



World Economic Situation and Prospects

Weekly Highlight

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Wage dynamics and deflation in Japan

Earlier this year, the Government of Japan introduced some significant policy packages to reverse the deflation that has prevailed since 1998. Recent statistics show that since June 2013 the headline consumer price index (CPI) has surpassed its level from the previous year. However, the main contribution to this improvement was from energy prices, which are now about 8 per cent higher than one year ago. The core CPI, which does not include food and energy, remains flat compared with 12 months ago.

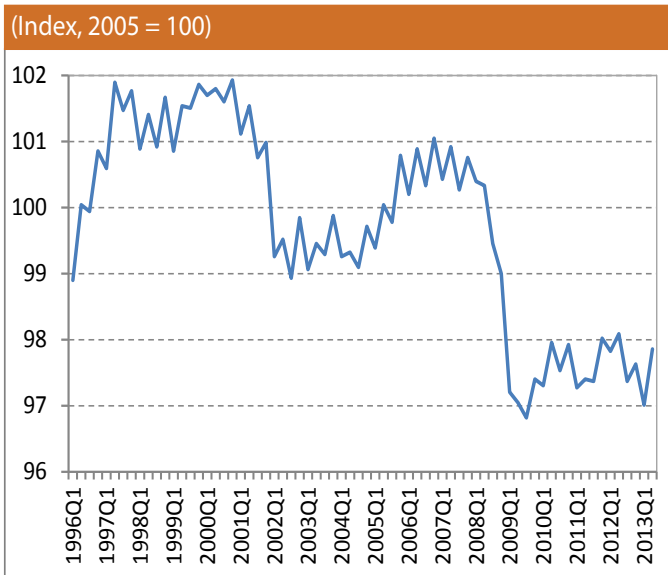
Actually, the deflation situation in Japan appears more severe when measured by the core CPI than by the headline CPI. From the year 2000 to the third quarter of 2013, headline CPI has declined by 2.3 per cent while core CPI has declined by more than 6.8 per cent. One reason for this phenomenon is the medium-term downward trend in the wage rate.

Over the same period, the wage index has declined by 3.8 per cent (figure 1) — underscoring the extreme, forceful impact of the Great Recession.

Based on the statistics of the Organization for Economic Cooperation and Development (OECD), the reduced wage rate and sustained increase in labour productivity have cut Japanese unit labour costs (for the whole economy) by about 23 per cent from 2000 to mid-2013 (figure 2). Lower production costs further exacerbated the downward pressure on prices, which was originally triggered by the bursting of the bubble in the mid-1990s.

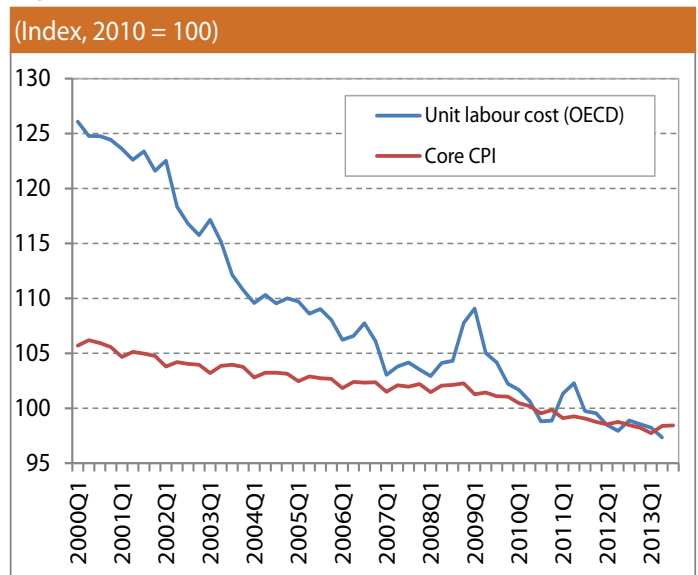
Recent statistics have not shown sustainable improvement in wage income yet. Whether the recent re-emergence of headline inflation can be sustained will depend upon further developments in the labour market.

Figure 1: Wage index for Japan



Source: IMF, International Financial Statistics database.

Figure 2: Unit labour cost and core consumer price index



Source: OECD Main Economic Indicators and the Statistics Bureau of Japan.