

Daiwa's Economic View

FICC Research Dept.

Headroom for wage hikes by company size

- Sharp improvement in recurring profit
- Labor share of income suggests ample scope for wage hikes at macro level
- K-shaped disparity between Japanese firms

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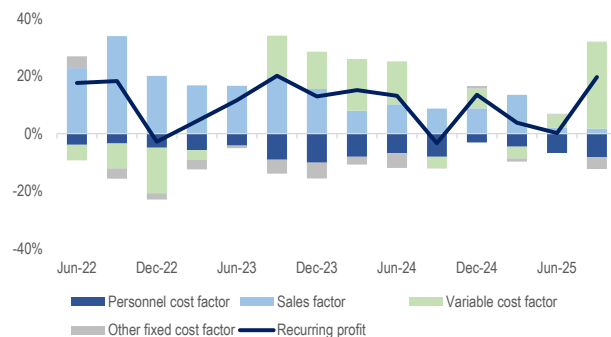


Sharp improvement in recurring profit

The Financial Statements Statistics of Corporations by Industry for Jul-Sep, released on 1 December, showed that recurring profit (all-size enterprises) rose 19.7% y/y for all industries (+0.2% in Apr-Jun), 23.4% for manufacturers (–11.5%), and 17.6% for non-manufacturers (+6.6%). Recurring profit levels remained high regardless of industry or size, including large and small/medium-sized enterprises as well as manufacturers and non-manufacturers, suggesting that the impact of US tariff policy has been limited.

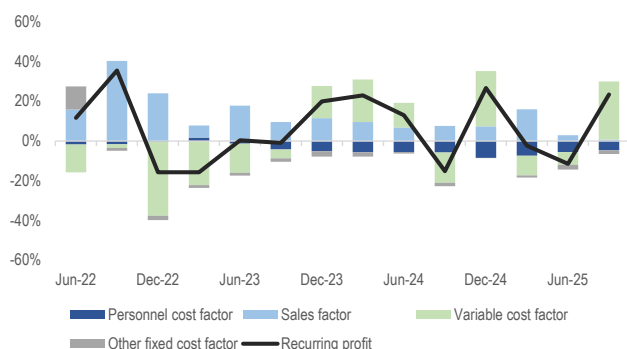
A factor analysis of y/y recurring profit growth in Jul-Sep shows that variable costs had a positive impact at both manufacturers and non-manufacturers. This reflected a notable contribution from cost factors, such as lower COGS and other non-operating costs.

Factor Analysis of Recurring Profit (y/y, all-size companies in all industries)



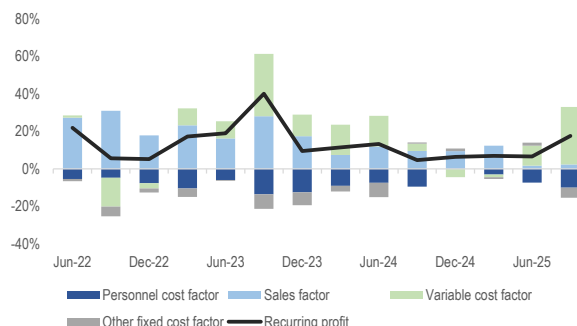
Source: MOF; compiled by Daiwa.

Factor Analysis of Recurring Profit (y/y, all-size manufacturers)



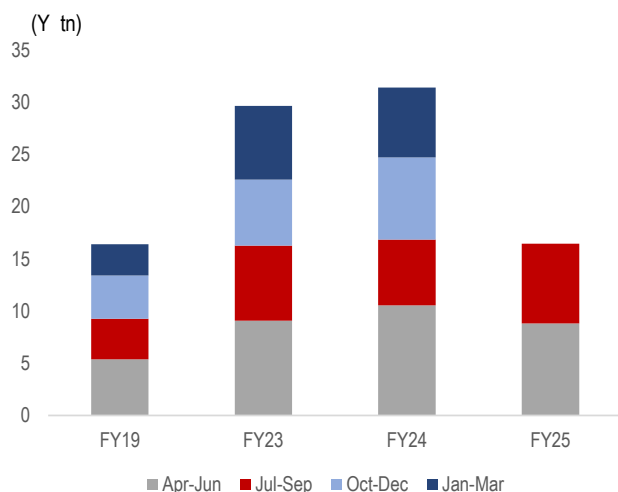
Source: MOF; compiled by Daiwa.

