23 November 2022

Economic Brief (Japan)

Attention is focused on next year's annual wage negotiations amid higher prices, improvements in the labour market and corporate profits

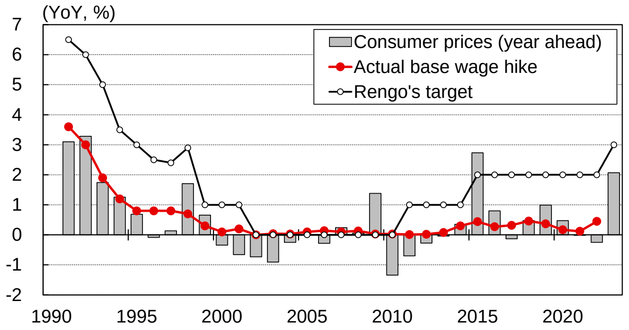
Summary

- The Japanese Trade Union Confederation (Rengo) announced its plans to demand a base wage hike of around 3% for the 2023 annual wage negotiations (*shunto*), the highest rate since 1995 but commensurate with the current rise in prices.
- The relationship between Rengo's past targets and the actual base wage hikes suggests next year's base wage hike will be around 1%. Even if consumer price growth slows from its current pace of more than 3% YoY due to falling commodity prices, it is likely to remain above 1% YoY, which means real wage growth will remain negative next year if base wages are raised around 1%.
- Nevertheless, there are many factors that could support higher wage growth, such as the swift rise in consumer prices, labour shortage, falling labour share, and rising labour productivity. Since base wages are an important indicator of private consumption, a continued increase in wages could lead to a change in consumers' perception of prices and result in a self-sustaining upward trajectory for prices. The result of next year's *shunto* will be watched closely.

At its Central Executive Committee meeting on 20th October, the Japanese Trade Union Confederation (Rengo) set a base wage hike target of 3% for the 2023 annual wage negotiations (*shunto*). At a press conference, President of the Japanese Trade Union Confederation Tomoko Yoshino said the higher prices are taking a major toll on people's lives and that Rengo is determined to achieve a wage hike in line with the rise in prices. A target of 3% is the highest since 1995 (28 years).

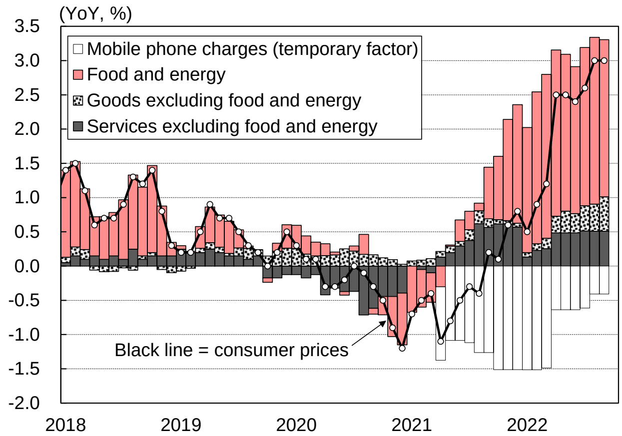
In many cases, base wages were not raised by the amount demanded by Rengo. The relationship between Rengo's past targets and the actual base wage hikes suggests next year's base wage hike will be around 1% (Chart 1). In September, consumer prices increased 3% YoY – the fastest growth in 31 years if the impact of consumer tax rate hikes is omitted. The largest contributing factor to the current rise in consumer prices is the rise in food and energy prices (Chart 2). Therefore, given that commodity prices, such as oil, have peaked, the rise in prices is expected to slow from next year. Nevertheless, there are a wide range of other items apart from food and energy where costs have risen owing to the weak yen and other factors, and it appears these costs have been passed on. As a result, it is highly likely that prices will continue to grow faster than 1% YoY next year too. If base wages are raised by around 1% as previously mentioned, year-on-year growth of real wages will be negative and the heavy burden on households will continue.

