

## ***Employee compensation is rising and the downward pressure on disposable income is fading***

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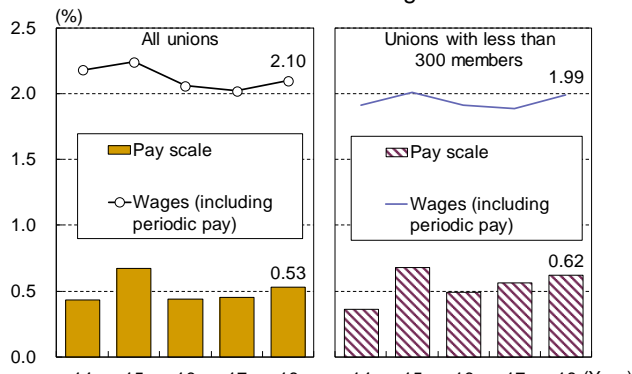
### 1. The Real Economy

According to the fourth tally of annually negotiated wage hike settlements published by Rengo (The Japanese Trade Union Confederation) on 19<sup>th</sup> April, wages (including periodic pay) increased by 2.10%, exceeding the previous year for the first time in three years, and the pay scale increase rose by 0.53% compared with last year (Chart 1). This includes wage (including periodic pay) and pay scale hikes of 1.99% and 0.62% respectively in unions with less than 300 members, which is close to the level in 2015 – the highest since the start of Prime Minister Abe’s second term. It is likely that the rate of wage hikes by small and medium-sized corporations, who find it comparatively harder to hire workers, will accelerate as population ageing and the resulting labour shortage worsens. It appears that the upward trend in the number of employees will continue for the time being owing to corporations’ strong appetite for hiring, which means employee compensation is forecast to rise in the future.

In addition to employee compensation, disposable income – real income after tax and social insurance premiums – is important in understanding household income. Disposable income is not included in the Quarterly Estimates of GDP; however, looking at the difference between FY2012, the start of the Abe administration, and FY2016 on a financial yearly basis, employee compensation increased by JPY16.8 trillion during this period, while disposable income increased by JPY7.9 trillion (Table 1). Omitting the rise in income tax as wages improve (which had a negative impact of JPY2.7 trillion on disposable income during the same period), it appears the reason for this disparity between employee compensation and disposable income is social security, which has squeezed disposable income in terms of benefits received and payments made. During the period from FY2012 to FY2016, growth of pension benefits was sluggish (impact of JPY0.9 trillion) and the burden of social insurance premiums increased (negative impact of JPY7.1 trillion). That being said, the cut to pension benefits which aimed to eliminate the impact of the additional benefits caused by negative CPI was only completed in FY2015, and there was not a reduction in pension benefits owing to the fact that the “macroeconomic slide” mechanism was not implemented for 2018. In addition, a phased increase in pension contributions was finished in 2017. Needless to say, a decrease in social security benefits and a rise in contributions are unavoidable in the long term as the population ages and shrinks, yet the downward pressure on disposable income from these factors is

forecast to fade at least in the short term. Looking at disposable income and the rise in employee compensation, household income from wages is expected to improve in FY2018.

Chart 1: Increase in Wage Pay Scale and Periodic Pay at the Annual Labour Negotiations



Note: 2018 is fourth tally of wage hike settlements, 2017 and previous years are a tally of the same period  
Source: RENGO, MUFG Bank Economic Research Office

Table 1: Breakdown of Households' Disposable Income

		(JPY, trillions)					
		FY2012	FY2013	FY2014	FY2015	FY2016	Impact on disposable income FY12→FY16
Benefits (①)	Employee compensation	253.1	254.9	259.6	263.5	269.9	16.8
	Operating surplus and mixed income (net)	38.3	39.2	38.0	39.3	37.3	-1.0
	Property income (net)	23.0	22.4	24.4	25.0	24.5	1.5
	Social benefits excluding social transfers in kind	77.3	77.6	76.9	77.7	78.2	0.9
Contributions (②)	Current taxes on income, wealth, etc.	26.0	27.8	28.1	28.8	28.7	-2.7
	Net social contribution	71.4	72.6	74.9	76.7	78.5	-7.1
	Other (net)	2.9	3.0	3.1	2.8	3.5	-0.5
Disposable income (① less ②)		291.3	290.6	292.8	297.2	299.3	7.9

