6 December 2023 (No. of pages:12)

Japanese report: 22 Nov 2023

Japan’s Economy: Monthly Outlook (Nov 2023)

Economic outlook revised; moderate recovery seen, with inflation expected to take hold

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Summary

- In light of the announcement of the Jul-Sep 2023 GDP 1st preliminary results, we have revised our economic outlook. We now see growth in Japan’s real GDP according to our main scenario at +1.7% in FY2023, and +1.3% in FY2024 (on a calendar year basis we expect +1.8% in 2023 and +1.5% in 2024).

- The real GDP growth rate for FY2024, excluding the carryover from the previous year, is expected to be +0.7% y/y, with a moderate economic recovery due in part to economic normalization having run its course. The economy is expected to be supported by the silicon cycle's recovery phase and the government's economic stimulus measures. The consumer price index of all items, less fresh food (core CPI), is expected to rise by 2.8% y/y in FY2023 and by 2.8% y/y in FY2024. The price outlook has been raised from the previous forecast, taking into account further progress in price pass-through and other factors.

- We assume that the Bank of Japan (BOJ) will eliminate its long- and short-term interest rate operations (yield curve control; YCC) and lift its negative interest rate policy at its April 2024 monetary policy meeting, when the rate of wage increases in the 2024 spring wage negotiations are known to some extent. The BOJ will move to a zero-interest-rate policy, and the accommodative monetary environment will be maintained for the time being. Thereafter, we expect the BOJ to gradually reduce the degree of easing (assuming an 0.25% rate hike in Oct-Dec 2024), while closely monitoring economic and price conditions.

1. Growth Expected to Slow in FY2024 while Inflation Seen Taking Hold

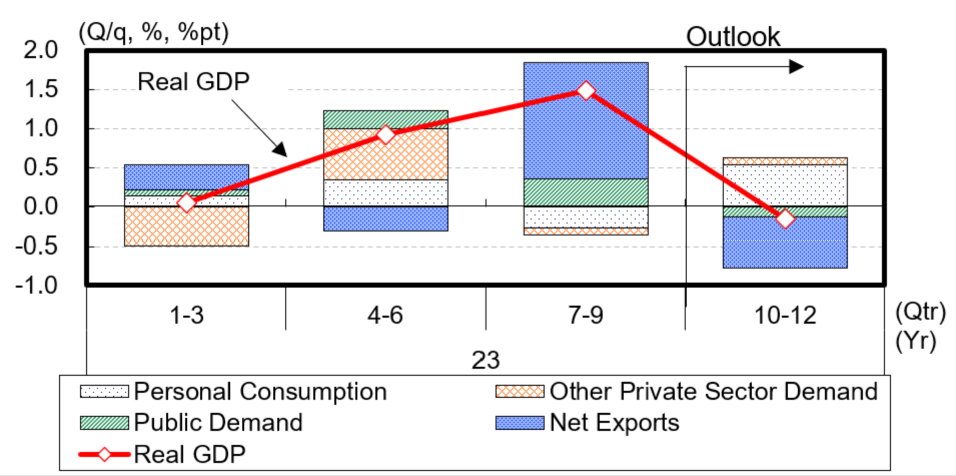
Jul-Sep period real GDP saw negative growth for the first time in three quarters, due to high prices and motor vehicle supply constraints

The real GDP growth rate for Jul-Sep 2023 recorded a decline of -2.1% q/q annualized (-0.5% q/q), recording negative growth for the first time in three quarters (chart 1)[1]. While exports grew, private sector demand components such as capex and personal consumption were weak, producing a strong sense of stagnation. The downturn in real GDP was due mostly to the approximately 60% decline in private sector inventories with the drop in motor vehicle inventories the major factor. Supply constraints were experienced when operations were halted at the domestic factories of some motor vehicle manufacturers during July and August. While auto inventories went to exports, the impact on households showed up as a decline in sales volume. Excluding inventory changes, final demand was -0.9% q/q annualized, a smaller decline than the high growth of +5.0% in the Apr-Jun period.

Looking at performance by demand component (Chart 1), in the area of private sector demand, all categories suffered declines. As for public sector demand, government consumption grew, but public investment declined. In the area of overseas demand, both exports and imports grew, but growth in imports was larger than that of exports, hence net exports shifted into the negative.

Real GDP growth in the Oct-Dec 2023 period is expected to be +2.8% q/q annualized, shifting back into positive growth. Recovery production of motor vehicles is expected to occur as a means of eliminating order backlog which built up as a result of supply constraints, and this should be a lift to consumption of durables. Lower inflation is expected to contribute to a recovery in personal consumption. While capex is currently sluggish with the slowdown in the US and European economies and an adjustment in the semiconductor market, a rebound is seen after two consecutive quarters of decline, and with the Chinese economy also recovering, the Oct-Dec period is expected to shift into growth.

Real GDP Growth Rate Results & Outlook **Chart 1**



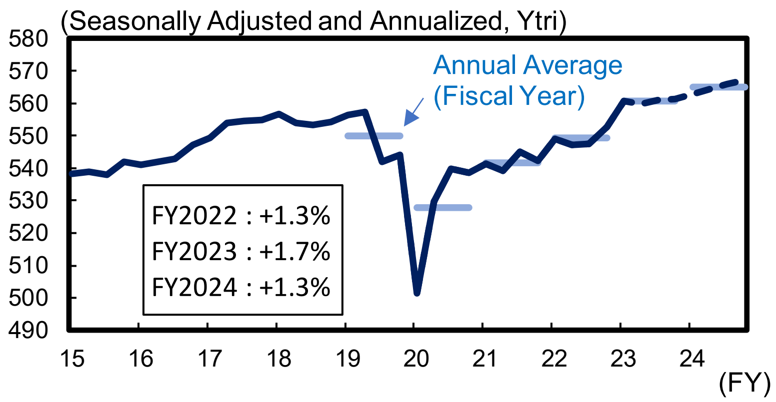
Source: Cabinet Office; compiled by DIR.
Notes: Figures are seasonally adjusted.