Factor Analysis of Recurring Profit (y/y, all-size non-manufacturers)



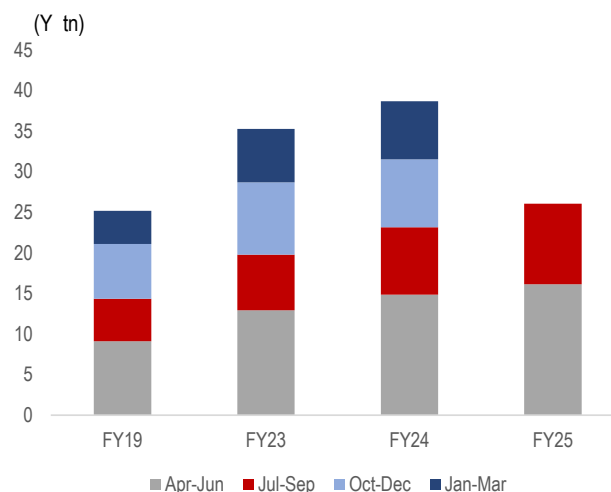
Source: MOF; compiled by Daiwa.

Recurring Profit Levels (large manufacturers)



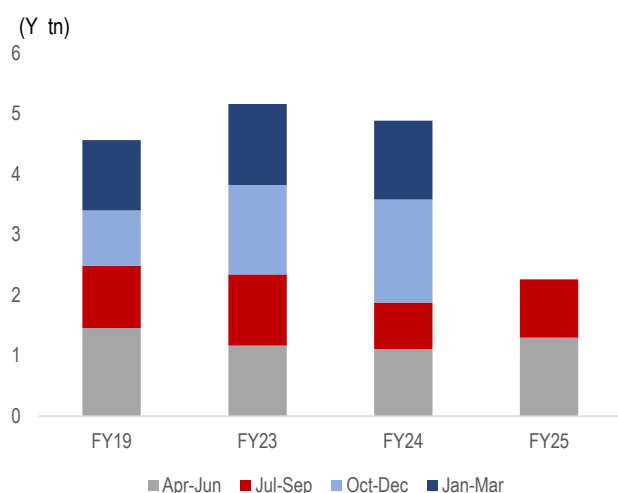
Source: MOF; compiled by Daiwa.

Recurring Profit Level (large non-manufacturers)



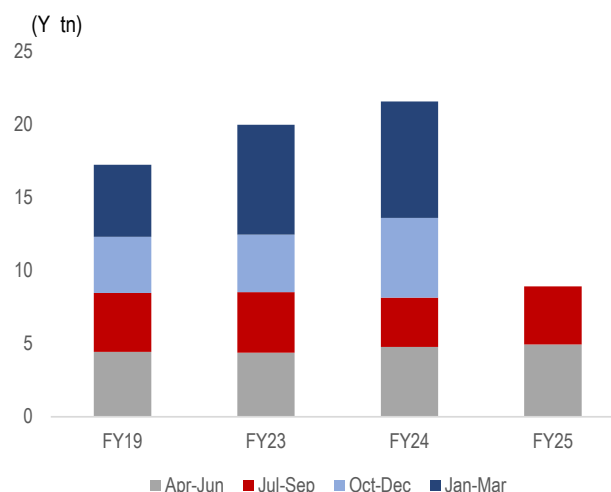
Source: MOF; compiled by Daiwa.

Recurring Profit Levels (small/medium-sized manufacturers)



Source: MOF; compiled by Daiwa.

Recurring Profit Levels (small/medium-sized non-manufacturers)



Source: MOF; compiled by Daiwa.