Source: Cabinet Office, MUFG Bank Economic Research Office

## 2. Monetary Policy and Financial Markets

On 4<sup>th</sup> April, the Bank of Japan announced the output gap ([real GDP less potential GDP]/potential GDP) for the October – December 2017 quarter was 1.5%, the highest level since October – December 2007 where it peaked before the global financial crisis, which suggests the gap between demand and supply is tightening further (Chart 2). Meanwhile, the overall trend of prices is still not rising. In March, the core base of CPI, which excludes fresh food, maintained strong growth at 0.9% YoY, yet a significant portion of this rise was due to external factors such as energy prices and JPY depreciation which occurred mid-2017. Growth of the basic trend of CPI, which excludes energy as well as fresh food, remains gradual at 0.5% YoY.

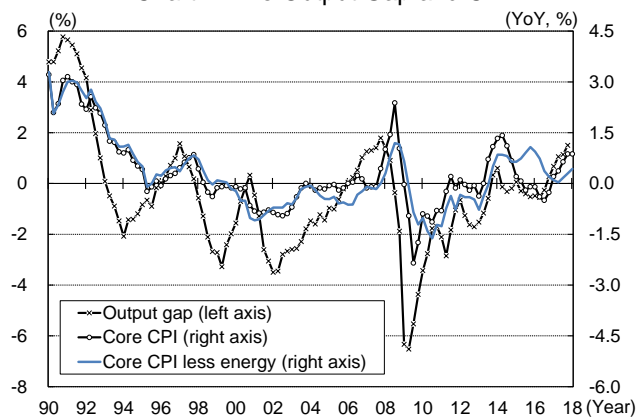
The reason for the situation described above is a certain level of delay before the knock-on effect from the tight gap between supply and demand hits prices. As a rule of thumb in the past, a change in the output gap was followed by a change in CPI (less fresh food and energy) with a lag of between two to six quarters. It seems that the tightening of the demand and supply balance will be fully reflected in prices from this point onwards.

On the other hand, the Cabinet Office and the Bank of Japan have noted that prices have not been particularly responsive to demand and supply in recent years, which can be confirmed by looking at the relationship between the output gap and the CPI growth rate (less energy and food prices). However, this relationship has been strengthening again since the start of Abe's second term (Chart 3). The current economic recovery – the second longest in the post war era – forms the backdrop for an improvement in corporate sentiment which, together with a rise in labour costs owing to a worsening labour shortage, means corporations are starting to consider raising their prices. It appears this possible rise in prices could lead to a greater response by CPI to changes in the output gap. Furthermore, the import penetration rate of consumer goods was following an upward trend in the long term but is currently falling as the JPY shifted to a trend of depreciation, which led corporations to move their production back to

Japan. In addition, the ratio of imported goods (which are affected by changes in the exchange rate) to overall consumer prices has decreased and it is assumed that this is also affecting the relationship between prices and the output gap.

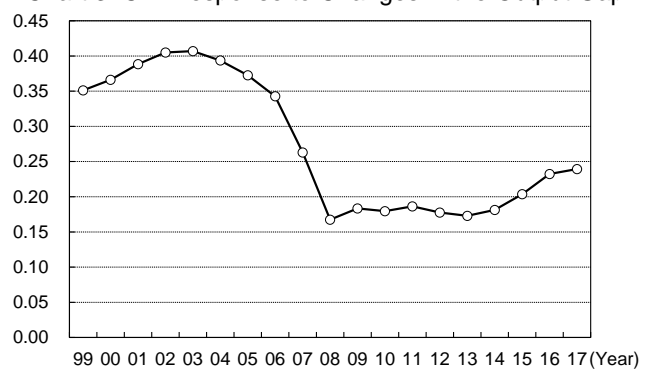
The sharp JPY appreciation at the start of the year put downward pressure on prices, yet it appears that the JPY will follow the difference in US and Japanese interest rates and return to a trend of depreciation in the future; its effect on prices is likely to be temporary. Currently, warnings about the risk of JPY appreciation in the near future are waning as the Japan-US Summit ended smoothly and the JPY is already returning to a level just above JPY109 to the USD. While the growth of prices will slow in the future owing to JPY appreciation, their gradual upward trend is forecast to strengthen owing to a visible increase in upward pressure from a tightening of the supply and demand balance and an increase in labour costs following the result of the annual labour negotiations.

