

Personal Consumption Trend After Real Wages Turning Positive

28 June 2024

- ▶ Should real wages turn positive in the second half of this year, it will be the first time since the early 1990s that the wage growth rate exceeds the inflation rate. Inflation can change consumer behavior, while a steady increase in income, accompanied by an aging population and work style reforms, has the potential to lead to an increase in spending on goods and services that enhance the quality of life.
- ▶ However, there are factors inhibiting consumption, such as (1) modest real wage growth, (2) limited growth in disposable income due to social security burdens, and (3) persistent concerns about the future among the population. Therefore, reforms aimed at enhancing the future sustainability of wage and price cycles, as well as personal consumption, are needed to continue progressing.

Real wages to be positive this year

This year, real wages are expected to turn positive in Japan against the backdrop of a global surge in commodity prices, a weakening yen, and labor shortages. Both prices and wages have recorded growth rates not seen in about 30 years. However, the inflation rate has exceeded the wage growth rate, leading to a reduction in household purchasing power. As a result, consumption lacks strength after the rapid recovery phase from the COVID-19 pandemic.

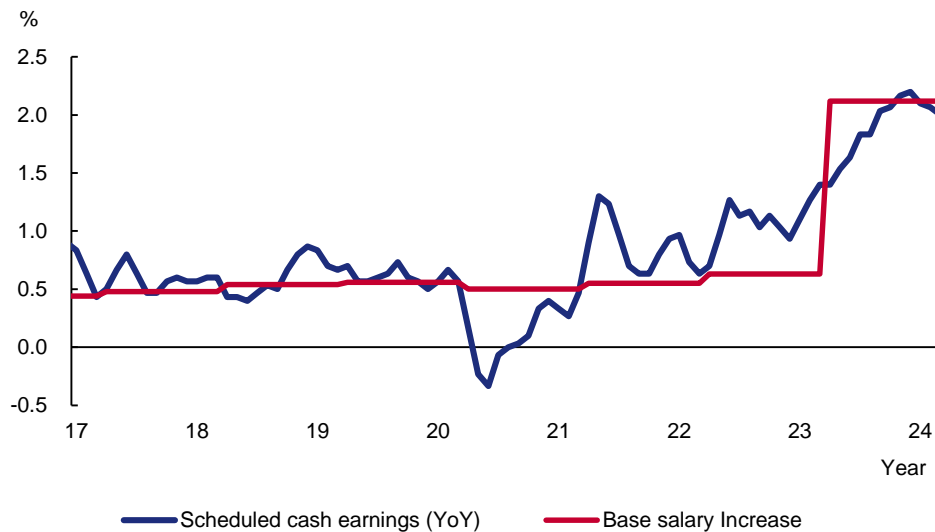
In such circumstances, the wage growth rate during this year's spring labor negotiations has experienced even higher growth compared to last year. This has raised hopes that the wage growth rate will surpass the rate of inflation, leading to positive real wages.

According to the aggregate data released by RENGO (Japan Trade Union Confederation), the base salary increase in the 2023 spring labor negotiations was reported to be 2.1%. As a result, scheduled cash earnings have been trending at around a +2% YoY increase since the summer of last year (Figure 1, next page). Companies began implementing salary payments based on the wage increase policy determined at the beginning of the fiscal year, starting around April, and by autumn, revised salaries are being paid by the majority of companies.



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“The wage growth rate during this year's spring labor negotiations has experienced even higher growth compared to last year”

Figure 1: Trend of Base Salary Increase and Scheduled Cash Earnings


Source: MHLW (Ministry of Health, Labor and Welfare) and RENGO (Japan Trade Union Confederation).

Note: 1. Monthly data from January 2017 to March 2024.

2. Base salary increase applies the figures for each year from April to the following March.

3. Scheduled cash earnings refer to the three-month moving average based on the monthly labor statistics for common workplaces.

According to the aggregate data as of June, the base increase for this year is in the mid-3% range. Therefore, the regular wages will also likely expand to the mid-3% range compared to the previous year, probably around the summer of this year.

