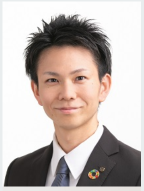
Economic Commentary

Jul Monthly Labour Survey: Reflects big wage hikes from spring labor-management wage negotiations

- Scheduled cash earnings (common data set, full-time employees) up 3.0% y/y; confirmed reflection of big wage hikes from spring negotiations, summer bonuses also strong
- Various wage statistics also pin cash earnings at around up 3.0% y/y; increased likelihood of virtuous wage-price cycle, seen as catalyst supporting BOJ rate hikes
- Still, observed wage situation alone not enough to determine whether rates should be hiked; also need to check economic, political, financial, and capital market trends, both domestic and overseas

FICC Research Dept



Kento Minami
81-3-5555-8789
kento.minami@daiwa.co.jp

Mari Iwashita
81-3-5555-8852
mari.iwashita@daiwa.co.jp

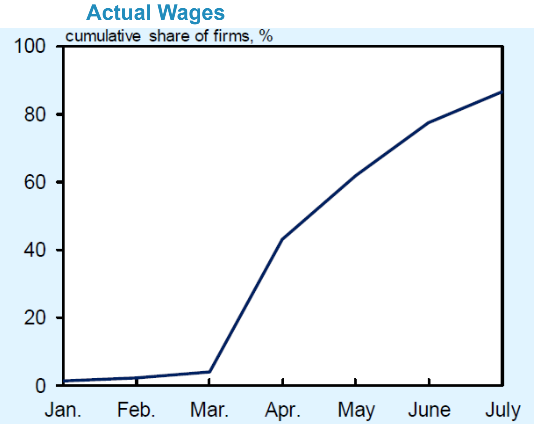
Daiwa Securities Co. Ltd

Japan's Monthly Labour Survey for July was released on 5 September. This monthly labor statistic is important in terms of confirming whether the high wage hikes emerging from the 2024 spring labor-management wage negotiations are actually being reflected as suggested by the BOJ in its April 2023 *Outlook Report* ("*The results of wage negotiations will likely be reflected in actual wages through this summer*.")

July total cash earnings (basic series) grew a strong 3.6% y/y (up 4.5% in Jun) and scheduled cash earnings increased 2.7% (up 2.2% in Jun). Likewise, real wages grew 0.4%, rising for the second straight month (up 1.1% in Jun). However, in terms of contributions, scheduled cash earnings were up 1.8% and special cash earnings were up 1.8%. The impact of the special cash earnings growth was significant. We should note that in terms of the basic series, there is, from the start, some discontinuity between the old and new data due to the replacement of some samples. In particular, this month there was a partial reshuffling of the survey sample of companies with 5 to 29 regular employees, so we shouldn't simply compare the growth from the previous month.

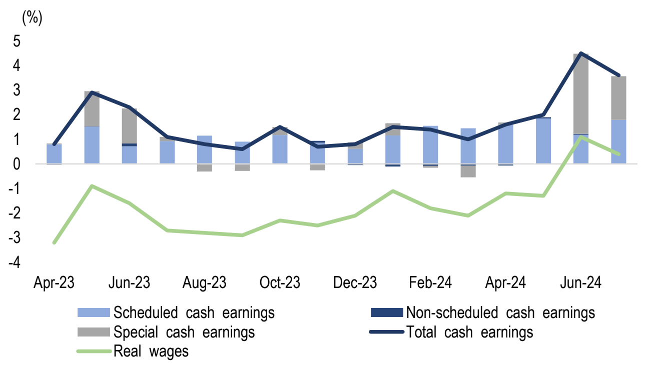
When looking at short-term wage trends, the focus is on the common data set values, which removes the impact sample replacement and other factors. Scheduled cash earnings grew 2.9% y/y under the common data set (up 2.5% in Jun) beating the market median forecast for a 2.8% gain. Also, scheduled cash earnings for regular employees grew 3.0% (up 2.7% in Jun), finally reaching the 3.0% mark. Total cash earnings also remained high at up 4.8% (up 5.1% in Jun). Real wages, deflated by CPI (excl. imputed rent), also increased for the second straight month, up 1.6% (up 1.8% in Jun). Special cash earnings also expanded from the previous month, growing 10.0% (up 8.6% in Jun). Scheduled cash earnings confirmed that high wage increases from the annual spring labor-management negotiations are being reflected. The growth for special cash earnings was high, indicating that this summer's bonuses were also strong.

