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Will high wage growth continue in 2024?

Wage increase momentum is expected to recede next year as inflation slows

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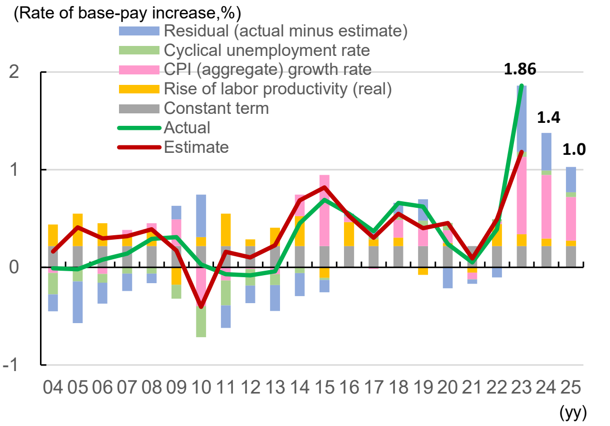
The reason for the high base-pay increase in 2023 is a change in the companies' stance on wage revision in response to record-high inflation

Average wage growth in Japan marked the highest level in about 30 years. According to the *Results of the Sixth Round of Responses to the Spring Labor Negotiations 2023*, released by the Japanese Trade Union Confederation (RENGO), the average wage increase was 3.66%, the highest increase since 1993 (3.9%). The base-pay increase is calculated to be around 1.9% (assuming a regular salary increase of around 1.8%). This is much stronger than many economists (including the author) had previously expected.

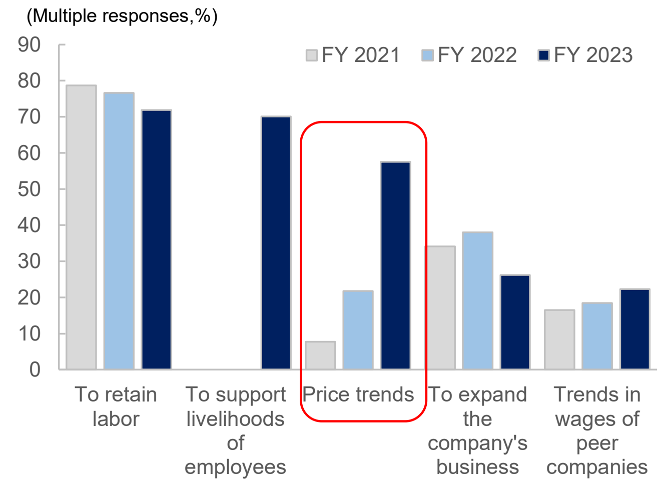
One reason for the high wage increases is that the degree of reflecting inflation in wages becomes stronger than past years. We estimated factors of the base-pay increase by using a statistical model that contains real labor productivity

[Chart 1: Wage hike rate (estimate)]



Notes: Estimated from (1) labor productivity growth (real), (2) CPI (aggregate) growth rate, (3) cyclical unemployment rate, and (4) constant term. For details of the estimation formulas, please refer to the following[1].
Source: Compiled by Mizuho Research & Technologies Ltd. (MHRT) based on data from the Ministry of Health, Labour and Welfare, the Ministry of Internal Affairs and Communications, and the Japan Institute for Labour Policy and Training

[Chart 2: Reasons for wage revision]



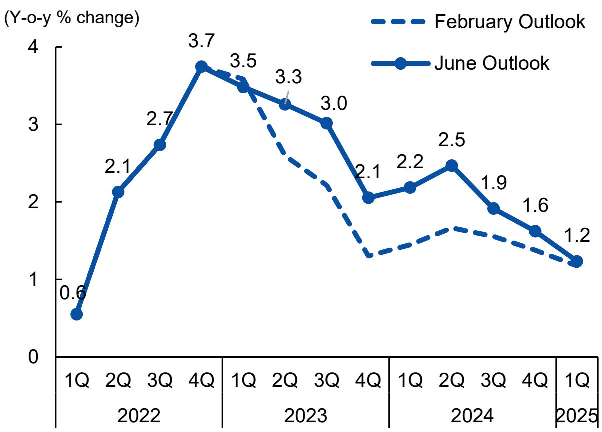
Source: Compiled by MHRT based on Teikoku Databank *Corporate Attitude Survey on Wage Trends in FY2023* growth, the inflation rate, etc., as explanatory variables. It shows this year's wage increase rate (actual) is much higher than the estimated value (**Chart 1**). We suppose that the degree of base-pay increase reflecting inflation might be higher than in the past under the circumstances that inflation rises more rapidly than ever. It results in a large discrepancy between the actual and the estimated values. In fact, according to the Teikoku Databank *Corporate Attitude Survey on Wage Trends in FY2023*, the percentage of companies that cited "price trends" as the reason for wage revisions jumped to 57.5% from the previous year (21.8%) (**Chart 2**).[2] It seems that, at least for 2023, companies' stance on wage revisions changed significantly in response to record-high inflation.

Spring labor wage hike rate is expected to recede in 2024 and beyond

Will the high wage increases be sustained in 2024 and beyond? We predict a 3.2% wage increase (1.4% base-pay increase) for the spring labor negotiations in 2024 and a 2.8% increase (1.0% base-pay increase) in 2025 (**Chart 1**). Although relatively high wage growth is expected to continue, but we expect the growth rate would recede from FY2023.

