

Improved Corporate Growth Expectations Hold the Key to Higher Wages in Spring Wage Negotiations

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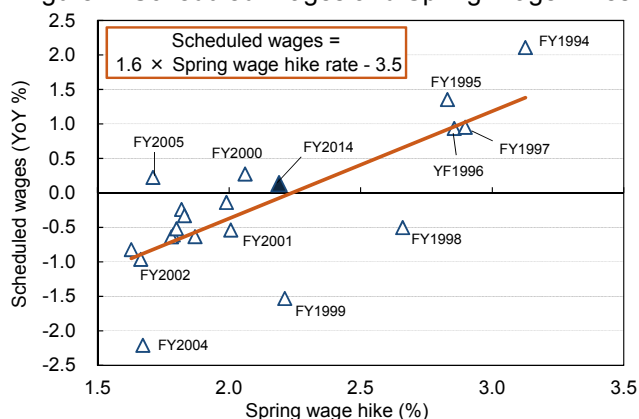
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1. The Real Economy

The size of wage hikes agreed to in this spring labor negotiations is an important point portending Japan's economy next fiscal year. Bigger household incomes from higher wages and more workers are a critical element to sustaining the economy's virtuous cycle. Spring wage hikes' rate and macro-level scheduled wages (for workers overall, including part-timers) have a clear positive correlation (Figure 1). Last spring wage negotiations resulted in the biggest wage hikes since 1999, at 2.19% (based on Ministry of Health, Labor, and Welfare data), and FY2014 scheduled wages rose +0.1% YoY on average through November. This was the biggest gain since FY2005. Wages next fiscal year, when the on-year impact of the consumption tax hike will be negated, are likely to turn positive even in real terms (excluding the impact of inflation) if this spring wage negotiations deliver bigger hikes than last year.

Many factors support greater wage hikes this year than last (Table 1). The labor distribution rate has been falling as corporate profits have improved, while tighter labor supply and demand have caused companies to feel a growing worker shortage. There appears to be more room for raising wages. Further, although the economic sluggishness following the consumption tax hike last April has caused labor productivity (real GDP per working hour) to worsen, inflation has been rising faster than last year, even when excluding the direct impact of the consumption tax hike. Given these economic conditions, the Japanese Trade Union Confederation, or Rengo, has presented a bullish stance ahead of the spring negotiations. In its *2015 Spring Labor Negotiation Strategy*, released in December, the confederation announced it would seek to raise base wages by 2% or more. On the other hand, the Japanese Business Federation, or Keidanren, noted in its *Position Paper on Management and Labor Policy*, released in January, that even as it strongly expects companies to positively considering wage hikes, it is still cautious about expecting a uniform base pay hike of 2%. Companies consider the economic sluggishness in the first half of the fiscal year to be temporary or not. And confidence in the direction of the economy can be restored or not. Any improvement in companies' growth expectations over the medium- to long-terms will likely be the key to bigger pay increases at the spring labor talks.

Figure 1: Scheduled Wages and Spring Wage Hikes



Notes: 1) Excludes FY2009, after the collapse of Lehman Brothers.
 2) FY2014 *Scheduled wages* is Apr-Nov average.
 Source: Compiled by BTMU Economic Research Office from MHLW data.

Table 1: Spring Wage Talks Negotiations Background Factor

	2014	2015	Impact on wage hike rate
Labor distribution rate (one-year average through Jul-Sept of previous year, %)	63.8	61.9	↑
Employment conditions DI (<i>Excessive - Insufficient</i>) (as of previous December, %pt)	-10	-15	↑
Rate of labor productivity rise (one-year average through previous Jul-Sept, %)	2.0	0.8	↓
Rate of Core CPI rise (one-year average through previous November, %)	0.3	1.2	↑
Rengo wage hike demand	1%+ base pay increase (3% incl regular hike)	2%+ base pay increase (4% incl regular hike)	↑
Keidanren wage hike guidelines	First base pay increase in 6 years	2%+ base pay increase is not adapted	→
Rate of wage increase (regular increases + higher base) (actual, %)	2.19	-	-

Note: *Core CPI* excludes direct impact of sales tax hike.
 Source: Compiled by BTMU Economic Research Office from various data and materials.

