

Achievements of the Kishida Administration and Issues to be Addressed by the Next Prime Minister

30 August 2024

- ▶ Prime Minister Kishida will step down at the end of his term. He deserves a certain amount of credit for overcoming deflation with the highest wage increase rate in 33 years, capital investment exceeding 100 trillion yen, record high recurring profits, and nominal GDP reaching 600 trillion yen. The effects of policies such as wage increases in the public sector, the establishment of a proper price pass-on environment for small and medium-sized enterprises, and the expansion of minimum wage hikes were not small.
- ▶ The period up to 2030 is the last chance to make changes to the economic structure as the end of this era is when the decline in the working age population is expected to accelerate. The initiatives to do so have been left to the next prime minister. While support measures for high prices may be justified for the time being in order to completely exit from deflation, attention will be focused on social security reform in response to a society with a declining population and energy plan.

Achievements in Overcoming Deflation

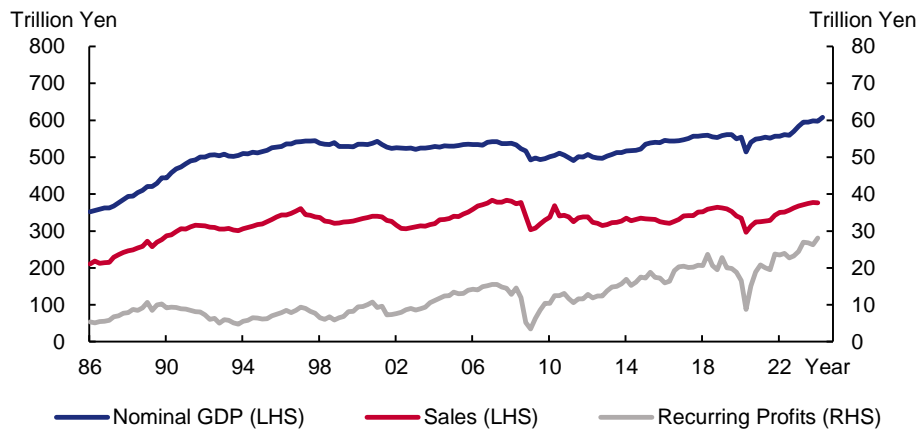
Prime Minister Kishida has announced that he will not run in the Liberal Democratic Party (LDP) presidential election in September and will step down when his term ends at the end of that month. At this point, there will be a lot of candidates running for the LDP presidential election, so the next administration cannot be decided, but we would like to identify issues for future policy management by reviewing the achievements of the Kishida administration's economic policies and remaining challenges.

The “Basic Policy on Economic and Fiscal Management and Reform 2024: Achieving a Growth-Oriented Economy Driven by Wage Increases and Investment,” approved by the Cabinet under Prime Minister Kishida in June of this year, outlines the short-, medium-, and long-term path to economic renewal. Regarding the short-term “complete exit from deflation / transition to a new growth-oriented economic stage”, we can assess that certain achievements have been made, including the highest wage increase rate in 33 years, capital investment of 100 trillion yen, record-high recurring profits, and nominal GDP of 600 trillion yen (Figure 1, next page).



Yuko Iizuka, Economist

Figure 1: Nominal GDP and Corporate Performance

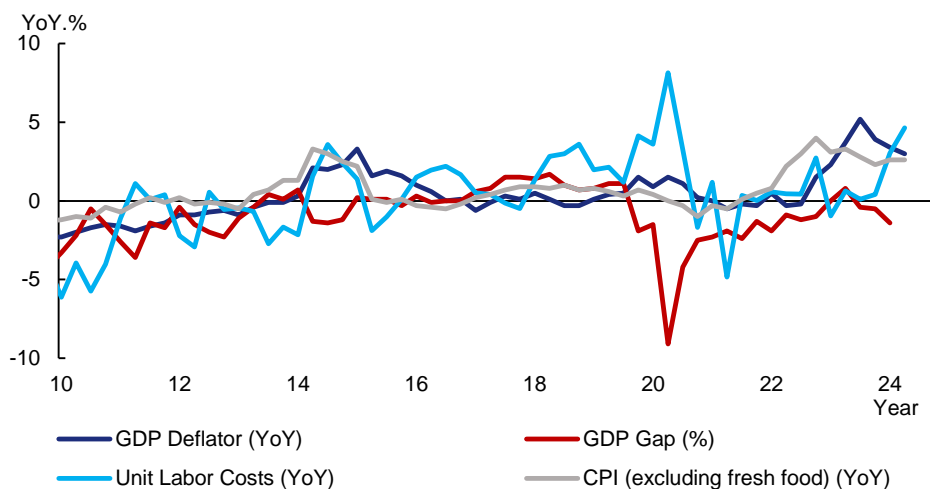


Source: Japan Cabinet Office and Ministry of Finance
 Note: 1. Quarterly data from Q1 1986 to Q2 2024, except sales and recurring profits are aggregated until the Q1 2024 period
 2. Sales and recurring profits are for all sizes and all industries except finance and insurance (seasonally adjusted values)

Policy Provides Indirect Support for Overcoming Deflation

In terms of overcoming deflation, three of the four indicators that the government is emphasizing (Figure 2), with the exception of the supply-demand gap, have turned positive. The core CPI (consumer prices excluding fresh food) has been above +2% (year over year) since April 2022; the GDP deflator has also been above +2% (year over year).