Chart 2: The Output Gap and CPI



Note: "Core CPI" is total CPI less fresh food  
 Source: Bank of Japan, Ministry of Internal Affairs and Communications, MUFG Bank Economic Research Office

Chart 3: CPI Response to Changes in the Output Gap



Note: 1. "CPI" is total less fresh food, energy and public services  
 2. Chart shows a simple linear regression for CPI over 15 years using the "output gap" as the independent variable  
 Source: Bank of Japan, Ministry of Internal Affairs and Communications, MUFG Bank Economic Research Office

(Translated by Elizabeth Foster)

## MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

### 1. Main Economic Indicators

As of Apr. 25, 2018

	Fiscal	Fiscal	2017			2017		2018		
	2015	2016	2Q	3Q	4Q	NOV	DEC	JAN	FEB	MAR
Real GDP Growth Rate <% changes from previous period at SA annual rate>	1.4	1.2	2.4 (1.5)	2.4 (1.9)	1.6 (2.0)	***	***	***	***	***
Index of All Industries Activity	0.9	0.6	1.6 (2.5)	-0.3 (1.5)	0.8 (1.9)	1.0 (1.9)	0.6 (1.9)	-1.8 (1.8)		
Industrial Production Index										
Production	-0.9	1.0	1.8 (5.6)	0.5 (4.0)	1.6 (4.6)	0.7 (3.6)	1.8 (4.5)	-4.5 (2.9)	2.0 (1.6)	
Shipments	-1.1	0.8	1.4 (5.2)	0.6 (3.8)	0.8 (3.1)	1.9 (2.4)	2.0 (4.3)	-4.5 (2.2)	1.6 (0.7)	
Inventory	1.1	-4.0	-0.3 (-2.8)	-1.4 (-2.5)	2.2 (1.9)	-0.6 (2.8)	0.0 (1.9)	-0.5 (1.5)	0.5 (1.6)	
Inventory/Shipments Ratio (2010=100)	114.9	112.9	111.8 [116.0]	111.1 [114.3]	112.1 [109.7]	111.3 [108.0]	111.7 [108.9]	113.7 [111.2]	114.0 [111.1]	111.0
Domestic Corporate Goods Price Index	-3.3	-2.4	0.5 (2.1)	0.4 (2.8)	0.9 (3.3)	0.4 (3.5)	0.2 (3.0)	0.3 (2.7)	0.1 (2.6)	-0.1 (2.1)
Consumer Price Index(SA, total, excl.fresh foods)	0.0	-0.2	0.6 (0.4)	0.0 (0.6)	0.4 (0.9)	0.1 (0.9)	0.0 (0.9)	0.2 (0.9)	0.1 (1.0)	-0.1 (0.9)
Index of Capacity Utilization (2010=100)	98.0	98.6	101.8 [96.3]	101.6 [98.0]	102.7 [100.1]	102.3 [100.5]	103.9 [101.1]	98.6 [99.3]	101.9 [100.8]	100.2
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	4.1	0.5	-3.4 (-1.0)	2.8 (-2.5)	0.3 (0.0)	5.5 (4.1)	-9.3 (-5.0)	8.2 (2.9)	2.1 (2.4)	
Manufacturing	6.2	-4.6	2.6 (3.5)	6.2 (9.2)	3.5 (13.3)	0.0 (14.2)	-8.5 (3.0)	9.9 (16.8)	8.0 (21.4)	
Non-manufacturing	2.5	4.3	-8.1 (-4.5)	0.0 (-10.1)	-2.1 (-9.7)	6.0 (-3.9)	-5.3 (-10.9)	4.4 (-7.0)	0.0 (-10.4)	
Excl.Electric Power & Ship building										
Shipments of Capital Goods (Excl.Transport Equipment)	-2.2	1.4	3.5 (6.3)	1.2 (4.3)	3.1 (7.2)	2.4 (5.7)	3.1 (10.4)	-3.4 (9.5)	-1.4 (3.1)	
Construction Orders	-0.9	4.0								
Private	7.9	5.1								
Public	-15.6	8.4								
Public Works Contracts	-3.8	4.1								
Housing Starts 10,000 units at Annual Rate, SA	92.1 (4.6)	97.4 (5.8)	98.7 (1.1)	95.4 (-2.4)	94.8 (-2.4)	96.2 (-0.4)	93.6 (-2.1)	85.6 (-13.2)	92.6 (-2.6)	
Total floor	(2.1)	(4.1)	(1.0)	(-3.7)	(-3.2)	(-1.2)	(-2.9)	(-14.9)	(-5.6)	
Sales at Retailers	0.8	-0.2								
Real Consumption Expenditures of Households over 2 persons (SA)	-1.2	-1.6	0.8 (0.2)	-0.4 (0.0)	-0.6 (0.5)	1.4 (1.7)	-1.6 (-0.1)	2.8 (2.0)	-1.5 (0.1)	
Propensity to Consume (SA,%)	73.6	72.1	74.6 [72.3]	70.3 [71.3]	71.3 [71.8]	71.7 [72.1]	70.9 [72.0]	74.5 [71.5]	69.3 [75.1]	72.4
Overtime Hours Worked (All Industries, 5 employees or more)	-1.3	-0.7	-0.3 (0.9)	-0.2 (0.9)	0.3 (1.2)	0.6 (1.5)	-0.8 (1.5)	-1.7 (-2.0)	1.4 (-0.9)	
Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more)	0.2	0.4								
Employment Index(Regular Employees Only;All Industries, 5 employees or more) (Change over the M/Q/Y)	98	103	131	130	133	136	129	25	30	
Ratio of Job Offers to Applicants (SA,Times)	1.23	1.39	1.49 [1.35]	1.52 [1.37]	1.57 [1.41]	1.56 [1.41]	1.59 [1.43]	1.59 [1.43]	1.58 [1.44]	1.45
Unemployment Rate (SA,%)	3.3	3.0	2.9	2.8	2.7	2.7	2.7	2.4	2.5	
Economy Watcher Survey (Judgment of the present condition D.I.%)	48.8	46.4	49.2 [41.4]	50.3 [45.5]	53.3 [49.8]	54.1 [50.5]	53.9 [50.7]	49.9 [49.4]	48.6 [48.8]	48.9 [47.9]
Bankruptcies (Number of cases)	8,684 (-9.0)	8,381 (-3.5)	2,188 (2.8)	2,032 (-2.6)	2,106 (1.0)	677 (-2.3)	696 (-2.0)	635 (5.0)	617 (-10.3)	789 (0.4)