2. Monetary Policy and Financial Markets

(1) MONETARY POLICY & LONG-TERM YIELDS

At its January 20-21 Monetary Policy Meeting, the Bank of Japan agreed to keep current monetary policy intact. At the same meeting, the BoJ released its interim review of the *Outlook for Economic Activity and Prices* from October. The BoJ lowered its outlook for the growth rate of CPI by 0.7% point for FY2015 because of falling oil prices, but raised its outlook slightly for FY2016 and still maintains the view that Japan's growth rate of CPI will hit 2% sometime around FY2015. Governor Haruhiko Kuroda explained his rationale at the post-meeting press conference, noting that the supply-demand gap will improve as a result of upwardly-revised real GDP growth rate while also maintaining medium- to long-term expected inflation rate in some survey researches. The BoJ's CPI outlook is 0.9% point higher than private sector outlooks for FY2016; inflation expectations in the private economic entities themselves would have to rise significantly in order for the BoJ's price stability target to be achieved (Figure 2). Thus, the result of the spring wage negotiations will be important for measuring how much corporate deflation mindset have diminished, as well as any improvement in inflation expectations.

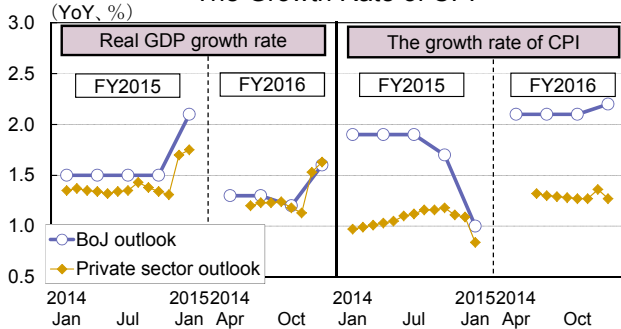
The 10Yr JGB yield has fallen further since the BoJ's bolstered additional monetary easing last October 31, dipping into the 0.1% range in mid-January for the first time ever (Figure 3). This is because not only are investors aware of the tight supply and demand for JGBs following the BoJ's large purchases, but also because inflation rate has eased around the world due to falling oil prices. Also, overseas interest rates have been falling overall after the ECB's introduction of quantitative monetary easing.

(2) EXCHANGE RATES

The JPY has weakened against the USD, with USD/JPY hitting USD/JPY121 for the first time since 2007 in early December, but since then the JPY has been strengthening once again. The sudden JPY weakening since the BoJ bolstered additional monetary easing October 31 might

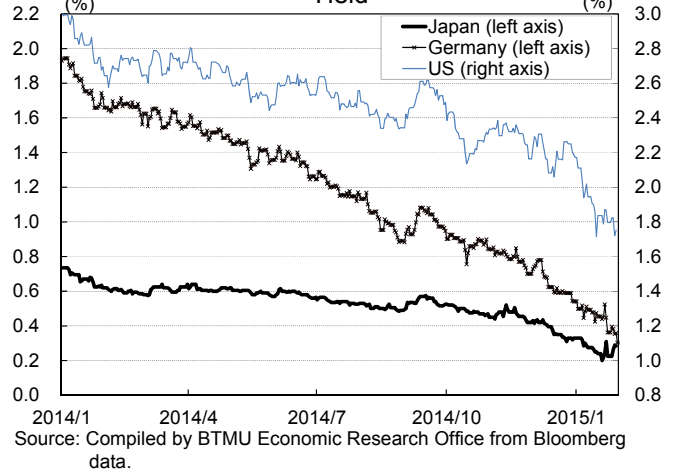
be caused by excessive expectations, and we think that the JPY could easily strengthen once again. Over the longer term, the differing directions of US and Japan monetary easing policies are expected to cause the JPY's weakening to persist, but risk aversion by investors is also expected to heighten amidst a less-than-strong global economy. USD/JPY may struggle to establish a firm direction for now.