Outlook for Japan's real GDP growth rate revised: +2.1% in FY2023, and +1.3% in FY2024

Chart 2 shows real GDP according to our main scenario, and our outlook for overseas economies on which the scenario is based. The overseas economic outlook is based on the latest (as of November 21) forecasts of our staff in charge of each country. For details, please refer to the economic outlook for each country.

[1] See the DIR report by Keiji Kanda and Munehisa Tamura dated 15 November 2023, *Jul-Sep 2023 1st Preliminary GDP Estimate.*

Outlook for Japan's Real GDP and Assumptions Regarding Overseas Economies **Chart 2**



US, Eurozone & China
Real GDP Growth Rate

US	2022 : ＋1.9% 2023 : ＋2.4% 2024 : ＋1.5%
Eurozone	2022 : ＋3.4% 2023 : ＋0.5% 2024 : ＋0.8%
China	2022 : ＋3.0% 2023 : ＋5.4% 2024 : ＋4.3%

Source: Produced by DIR based on data from Cabinet Office and various countries.
Note: The dashed line in the chart represents predicted values as estimated by DIR. Outlooks for the US, Eurozone and China are based on predictions by DIR's in-house expert.

With this overseas economic outlook, Japan's real GDP growth rate according to our main scenario is expected to be +1.7% y/y in FY2023 and +1.3% in FY2024 (+1.8% in 2023 and +1.5% in 2024 on a calendar year basis).

Our outlook for growth rate in FY2023 was revised downwards by 0.2%pt in comparison to the September 8, 2023 report, *"Japan's Economic Outlook No. 218 Update"* (Japanese only, our previous outlook). This is mainly due to the downward revision of personal consumption and capex reflecting the Jul-Sep period results. However, our view that Japan's economy will continue recovering despite price highs due to economic normalization, accelerated wage hikes, and accommodative fiscal and monetary policies, remains unchanged from our previous outlook.

The outlook for the FY2024 growth rate has been revised upwards by 0.4%pt in comparison to the previous outlook. However, it comes to +0.7% when carryover (real GDP growth rate that can be achieved with zero q/q growth in each quarter) is excluded. Actual growth is expected to be moderate. Government consumption was revised upwards as government expenditures, which have ballooned since the Corona crisis, are expected to continue to be at a high level for the time being. Meanwhile, personal consumption was also revised upwards, with the recovery in demand estimated to occur in FY2023 in our previous report now expected to be postponed until FY2024 due to high prices.

Major demand components are expected to perform as illustrated in the left side of Chart 3. Of these, personal consumption is expected to continue to grow, centering on consumption of services and motor vehicles, due to the normalization of economic activity (Chart 5). Even amid persistently high prices, consumption will be supported by the high rate of wage hikes and the easing of downward pressure on real income as inflation slows, and by the withdrawal of household savings that have accumulated substantially since the Corona crisis.

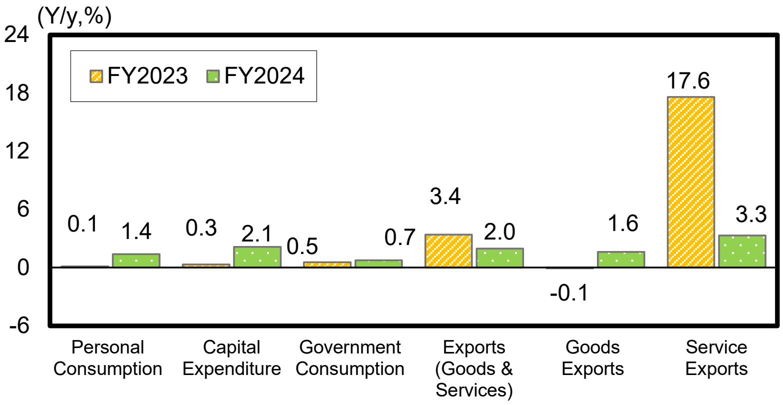
Capital expenditure is expected to pick up in renewal and capacity expansion, centering on the non-manufacturing sector, with the normalization of domestic economic activity. Investments to respond to greening and digitalization will also likely provide underlying support. However, caution should be exercised with the possibility that the manufacturing sector may hold back on investment due to growing uncertainty over the outlook for overseas economies.

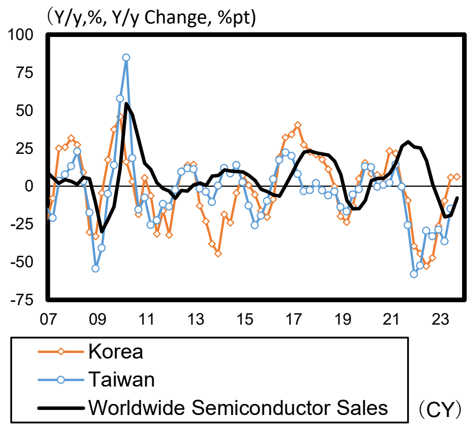
Government consumption is expected to continue growing centering on medical and nursing care as the aging of the population progresses. While the decline in expenses associated with COVID-19 , such as testing programs and vaccinations will continue to bring downward pressure for the time being, the effects of said decline will gradually wear off in FY2024, and growth will likely accelerate.