(Notes)

Unless otherwise indicated, tabulated figures and those in parentheses show % changes from previous quarter/month as applicable.

The figures in ( ) indicate % changes from previous year.

[ ] show the comparable figure of the previous year.

## 2. Balance of Payments

As of Apr. 25, 2018

	Fiscal	Fiscal	2017			2017		2018		
	2015	2016	2Q	3Q	4Q	NOV	DEC	JAN	FEB	MAR
Customs Clearance (Exports in Yen Terms)	-0.7	-3.5	(10.5)	(15.1)	(13.0)	(16.2)	(9.4)	(12.3)	(1.8)	(2.1)
Value	2.0	-5.8	(5.2)	(8.8)	(8.1)	(10.1)	(4.6)	(2.7)	(4.1)	(0.3)
Volumes	-2.7	2.4	(5.1)	(5.8)	(4.6)	(5.5)	(4.5)	(9.3)	(-2.1)	(1.8)
Imports (In Yen terms)	-10.2	-10.2	(16.2)	(14.8)	(17.0)	(17.3)	(15.0)	(7.8)	(16.6)	(-0.6)
Value	-8.4	-10.7	(10.8)	(12.8)	(12.7)	(14.3)	(8.6)	(5.0)	(4.4)	(4.1)
Volumes	-1.9	0.5	(4.9)	(1.8)	(3.9)	(2.6)	(5.9)	(2.6)	(11.7)	(-4.5)
Current Account (100 mil. yen)	182,720	210,188	45,988	70,061	43,257	13,407	7,965	6,074	20,760	
Goods (100 mil. yen)	2,999	57,851	9,574	17,588	11,527	1,991	5,250	-6,666	1,887	
Services (100 mil. yen)	-13,140	-13,813	-2,878	-2,652	-1,975	189	-1,941	-1,682	1,227	
Financial Account (100 mil. yen)	242,596	247,407	43,982	45,817	30,753	17,486	18,645	12,072	15,390	
Gold & Foreign Exchange Reserves (\$1mil.)	1,262,099	1,230,330	1,249,847	1,266,310	1,264,283	1,261,242	1,264,283	1,268,535	1,261,749	1,268,287
Exchange Rate (¥/\$)	120.13	108.37	111.06	111.01	112.95	112.92	112.97	110.77	107.82	106.00