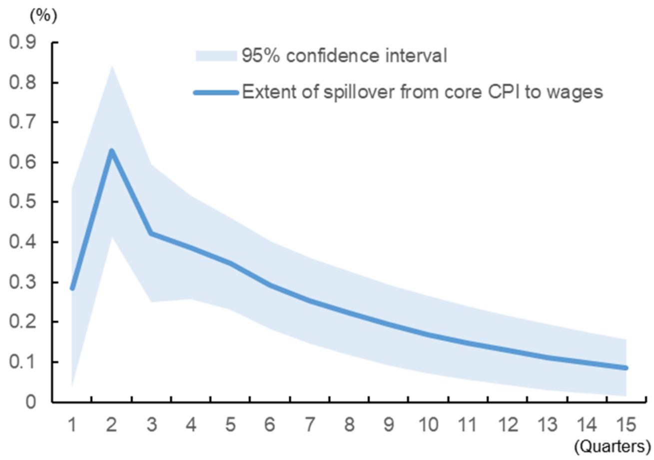
As background for the forecast, we believe that Japanese companies will continue to raise wages in terms of retaining labor force as the labor shortage becomes more serious, especially in the service industry that benefit from the recovery of inbound demand. On the other hand, wage growth momentum from inflation is expected to weaken gradually. The core CPI (consumer price index excluding fresh food) is expected to slow down after this summer (**Chart 3**). The pace of the slowdown will be slower than in our February forecast, given that there is still a residual trend to pass on raw material costs to consumer prices. However, import prices have already peaked out, the pressure to pass on these costs to consumer prices is expected to gradually wane. In line with this, the momentum for wage increases in consideration of inflation will also recede compared to 2023. Based on the base-pay increase rate model shown in **Chart 1,** we expect that the price increase factor and the residual (temporary factor) will be smaller than in 2023.

[Chart 3: Core CPI (outlook)]



Source: Compiled by MHRT based on Ministry of Internal Affairs and Communications, *Consumer Price Index*

[Chart 4: Spillover from core CPI to wages]



Note: Estimated using a VAR model with three variables: (1) import price index, (2) core CPI, and (3) regular payrolls. For details of the estimation, please refer to the endnote[3]. The impulse response shows the spillover to wages when a 1% upward shock to core CPI is added.

Source: Compiled by MHRT based on Ministry of Health, Labor and Welfare, *Monthly Labour Survey*, and Ministry of Internal Affairs and Communications, *Consumer Price Index*

Chart 4 shows another statistical model estimating how a temporary increase in prices spills over into wages in subsequent quarters. The line graph in **Chart 4** shows the lag in the impact on wages of a 1% shock to consumer prices (core CPI). It indicates that the effect on wages begins in the current quarter (the first quarter) when a shock to consumer prices is applied, increases over the second quarter, and then gradually wanes. Based on these estimates, the impact of the large increase in prices over the course of 2022 seems to have supported wage negotiations in 2023, but that most of the impact will be eroded in 2024. The rate of wage increases in 2024 will be slower than in 2023 if there are no additional inflation shocks.

In the long run, as Yamamoto et al. (2023) pointed out, structural changes in the labor market (e.g., the continuing decline in the number of new graduate students due to the falling birthrate and aging population, and the limitation of labor force participation of women and seniors) may increase upward pressure on wages after the late 2020s. In order to firmly establish sustainable wage increases amid the medium- to long-term outlook of a tight labor supply-demand balance, it will be necessary for the government and private-sector to work together to (1) create an environment in which companies can appropriately pass on wage costs to consumer prices, (2) improve productivity by utilizing robots, AI, and software, and (3) expand human capital investment to achieve reskilling of workers.

Reference

Refer to the original Japanese report by clicking the URL below for the reference material

https://www.mizuho-rt.co.jp/publication/report/2023/pdf/express-jp230620.pdf

[1] The estimation results are as follows

$$base - pay\ \ increase\ \ rate_t = 0.22^{**} + 0.15^{**} \times (real\ \ labor\ \ productivity\ \ growth_{t-1}) + 0.25^{***} \times (aggregate\ \ CPI\ \ growth_{t-1}) - 0.18^{*} \times (cyclical\ \ unemployment\ \ rate_{t-1})$$

*** is statistically significant at 1% level, ** at 5% level and * at 10% level. The estimation period is 1995-2022.

[2] The percentage of respondents citing "price trends" in 2023 is significantly higher than when prices rose in 2008 (21%) and when the consumption tax was increased in 2014 (22.5%).

[3] Each variable is on a seasonally adjusted basis by MHRT. All data are logarithmically transformed and taken differences. Core CPI excludes the impact of the tax hike. The Granger causality of (1) import price index → (2) core CPI and (2) core CPI → (3) regular payrolls are all significant, and Cholesky decomposition was performed in the order of (1) → (2) → (3) when calculating the impulse response.
When the sample period is set to the late 1990s (1996-) , the Granger causality of (2) core CPI → (3) regular payrolls is not significant. It suggests that the relationship between prices and wages has waned in this period. This relationship might be strengthened Spring Labor Negotiations in 2023.