

Kishida administration's policies from the perspective of overcoming deflation

05 November 2021

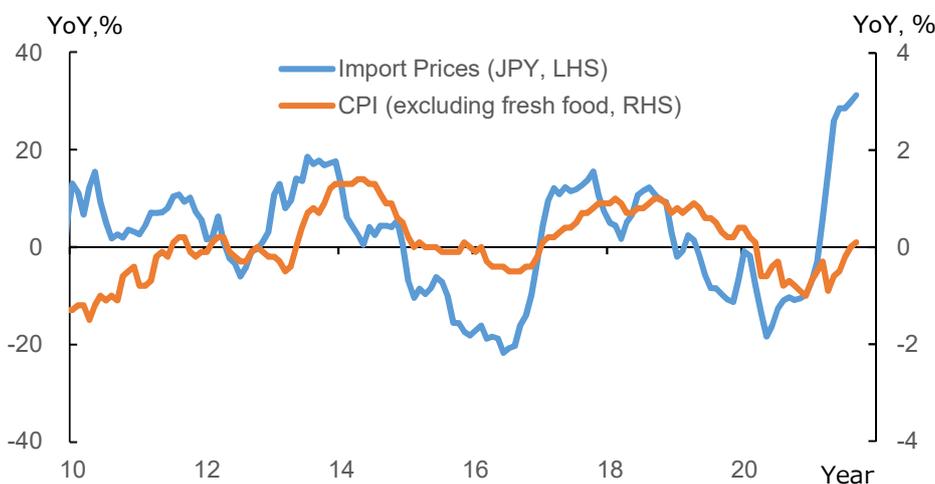
- ▶ Despite the global surge in commodity prices, the pass-through to consumer prices in Japan has been limited.
- ▶ Looking back at price movement since the beginning of Abenomics initiatives, while there were signs of a change in firms' pricing behavior in the initial phase, consumers' tolerance for price increases has not increased.
- ▶ Households' tolerance of price increases will depend on the employment/income environment and macroeconomic prospects moving forward. The Kishida administration's policy target of income distribution to the middle class, which focuses on prices in the public sector and the incomes of those who work there, has the potential to create the foundations for a virtuous cycle in prices and wages.

As developed markets lead the global economy in its path of post-pandemic normalization, the price of commodities such as crude oil has soared in line with increased demand under constrained supply conditions. This has been resulting in higher goods prices around the world. In Japan, import prices (in yen terms) rose by 31.3% YoY in September, the highest recorded increase since records began in January 1981. While the September CPI (excluding fresh food) rose 0.1 percent YoY, the first increase in one year and six months, it remained near zero (Figure 1). Raw materials and intermediate input prices have risen, but with the exception of energy prices, such as gasoline and electricity, their pass-through to consumer prices at the downstream level has been limited. With households less tolerant of price increases, we think firms are likely to maintain a cautious stance on price increases, wary of losing customers. So far, few expect consumer prices to reach and stabilise at the Bank of Japan's price target of 2%.

Yuko Iizuka, Economist

“Consumer prices in Japan have hovered around zero year-on-year”

Figure 1 : Import Prices and CPI



Period : From Jan. 2010 to Sep. 2021 (Monthly)
 Source : BOJ, NEEDS-FinancialQUEST
 (Note) CPI is adjusted for consumption tax