Finally, in terms of exports, goods exports in FY2023 are expected to fall below that of the previous year. Pent-up demand for automobiles began to emerge in the spring due to the easing of supply constraints, and while this is expected to provide underlying support for exports throughout FY2023, capital goods and other items are expected to be severely impacted by the slowdown in overseas economies until the end of the fisical year. In FY2024, exports are expected to grow due to an expected moderate upswing in overseas economies and a recovery in the silicon cycle (the boom-bust cycle seen in the global semiconductor market). The silicon cycle as seen in worldwide semiconductor sales hit bottom in the spring of 2023. The shipment-inventory balance of electronic parts and devices in Taiwan and Korea, which hold a high share of the market for the most advanced semiconductors, is clearly improving (Chart 3, right).

As for services exports, inbound consumption is expected to recover significantly in FY2023, especially among Chinese visitors to Japan, as the ban on group tours to Japan has been lifted. The number of Chinese visitors to Japan as of October 2023 reached 35% of the level seen in the same month of 2019. We expect growth to continue in FY2024, though at a moderate pace.

Outlook for Major Demand Components (Left), Shipment-Inventory Balance of Electronic Parts and Devices in Taiwan and Korea, and Worldwide Semiconductor Sales (Right) Chart 3





Source: Cabinet Office, KOSTAT, MOEA, SIA, Haver Analytics; compiled by DIR.

2. Important Factors in Japan's Economy through FY2024

Overcoming deflation and turning point in monetary policy expected with moderate economic recovery

Chart 4 brings together a list of important factors affecting Japan's economy through FY2024 based on recent developments. Economic normalization progressed significantly over the past year, but there is still potential growth remaining for motor vehicle production, inbound tourism and consumption of services. This factor is expected to provide a certain level of underlying support in FY2024 as well[2] (more data on margin for recovery in consumption of services is provided later in this report in Chart 5).

[2] See Chart 2-5 in our previous forecast for the method used to estimate household pent-up demand for motor vehicles. The outlook for inbound consumption is discussed in our *Japan's Economy: Monthly Outlook October 2023* （Japanese only）.

Important Factors in Japan's Economy through FY2024 — Chart 4

Economic Normalization

○Recovery production of motor vehicles: cycle to complete in first half of 2024

⇒Household pent-up demand totaled 390,000 units (1.0 tril yen) as of end October 2023

○Inbound tourism: pace of growth expected to slow, but margin of growth remains centering on visitors from China

⇒Number of foreign tourists visiting Japan in 2024 expected to reach 36,000,000 (y/y change 10,900,000), amount in consumption is estimated at 5.0 tril yen (y/y change 0.9 tril yen)

○Personal consumption: Room for recovery centering on consumption of services

⇒Margin for recovery was 7 tril yen as of the Jul-Sep period of 2023. Recovery in consumption of services will likely accelerate if the income environment and consumer confidence improve.

Supporting Factors and Growth Factors

○2024 spring wage negotiations: rate of wage increases expected to be around same level as previous year or better

⇒Rate of increase including annual wage increase expected to be 3.8% (2023 spring wage negotiations came to 3.58% aggregated value by the JTUC)

○Fiscal & monetary policy: economic measures expected to be effective, and accommodative financial environment will continue

⇒Comprehensive economic stimulus measures to be implemented. BOJ will abolish YCC in April 2024 and cancel negative interest rate, but at the same time will likely maintain a low interest rate environment.

○Household savings: excess savings built up during the Corona crisis are still at a high level

⇒Household savings, which grew at a pace exceeding that seen before the Corona crisis, totaled 44 tril yen as of end September 2023 (the equivalent of 15% of consumption in 2022).

○The silicon cycle: may enter a recovery phase in 2024

⇒The shipment-inventory balance of electronic parts and devices in Taiwan and Korea, which hold a high share of the market for the most advanced semiconductors, is clearly improving.

Major Downside Risks

○US enters severe recession (economy worsens significantly due to stricter lending attitudes of US banks)

⇒If lending attitudes of US banks continue at the current level, the effect on real GDP (annually) will be -1.7% in the US and -1.1% in Japan.

○Situations in Middle East and Ukraine becomes more tense

⇒If the price of crude oil increases to 150 USD/BBL, the effect on Japan's real GDP would be around -0.6%.

○China's excessive debt problem becomes more apparent

⇒Against a backdrop of technological stagnation and other factors, China's capital stock has an excess of 2,840 tril yen (deviation of capital coefficients from long-term trend)

○US-China conflict intensifies (appearance of economic security risks, etc.)

⇒Important materials such as rare metals become difficult to procure. Japan possibly participates in US restrictions on investment in China.

○Domestic long-term interest rate highs and sharp appreciation of the yen

⇒Interest rate differential shrinks with shift in monetary policies of both Japan and the US. Purchasing power parity (90-120 yen/dlr) may come into focus.

・The economy is expected to continue recovery in FY2024, though at a moderate pace (The real GDP growth rate excluding carryover from the previous year is expected to be +0.7% y/y)
・Inflation sustainability to increase, with BOJ shifting its policy in April of next year and Japan's government likely to announce that it has beat deflation in the second half of FY2024.
・Scrupulous care should be taken regarding downside risk in overseas economies.
・Risk will also increase associated with rising domestic interest rates and yen appreciation.

ource: Various Sources; compiled by DIR.