Chart 1: Timing When Agreed Wage Revisions Are Reflected in Actual Wages



Source: Excerpted from BOJ materials.

Chart 2: Contributions to Total Cash Earnings (basic series, y/y)

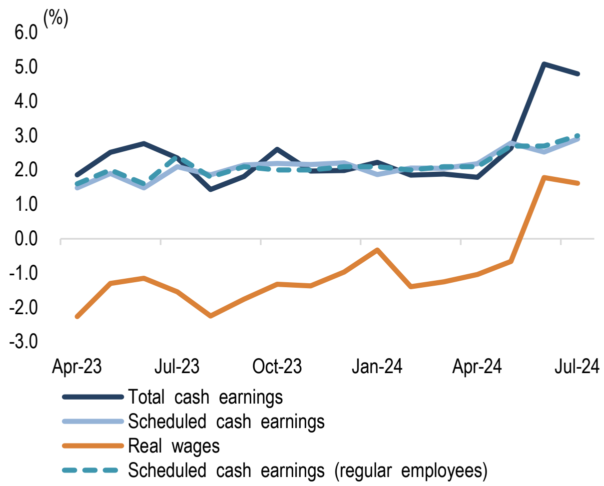


Source: Ministry of Health, Labour and Welfare (MHLW); compiled by Daiwa.

However, there are some issues with the common data set series as well. It has been indicated that (1) The sample size for the common data set series is small compared to the basic series because it is limited to the survey targets (common data set) for both the current month and in the same month of the previous year and (2) Strong likelihood of targeting businesses that have continuously responded and have characteristics such as being financially stable with relatively high wage levels (survival bias).

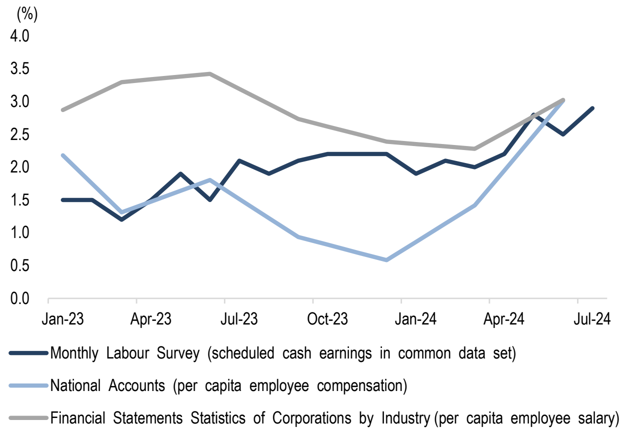
However, the per capita employee compensation, as seen in the National Accounts, and the per capita employee salary, as seen in the Financial Statements Statistics of Corporations by Industry, have increased to around up 3% y/y in the April-June period. For these statistics, employer compensation includes the company's share of social insurance premiums. If the number of part-time workers with relatively low wages increases, there would be some problems, such as contributing to downward pressure on per capita wages. Still, there is certainly the positive view that the high wage increase rates from the spring labor-management negotiations are steadily being reflected.

Chart 3: Wage Growth Rates (common data set series, y/y)



Source: MHLW; compiled by Daiwa.