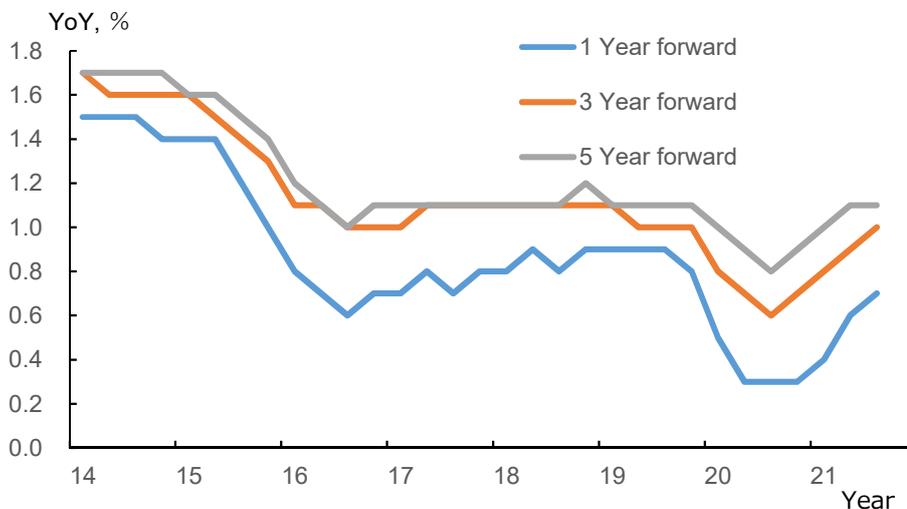
Looking back at the policies and price movements since Abenomics, we will examine the current focus of the Kishida administration's policies from the perspective of overcoming deflation.

When Shinzo Abe became Prime Minister at the end of 2012, he set three core pillar policies (the three arrows) as his top priority to end deflation. The first arrow was a super easy monetary policy, the second was a flexible fiscal policy, and the third was a growth strategy to stimulate private investment. In the early years of the cabinet, the emphasis was on the monetary policy, and a joint statement was issued by the Bank of Japan and the government to end deflation. The target for price stability was set at 2% and the Bank of Japan would pursue monetary easing to achieve this target as soon as possible. The Government has been pressing companies to raise wages so that the recovery in corporate profits will quickly lead to higher wages and other benefits. The aim was to create a virtuous circle of rising prices and rising wages.

“The three arrows of Abenomics”

Prompted by the rising costs associated with the weakening of the yen and political commitment, there were signs of a change in the pricing behaviour of companies. In 2014, consumer prices (excluding fresh food) rose by 1.1 % YoY, marking the first time the gauge topped the 1% level since 2008 (excluding the impact of the consumption tax rate hikes). The Bank of Japan's Tankan survey of corporate sentiment at the time showed that firms were looking at an inflation rate of 1.7 % in three years, which is close to the 2% target (Figure 2).

Figure 2 : Companies' Price Outlook



Period : From Mar. 2014 to Sep. 2021 (Quarterly)
Source : BOJ
(Note) Average of companies' overall prices outlook

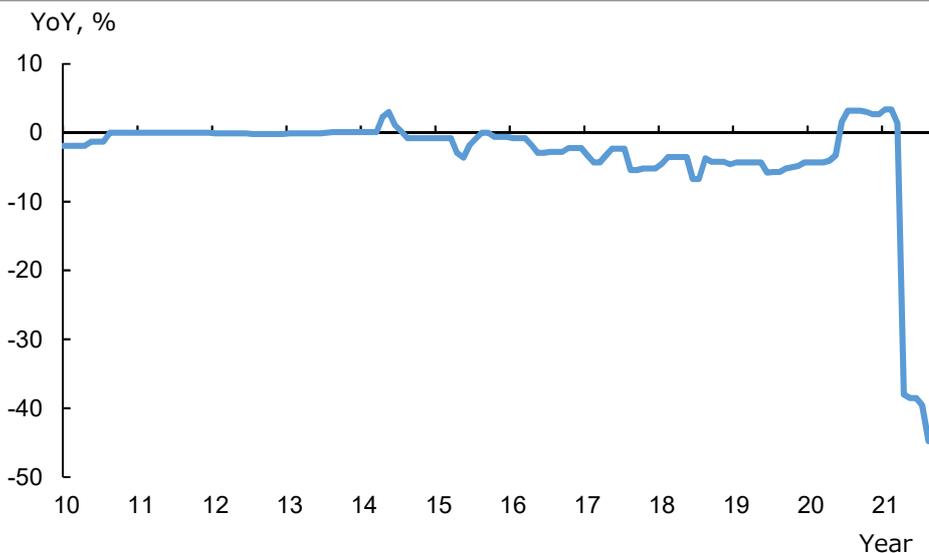
However, price increases did not continue due to consumers' persistent preference for lower prices and pressure on household incomes mainly stemming from an increase in the consumption tax rate.