In addition, in FY (or CY) 2024, the rate of wage increases in the spring wage negotiations is expected to be at or above the previous year's level (left side of Chart 7). Combined with slowing inflation, real wages (real per capita employee compensation) are expected to turn positive on a y/y basis in the Jul-Sep period of 2024 (Chart 7, right). The economic effects of the "Comprehensive Economic Measures for Completely Break Free from Deflation: Toward New Stage of the Japanese Economy" (hereinafter referred to as Comprehensive Economic Measures), which were decided by the Kishida Cabinet on November 2, 2023, are estimated to be around 8.8 tril yen over the next three years, and will support the economy for the time being.

As will be discussed in Chapter 3, we assume that the Bank of Japan (BOJ) will decide at its April 2024 Monetary Policy Meeting that it is on track to achieve its 2% price stability target and will eliminate yield curve control (YCC) and remove negative interest rates. However, short-term interest rates will remain unchanged at zero percent for the time being, and the low interest rate environment is expected to be maintained after the change in monetary policy. The government may declare an end to deflation as early as the second half of FY2024.

Household savings, which have accumulated rapidly since the Corona crisis, remain high and will continue to mitigate the impact of higher prices. Looking at flow-based household savings, excess savings, which were accumulated above the 2015-19 pace, amounted to about 44 tril yen as of the end of September 2023 (equivalent to about 15% of personal consumption in 2022). Household financial assets reached a record high of 2,115 tril yen as of the end of June 2023, up by about 230 tril yen in comparison to the end of December 2019, partly due to rising stock prices (of which cash and deposits increased by about 110 tril yen in comparison to the same period).

On the other hand, there continue to be many downside risk factors in FY2024, centering on overseas economies. The main ones are: (1) a significant deterioration in the US economy due to stricter lending attitudes of US banks, (2) growing tensions in the Middle East and Ukraine, (3) the emergence of China's excessive debt problem, (4) intensifying US-China conflict (appearance of economic security risks), and (5) domestic long-term interest rate highs and rapid yen appreciation.

With regard to point (1), although the US economy is expected to remain firm for the time being as the speculation of additional interest rate hikes recedes, it is undeniable that a strong credit contraction could eventually occur if monetary tightening is prolonged due to the persistently high service price inflation rate. Therefore, assuming that the lending attitude of US banks remains at the current level, our macroeconomic model estimates that the annual impact on real GDP will be -1.7% in the US and -1.1% in Japan[3].

The situations in the Middle East and Ukraine are unpredictable and could cause resource prices to soar. If crude oil prices were to rise to 150 USD/bbl, the annual impact on Japan's real GDP is estimated to be about -0.6%. In China, the real estate recession appears to be prolonged, and companies have an excessive debt problem. If we consider the deviation of the capital coefficient from its long-term trend as excess capital stock, the size of the excess capital stock is about 2,840 tril yen. Economic security risks are rising against the backdrop of intensifying confrontation between the US and China, and Japanese companies' production activities may be affected by obstacles to procurement of rare metals and other critical commodities that are heavily dependent on China, or by Japan's participation in the restrictions on investment in China that the US is preparing to impose.

If the Bank of Japan (BOJ) continues to normalize its monetary policy, upward pressure on long-term interest rates will increase. On the other hand, the US is expected to cut interest rates in the Jul-Sep period of 2024, and the dollar-yen rate may turn toward a stronger yen, partly due to a narrowing of the

[3] For estimation method, see the DIR report dated 8 June 2023, *Japan's Economic Outlook No. 217* (Japanese only).

Japan-US interest rate differential. If market participants' attention then shifts to purchasing power parity (PPP), it may accelerate the yen's appreciation. Since PPP results vary depending on calculation methods and other factors, the following table shows the relative PPP (calculated using consumer prices, corporate prices, and unit labor costs, respectively) based on the 1973 standard and the absolute PPP of the Organization for Economic Cooperation and Development (OECD). The yen's appreciation against the US dollar is around 90-120 yen per dollar, which is much stronger than the recent market rate.

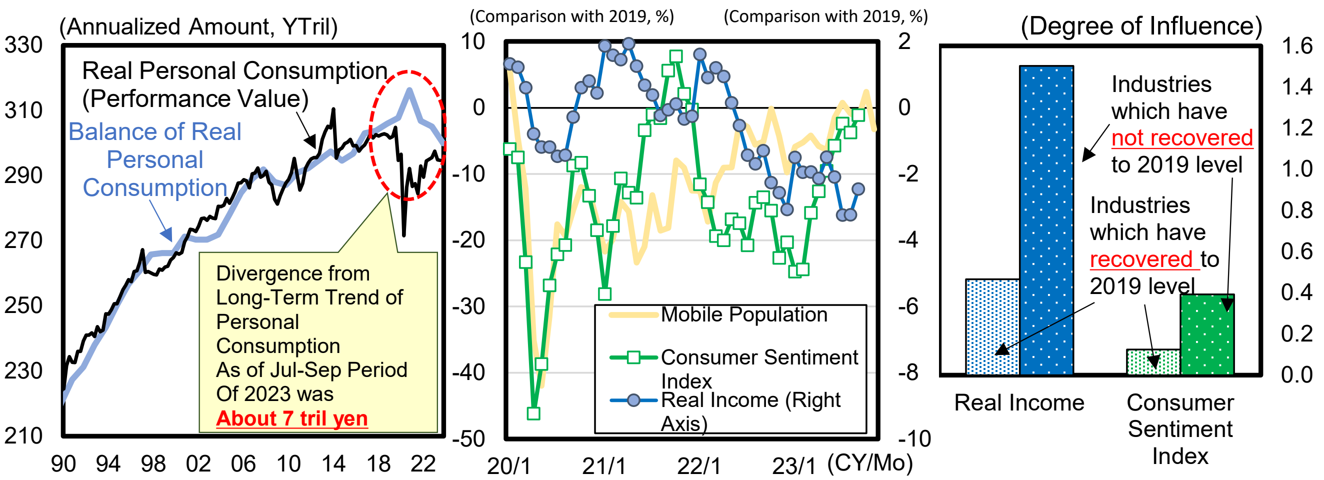
The above is an overview of the key points of the Japanese economy through FY2024. Of these, the margin for recovery in personal consumption is discussed in more detail below.

