

Wage hikes: Can Japan Inc. fix what the BoJ can't?

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Japan's economic policies over the recent years seem to have added yet another ironic angle to the very conundrum they were meant to solve – its extended deflationary, low/no growth period, dubbed the '[lost decade](#)'¹, when falling prices, among other things, punctured consumers' appetite to buy.

Even as Japan's gargantuan stimulus packages, aimed at stoking inflation and – thereby – growth, seemed to offer some hope, its economy now faces the prospect of being pushed into stagflation again, with its hard-fought inflation soaring past wage growth, threatening consumption appetite – this time, for completely contrary reasons.

While the Bank of Japan (BoJ) has for long done the heavy lifting, Japan Inc.'s increasingly cash-rich balance sheets [are now being called upon](#)² to drive wage hikes and, potentially, pay higher taxes. Several companies have already announced wage hikes¹⁴, and several more may follow. However, this seems like a quick fix, with long-term solutions likely to entail closure of the stimulus tap, even if only partially and gradually.

Falling yen, record trade deficit and galloping inflation – an unenviable cocktail

The Japanese yen fell to [150 yen per USD](#)⁶ in October 2022, its lowest in over three decades, further exacerbating the big spike in oil and gas prices. Combined, the two factors have driven a streak of [rising trade deficits](#)⁴, setting in motion the vicious cycle of a falling currency and rising import bills.

Japan's trade deficit hit a historic high in 2022 (comparable data available since 1979) even as exports rose to an [all-time high](#)⁴, reflecting the significant surge in imports, which also rose sharply to [record levels](#)⁵.

The end result? Japan's consumer price index (CPI) touched a 41-year high of [4.2%](#)³ in January 2023, racing past wage growth; real wages fell [4.1% YoY in January 2023](#)⁷, the largest decline since May 2014.

Energy subsidies may not be enough to rein in inflation, only adding to debt burden

Japan plans to roll out new [subsidies in 2023](#)¹² (largely energy-related subsidies, to the tune of [USD200bn](#)¹¹), which it believes will normalise inflation to c.2%. While that could offset inflation in energy prices, food prices are still likely to be a major concern. Food is one of Japan's key imports ([c.10% of merchandise imports](#)¹³), and depreciation of the yen could make food costlier.

However, of specific concern is the rise in Japan's '[core core inflation](#)'⁴ – a subset of the CPI that excludes energy and food prices – which shows that it's not just these two factors that are driving inflation.

Furthermore, these subsidies may only add to Japan's fiscal burden, with government debt likely to hit [record highs](#)⁸ in the coming years and the IMF recommending higher taxes and reduced spending to curb Japan's debt/GDP ratio – this, even as the nation is poised to raise defence spend.

The flip side of wage hikes

[Bloomberg reports](#)¹⁰ that consumption rebounded by the most in 10 months in January 2023. However, the Japanese propensity to save rather than spend and the structural issue of an ageing population – which could limit the beneficiaries of higher wages – could cast a shadow of doubt over the sustained impact of wage hikes, for starters. Reportedly, Prime Minister Kishida is now proposing [student debt waivers](#)⁹ for couples that have babies. While the method may be debatable, this highlights the root of the problem, which wage hikes cannot fix.

However, even assuming the policy of pushing for wage hikes works, it could push inflation even higher, or prevent it from falling, at least. So far, inflation seemed to be, largely, supply-side inflation, driven by the falling yen and higher prices of imports. While both the yen/USD exchange rate and oil-and-gas prices have eased, the yen/USD exchange rate remains elevated YoY; and if wage-hike-driven demand-side inflation offsets (or more than makes up for) the decline in oil and gas prices, we could see stubborn/rising inflation.

Easing of yield-curve control – beginning of the end?

The BoJ introduced yield-curve control (YCC) in 2016, adding a 0% target for 10-year bond yields, in addition to the -0.1% short-term rate target it had set in January that year. In 2018, the central bank said the 10-year bond yield could move in a $\pm 0.1\%$ range, which it widened to $\pm 0.25\%$ in March 2021 and [\$\pm 0.5\%\$ in December 2022](#)¹⁵. Changes have been few and far between, but the direction is clear and undeniable.

With inflation rising swiftly, hurting real returns, the YCC will only get trickier to manage. For starters, the BoJ already holds over 50% of Japanese government bonds, and buying up more and more may not be the best way to allocate funds, given the government's growing – and already stretched – debt load (80% of 2023 energy subsidy outlay to be [funded via debt](#)¹⁶).

One would imagine that the BoJ will eventually pull the plug on YCC, albeit slowly enough to soften the rise in the government's cost of borrowing.

Wage hike to provide stop-gap relief, at best

First, wage hikes cannot provide endless support. Second, if untamed, inflation could end the fledgling dream of reigniting growth, pushing purchases beyond household budgets.

For instance, in January, Japan's [real wages fell](#)¹⁷ at the fastest pace since 2014, falling 4.1% YoY. Juxtapose this with the 4.5% hike that Japan's trade unions are demanding, and it's easy to see that wage growth may not be able to keep up if inflation spirals, suggesting a more sustainable solution is called for.

The road ahead

For starters, this is not even the kind of inflation Japan might have wanted, being supply-side driven rather than demand driven. For now, although no major policy changes seem likely in the near term, all eyes will be on the change of guard at the BoJ, with governor Haruhiko Kuroda's term set to end on 8 April 2023.

At some point, access to easy money will have to stop if inflation is to be bridled. While wage hikes, energy subsidies and the likes may help consumers in the short term, the question is, how long can one stimulus package be used to cure the ills of another?

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Sources:

¹[Lost decade](#)

²[Most big Japanese firms heed prime minister's call to raise wages this year - Reuters poll | Reuters](#)

³[Japan's real wages drop at fastest pace since 2014 as hot inflation takes toll | Reuters](#)

- ⁴[Japan extends long trade deficit run, slow Chinese demand stokes worry | Reuters](#)
- ⁵[Japan's consumer inflation hits fresh 40-year high, eyes on BOJ policy | Reuters](#)
- ⁶[Explainer: Yen is past key 150 threshold. What's next? | Reuters](#)
- ⁷[Japan's real wages drop at fastest pace since 2014 as hot inflation takes toll | Reuters](#)
- ⁸[Borrowing to drive Japan's debt over 1,100 trillion yen for first time -draft | Reuters](#)
- ⁹[Japan PM offers debt waiver for having children \(newagebd.net\)](#)
- ¹⁰[Japan Consumption Rebounds by Most Since March Despite Inflation - Bloomberg](#)
- ¹¹[Japan unveils \\$200 billion in new spending to ease inflation pain | Reuters](#)
- ¹²[Japan to rely on debt for nearly 80% of \\$200bn stimulus package - Nikkei Asia](#)
- ¹³[Japan - Food Imports - 2023 Data 2024 Forecast 1962-2021 Historical \(tradingeconomics.com\)](#)
- ¹⁴[Majority of Japan firms heed Kishida's call to raise wages this year | The Japan Times](#)
- ¹⁵[Explainer: How does Japan's yield curve control work? | Reuters](#)
- ¹⁶[Japan to rely on debt for nearly 80% of \\$200bn stimulus package - Nikkei Asia](#)
- ¹⁷[Japan's real wages drop at fastest pace since 2014 as hot inflation takes toll | Reuters](#)
- ¹⁸[Japan unions ask average 4.5% wage hike, biggest since 1990s \(msn.com\)](#)

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