Figure 2: Four Key Indicators for Observing Overcoming of Deflation



Source: Japan Cabinet Office and Ministry of Internal Affairs and Communications
 Note: 1. Quarterly data from Q1 2010 to Q2 2024, except GDP gap is aggregated until the Q1 2024 period
 2. Unit labor costs = Nominal employee compensation / Real GDP, and the years of 2014 and 2019 were affected by the increase of consumption tax rate

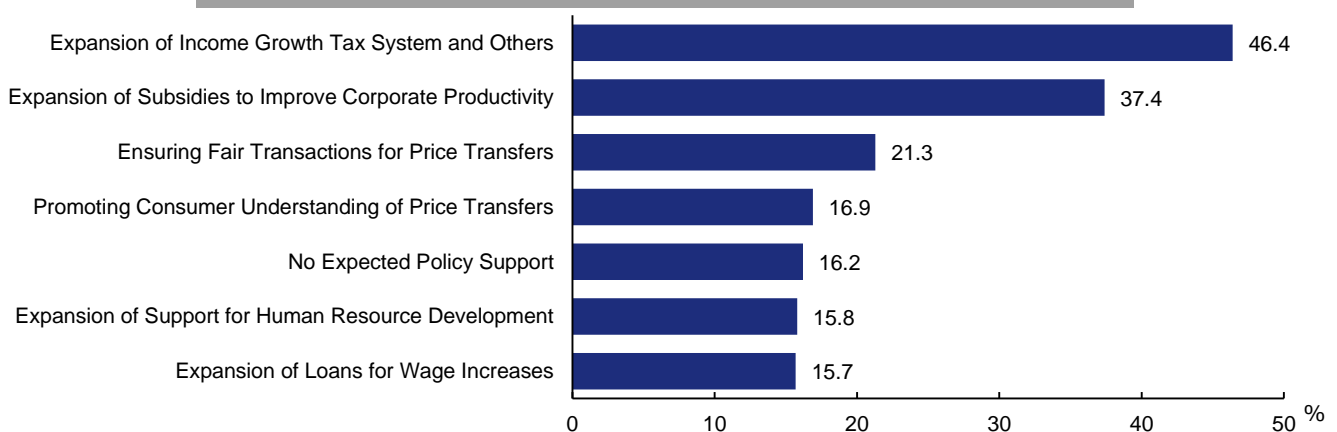
Unit labor costs (nominal employee compensation / real GDP) have been rising, driven by employee compensation on the back of employment growth and wage increases. The supply-demand gap is also expected to become positive sooner or later. The Bank of Japan took steps to normalize monetary policy by lifting the negative interest rate in March and raising the policy rate to 0.25% in July 2024, on the grounds that it now foresees sustainable and stable realization of its 2% price stability target.

The trigger for the start of the favorable cycle between prices and wages was higher prices against the backdrop of soaring international commodity prices, the progressive depreciation of the yen, and wage hikes against the backdrop of labor shortages. However, we appreciate that the effect of policies that encouraged companies to change their behavior toward aggressive price setting and wage hikes was not small. The Kishida administration, under the slogan of a “favorable cycle of growth and distribution,” has raised wages in the public sector such as medical and nursing care, childcare, and public procurement and raised public service prices in areas. It has expanded the tax policy to promote wage increases, expanded the range of minimum wage increases, and created an environment for small and medium-sized enterprises (SMEs), many of which are subcontractors, to pass on costs properly.

The guideline for the minimum wage in FY2024 has been set at a national average of 1,054 yen per hour, an increase of 50 yen, the largest ever. The minimum wage will affect the wage determination of part-time and other non-regular employees and will have a ripple effect on the pricing of SMEs.

Prime Minister Kishida has set a goal of raising the minimum wage to 1,500 yen per hour by the mid-2030s, and it is believed that SMEs will be key to the establishment of wage increases that exceed price increases and price transfers in order to completely exit from deflation. The policy support that SMEs expect in order to cope with the increase in minimum wages include: “expansion of tax benefits (such as tax policy to promote wage increases) in the case of wage increases” and “requests for expansion of subsidies for capital investment and other efforts to improve corporate productivity (profitability)” (Figure 3).

