Economic Commentary

Considering market trends, wages in Japan at start of 2025

- Higher yields at start of 2025 originating from US, Japan remains calm
  Room for 10-year UST yield to rise to around 5% unless the Fed starts hiking rates
  BOJ assessing policy management of the new US administration and resulting market trends
- BOJ branch managers' meeting report: Spreading recognition that continuous wage hikes needed
- Output gap, potential growth rate expected to gradually increase
  November wages on track, but real wages yet to turn positive

FICC Research Dept.

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

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

Daiwa Securities Co. Ltd.

Higher yields at start of 2025 originating from US, Japan remains calm

Long-term government bond yields rose at the start of 2025. This trend originated from the US due to receding expectations for a rate cut. With the start of a new year, the US economy has remained resilient and the situation is such that UST yields are unlikely to decline. If the "Trump 2.0" inflationary policies are implemented, higher UST yields would be a natural outcome. According to the December FOMC meeting minutes (released on 8 Jan), some participants stated that there were merits to leaving the policy interest rate unchanged and that almost all members recognized that the risk of inflation had increased due to the policies of the incoming administration. On 8 January, the 10-year UST yield briefly rose to the 4.7% level, but paused following dovish comments from Fed Governor Christopher Waller. However, since the interest rate cut in December was a last-minute decision, there is a possibility that it marked the end of interest rate cuts for now. Meanwhile, President-elect Trump has promised that the first 100 days of his presidency will "focus on border issues and inflation." While dealing with the issue of illegal immigration, his administration will probably want to avoid causing a significant rise in prices by excessively raising tariffs. Unless inflation becomes a serious risk in the US and the Fed once again starts raising interest rates, we believe that upside for the 10-year UST yield will be limited to around 5%.

In line with the situation in the US, the 10-year JGB yield rose to 1.175% on 8 January to mark its highest level in 13 and a half years. Then it briefly hit 1.185% on 9 January. When the BOJ decided at its July 2024 meeting to raise interest rates and reduce its purchases of JGBs at the same time, the Bank seemed worried about whether it could set a purchasing reduction pace that could avoid a sudden rise for long-term JGB yields, but its concerns were unfounded. The yield rise on 8 January was rapid, but not sustained. So, at this level, the market can probably just calmly sit back and monitor the situation. The BOJ wants to assess the policy management of the new US administration and the market trends arising from that management. Considerable time will be needed to grasp the specific tariff policies and allow for the resulting market trends to calm down. Naturally, grasping these conditions immediately after Trump takes office on 20 January is not possible.

BOJ branch managers' meeting report: Spreading recognition that continuous wage hikes needed

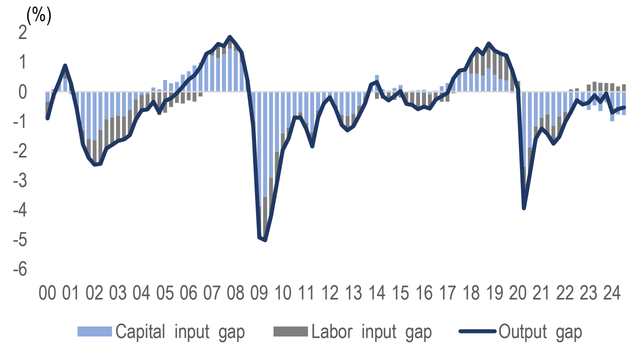
The report from the BOJ's branch managers' meeting held on 9 January stated that, in terms of employment and wages, even minimum wages are increasing amid a structural labor shortage. This was summarized as, "There were many reports that the recognition of the need for continuous pay increases is spreading to a wide range of companies in terms of both industry and size." There were cautious opinions regarding wage setting for FY25, such as, "We have not decided on the wage increase rate because we are assessing the trends of our competitors" and "There is a cautious attitude, especially among SMEs, due to the severity of the earnings situation." Meanwhile, there were also reports that "specific considerations of wage increase rates are underway." The both sides of the issue were included, as expected. If "spreading" is the keyword, it seems like progress has been made, but we can only confirm that conditions in Japan are "on track." The situation in which risk in the US has not been eliminated seems unchanged.

Gradual increase for output gap, potential growth rate?