Chart 4: Growth Rates by Each Wage Statistic (y/y)

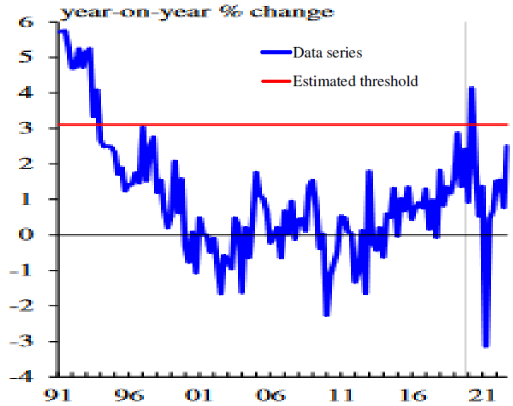


Source: MHLW, Cabinet Office, MOF; compiled by Daiwa.

This point was introduced during a 6 December 2023 speech by BOJ Deputy Governor Ryozo Himino at a at a meeting with local leaders. Here, his speech materials noted that, "If the rate of wage growth exceeds the threshold (roughly up 3% y/y), the degree of pass-through to the consumer price inflation rate will be greater." It is possible that the threshold has changed at this juncture. However, the fact that the wage growth rate in each of the wage statistics is roughly up 3% y/y will increase the likelihood of achieving a virtuous cycle between wages and prices, which in turn will provide support for additional BOJ interest rate hikes.

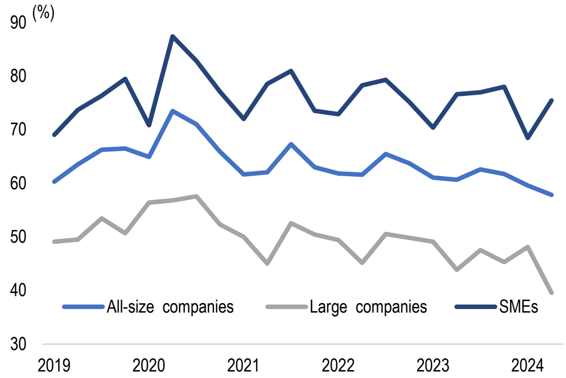
Also, even though the labor share for Apr-Jun 2024, as confirmed by the Financial Statements Statistics of Corporations by Industry, rose for SMEs, it was still lower than that for Apr-Jun 2023 and declined for large companies. In other words, as of Apr-Jun 2024, companies' capacity to raise wages will be about the same for SMEs as last year, while large companies will have increased their capacity. The figures for the current period need to be considered with some leeway, given the possible gaps between bonus periods and the different surveyed corporations. However, at least when looking at the results for just Apr-Jun, it does not appear that labor costs are exerting increased pressure on earnings.

Chart 5: Passing Higher Wages to Core-core CPI



Source: Excerpted from BOJ Deputy Governor Ryozo Himino's 6 Dec 2023 speech materials.
Note: Estimate that the degree to which higher wages are passed on to consumer prices will be greater when wage growth rate exceeds the threshold. The average hourly wage hike rate is calculated by dividing the regular salary (scheduled + non-scheduled cash earnings) by the total hours worked.

Chart 6: Labor Share

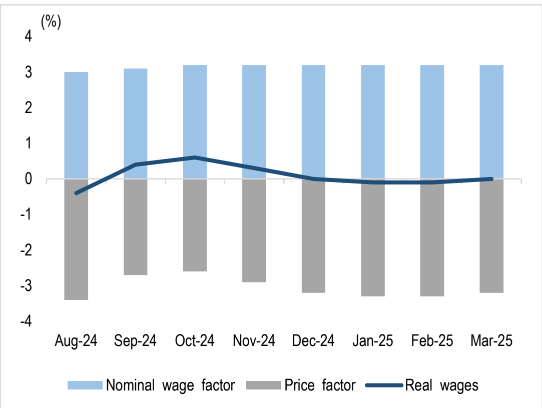


Source: MOF; compiled by Daiwa.
Note: Labor share is calculated as labor costs (executive salaries + executive bonuses + employee salaries + employee bonuses + benefit costs) divided by the amount of value added (operating profit + labor costs + depreciation).