Figure 2: Outlook for Real GDP Growth Rate and The Growth Rate of CPI



Notes: 1) *BoJ outlook* is median outlook of Policy meeting members; *Private sector outlook* is average outlook of private research institutions (approximately 40) responding to ESP Forecast Survey.
 2) *The growth rate of CPI* is overall excluding fresh foods and direct impact of consumption tax hike.
 Source: Compiled by BTMU Economic Research Office from BoJ, Japan Center for Economic Research materials.

Figure 3: Japan/US/German 10Yr Government Bond Yield



Source: Compiled by BTMU Economic Research Office from Bloomberg data.

MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

1. Main Economic Indicators

As of Feb. 25, 2015

	Fiscal 2012	Fiscal 2013	2014			2014				2015
			2Q	3Q	4Q	SEP	OCT	NOV	DED	JAN
Real GDP Growth Rate <% changes from previous period at SA annual rate>	1.0	2.1	-6.7 (-0.4)	-2.3 (-1.4)	2.2 (-0.5)	***	***	***	***	***
Index of All Industries Activity	0.1	1.9	-3.4 (-0.9)	-0.1 (-1.6)	0.8 (-1.3)	1.3 (-0.7)	0.1 (-0.9)	0.0 (-2.0)	-0.3 (-0.9)	
Industrial Production Index	-2.9	3.2	-3.8 (2.7)	-1.9 (-1.0)	1.7 (-1.5)	2.9 (0.8)	0.4 (-0.8)	-0.5 (-3.7)	0.8 (0.1)	
Production										
Shipments	-1.8	2.9	-6.8 (1.3)	-0.8 (-0.5)	2.2 (-1.6)	4.4 (1.7)	0.6 (-0.4)	-1.4 (-4.5)	1.0 (0.3)	
Inventory	-3.0	-1.4	4.6 (2.8)	1.1 (4.0)	-0.1 (5.9)	-0.7 (4.0)	-0.4 (3.8)	1.1 (6.5)	-0.7 (5.9)	
Inventory/Shipments Ratio (2010=100)	114.4	106.2	107.7 [108.3]	113.0 [109.4]	113.8 [104.6]	111.4 [108.2]	112.3 [105.5]	117.0 [104.3]	112.0 [104.1]	[99.3]
Domestic Corporate Goods Price Index	-1.1	1.9	3.0 (4.3)	0.5 (4.0)	-1.3 (2.4)	0.0 (3.6)	-0.8 (2.9)	-0.3 (2.6)	-0.5 (1.8)	-1.3 (0.3)
Consumer Price Index(SA, total, excl.fresh foods)	-0.2	0.8	2.7 (3.3)	0.2 (3.2)	-0.1 (2.7)	-0.1 (3.0)	0.0 (2.9)	0.0 (2.7)	0.0 (2.5)	
Index of Capacity Utilization (2010=100)	95.4	100.0	101.4 [96.3]	98.1 [97.8]	100.7 [100.2]	99.9 [98.9]	100.6 [99.4]	99.8 [99.9]	101.8 [101.4]	[107.7]
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	-3.0	11.5	-10.4 (-0.4)	5.6 (2.4)	0.4 (-2.6)	2.9 (7.3)	-6.4 (-4.9)	1.3 (-14.6)	8.3 (11.4)	
Manufacturing	-10.1	10.2	-8.5 (4.1)	12.6 (10.2)	0.8 (8.6)	12.0 (13.4)	-5.5 (2.9)	-7.0 (-4.8)	24.1 (27.1)	
Non-manufacturing Excl.Electric Power & Ship building	2.8	12.1	-6.7 (-3.1)	-1.2 (-2.7)	-0.7 (-9.6)	1.7 (3.5)	-7.5 (-10.2)	0.5 (-21.2)	7.2 (2.0)	
Shipments of Capital Goods (Excl.Transport Equipment)	-6.0	5.6	-8.0 (8.1)	0.1 (7.2)	3.7 (5.3)	2.7 (7.9)	6.2 (6.2)	-2.8 (2.0)	1.3 (7.6)	
Construction Orders	2.4	20.1								
Private	2.6	14.2								
Public	5.3	31.2								
Public Works Contracts	10.3	17.7								
Housing Starts 10,000 units at Annual Rate, SA Total floor	89.3 (6.2) (4.8)	98.7 (10.6) (9.9)	89.1 (-9.3) (-13.4)	86.8 (-13.6) (-17.9)	86.8 (-13.8) (-19.3)	87.7 (-14.3) (-18.6)	88.6 (-12.3) (-17.6)	87.3 (-14.3) (-20.7)	88.3 (-14.7) (-19.5)	
Sales at Retailers	0.3	2.9								
Real Consumption Expenditures of Households over 2 persons (SA)	1.6	0.9	-9.0 (-5.2)	-0.5 (-5.4)	1.9 (-3.4)	1.5 (-5.6)	0.9 (-4.0)	0.4 (-2.5)	0.4 (-3.4)	
Propensity to Consume (SA,%)	74.8	75.5	73.8 [74.0]	74.7 [74.8]	73.9 [74.6]	75.5 [75.6]	74.2 [75.3]	75.8 [74.9]	73.6 [75.0]	[75.9]
Overtime Hours Worked (All Industries, 5 employees or more)	-0.3	4.4	0.6 (5.1)	-2.0 (2.2)	0.0 (0.5)	1.5 (2.9)	0.0 (1.8)	-0.7 (0.0)	-0.3 (0.0)	
Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more)	-0.7	0.1								
Employment Index(Regular Employees Only;All Industries, 5 employees or more) (Change over the M/Q/Y)	107	45	65	76	76	75	73	74	80	
Ratio of Job Offers to Applicants (SA,Times)	0.82	0.97	1.09 [0.90]	1.10 [0.95]	1.12 [1.01]	1.09 [0.96]	1.10 [0.98]	1.12 [1.01]	1.15 [1.03]	[1.04]
Unemployment Rate (SA,%)	4.3	3.9	3.6	3.6	3.5	3.6	3.5	3.5	3.4	
Economy Watcher Survey (Judgment of the present condition D.I,%)	46.3	54.0	44.8 [55.1]	48.7 [52.1]	43.6 [53.7]	47.4 [52.8]	44.0 [51.8]	41.5 [53.5]	45.2 [55.7]	45.6 [54.7]
Bankruptcies (Number of cases)	11,719 (-7.7)	10,536 (-10.0)	2,613 (-8.0)	2,436 (-8.5)	2,222 (-13.5)	827 (0.8)	800 (-16.5)	736 (-14.6)	686 (-8.5)	721 (-16.5)