## 3. Financial Market Indicators

	Fiscal	Fiscal	2017			2017		2018				
	2015	2016	2Q	3Q	4Q	NOV	DEC	JAN	FEB	MAR		
Uncollateralized Overnight Call Rates	0.063	-0.045	-0.054 [-0.050]	-0.054 [-0.046]	-0.042 [-0.043]	-0.048 [-0.049]	-0.042 [-0.044]	-0.040 [-0.045]	-0.042 [-0.038]	-0.062 -0.042		
Euro Yen TIBOR (3 Months)	0.157	0.057	0.056 [0.060]	0.062 [0.057]	0.063 [0.056]	0.063 [0.056]	0.063 [0.056]	0.068 [0.056]	0.068 [0.056]	0.097 [0.056]		
Newly Issued Japanese Government Bonds Yields (10 Years)	-0.050	0.065	0.075 [-0.230]	0.060 [-0.085]	0.045 [0.040]	0.035 [0.020]	0.045 [0.040]	0.080 [0.085]	0.045 0.050	0.045 [0.065]		
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	0.924	0.847	0.842 (-0.005)	0.831 (-0.011)	0.828 (-0.003)	0.835 (0.001)	0.828 (-0.007)	0.827 (-0.001)	0.827 (0.000)			
The Nikkei Stock Average (TSE 225 Issues)	16,759	18,909	20,033 [15,576]	20,356 [16,450]	22,765 [19,114]	22,725 [18,308]	22,765 [19,114]	23,098 [19,041]	22,068 [19,119]	21,454 [18,909]		
M2(Average)	(3.5)	(3.6)	(3.9)	(4.0)	(3.9)	(4.0)	(3.6)	(3.4)	(3.2)	(3.2)		
Broadly-defined Liquidity(Average)	(3.7)	(1.8)	(2.8)	(3.7)	(3.8)	(3.9)	(3.5)	(3.3)	(3.0)	(2.8)		
Principal Figures of Financial Institutions												
Loans and Discount (Average)	Banks & Shinkin		(2.4)	(2.4)	(3.1)	(3.1)	(2.6)	(2.7)	(2.5)	(2.3)	(2.1)	(2.0)
	Banks		(2.5)	(2.4)	(3.2)	(3.2)	(2.6)	(2.7)	(2.4)	(2.3)	(2.1)	(1.9)
	City Banks etc.		(1.2)	(1.2)	(2.8)	(2.8)	(1.7)	(1.8)	(1.2)	(1.1)	(0.6)	(0.3)
	Regional Banks		(3.7)	(3.5)	(3.7)	(3.7)	(3.7)	(3.7)	(3.6)	(3.5)	(3.6)	(3.5)
	Regional Banks II		(3.2)	(3.1)	(3.0)	(3.1)	(3.0)	(3.0)	(3.0)	(2.8)	(2.8)	(2.8)
Deposits and CDs (Average)	Shinkin		(2.2)	(2.3)	(2.8)	(2.7)	(2.6)	(2.6)	(2.6)	(2.5)	(2.5)	(2.5)
	Total(3 Business Condition)		(3.7)	(3.8)	(4.5)	(4.5)	(4.3)	(4.4)	(4.0)	(3.8)	(3.5)	(3.3)
	City Banks		(4.5)	(5.5)	(6.5)	(6.4)	(6.1)	(6.3)	(5.7)	(5.3)	(4.9)	(4.5)
	Regional Banks		(3.0)	(2.3)	(2.6)	(2.6)	(2.5)	(2.5)	(2.5)	(2.4)	(2.2)	(2.0)
Regional Banks II		(2.5)	(2.1)	(2.3)	(2.3)	(2.0)	(2.2)	(1.8)	(1.6)	(1.7)	(1.5)	

(Notes)

Newly Issued Japanese Government Bonds Yields and Interest rates are averages. The Nikkei Stock Average is as of month-end. Unless otherwise indicated, tabulated figures and those in parentheses show % changes from previous quarter/month as applicable. The figures in ( ) indicate % changes from previous year. [ ] show the comparable figure of the previous year.

(Sources)

Cabinet Office, National Accounts, Machinery Orders; METI, Indices of Tertiary Industry Activity, Industrial Production, Current Survey of Commerce; MOF, Trade Statistics, Balance of Payments; MPMHAPT, Consumer Price Index, Family Income and Expenditure Survey, Labour Force Survey; MHLW, Monthly Labour Survey; Ministry of Land, Infrastructure, and Transport, Economic Construction Statistics; BOJ, Corporate Price Index, Financial and Economic Statistics Monthly, etc.

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