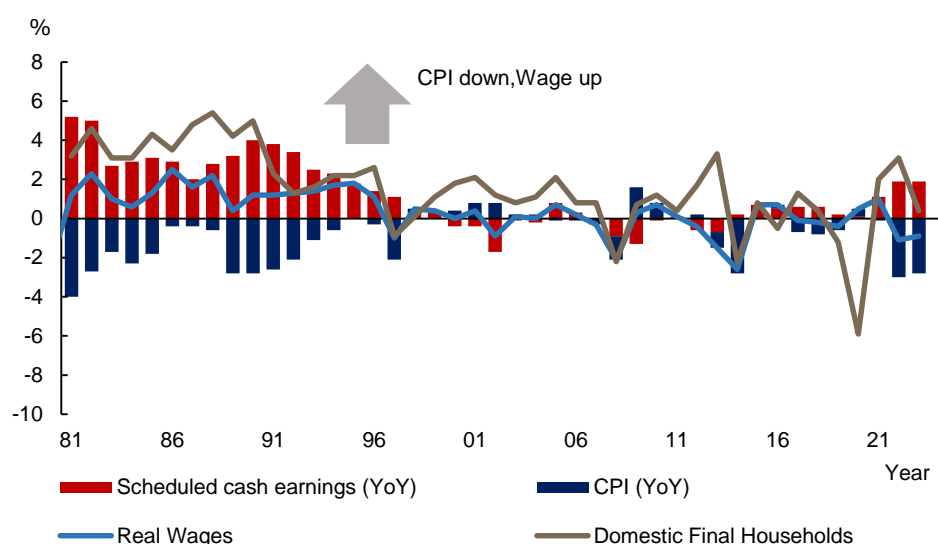
The core CPI (Consumer Price Index excluding fresh food) was +2.2% compared to the previous year in April. With the government's measures to curb electricity and gas prices coming to an end, it is likely to increase to the mid-3% range around the summer of this year, leading to a positive transformation of real wages.

“The regular wages will likely expand to the mid-3% range by summer”

Personal consumption amid price increases

If we look at the trend of real wages from 1981, there have been several periods when it turned positive. From the 1980s to the early 1990s, the wage growth rate exceeded the inflation rate, resulting in positive real wages. The subsequent positive periods were mainly brought about by a decrease in prices. In fact, these positive periods did not last long (Figure 2).

Figure 2: Trend of Real Wages and real CPI



Source: Ministry of Internal Affairs and Communications, Ministry of Health, Labor and Welfare and Cabinet Office.

Note: 1. Annual data from FY1981 to FY2023

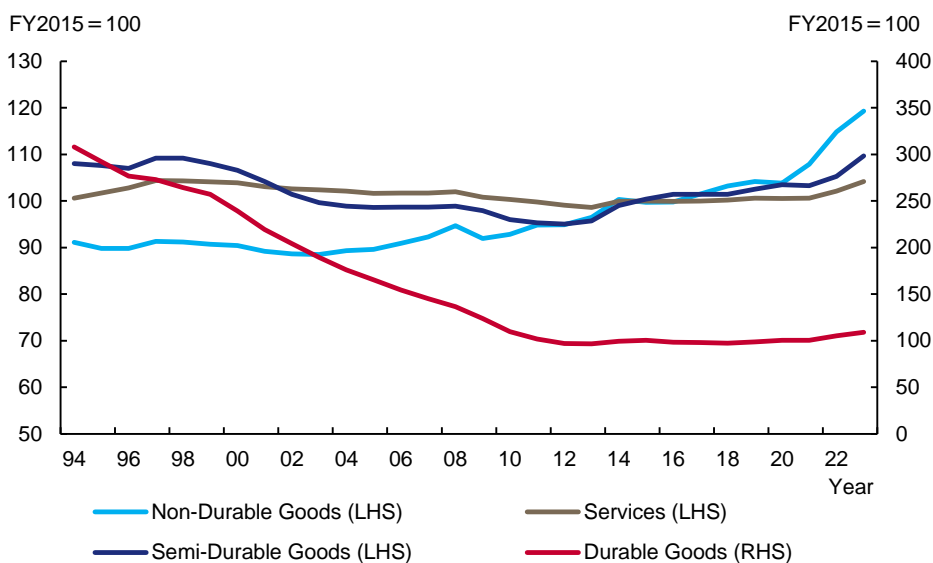
2. Real wages are for establishments with 30 or more employees in covered industries.
3. CPI refers to consumer prices excluding fresh food and is expressed as negative for increase or rise.

The positive real wage growth expected in the second half of this year, if realized, will result from the rate of wage growth exceeding the inflation rate.

Even with the same increase in real purchasing power, different impacts on consumer behavior can be expected depending on whether prices are rising or falling. If consumers are aware of the end of deflation and continuous price increases, behavior such as delaying consumption in anticipation of price declines would become irrational.

Looking at the price deflators for goods and services, the prices of durable goods such as electronics, as well as semi-durable goods such as miscellaneous goods and clothing, have declined since the mid-1990s (Figure 3).

Figure 3: Price Deflators for Goods and Services



Source: Japan Cabinet Office.

Note: Annual data from FY1994 to FY2023.

In these product categories, the increase in imported goods in domestic supply, combined with a stronger yen, is believed to have led to price declines. Additionally, intensified sales competition and the strategy of maintaining prices while improving performance and quality seemed to have influenced the trend.

Recently, changes in consumer deflation mindset have started to emerge. According to a survey conducted by the Bank of Japan on lifestyle awareness, the proportion of respondents who expect prices to rise "considerably" 5 years from now has increased. Furthermore, over 30% of respondents expect that "prices will inevitably rise in the medium to long term."

“Recently, changes in consumer deflation mindset have started to emerge”

Personal consumption driven by steady income growth

Furthermore, even with the same increase in real purchasing power, the expected continuation of wage increases can also influence consumer behavior. Generally, long-term increases in sustainable income, as opposed to temporary income increases like benefits or tax cuts, can increase the average propensity to consume.