Labor share of income: Room to raise wages

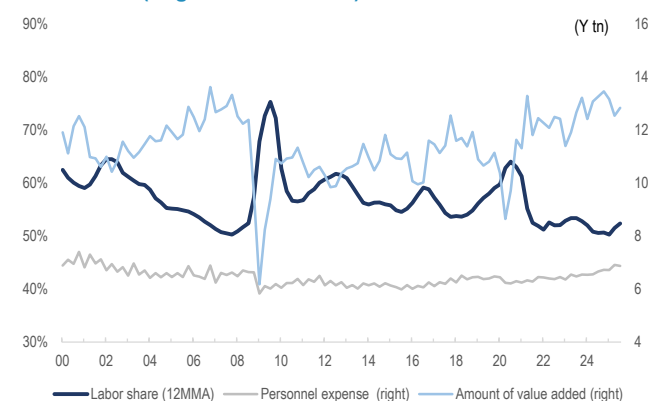
However, y/y operating profit growth was +15.2% for all industries (+0.5% in Apr-Jun), –6.9% for manufacturers (–10.2%), and +26.4% for non-manufacturers (+4.2%), with the decline at manufacturers standing out. Operating profit for transportation equipment firms in particular fell 53.0% y/y (–30.7%) due to the impact of tariff policies.

As a result, the labor share of income (based on operating profit) at large manufacturers is trending upward as value added declines, reducing their ability to raise wages. However, on average the labor share remains below historical levels, implying ample headroom for wage hikes even based on operating profit. While the labor share at small/medium-sized manufacturers is rising to reflect higher labor costs, it remains low, suggesting more scope for wage hikes than in the past.

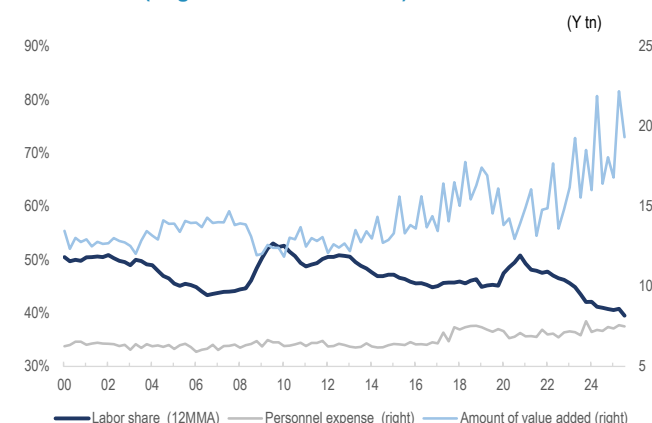
The labor share of income at both large and small/medium-sized non-manufacturers is notably trending downward, implying greater scope for wage hikes. In big-picture terms, we therefore think the results of the recent Financial Statements Statistics of Corporations by Industry (Jul-Sep 2025) make substantial wage hikes in the 2026 spring labor negotiations more likely.

At a 25 November joint meeting between representatives of the government, labor, and management, Japan Business Federation (Keidanren) chairman Yoshinobu Tsutsui also noted his strong desire to further lock in the strong momentum of wage hikes, and Japan Trade Union Confederation (Rengo) chair Tomoko Yoshino indicated that it aims to again achieve substantial wage hikes in next year's spring labor negotiations. Both profit levels and the momentum of wage hikes suggest that a weak outcome from the 2026 spring labor negotiations is unlikely.

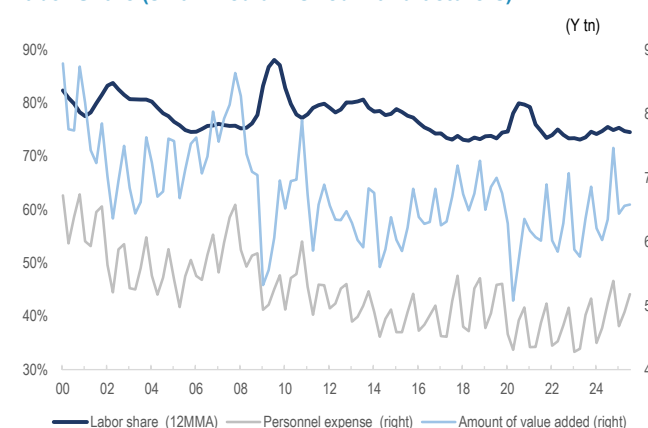
Labor Share (large manufacturers)