Figure 3: Expected Policy Support for Higher Minimum Wage



Source: Japan Ministry of Health, Labor and Welfare
Japan Institute for Labor Policy and Training,
'Survey on Minimum Wage Increases and Corporate Behavior' (2023)

Note: 1. Survey period from 12 January 2024 to 29 January 2024
2. Multiple responses

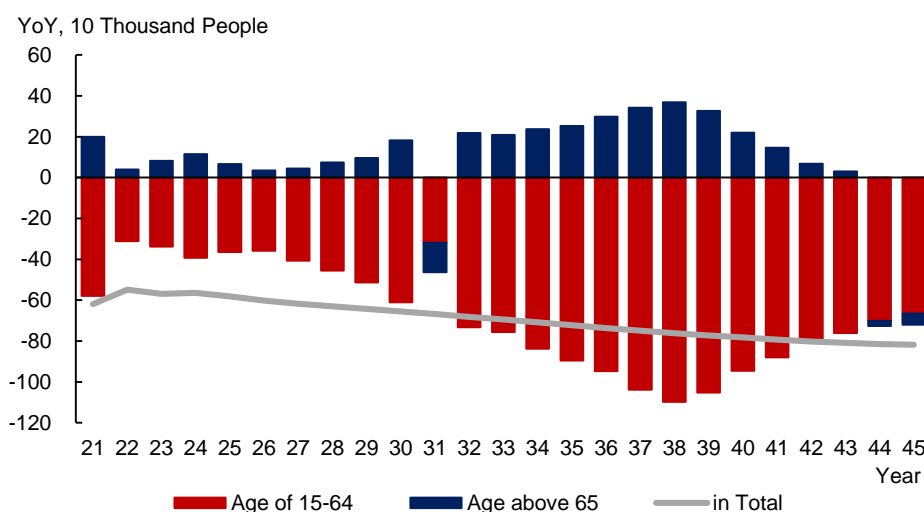
Transitioning to a New Growth-Oriented Economic Stage

In recent years, increase in demand for investments related to efficiency and Digital Transformation has been seen in response to labor shortages. In addition, as the global movement to strengthen and restructure supply chains in strategic and critical goods expands, the Kishida administration has expanded subsidies with regard to semiconductors and actively attracted domestic and foreign related companies to Japan. At the Hiroshima Summit in May 2023, major semiconductor companies from the U.S., Europe, and South Korea met with Prime Minister Kishida, and the companies expressed their desire to collaborate with Japan and increase investment, indicating high expectations for Japan as a semiconductor production location. Against this backdrop, and partly due to higher prices (deflators), domestic capital investment increased to a record level of over 100 trillion yen in nominal value.

Focusing on Medium- to Long-term Perspectives

In the “Basic Policy” approved by the Cabinet in June, the medium- to long-term policy beyond 2030 is to “overcome the declining birthrate, aging society, and declining population / create a sustainable economic society”. The policy states that “under the sustained and stable realization of the 2% price stability target, an economy of around 1,000 trillion yen in nominal value will be in sight around 2040”. However, there are many challenges that must be overcome. According to future population projections, the pace of decline in the working-age population is expected to accelerate in the 2030s (Figure 4). It was stated that the period up to FY2030 would be the last chance to make changes to the economic structure, and that intensive efforts, including necessary institutional reforms, would be undertaken over the next three years or so. The specifics of these efforts can be said to have been left to the next prime minister.

Figure 4: Projected Population Decline Trajectory



Source: Japan National Institute of Population and Social Security Research

Note: 1. Annual data from 2021 to 2045

2. Medium-fertility estimate

According to public opinion polls, in addition to “economic measures” and “political reforms related to the issue of politics and money,” “the state of the social security system” tops the list of political issues most desired for further discussion in the LDP presidential election. With concerns smoldering over the sustainability of public finances and social security against the backdrop of a shrinking population, consumption may be suppressed as people, especially the younger generation, increase their propensity to save in preparation for retirement.

It is anticipated that the next prime minister, upon taking office, will dissolve the House of Representatives and hold a general election in response to a potential recovery in the approval rating. Furthermore, with the Upper House election coming up next July, economic measures are expected to be formulated. In June, Prime Minister Kishida had mentioned the formulation of economic measures this fall, including benefits for low-income households and measures to support higher prices. As the final steps to a complete exit from deflation, measures to support higher prices, support for productivity-enhancing investments to raise wages, and expansion of the tax policy to promote wage increases are still required.

However, with a positive supply-demand gap just around the corner, the next prime minister is also expected to initiate institutional reforms to address the declining population and present a picture of a sustainable society. In 2024, the financial outlook for future public pensions (financial verification) was reviewed, but consideration of sustainability concerns has been postponed. Additionally, in FY2024, the 7th Strategic Energy Plan through 2040 is scheduled to be formulated, and the biggest focus will be on what the 2040 reduction target will be and the extent to which the assumed composition of decarbonized power sources will be built up. Prime Minister Kishida has also taken steps to consider the active use of nuclear power generation in light of issues such as power shortages and delays in decarbonization. It remains to be seen whether this will be a highly viable plan.

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