Amid a severe manpower shortage, we think that concerns about employment have diminished. In addition, we expect that Prime Minister Kishida's goal of raising the minimum wage to JPY 1,500 per hour by the mid-2030s will lead to sustained wage increase expectations, including for non-regular employees.

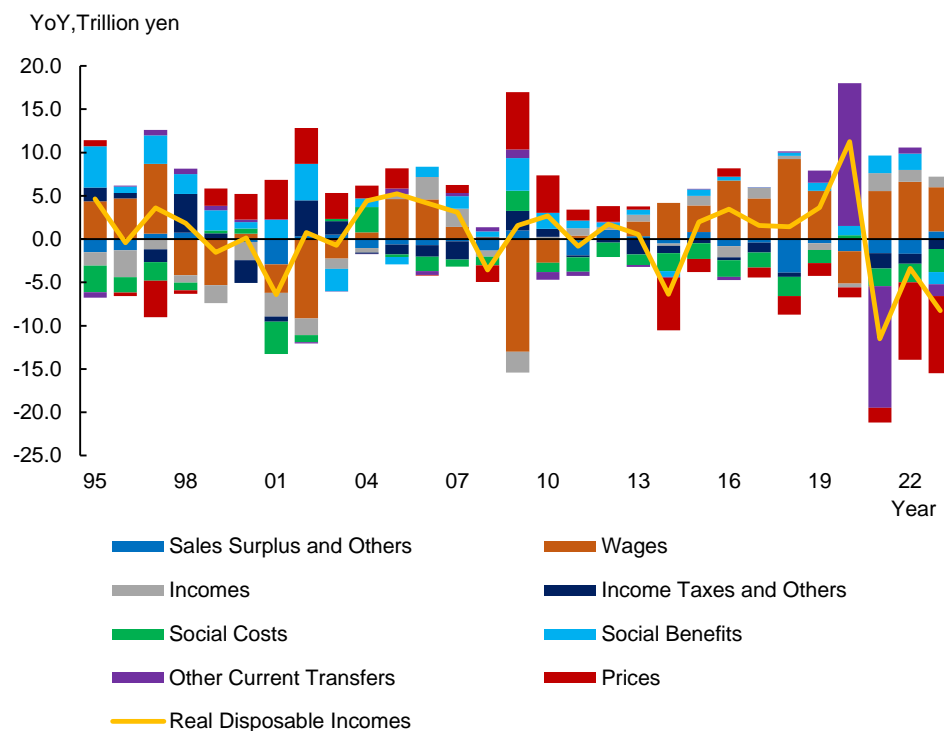
With an increase in leisure time due to aging and work-style reforms, there is a possibility of increased spending on goods and services that enhance quality of life. Although the population is declining, household numbers are expected to increase until around 2030, according to future estimates by the National Institute of Population and Social Security Research. With the projected increase in dual-income and elderly households, demand for convenient durable goods is still expected.

Points to note

There are still several points to note when considering the future of personal consumption. Firstly, even if the negative trend in real wages is resolved, the magnitude of the positive increase in 2024 is likely to remain moderate compared to that in the 1990s. In order to achieve a wage growth rate that comfortably exceeds the inflation rate, companies need to enhance their earning power through value-added expansion and productivity improvement in order to secure the funds for wage increases.

Secondly, even if the negative trend in real wages is resolved, there is a possibility that the growth of disposable income will be limited (Figure 4, next page). For households, in addition to rising prices, the burden of social security and other costs has been increasing steadily. Concerns about the increased burden of social insurance premiums to cope with declining birth rates, child-rearing measures, and the aging population still remain.

“With an increase in leisure time due to aging and work-style reforms, there is a possibility of increased spending on goods and services that enhance quality of life”

Figure 4: Disposable Incomes Breakdown


Source: Japan Cabinet Office.

Note: 1. Annual data from FY1995 to FY2023, including individual businesses.

2. Income taxes and others, social costs, and prices are expressed as negative for increases or rises.
3. Social benefits include pension insurance benefits, employment insurance benefits, child allowances, etc.
4. Incomes include investment incomes, interests, etc.
5. Social costs refer to insurance premiums and contributions to social security funds, etc.
6. Prices are calculated by subtracting the real value of disposable income from the nominal value.
7. Other current transfers have become highly volatile due to factors such as COVID-19 relief payments.

The third point to note is the simmering anxiety, particularly among the younger generation, about the future. While there are concerns about the sustainability of the economy, fiscal situation, and social security under a declining population, there is a possibility that individuals may increase their savings propensity in preparation for retirement.

The positive cycle of wages and prices, including consumption, not only requires an increase in non-discretionary spending for elderly medical and caregiving expenses but also the revitalization of consumption among all generations. First and foremost, it is important to establish wage increases and price hikes, but in order to secure future sustainability, reforms considering the structural changes in a declining population society are needed to progress.

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