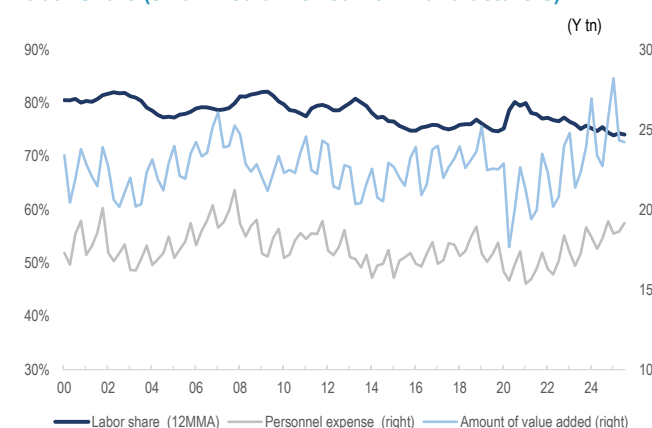
Labor Share (large non-manufacturers)



Labor Share (small/medium-sized manufacturers)



Labor Share (small/medium-sized non-manufacturers)



K-shaped divergence between Japanese firms

However, the size of wage hikes in the Monthly Labour Survey differs by company size. September 2025 scheduled cash earnings for full-time workers rose +2.9% at firms with 30 or more employees, versus just +2.0% at firms with 5-29 employees. The gap between large and small firms' wage hikes has widened particularly since 2024.

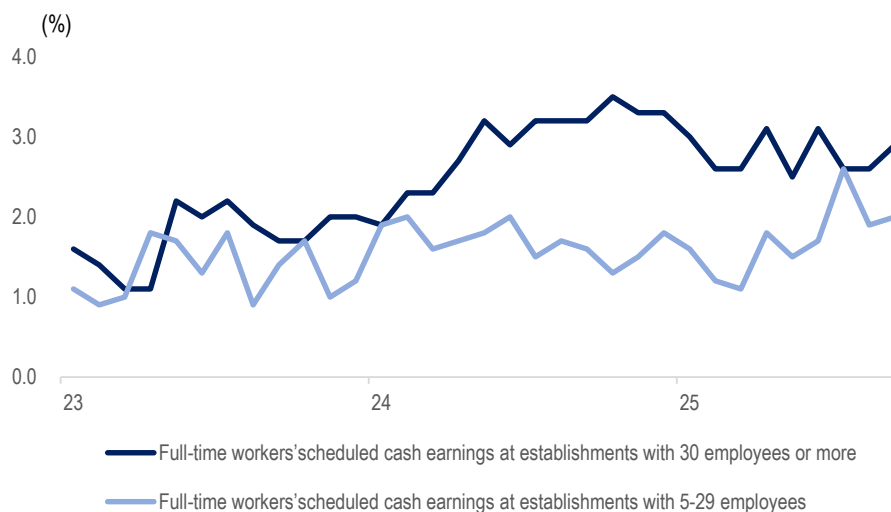
However, labor share data implies more cases of even SMEs that are successfully increasing value added to fund wage hikes, suggesting that they have somewhat more headroom than in the past. As a result, wage hikes at small companies are now catching up.

That said, compared to large companies (especially non-manufacturers) where the scope for wage increases has expanded significantly, SMEs still have limited headroom. Accordingly, even

if the 2026 spring labor negotiations (which will tend to focus mainly on large companies) result in substantial wage hikes, we question whether this will result in a broad-based spillover to SMEs.

In short, we will continue to monitor whether wage hikes at SMEs continue to gain traction in FY26 and whether the norm for pay increases is changing at SMEs. From a macro perspective, high corporate earnings and the low labor share of income suggest ample room to raise wages. However, from a more micro perspective we would also watch the potential for an increasingly K-shaped economy to develop in Japan. We would particularly watch the potential for policymakers to intervene to address this disparity.

Wage Growth Rate by Company Size



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

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