In 2015, the phrase "achieve the 2% price target as soon as possible" was removed from the wording within the Cabinet Office's Monthly Economic Report, a document which indicates the government's economic judgment. We believe that this happened because consumers were not ready to accept price hikes in the face of weak wage growth.

In September 2020, Prime Minister Abe abruptly resigned and Suga, then Chief Cabinet Secretary, took over as Prime Minister. As Chief Cabinet Secretary, Suga had been saying that there was room for a 40% reduction in the cost of using mobile phones in Japan, as mobile phone charges were becoming an increasingly significant part of household expenditure. As of September 2021, mobile phone charges were 44.8% lower than the previous year (Figure 3). The weight of mobile phone communication charges in the CPI is sizable (2.7%), pushing down the YoY change in CPI by 1.23% points. This demonstrates how consumer prices are being pushed down substantially by the government policy.

“Downward pressure on mobile phone tariffs from the Suga cabinet”

Figure 3 : Mobile Phone Communication Charges



Period : From Jan. 2010 to Sep. 2021 (Monthly)
Source : Ministry of Internal Affairs and Communications

In September 2021, then Prime Minister Suga decided not to run for the LDP presidency, and in October a new administration was formed by Kishida, who won the election. Kishida has stated that his main goal is to end deflation, and that he will deploy all policies necessary to create a virtuous circle of growth and distribution.

While the "growth" strategy includes the same menu of measures as before, such as the initiatives to make Japan more science- and technology- oriented and ensure economic security, the "distribution" strategy also seeks to strengthen the distribution function for working people. As part of this strategy, the government will fundamentally review the nature of public sector pricing in order to raise the incomes of nurses, care workers, kindergarten teachers, nursery school teachers and others whose wages have long been kept low in relation to the nature of their work, despite the fact that the source of their wages is publicly determined.

“The focal points of Kishida administration's distributional policy”

It has been pointed out that in Japan, the proportion of public services for which prices are set directly by the government is higher than in Europe and the US. Regulated prices under the medical treatment fee system and the nursing care fee system have restrained the prices of medical and nursing care services. Although the supply and demand balance for medical and nursing care staff has been tight, it has been difficult for this to be reflected in wages. While the young population is declining due to the declining birth rate, the need for medical and nursing care is increasing as the population ages, and the demand for workers in the medical and welfare industries is increasing. In 2020, the ratio of job openings per applicant (how many jobs are available for each job seeker) is 3.99 for care occupations, which is much higher than the overall ratio of 1.08 (Figure 4).

Figure 4 : Job-to-Applicants Ratio and Wages in Care Occupations



Period : Prescribed Wages in 2019 , Jobs-to-applicants ratio in 2020

Source : Ministry of Health, Labour and Welfare

(Note) Industry total and welfare facility care worker wages are based on prescribed wage data (does not include overtime)

On the other hand, whilst it is not a straight-forward comparison due to differences in length of service and other factors (care workers have a higher turnover rate), the average wage level for care workers is lower than the whole industry average.

In Europe and the US, independent regulatory commissions have been set up to avoid government intervention in setting prices too low. In his policy statement, Prime Minister Kishida said that he would set up a committee to evaluate public sector prices.

We believe that price controls on public services both directly reduce consumer price inflation, as well as indirectly through restraining wage increases and exasperating consumers' deflationary mindset.

To overcome deflation, it is necessary to raise the level of households' tolerance for price increases. Households' tolerance for price increases will depend on their views and outlook for the employment and income environment going forward. It goes without saying that the most important factor in raising wages is productivity growth. In addition to such measures, we believe that the Kishida administration's policy of income distribution to the middle class, which focuses on prices in the public sector and the incomes of those who work there, is noteworthy in that it has the potential to lay the foundations for a virtuous cycle between prices and wages.

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