(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 Feb. 25, 2015

	Fiscal	Fiscal	2014			2014				2015
	2012	2013	2Q	3Q	4Q	SEP	OCT	NOV	DEC	JAN
Customs Clearance (Exports in Yen Terms)	-2.1	10.8	(0.1)	(3.2)	(9.2)	(6.9)	(9.6)	(4.9)	(12.8)	(17.0)
Value	4.0	10.2	(1.1)	(2.8)	(6.6)	(4.0)	(4.6)	(6.7)	(8.6)	(5.2)
Volumes	-5.8	0.6	(-1.0)	(0.3)	(2.4)	(2.8)	(4.8)	(-1.7)	(3.9)	(11.2)
Imports (In Yen terms)	3.4	17.4	(2.7)	(2.4)	(1.2)	(6.3)	(3.1)	(-1.6)	(1.9)	(-9.0)
Value	2.5	14.6	(2.1)	(3.1)	(4.8)	(3.2)	(4.9)	(5.8)	(3.8)	(-2.9)
Volumes	1.0	2.3	(0.5)	(-0.6)	(-3.5)	(3.0)	(-1.7)	(-7.0)	(-1.8)	(-6.3)
Current Account (100 mil. yen)	42,233	8,312	3,571	16,345	14,537	9,830	8,334	4,330	1,872	
Goods (100 mil. yen)	-52,474	-109,709	-20,230	-24,227	-17,990	-7,107	-7,666	-6,368	-3,956	
Services (100 mil. yen)	-41,864	-34,522	-8,970	-9,198	-6,570	-1,995	-2,165	-1,063	-3,342	
Financial Account (100 mil. yen)	20,255	-23,521	18,909	27,583	22,594	16,649	12,077	5,064	5,452	
Gold & Foreign Exchange Reserves (\$1mil.)	1,254,356	1,279,346	1,283,921	1,264,405	1,260,548	1,264,405	1,265,925	1,269,079	1,260,548	1,261,103
Exchange Rate (¥/\$)	83.08	100.23	102.13	103.92	114.56	107.09	108.06	116.22	119.40	118.24

