Registration No.: Director of Kanto Local Finance Bureau
(Financial Instruments Firms) No.324
Commodity Trading Advisor License #(1) No.24, the Minister of Agriculture, Forestry and Fishery & the Minister of Economy, Trade and Industry
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Focus on the 2023 *Shunto*: Spring Negotiations to see wage increases near 3%

4 November 2022

- Investor attention is focused on the level of wage increases at the 2023 *Shunto* ; annual wage negotiations between enterprise unions and employers in Japan.
- The rate of wage increases at the 2022 *Shunto* was just under 2%, but it is highly likely that the proportion of companies giving higher wage hikes will increase and approach 3% amid price pressure on living standards and securing labour.
- Now that signs of change in the deflationary mindset of firms and households are beginning to emerge, expectations surrounding the government's role in raising domestic growth expectations and productivity are rising.

Yuko Iizuka, Economist

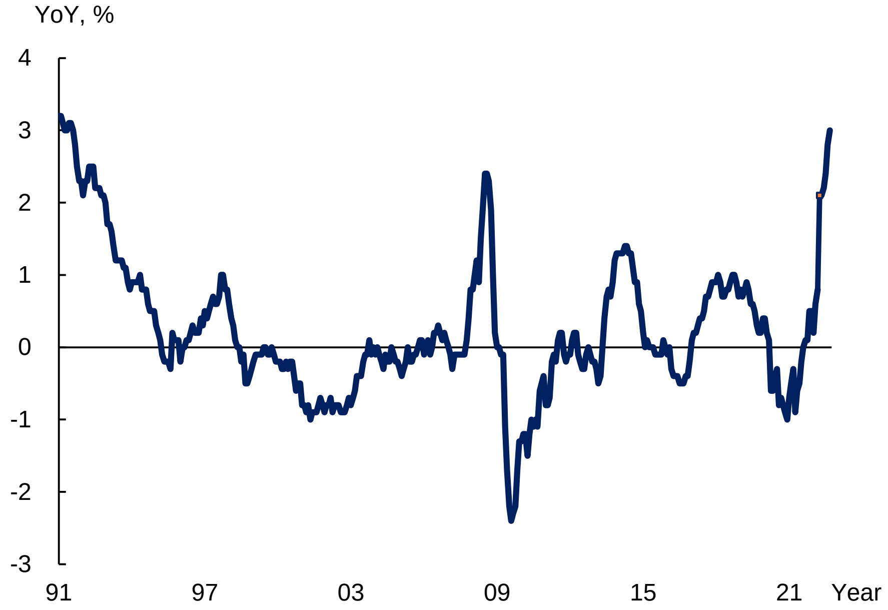
“Rising price momentum”

In September, Japanese consumer prices (excluding fresh food) rose to +3.0% year-on-year, the highest level in nearly 31 years excluding the impact of the consumption tax hike (Figure 1). Bank of Japan (BOJ) Governor Kuroda has stated that it is necessary to achieve the 2% ‘price stability target’ in a sustained and stable manner, accompanied by wage growth, and that it is appropriate to continue monetary easing and support the economy at present.

Looking at the price momentum that the BOJ is focusing on to achieve the 2% price target we note the following three points. (1) the BOJ's estimated output gap has narrowed to -0.7% in the April-June quarter of 2022. This is in line with the BOJ's forecast that the gap will turn positive in the second half of FY2022. (2) The average price outlook for companies (inflation expectation) was +2.1% in three years time and +2.0% in five years time, according to the Bank of Japan's Tankan survey. This is the first time five year expectations have also reached 2% since the survey began in 2014 (for all corporate sizes across all industries). On the other hand, (3) wage growth has not kept pace with price increases, with real wages declining.

Whether Japan will return to deflation or start a virtuous cycle of wage and price increases depends on wage increases, and we believe investors should focus their attention on wage increases at the 2023 spring *Shunto*.

Figure 1: Core CPI (excluding fresh food)



Source: NEEDS-FinancialQUEST, Ministry of Internal Affairs and Communications
Period: Monthly data from Jan. 1991 to Sep. 2022
Note: The Core CPI (excluding fresh food) above is the seasonally adjusted index

What is the rate of wage growth commensurate with achieving Japan's price target? The nominal wage growth rate (hereafter referred to as the wage growth rate) can be thought of as the rate of increase in prices plus the rate of increase in labour productivity, because when labour productivity increases, the incremental value added can be distributed as wages.

"What is the target rate of wage growth?"

The Government has set a labour productivity growth target of 2% in its Growth Strategy. This is based on the idea that productivity needs to increase to 1.5 times of the current levels by 2030 in order to maintain the level of GDP while coping with the decline in Japan's working population and the reduction in working hours associated with the work style reform that eliminates overtime work. Given the BOJ's price stability target of 2% and the Government's labour productivity target of 2%, the wage growth rate target set by the BOJ and the government can be inferred to be 4%.