Recovery in consumption of services will likely accelerate if the income environment and consumer confidence improve

Personal consumption, which accounts for 60% of nominal GDP, is a demand component that has been particularly slow to recover since the Corona crisis. In order to grasp the potential for future recovery, we estimated a theoretical value (long-term trend) of personal consumption based on age composition, disposable income, real interest rate gap, and net financial assets, and compared it to actual values in Chart 5 (left).

Personal consumption basically coincided with the long-term trend before the Corona crisis, but the two diverged significantly immediately after the crisis. Even in the most recent period, Jul-Sep 2023, personal consumption is still about 7 tril yen below the long-term trend on an annualized basis. This means that actual consumption is less than the consumption level achievable in terms of fundamentals. This can be viewed as room for recovery in personal consumption, most of which is accounted for by service consumption.

Long-Term Trends in Personal Consumption vs. Performance Values (Left); Consumer Turnout, Income, and Consumer Confidence (Center); Influence of Income and Consumer Confidence on Personal Services (Right) **Chart 5**



Source: Cabinet Office, Ministry of Internal Affairs and Communications, Ministry of Finance, Ministry of Health, Labour and Welfare, Ministry of Economy, Trade and Industry, V-RESAS; compiled by DIR.

Note: For estimation method, see Chart 4-1 in the DIR report dated 9 September 2019, *Japan's Economic Outlook No. 202 (Update)* (Japanese only). Mobile population as shown in the center chart is a weekly count of the population of presumed to reside outside the municipality for all municipalities, compared to the same week in 2019. Real income is found by multiplying scheduled salaries by the number of employees then finding the real value using CPI on a comprehensive basis, excluding imputed rent for owner-occupied housing. The right chart shows the estimated impact of real income and the consumer sentiment index for each industry that falls under broadly defined personal services in the tertiary industry activity index, weighted by each industry. To exclude the impact of outliers, industries falling in the upper and lower 10% were excluded from the tabulation.

Behind the sluggish recovery in services consumption, there is a possibility that the consumption behavior of households has structurally changed due to the Corona crisis, or that households are becoming more cautious about increasing consumption expenditures against the backdrop of high prices and other factors. Since there are many aspects of the former that are not yet clear, the latter will be examined quantitatively in the following sections.

Chart 5, center shows trends in the mobile population, consumer sentiment, and macro real income (shown on a predetermined salary basis to see the underlying tone). Consumer turnout, which fell sharply in the wake of the Corona crisis, recovered as economic activity normalized, and by October 2023 was about 2% above the pre-Corona crisis level on average per month. Turning to consumer sentiment, it has recently recovered to about -1% from 2019 levels[4]. On the other hand, real income has been on a downward trend since the beginning of 2022, as nominal income growth has not kept pace with higher prices.

Both consumer sentiment and real income are factors that affect service consumption in the short term. Chart 5, right shows the results of a quantitative analysis of the impact of these two factors on service consumption. Here, we estimated the impact of consumer sentiment and real income on the tertiary industry activity index for personal services (broadly defined as services for individuals).

When the activity index is divided into two categories, those with activity above the 2019 level (recovering industries) and those without (non-recovering industries), the impact of consumer sentiment and real income in the non-recovering industries tends to be higher than that in the recovering industries. In particular, the strong influence of real income suggests that the decline in real income due to high prices has made households more cautious in their consumption behavior, and has suppressed the pace of recovery in service consumption.

In light of our outlook, real per capita employment compensation is expected to turn positive on a y/y basis in the Jul-Sep period of 2024 due to the high wage hike forecast in the 2024 spring wage negotiations and lower price inflation, as discussed below (see Chart 7). The increase in real income may also stimulate an improvement in consumer sentiment, which will make it easier to increase consumer spending on services, which have been recovering at a slower pace until now.

[4] Regarding consumer sentiment, it should be noted that the starting point is low due to the impact of the 2019 consumption tax hike.