BOJ estimate released on the 8 January showed that the output gap for the Jul-Sep quarter of 2024 was -0.53%. Even though the reading was negative for the 18th straight quarter, it improved from -0.58% for the previous quarter (Chart 1). However, there is currently no sign of a significant improvement as the output gap declined due to the downturn in demand caused in part by the automobile certification scandal at the start of 2024. The capital input gap is contributing to the current downturn for the output gap. During the Jul-Sep quarter of 2024, there were also special factors such as the temporary suspension of factory operations due to the effects of typhoons. Also, Oct-Dec industrial production (based on METI's forecast survey) assuming the December revised value, is expected to turn positive, increasing 1.0% q/q. As such, there is no need to be overly pessimistic about the Jul-Sep output gap. Indeed, a gradual improvement can be expected going forward.

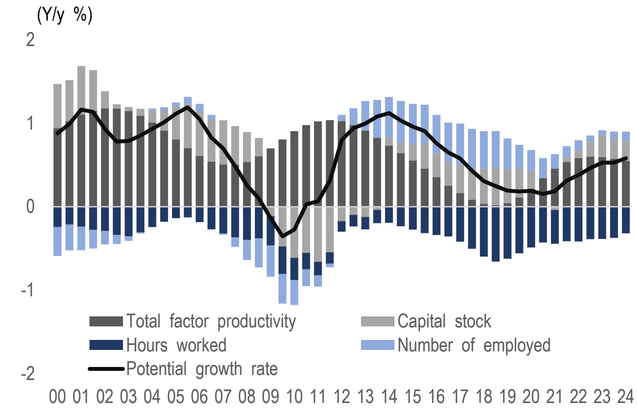
Also, the BOJ's estimate for Japan's 1H FY24 potential growth rate is +0.58%, maintaining an upward trend (Chart 2). In a situation where the number of employed people is struggling to grow, the fact that TFP (total factor productivity = sum of improvements in quality of input factors, technological progress, others) continues to rise is a positive sign. With a strong appetite for capex, upward pressure on capital stock in the future seems likely. The potential growth rate is also likely to gradually increase.

Chart 1: Output Gap (BOJ estimates)



Source: BOJ; compiled by Daiwa.

Chart 2: Japan's Potential Growth Rate



Source: BOJ; compiled by Daiwa.

Monthly Labour Survey: Bonuses contributed to growth, but downward pressure on real wages in Dec

According to the November Monthly Labour Survey (released on 9 Jan), basic series total cash earnings increased a large 3.0% (up 2.2% for Oct). However, due to the government reducing subsidies for electricity and gas fees, along with higher prices led by the sharp rise for food prices that month, basic series real wages declined 0.3% (Oct: -0.4%), marking negative growth for the fourth straight month. Total cash earnings at continuously surveyed firms also rose a significant 3.5% (2.8% in Oct) and scheduled cash earnings continued to grow strongly at +3.0% (+3.0% in Oct). As a result, the real wage at continuously surveyed firms remained positive at +0.1% (+0.2% in Oct) (charts 3 and 4).

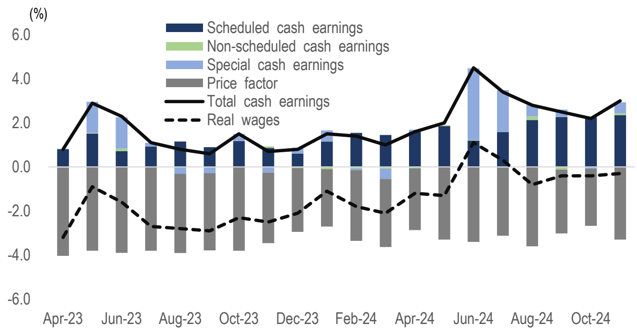
The growth in total cash earnings this time was largely due to special cash earnings and bonuses may have been paid earlier than usual. Meanwhile, winter bonuses are often paid in December, so we need to look at the growth in special cash earnings, including the leveling out of earnings December. We will have to wait until next month to determine whether this significant increase in total cash earnings is a sign of improving conditions. However, scheduled cash earnings have continued to grow and current wage growth remains "on track" with the BOJ's projections. According to the Japan Business Federation (Keidanren), year-end bonuses at major companies in 2024 increased 2.11% y/y, exceeding the growth of the previous year (+1.37% y/y in 2023). We expect that year-end bonuses were relatively upbeat (Chart 5).

We think that the growth in special cash earnings due to the increase in bonuses will support higher total cash earnings in December. However, at the same time, downward pressure on real wages due to rising prices could easily increase. Consumer prices in December are expected to grow at a faster rate than in November, due to the government ending its measures to address high prices, as well as other factors. Coupled with the growth in food prices, which have risen more than expected, real wages have been slower to turn positive than we had expected. There is the strong impression that the period when wage increases lead to increased consumer spending will be delayed.

