JAPAN

BANK OF JAPAN KEEPS ON TRACK

The Yen continued to plunge this summer, reaching its lowest level against the dollar in 24 years. The Bank of Japan (BoJ) is keeping its yield curve control policy unchanged, exacerbating the gap with other major central banks and, consequently, downward pressures on the currency. This depreciation has also led to an unprecedented widening of the trade deficit. Although the pace of inflation is significant for the country (3.0% y/y in August), it remains under control and at a lower level than in 2014 and the start of the Abenomics programme. Even if it's tightening, there is still room for manoeuvre for the BoJ. However, with a GDP level almost 2.5% below its 2019 summer level, Japan remains the G7 country where the upturn in activity has been the least pronounced since two years.

The Japanese economy is suffering from multiple obstacles, in addition to the energy crisis. Country access restrictions have been maintained as part of the fight against Covid-19, even if they will be, for the most, lifted on October 11th. The industrial sector, which represents almost 20% of domestic activity, is still weakened by supply problems as well as by the economic situation in China, where the zero-Covid policy and difficulties in the real estate sector are causing a slowdown in demand. China remains the leading destination country for Japanese goods[1]. The lockdown introduced in Shanghai last May, for example, led to a plunge in industrial production in Japan (-7.5% m/m in May). This subsequently rebounded after the lockdown was lifted.

PRICE-SALARY LOOP: IS IT DIFFERENT THIS TIME?

The BoJ wishes to initiate a price-salary loop as a prerequisite for a readjustment of its monetary policy. However, this is not materialising. Wages were even down 2.1% y/y in July in nominal terms and 4.7% y/y in real terms[2]. The low wage dynamics partly reflect the strong structural rigidities in the country. But the rise in inflation and still very significant recruitment problems –observable for example in the Tankan surveys – are an unprecedented combination that is conducive to pushing wages upwards. The unemployment rate had reached a record 2.2% just before the global pandemic and could come close to this again, with some indicators of tensions on the labour market having returned close to pre-crisis records this summer[3].

In addition, Japanese companies have considerable room for manoeuvre to raise wages if necessary. According to figures from the Ministry of Finance, they recorded pre-tax profits in the second quarter of 2022 (in level terms [Y24.6 tr] and as a share of GDP [18%]). The increase in production costs, exacerbated by the drop in the Yen, therefore seems, for the time being, to have been well absorbed by companies, which have passed on a large share of this increase to consumers. Nevertheless, the increase in imports left its mark on the country's trade balance: it moved from a comfortable surplus of Y262 billion (USD 1.82 billion) in July 2021, to a record deficit of Y1,808.7 billion (USD 12.6 billion) twelve months later.

POLITICAL SHIFTS

The global energy crisis and the exacerbation of geopolitical tensions in the China Sea have led to major political upheavals in Japan in recent weeks. Fumio Kishida's government first announced the restart of 17 nuclear reactors by the summer of 2023, which have been shut down since the Fukushima disaster in 2011. New constructions of nuclear plants could also begin. Over the past decade, the share of nuclear energy in the country's energy mix has decreased considerably, from 13% (2009) to 3% (2019), a drop mainly offset by fossil fuels and solar.

GROWTH & INFLATION

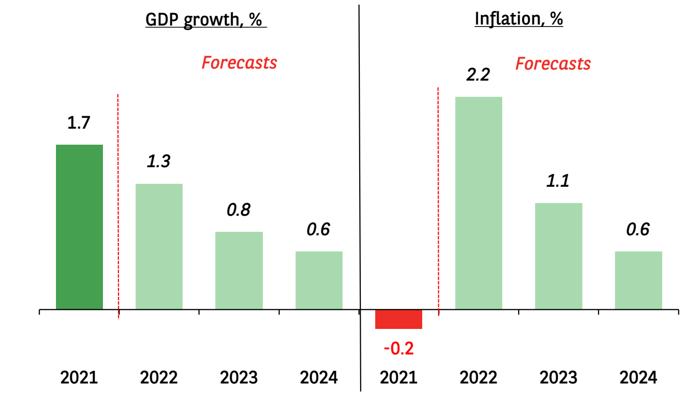

CHART 1 SOURCE : BNP PARIBAS GLOBAL MARKETS

The second major upheaval is that military investment should be drastically increased over the next five years, with a possible doubling of public spending in this sector by 2027. More precise figures will be revealed at the end of the year, with the approval of the budget for 2023 and the unveiling of the new national security strategy. Military expenditure has only fluctuated between 0.8% and 1.0% of GDP over the past sixty years. However, this expenditure will feed the deficit and public debt, forecast in the 2022 budget at 6.5% and 249.6% of GDP respectively. Against this difficult political and economic backdrop, curbing public spending will once again not be a priority for the current administration.

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1 Its share of total exports stood at 21.6% in 2021, compared with 18.0% for the United States, IMF Direction of Trade Statistics.
2 Family income and expenditure survey, Statistics Bureau of Japan
3 The ratio between new job openings and jobseekers rose to 2.4 in July, close to the all-time high of April 2019 (2.48).