3. Outlook for Wages, Prices, and Monetary Policy

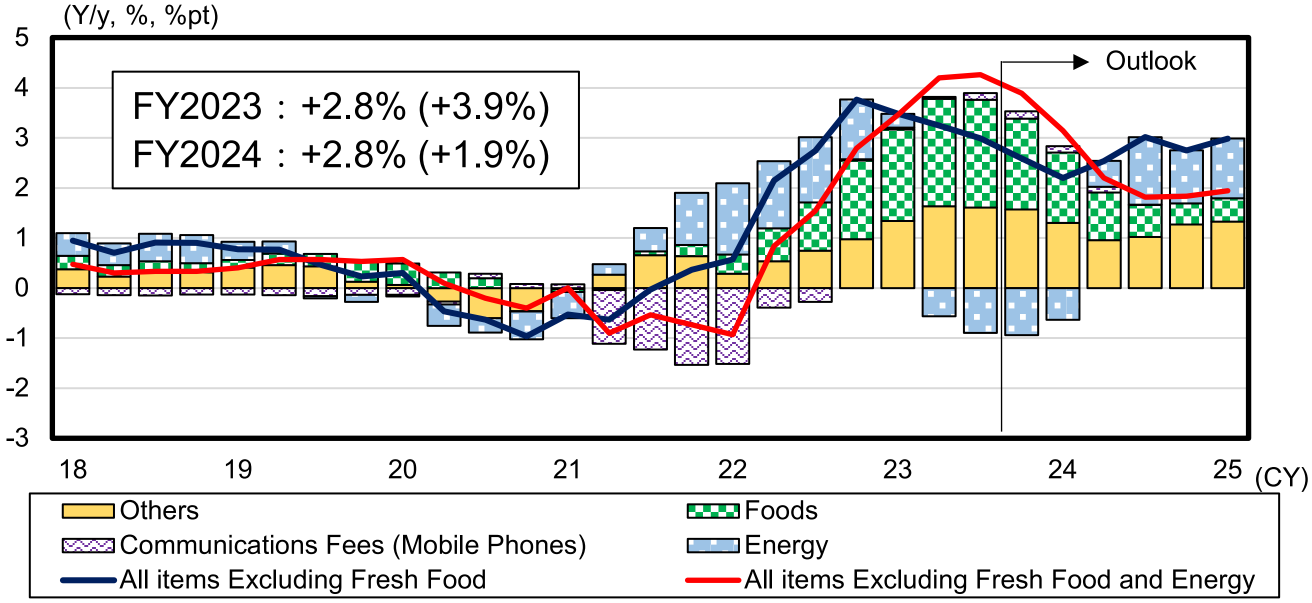
Outlook for new core-core CPI in FY2024 revised upwards to +1.9% y/y

On an all items basis, less fresh food, Core CPI is projected to increase by +2.8% y/y in FY2023 and by +2.8% y/y in FY2024, assuming recent resource prices and exchange rates (Chart 6). On an all items basis, excluding fresh food and energy, the forecast is +3.9% in FY2023 and +1.9% in FY2024. The price outlook has been raised from the previous forecast, taking into account further progress in price pass-through, as well as the fact that the rate of wage increases in the 2024 spring wage negotiations is expected to be at or above the previous year's level, as will be explained further later in this report.

According to a survey by Teikoku Databank on price revision trends, the number of food items scheduled for price hikes in 2023 totaled 32,000 as of the end of October[5]. Approximately 4,600 products saw price hikes in October centering on alcoholic beverages and other beverages, due to the influence of an increase in taxes on alcoholic beverages. There are plans for price hikes on around 500 products in 2024 (as of end October). The rush to raise prices appears to be settling down as of this point. Personnel expenses continue to grow, and price hikes are expected to continue to occur intermittently after the beginning of 2024, but the rate of change in the price of foods on a y/y basis will likely see a gradual decline.

In the energy sector, regulated rates increases by the seven major electric power companies, including Tokyo Electric Power Company, are a factor pushing up prices. On the other hand, subsidies for the reduction of fuel oil prices have been extended until the end of April 2024 under the Comprehensive Economic Measures discussed earlier in this report. After the subsidies have ended, energy prices will rise on a y/y basis due to the hidden effects of implementing said policy during the previous year. Hence it must be kept in mind that energy will continue to be a factor bringing upward pressure on prices for the time being (Chart 6).

Outlook for CPI (Excluding Fresh Food; Figures in Parenthesis Excluding Fresh Food and Energy)
Chart 6



Source: Ministry of Internal Affairs and Communications; compiled by DIR.
Note: Price outlook assuming resource prices and exchange rates at the time of preparation. Assumes that high energy price measures will be implemented until the end of April 2024 (energy bills will be reduced until end of May with the subsidy amount reduced by half).

[5] Teikoku Databank, "Major 195 Food Companies Price Revision Trend Survey - November 2023" (October 31, 2023) (Japanese only).

Rate of wage hikes expected to maintain high level in 2024 wage negotiations

In the 2023 spring wage negotiations, the weighted average wage increase rate (including regular salary increases) was 3.58%, the highest level in 30 years[6], and in the 2024 spring wage negotiations, the rate of increase is expected to remain at or exceed the previous year's level.

When we estimated the explanatory variables that affect the rate of wage increases in the spring wage negotiations, such as corporate performance, labor supply and demand, the rate of increase in CPI, and terms of trade (all of which are values for the previous year), we found that the rate of wage increases in 2024 will be 3.8% (Chart 7, left). Although the contraction in the rate of sales growth in 2023 will act as downward pressure on the rate of wage increases, the improvement in terms of trade and the higher rate of CPI increase will act to a greater extent to boost the rate of wage increases in 2024, resulting in an estimated rate of wage increases in 2024 that is slightly higher than in the previous year.

