MARCH 31, 2023

Japan Gets A Raise

The risk of Japanese inflation getting out of control is not high.

Shuntō is a Japanese term which translates to "spring wage offensive." Every year at this time, Japan's labor unions meet large employers for salary negotiations. Over the past three decades, economic stagnation and deflation led unions to limit their demands; in some years, discussions concluded with no wage increases at all. Japanese employees rarely demand higher pay; Japanese consumers resist paying more; and Japanese businesses seldom try to hike prices. Consequently, *Shuntō* talks have been losing significance.

However, this year's *Shuntō* negotiators revived the meetings' *offensive* spirit. Workers at major Japanese corporations secured a 3.8% increase in wages, far above the previous year's raise of 2.1% and the largest gain since 1993.

Higher prices are the driving force behind higher pay. Headline inflation in Japan has been hovering well above 2% since March 2022. The leading core inflation measure climbed to 2.1%

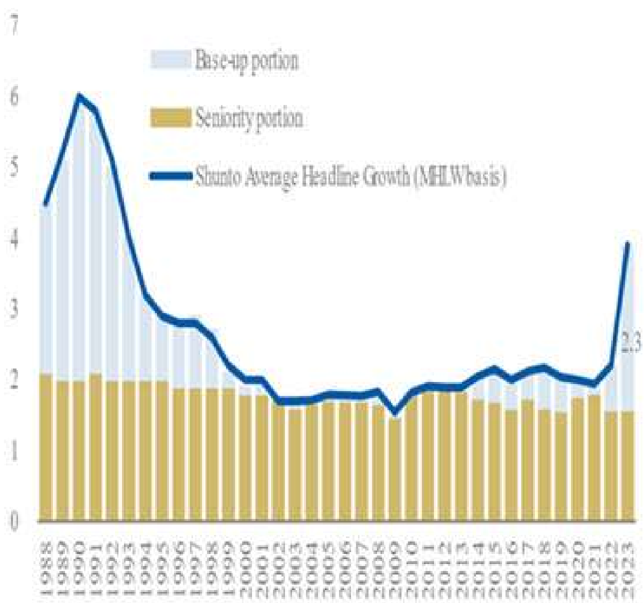
year over year in February, the highest reading in over 40 years. Japanese companies are starting to pass on higher costs to consumers, a sign that price increases could persist.

While the biggest Japanese corporations have agreed to higher wages, the outlook is less certain for employees at small and medium-sized enterprises (SMEs). SMEs account for almost 70% of the workforce and 99.7% of the total number of companies in Japan, but only a small share of their workers are union members. Absent union pressure, these firms are unlikely to implement or offer large wage hikes. According to a **survey**, over 70% of small and midsize firms in Tokyo had no plans to raise wages this year.

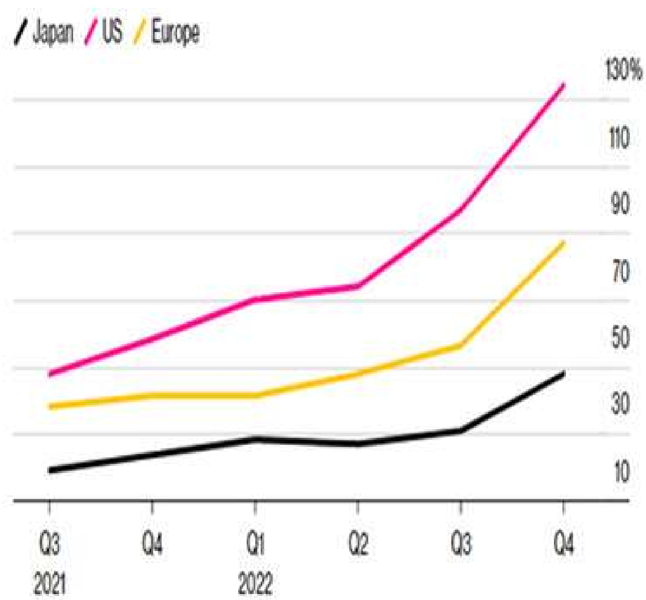
According to outgoing Bank of Japan (BoJ) Governor Kuroda, the Japanese economy would need to see 3% overall wage growth to achieve the price stability target in a sustainable and stable manner. In an effort to finally put deflation into the past, the Japanese government has promoted a cycle of higher wages, consumption, price increases and growth. It is providing tax breaks for smaller firms raising wages by 2.5% or more.

The breakthrough in wages is especially significant considering that the Japanese labor market is much more rigid than is the case in other nations. Employees rarely switch jobs. Large employers still provide long-term job security and set pay levels based on seniority rather than performance.

Japan: Decomposition of Shuntō Wage Growth



Percentage of Rising Costs Firms Have Passed on to Customers



Sources: Morgan Stanley, Bloomberg, Mitsubishi Research Institute

To beat deflation, Japanese firms need to pay more.

With most developed economies working feverishly to contain inflation, it is unusual to see Japan promoting it. But the risk of Japanese inflation getting out of control is not high. Energy and food costs are already on the way down, and wage levels remain low by international standards. The pricing power of Japanese corporations in world markets remains modest. The drivers of the nation's decades of structurally low inflation remain in place.

Japan's recovery from the pandemic has been bumpy, with the economy barely growing over the course of 2022. Most major economies have welcomed a return to normal levels of activity, but for Japan, the pre-pandemic norm was rather stagnant. It may be early days, but the blooming of wage and prices in Japan makes this an especially promising spring.

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