

Is tide turning for Japan's "30 years of economic stagnation"?

Politicians and central government officials watching budding potential for break from prolonged stagnation

- Japan's economy has stagnated for 30 years since bursting of bubble economy, mainly due to cautious business activities; however, there is sense of hope among policy makers that tide is finally turning based on upbeat 2023 spring wage negotiation results
- That said, at this juncture there are only "signs" of change; expect continuation of policies so that opportunity for tidal shift is not missed

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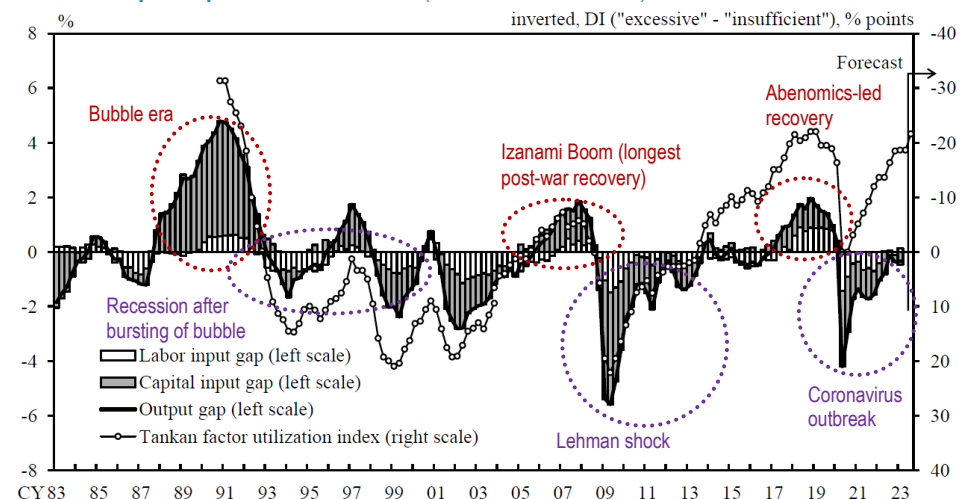
Japan's economy has stagnated for three decades since the bursting of the bubble economy, mainly due to corporations adopting cautious business stances. However, there seems to be expectations among policy makers that the robust results from the 2023 annual spring labor-management wage negotiations suggest that the tide is finally turning to a break from economic stagnation. That said, at this juncture there are merely "signs" of change. We expect a continuation of policies to ensure that this opportunity for a tidal shift is not missed.

Adoption of cautious corporate stances was only option

After the bursting of the bubble economy in the late 1980s, companies became more cautious about investing in equipment and personnel. Instead, they shifted to building up excessive savings. This was the main cause for the economic stagnation that has persisted for 30 years. It is widely known that the excessive savings were needed to reduce debts and build up internal reserves.

On 5 July, the BOJ announced its Japan output gap estimates (Chart 1). Generally speaking, after the bubble economy era of the late 1980s, the periods of positive output were short and these peaks were modest. Conversely, the periods of negative output were long and their troughs were deep. In the 1990s, after the bursting of the bubble economy, the excessive debt held by corporations became a major problem and banks were forced to dispose of non-performing loans behind the scenes. Then came the "Izanami Boom," Japan's longest post-war recovery, which was abruptly ended by the 2008 collapse of Lehman Brothers, which led to the global financial crisis and a deep trough for Japan's economy. Likewise, just when the economic outlook brightened with the advent of Abenomics, the coronavirus outbreak restricted activities for three years. In some respects, it is not surprising that companies became pessimistic about the future and turned cautious and conservative in their management approaches.

Chart 1: Output Gap Estimate from BOJ (announced 5 Jul 2023)



Source: BOJ; compiled by Daiwa Securities.

Politicians and central government officials expect tidal shift on robust results from 2023 spring wage negotiations

Amid the continuation of these conditions, the robust results from the 2023 annual spring labor-management wage negotiations have raised hopes among policy makers that the tide may finally be turning for Japan's prolonged economic stagnation. As consumer prices posted the biggest rise in 41 years, many companies significantly raised wages. According to wage negotiation results tallied by the Japanese Trade Union Confederation (*Rengo*), the average wage increase rate at companies (base pay + regular pay) came to 3.58%. This was the first time in 29 years that the average wage hike topped 3%, since the 3.90% hike in 1993.