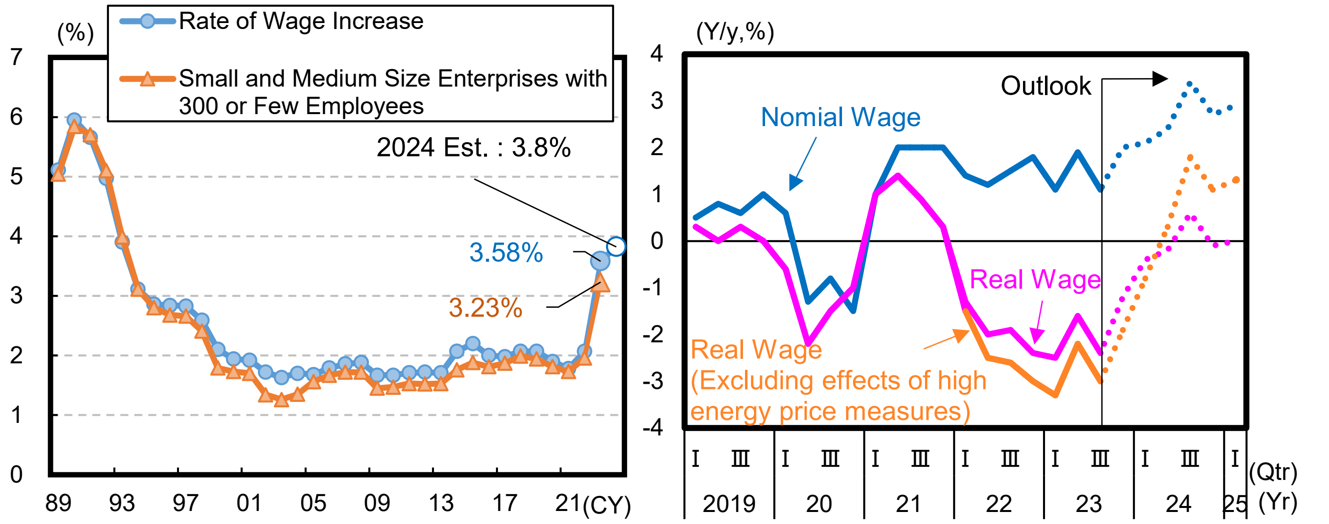
The external labor market (job change market) is also active at present. According to Persol Career (doda), the ratio of job offers to job seekers increased significantly in 2022 due to an increase in the number of job openings, and has continued its gradual upward trend into 2023. In September 2023, the most recent month, it was 2.39 times (+0.28 pt y/y). In a situation where wages are likely to rise due to job changes, even in Japan with its well-developed internal labor market, companies will have no choice but to be aggressive in raising wages to prevent employees from leaving their jobs[7]. Such "defensive wage increases" are more likely to be implemented in industries with serious labor shortages and in small and medium-sized companies, and will be a factor in wage increases in the 2024 spring wage negotiations.

Furthermore, in the second half of 2024, real wages on a per capita employee compensation basis are expected to turn positive on a y/y basis (Chart 7, right). Real wages, which had seen negative y/y growth expanding for some time until now, are beginning to see that trend settle down in the first half of 2023. Going forward, real wages will turn positive on a y/y basis in the Jul-Sep period of 2024 as the nominal wage growth rate gradually increases amid a declining inflation rate. Thereafter, wage growth will hover near zero, but will remain stable in positive territory, excluding price increases due to the end of the high energy price measures.

[6] See Japan Trade Union Confederation (RENGO), "High Level of Responses That Could Be Turning Point Leading to the Future: Results of the Seventh (Final) Round of Responses to the Spring Wage Negotiations 2023" (July 5, 2023) (Japanese only).

[7] Kakuho Furukawa, Yosuke Kido, and Yoshihiko Hogen (2023), "Labor Market of Regular Workers in Japan: A Perspective from Job Advertisement Data" (Bank of Japan Working Paper Series, No. 23-J-2 (Japanese only, translated by DIR.)), pointed out the following spillover channels through which an increase in wages offered in the job market boosts average wages for regular employees: (1) a channel in which firms raise wages in order to retain workers as it becomes easier for them to move to higher paying jobs (external effect), and (2) a channel in which firms raise wages for fairness consideration as newly hired workers are paid high wages within a firm (internal effect).

Outlook for Rate of Wage Hikes in 2024 Wage Negotiations (Left); Outlook for Per Capita Employee Compensation (Right) **Chart 7**



Source: Cabinet Office, Ministry of Internal Affairs and Communications, Ministry of Finance, Ministry of Health, Labour and Welfare, Bank of Japan, Japan Trade Union Confederation (RENGO), "High Level of Responses That Could Be Turning Point Leading to the Future: Results of the Seventh (Final) Round of Responses to the Spring Wage Negotiations 2023" (July 5, 2023); compiled by DIR.

Notes: 1) The left chart is the result of tabulating the responses using the average wage method. The forecast for the rate of wage increase in 2024 was created from an estimation equation using as explanatory variables (1) sales growth rate, (2) CPI growth rate, (3) unemployment rate due to insufficient demand, (4) terms of trade (in log terms), (5) wage dummy, and (6) constant term ((1) to (4) are values from the previous year, 10% significance for (1) and (3), 1% for the rest. The period of estimation is 1976-2023, and the adjusted coefficient of determination is 0.92). The explained variable, the rate of wage increase, is based on the actual results of RENGO's final tabulation after 1989, and on the Ministry of Health, Labour and Welfare's "Survey on Wage Increases and Other Conditions" until 1988.

2) The dotted line in the chart on the right is forecast by DIR.