3. Financial Market Indicators

	Fiscal	Fiscal	2014			2014				2015	
	2012	2013	2Q	3Q	4Q	SEP	OCT	NOV	DEC	JAN	
Uncollateralized Overnight Call Rates	0.083	0.073	0.067	0.067	0.064	0.066	0.059	0.065	0.068	0.074	
			[0.073]	[0.073]	[0.072]	[0.072]	[0.070]	[0.073]	[0.074]	[0.073]	
Euro Yen TIBOR (3 Months)	0.312	0.223	0.211	0.210	0.184	0.210	0.192	0.182	0.179	0.173	
			[0.228]	[0.228]	[0.220]	[0.228]	[0.221]	[0.220]	[0.220]	[0.220]	
Newly Issued Japanese Government Bonds Yields (10 Years)	0.560	0.640	0.565	0.525	0.330	0.525	0.450	0.420	0.330	0.275	
			[0.855]	[0.680]	[0.735]	[0.680]	[0.590]	[0.600]	[0.735]	[0.620]	
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	1.184	1.077	1.067	1.048	1.025	1.048	1.041	1.037	1.025		
			(-0.010)	(-0.019)	(-0.023)	(-0.013)	(-0.007)	(-0.004)	(-0.012)		
The Nikkei Stock Average (TSE 225 Issues)	12,398	14,828	15,162	16,174	17,451	16,174	16,414	17,460	17,451	17,674	
			[13,677]	[14,456]	[16,291]	[14,456]	[14,328]	[15,662]	[16,291]	[14,915]	
M2(Average)	(2.5)	(3.9)	(3.3)	(3.0)	(3.4)	(3.1)	(3.2)	(3.6)	(3.6)	(3.4)	
Broadly-defined Liquidity(Average)	(1.0)	(3.7)	(3.1)	(3.1)	(3.4)	(3.3)	(3.3)	(3.4)	(3.5)	(3.4)	
Principal Figures of Financial Institutions											
Loans and Discount (Average)	Banks & Shinkin	(0.9)	(2.0)	(2.2)	(2.2)	(2.5)	(2.3)	(2.3)	(2.7)	(2.6)	(2.5)
	Banks	(1.1)	(2.3)	(2.3)	(2.3)	(2.7)	(2.4)	(2.4)	(2.8)	(2.8)	(2.6)
	City Banks etc.	(-0.2)	(1.7)	(1.3)	(1.1)	(1.7)	(1.2)	(1.3)	(2.0)	(1.7)	(1.4)
	Regional Banks	(2.9)	(3.3)	(3.6)	(3.7)	(3.8)	(3.7)	(3.7)	(3.8)	(3.9)	(3.9)
	Regional Banks II	(0.8)	(1.4)	(2.5)	(2.9)	(3.1)	(3.0)	(3.0)	(3.2)	(3.2)	(3.2)
	Shinkin	(-0.7)	(0.3)	(1.2)	(1.4)	(1.5)	(1.4)	(1.5)	(1.5)	(1.6)	
Deposits and CDs (Average)	Total(3 Business Condition)	(2.2)	(3.8)	(2.8)	(2.8)	(3.8)	(2.9)	(3.3)	(4.0)	(4.2)	(3.8)
	City Banks	(1.8)	(3.7)	(2.1)	(2.4)	(4.4)	(2.7)	(3.4)	(4.8)	(5.1)	(4.7)
	Regional Banks	(2.8)	(4.3)	(3.6)	(3.2)	(3.2)	(3.2)	(3.2)	(3.2)	(3.3)	(2.9)
	Regional Banks II	(1.8)	(2.5)	(3.0)	(3.1)	(3.3)	(3.0)	(3.3)	(3.3)	(3.2)	(3.1)

(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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