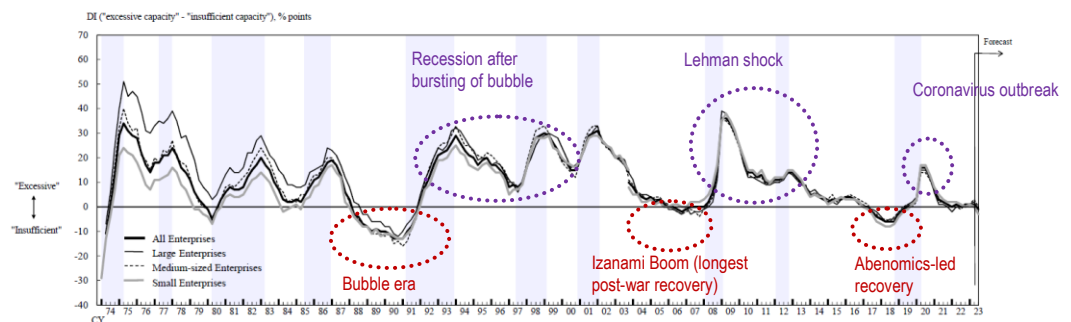
We see no other tidal shifts and there is no certainty that Japan's economy can truly break free from its prolonged stagnation. However, the BOJ's Tankan survey (Chart 2) released on 3 July, for example, shows the potential for a change in the cautious attitudes of companies going forward.

Looking at the production capacity (manufacturing) DI, there was "insufficient capacity" during the bubble economy era, followed "excessive capacity" in the 1990s after the bursting of the bubble economy, even approaching 40 points at one stage. This DI at long last trended around the zero (= neutral) level due to the Izanami Boom in the early to mid-2000s. However, the "excessive capacity" reading surged to more than 40 points following the Lehman shock. Even though production capacity became slightly "insufficient" due to the Abenomics-led recovery, it again turned "excessive" due to the coronavirus outbreak. However, the coronavirus impact was not that strong and this DI has recently returned to around zero.

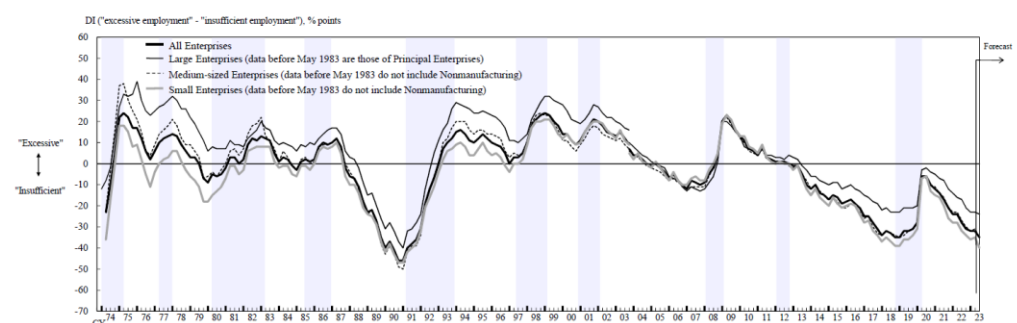
The situation is even better for the employment conditions DI than for the production capacity DI. In the 1990s, "excessive" employment persisted, but employment turned "insufficient" in the 2000s amid the Izanami Boom. Employment was again "excessive" due to the Lehman shock, but turned sharply "insufficient" to the tune of -30 to -40 points due to the Abenomics-led recovery. These conditions again returned to roughly zero amid the pandemic, but they have recently trended around the "insufficient" level seen during the Abenomics-led recovery. This sense of a labor shortage may have also spurred on the large wage increases resulting from the 2023 annual spring wage negotiations.

Chart 2: BOJ's Tankan Survey of Production Capacity (manufacturing), Employment Conditions (all enterprises) (announced 3 Jul 2023)

[Production Capacity (Manufacturing)]



[Employment Conditions (All industries)]



Source: BOJ; compiled by Daiwa Securities.

Expect continued policies to change private sector behavior so that tidal shift opportunity is not missed

Considering future fiscal policy, we note that the crisis response policy to deal with the coronavirus is no longer necessary. Meanwhile, there are still needs for policy-based prodding to nurture budding private sector behavioral changes until the "animal spirits" of capitalism are fully awakened.

The important point is for the private sector to pursue forward-looking investments over the long term with confidence, rather than focusing on the size of public spending (fiscal stimulus). Fortunately, Prime Minister Fumio Kishida has put forward a number of policies that the government will support over the long term, such as 10 years, so that the private sector can invest without worry. This is an extremely effective response to change private sector behavior.

However, it will still take some time for the economy to move toward a self-sustaining recovery driven by the private sector. We hope that policy makers will not miss this opportunity to turn the tide and break Japan's economy free from the prolonged stagnation, and we hope that they will be persistent in their response.

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