At this point, however, wages are moving in the right direction. Still, real wages could turn negative in August as growth for special cash earnings drop off. Furthermore, there is the strong possibility that real wages will remain near zero from Sep-Nov, when the effects of the government's measures to address high prices are reflected. Moreover, real wages have been in negative territory for the past 26 months and it is hard to believe that consumption will immediately start to recover now that real wages are close to zero. Going forward, a slowing US economy and yen appreciation may put pressure on corporate earnings, making it much harder to continue raising wages. Here, the current wage situation, on its own, may not be enough encourage a rate hike decision from the BOJ. This is because the Bank will also need to confirm trends for the US economy and financial/capital markets, along with assessing political situations in Japan and abroad.

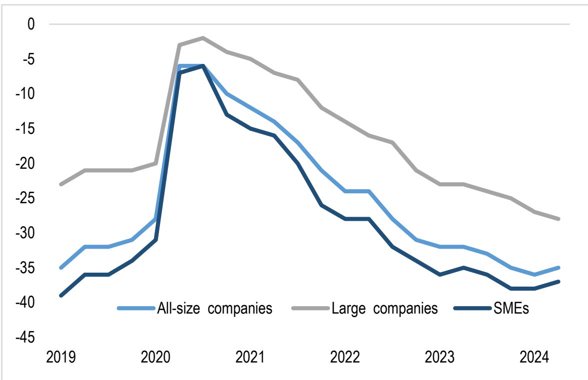
Meanwhile, on 27 August, the BOJ announced that it would conduct a preliminary survey of about 1,500 firms in order to add new items to its Tankan survey, including items pertaining to actual and projected wage increase rates. In the BOJ Tankan survey up until now, it was possible to grasp the labor supply-demand situation through the employment DI, but there was no way to determine how this was reflected in wages other than checking the monthly labor statistics and other such data. It will likely take a few years before such items are added to the Tankan and used as a catalyst for BOJ's policy decisions. Still, this could offset the issues and slow publication schedules for each of the existing labor statistics, allowing for a faster and more accurate understanding of wage trends. In addition to existing statistics, information from hearings conducted by the BOJ itself is expected to become increasingly important in the BOJ's decision-making process.

Chart 7: Our Forecasts for Real Wages (y/y contribution)



Source: Compiled by Daiwa.

Chart 8: Employment DI (excessive – insufficient, BOJ Tankan)



Source: BOJ; compiled by Daiwa.

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Securities Co. Ltd. retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.

Ratings
Issues are rated 1, 2, 3, 4, or 5 as follows:
1: Outperform TOPIX/benchmark index by more than 15% over the next 12 months.
2: Outperform TOPIX/benchmark index by 5-15% over the next 12 months.
3: Out/underperform TOPIX/benchmark index by less than 5% over the next 12 months.
4: Underperform TOPIX/benchmark index by 5-15% over the next 12 months.
5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

Benchmark index: TOPIX for Japan, S&P 500 for US, STOXX Europe 600 for Europe, HSI for Hong Kong, STI for Singapore, KOSPI for Korea, TWII for Taiwan, and S&P/ASX 200 for Australia.

Target Prices
Daiwa Securities Co. Ltd. sets target prices based on its analysts' earnings estimates for subject companies. Risks to target prices include, but are not limited to, unexpected significant changes in subject companies' earnings trends and the macroeconomic environment.

Disclosures related to Daiwa Securities
Please refer to https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/e_disclaimer.pdf for information on conflicts of interest for Daiwa Securities, securities held by Daiwa Securities, companies for which Daiwa Securities or foreign affiliates of Daiwa Securities Group have acted as a lead underwriter, and other disclosures concerning individual companies. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings
This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/credit_ratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law
(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)
If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.
** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.
Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108
Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association, Japan Security Token Offering Association