However, the reality is that labour productivity has not risen very much. According to estimates by the Japan Productivity Centre, the real labour productivity growth rate (per hour worked) since 2000 until the COVID pandemic was only 0.8% (Figure 2). It seems realistic to aim for a wage growth rate of 3% in 2023, assuming a price target of 2% and current labour productivity of 1%.

Figure 2: Labour productivity and Labour equipment rate

Year	1960 ～ 1969	1970 ～ 1979	1980 ～ 1989	1990 ～ 1999	2000 ～ 2009	2010 ～ 2019
Labour productivity rate, %	9.4	4.6	3.6	1.7	0.8	0.8
Labour equipment rate, %	10.4	10.8	7.6	4.1	-1.4	0.3

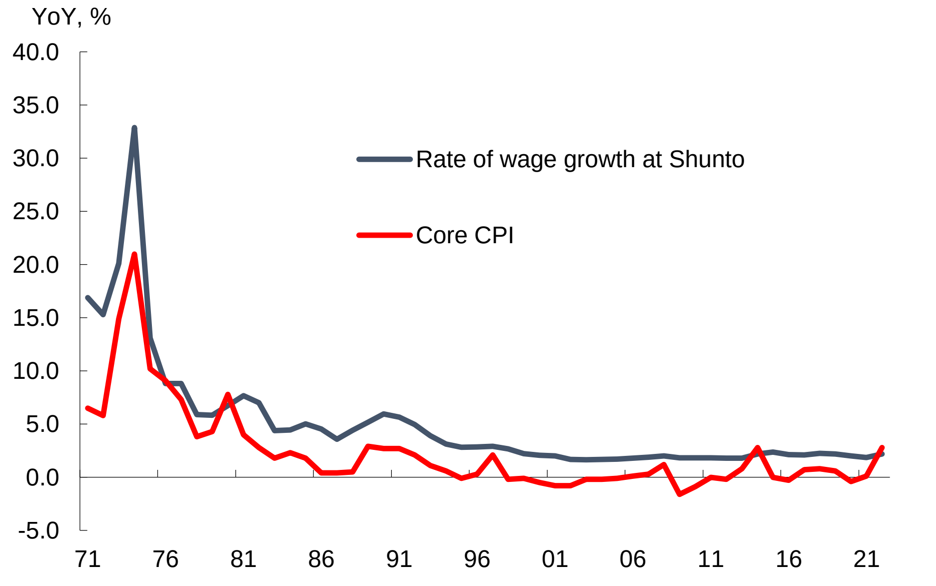
Source: Japan Productivity Centre, Ministry of Finance Japan
Period: Annual data from 1960 to 2019. Labour equipment rate was calculated from 1961.
Note: Labour productivity shows output per hour. Labour equipment rate shows the average growth rate of each FY.

"Results of the 2022 *Shunto*"

Prime Minister Kishida referred to the Council of Realisation of New Capitalism's decision to raise the incomes of workers which are heavily influenced by official prices set by the government, such as childcare workers, by around 3%, and stated that he expects a wage increase of over 3%, desirable level to mark the beginning of the new capitalism, at companies whose business performance have recovered pre-COVID levels.

Although the rate of wage increases in spring 2022 did not reach 3%, it recovered pre-COVID levels of 2.07% according to RENGO, the Japanese Trade Union Confederation, and 2.2% according to the Ministry of Health, Labour and Welfare (Figure 3).

Figure 3: Rate of wage growth at *Shunto* and Core CPI



Source: NEEDS-FinancialQUEST
Period: Annual data from 1971 to 2022
Note: 2022 data of Core CPI is based on the Asset Management One outlook.

The RENGO has announced that it will push for wage hikes of around 5% during the 2023 spring negotiations in recognition of higher prices and other factors. This is the first time it demands a 5% increase since 1995 and the last time such a level was achieved was 1991, shortly after the burst of the bubble economy.

