ECONOMICS: JAPAN PERSPECTIVES

# WAGE GROWTH THE MAIN GAME

+ Guy Bruten, Senior Economist—Asia Pacific, guy.bruten@abglobal.com

Wage growth is fast becoming the key metric used by central banks to judge both the "true" slack in the labor market and inflation expectations. Japan is no exception, and the positive outcome in this year's "Shunto" negotiations is a central reason why the Bank of Japan is in no hurry to accelerate monetary easing.

One theme that is becoming more prevalent among policymakers—in developed market economies, at least—is the rising importance of wage-setting behaviors as an indicator of both the degree of slack in the economy and the state of inflation expectations.

Nowhere is this truer than in Japan. Shifting inflation expectations higher is *the* critical part of the Bank of Japan's (BoJ) story. Governor Haruhiko Kuroda gives a great exposition of that in his recent speech to the Economic Club of Minnesota. In a nutshell, Mr. Kuroda argues that while inflation expectations are largely formed in a backward-looking manner, a credible and well-communicated shift in the central bank's policy regime can also have a big influence.

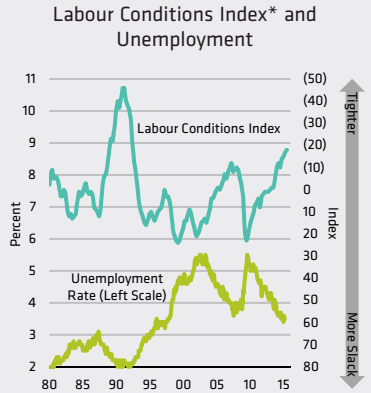
For illustration, Mr. Kuroda looks at the change in the distribution of surveyed inflation expectations during the early phase of the 1980s Volker disinflation, and argues that a similar type of shift is visible in the Japanese inflation expectations surveys today.

That said, he acknowledges that where the rubber hits the road on this debate is during wage negotiations, where any change in expectations will be revealed in the reality of pay settlements. In Japan, this process is being helped by the consistent tightening in the labor market in recent years. That's clearly evident in both the fall in the unemployment rate (*Display 1*) and, perhaps more importantly, the assessment of the availability of labor by businesses—e.g., the BoJ's quarterly Tankan survey. On the latter metric, the labor market is tighter than it ever has been, with the exception of the height of the 1980s "bubble" era.

The combination of labor shortages, a BoJ regime change and political pressure is now showing up in higher wage growth. Figures from the Japan Business Federation, the employer group better known as Keidanren, show that this year's "Shunto (spring offensive)" negotiations delivered average wage increases of 2.59%—an improvement over last year's 2.34% outcome.

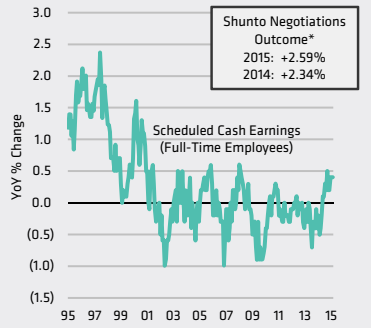
Now, those numbers seem a little hard to square with aggregate wage growth figures which, while showing an acceleration, still have the increases running at 0.5% year on year (*Display 2*). That's

Display 1
Jobs Market Tightest Since Bubble Era




Unemployment as of February 2015; Labour Conditions Index as of 1Q:2015
*A component of the Bank of Japan's "Tankan" survey
Source: Bank of Japan, CEIC Data and Thomson Reuters Datastream

Display 2
Base Wages Are Starting to Rise




As of February 2015
*Based on a Keidanren survey
Source: CEIC Data, Japan Business Federation (Kendanren) and Thomson Reuters Datastream

because the Shunto figures include seniority-based annual increases (around 1.5%) and a "base-up" component. In traditional Japanese corporations, the oldest (highest paid) cohort retires each year, while a fresh crop of new graduates (or other young, entry-level cohort) starts from the bottom of the totem pole. So it's perfectly consistent for the wage of the average worker to rise, even if the wage bill per employee is static.

In any case, it's the "base-up" figure that's worth keeping an eye on. As Mr. Kuroda points out, that was positive last year for the first time in almost 20 years. And this year's was even larger. He's using that as prime Exhibit No. 1 in his case that there's no urgency to accelerate the pace of monetary easing even if—as seems highly likely—the BoJ revises inflation forecasts lower in next week's semiannual outlook report. ■