However, the BOJ's is focusing more on the momentum ahead of the spring 2025 labor-management wage negotiations than on the current wage trends. In this regard, if we look at the labor share[1] from the Financial Statements Statistics of Corporations by Industry, we can see that the current situation for SMEs is such that there is little room for wage increases, as the labor share is increasing.

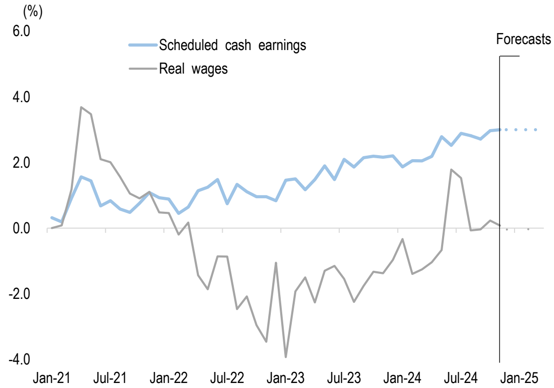
The Chamber of Commerce and Industry released its LOBO survey on 27 December. According to this survey, among those companies that said they would be raising wages, 32.8% plan to raise wages in a positive manner (actual result of 36.5% in FY24) in FY25 and 67.2% plan to raise wages in a defensive manner (actual result of 63.5% in FY24), with the percentage of defensive wage hikes increasing (Chart 6). In this survey, nearly half of companies are increasing wages, including regular pay rises, by 3% or more. At present, it is unlikely that the rate of wage increase will be significantly lower than last year. Indeed, we believe that a high level will be maintained. However, SMEs in particular are certainly in a difficult situation, so we will need to pay attention to trends for their earnings and wage increases.

Chart 3: Breakdown of Contributions to Total Cash Earnings*



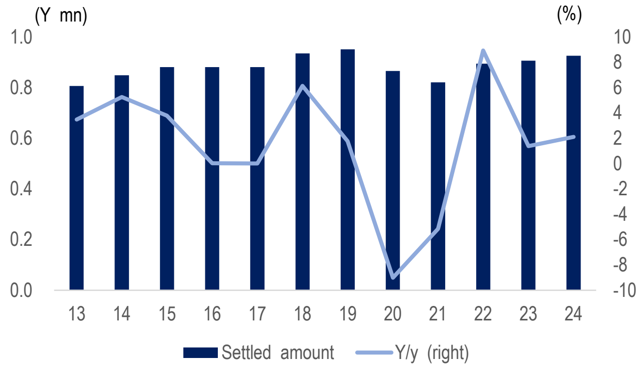
Source: Ministry of Health, Labour and Welfare (MHLW); compiled by Daiwa.
**Basic series.*

Chart 4: Forecasts for Scheduled Cash Earnings and Real Wages*



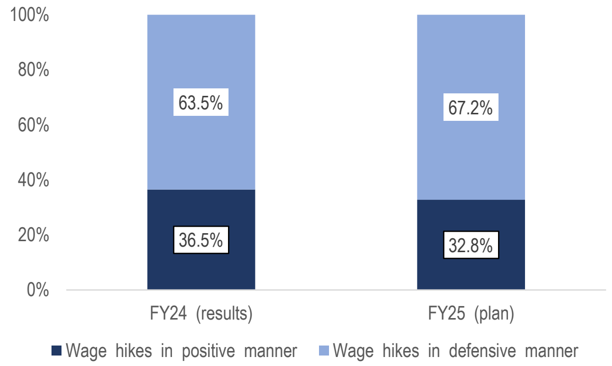
Source: MHLW; compiled by Daiwa.
**Based on data continuously collected from same establishments.*

Chart 5: Results of Year-end Bonuses, Lump-sum Settlements (Japan Business Federation)



Source: Japan Business Federation; compiled by Daiwa.

Chart 6: FY25 Questionnaire Survey on Wages (LOBO)



Source: Japan Chamber of Commerce and Industry; compiled by Daiwa.
Note: Survey of 2,471 member companies conducted by Chamber of Commerce and Industry between 12-18 Dec 2024.

[1] Economic Commentary: Lessons from 2024 buzzword "Why?"; checking corporate trends (3 Dec 2024).

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