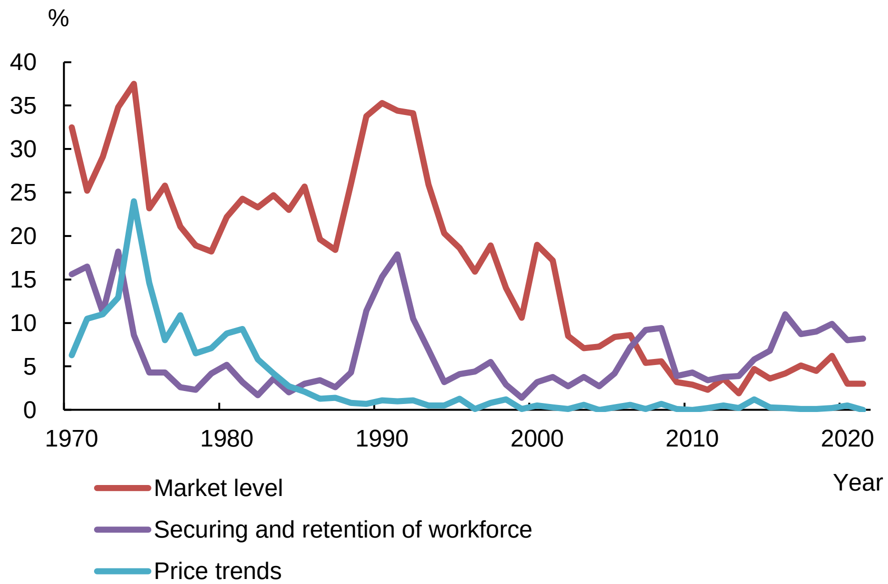
Even if the 5% target may be a deliberate lofty pickoff play from the RENGO, Japanese Trade Union Confederation, it will be interesting to see whether the long-standing wage growth rate of 2% will rise to around 3% in 2023. Up until the mid-1990s, when the wage growth rate was above 3%, the rate was determined by factors such as "securing and retention of workforce" and "market level", in addition to "price trends" (Figure 4). In the last few years, consideration of labour recruitment and retention has increased against the background of a declining working population. Due to the intense competition for human resources amid labour shortages, there is a possibility that global market rates will also become more important.

The distribution of wage revision rates since 2000 has remained the same with many companies having wage revision rates of around 2%, however since the late 2010s the proportion of companies with a wage revision rate of zero per cent has decreased significantly, and the proportion of companies with a wage revision rate in the high 2% to 3% range is increasing (Figure 5).

In 2023, it is expected that the proportion of companies increasing their wage growth rates to even higher levels will increase in order to maintain living standards and secure the labour force amid rising prices.

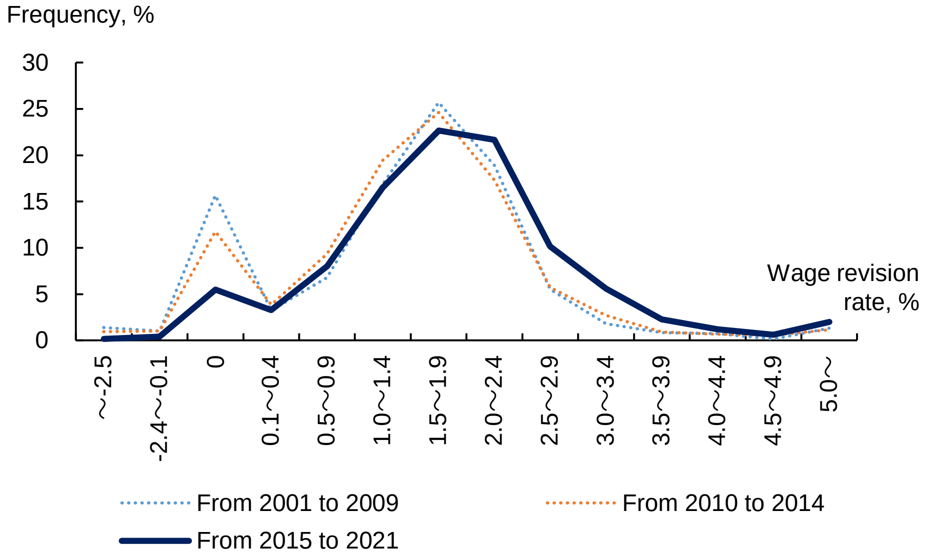
"Looking towards the 2023 *Shunto*"

Figure 4: Factors chosen by companies as the most important in determining wage revision rates



Source: Ministry of Health, Labour and Welfare
Period: Annual data from 1970 to 2021
Note: The sum of these three factors is not 100% as there are other factors.

Figure 5: Distribution of wage revisions



Source: Ministry of Health, Labour and Welfare
Period: Annual data from 2001 to 2021

Raising wages and as a function of that labour costs means that domestic growth expectations and increased labour productivity are essential from a company's perspective.

"Policy push essential"

With an ageing and shrinking population, in Japan the expected domestic growth rate (real economic growth forecast for the next five years) has remained in the low 1% range for more than a decade, according to a survey of companies conducted by the Cabinet Office.

The Kishida Government placed emphasis on the distribution of income to people at the beginning of its term, but since the middle of this year, it has also emphasised investment and growth. The growth strategy includes the promotion of science, technology and innovation, support for start-ups, and investment in digital transformation (DX) and green transformation (GX). In his policy speech in October this year, he also indicated that the government would focus on attracting production plants of semiconductors and other critical materials to the country.

We believe that measures to increase the labour equipment ratio (capital equipment ratio) through investment in people, such as retraining, and capital investment, including DX, are essential to raising labour productivity. The labour equipment rate is the equipment used per employee and is closely related to labour productivity (Figure 2). We hope that a virtuous cycle of rising wages and prices can be initiated by addressing domestic growth expectations and improving productivity, so as not to fall back into deflation again, without missing this opportunity when the consumer prices have risen to their highest levels in about 31 years.

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22-034 GBDG