BOJ expected to eliminate YCC in April 2024, and remove negative interest rate

The BOJ is expected to (1) eliminate the YCC and (2) lift its negative interest rate policy (shift to a zero-interest rate policy) at its April monetary policy meeting when the results of the 2024 spring wage negotiations are known to some extent.

At the October 2023 Monetary Policy Meeting, the BOJ allowed long-term interest rates to fluctuate up to ±1%, reducing the YCC to a mere formality[8]. However, the degree to which the bond market functions remains low. Going forward, the challenge will be to eliminate the YCC itself and reduce the degree to which the BOJ is involved in the formation of long-term interest rates.

One of the concerns about the elimination of the YCC is a sharp rise in long-term interest rates due to speculative activities. While a gradual rise in long-term interest rates based on fundamentals such as the economy and prices is desirable, a sharp rise in long-term interest rates due to speculative activities would adversely affect the real economy and financial markets. To avoid such a situation and stabilize long-term interest rates, the BOJ is expected to retain its limit operations even after the YCC is abolished.

We assume a shift to a zero-interest-rate policy after the lifting of the negative interest-rate policy, and that an accommodative financial environment will be maintained for the time being. The BOJ is expected to gradually reduce the degree of easing, while closely monitoring economic and price conditions (the main scenario in this forecast assumes a 0.25% rate hike in the Oct-Dec period of 2024).

[8] Bank of Japan "Statement on Monetary Policy" (October 31, 2023)

Japan’s Economic Outlook No. 219 (November 21, 2023) Chart 8

		2022			2023				2024				2025	FY2022 (CY)	FY2023 (CY)	FY2024 (CY)
		Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar			
Real GDP	Y tril; annualized	547.9	547.4	547.1	552.0	558.1	555.1	559.0	561.9	563.6	565.2	566.5	567.6	548.7	558.2	565.6
	Q/q %	1.2	-0.1	-0.1	0.9	1.1	-0.5	0.7	0.5	0.3	0.3	0.2	0.2			
	Q/q %; annualized	4.7	-0.4	-0.2	3.7	4.5	-2.1	2.8	2.1	1.2	1.1	0.9	0.8			
	Y/y %	1.5	1.4	0.3	2.0	1.7	1.2	2.2	1.7	1.1	1.9	1.3	1.0	1.3	1.7	1.3
														0.9	1.8	1.5
Private Consumption	Q/q %	1.7	0.2	0.2	0.7	-0.9	-0.0	0.7	0.5	0.3	0.3	0.2	0.2	2.5	0.1	1.4
Private Residential Investment	Q/q %	-2.1	0.1	1.0	0.5	1.8	-0.1	0.0	-0.5	-0.5	-0.5	-0.5	-0.5	-3.2	2.5	-1.7
Private Non-Resi. Investment	Q/q %	1.7	1.9	-0.9	1.7	-1.0	-0.6	0.8	0.7	0.6	0.6	0.5	0.5	3.0	0.3	2.1
Government Consumption	Q/q %	0.4	-0.0	0.1	0.1	0.0	0.3	0.2	0.1	0.2	0.2	0.2	0.2	0.7	0.5	0.7
Public investment	Q/q %	0.5	1.1	0.0	1.4	0.3	-0.5	0.7	0.5	0.4	0.2	0.2	0.2	-3.2	1.8	1.2
Exports	Q/q %	1.9	2.2	1.5	-3.5	3.9	0.5	0.6	0.5	0.4	0.5	0.5	0.4	4.5	3.4	2.0
Imports	Q/q %	1.2	5.1	0.2	-2.1	-3.8	1.0	0.1	0.2	0.4	0.4	0.3	0.3	7.2	-3.3	1.4
Nominal GDP	Q/q %; annualized	3.7	-3.1	5.4	9.4	10.5	-0.2	5.1	4.6	3.4	3.5	3.3	3.2	2.0	5.6	3.6
GDP deflator	Y/y	-0.2	-0.3	1.2	2.0	3.5	5.1	3.9	3.0	2.2	2.1	2.3	2.3	0.7	3.8	2.2
Industrial production	Q/q	-1.5	3.1	-1.7	-1.8	1.4	-1.2	0.9	0.6	0.3	0.5	0.5	0.6	-0.3	-0.5	1.7
Core CPI	Y/y	2.1	2.7	3.8	3.5	3.2	3.0	2.6	2.2	2.5	3.0	2.7	3.0	3.0	2.8	2.8
Unemployment rate	%	2.6	2.6	2.5	2.6	2.6	2.7	2.6	2.5	2.4	2.4	2.4	2.4	2.6	2.6	2.4
Trade balance (goods, services)	Y tril; annualized	-14.8	-22.3	-20.6	-14.9	-3.9	-2.7	-4.6	-3.2	-3.0	-2.8	-3.0	-2.9	-18.0	-3.6	-2.9
Current account balance	Y tril; annualized	11.8	3.0	8.7	9.7	23.5	24.6	27.7	28.5	28.7	28.8	29.0	29.1	8.3	26.0	28.8
Major assumptions																
Crude oil price (WTI futures)	$/bbl	108.5	91.4	82.6	76.0	73.6	82.2	79.5	75.9	75.9	75.9	75.9	75.9	89.6	77.8	75.9
Exchange rate	Yen/$	129.8	138.4	141.6	132.4	137.5	144.6	149.8	149.6	149.6	149.6	149.6	149.6	135.4	145.4	149.6

Source: Compiled by DIR.

Note: Shaded areas are DIR estimates.