6)	(0.6)	(▲ 0.6)	(0.1)	(0.8)	(▲ 0.5)	(0.3)	(0.2)	(0.1)	(0.1)	(0.2)	(0.7)	(0.2)	(0.1)

	(% changes from the same quarter of the previous year)											(% changes from the previous fiscal year)		
	7~9	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	FY2020	FY2021	FY2022
Nominal GDP	▲ 4.6	▲ 2.4	▲ 1.7	7.4	2.5	1.7	1.9	1.9	1.9	2.1	2.1	▲ 4.4	3.3	2.0
GDP deflator	1.2	0.2	0.2	▲ 0.3	▲ 0.5	0.0	▲ 0.1	0.0	0.3	0.4	0.5	0.7	▲ 0.2	0.3
Consumer Price Index (excluding fresh food)	▲ 0.2	▲ 1.2	▲ 0.9	0.0	0.1	0.6	0.5	0.6	0.6	0.7	0.7	▲ 0.6	0.3	0.6
(excluding fresh food, consumption tax, education free of charge)	▲ 0.5	▲ 1.2	▲ 0.8	0.0	0.1	0.6	0.5	0.6	0.6	0.7	0.7	▲ 0.7	0.3	0.6
Unemployment Rate (%)	3.0	3.4	3.8	3.8	3.6	3.4	3.3	3.2	3.1	3.0	2.9	3.2	3.5	3.1
Exchange Rates (JY/US\$)	106	104	104	105	105	105	105	106	106	106	107	106	105	106
Import Price of Crude Oil (US\$/barrel)	41	45	50	50	51	51	54	57	59	58	59	41	51	58

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.