Chart 1: Rengo's Pay Hike Target, Base Wage Hikes and CPI (Total)



Note: CPI for 2022 is an average of results from January to September
Source: Ministry of Internal Affairs and Communications, Japan Business Federation, The Japanese Trade Union Confederation (RENGO), MUFG Bank Economic Research Office

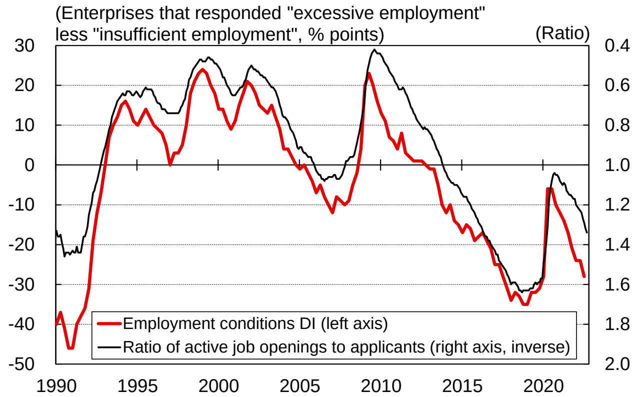
Chart 2: Consumer Prices



Note: The impact of consumtion tax hikes has been omitted
Source: Ministry of Internal Affairs and Communications

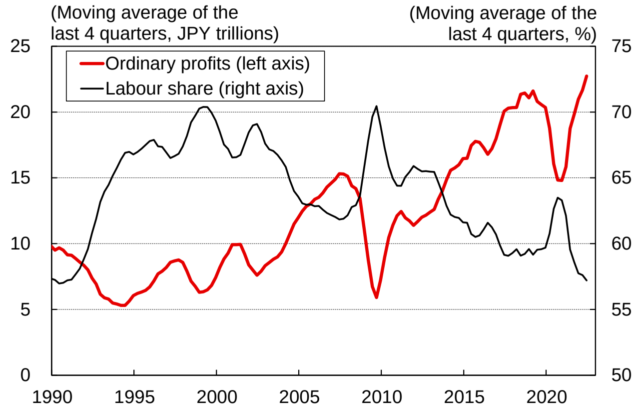
Looking at the situation surrounding next year's *shunto*, however, there appears to be many factors other than higher prices that are likely to push the growth of wages higher. The first of these is Japan's tight labour market (Chart 3). According to the Bank of Japan's Tankan survey, the normalisation of economic activities since the pandemic has resulted in the number of industries that say the supply of labour is "insufficient" far exceeding those who say it is "sufficient", pushing the diffusion index to roughly the same level it was at in 2019 when it reached an historically low level. This trend reflects the rise in job openings, and the ratio of job openings to applicants is rising. The second factor is the falling labour share. While corporate profits are historically high on the back of a recovery in sales since the pandemic and the weak yen, growth of labour costs has plateaued (Chart 4). As a result, the labour share continues to decrease and is at its lowest level since 1990.

Chart 3: Diffusion Index of Employment Conditions and the Ratio of Active Job Openings to Applicants



Source: Ministry of Health, Labour and Welfare, Bank of Japan, MUFG Bank Economic Research Office

Chart 4: Ordinary Profits and Labour Share



Note: Labour share = personnel expenses ÷ (personnel expenses + ordinary profits + depreciation cost + interest expenses)
Source: Ministry of Finance, MUFG Bank Economic Research Office

Furthermore, while real wages per hour have remained flat since 2000, labour productivity (real GDP per hour of labour) is rising steadily. It is possible the widening gap between the two will be a factor in pushing wages higher.

Chart 5: Labour Productivity and Real Wages

Source: Cabinet Office, Ministry of Labour, Health and Welfare, MUFG Bank Economic Research Office

It is likely that the labour market will remain tight and corporate profits will continue to improve as domestic demand recovers after the pandemic. Labour productivity is also forecast to remain at a high level. For individual companies, workers and management will decide an appropriate rate for wage hikes according to each company's situation. However, based on the relationship between the level of demand by the union and the actual base wage hike, it is possible that the hike agreed at the next year's *shunto* will exceed the 1% estimated. The level of base wages is an important indicator of private consumption trends for the upcoming year. In addition, sustained wage increases could lead to a change in consumers' perception of prices, and it is possible prices will have the momentum to achieve a self-sustaining upward trajectory. All of this means the result of next year's *shunto* will be watched closely.

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