JAPAN: TOWARDS A CHANGE IN INFLATION REGIME

Inflation in Japan continues to rise, spreading to all the items in the consumer price index. Inflation expectations remain anchored around the 2% target and price increases should remain at this level in the medium term. We expect the Bank of Japan (BoJ) to raise the 10-year sovereign rate ceiling to 1% in July, before ending its yield curve control policy by the end of 2024. Real GDP grew by 0.7% q/q in Q1 (+2.7% in annualised terms), mainly supported by household consumption and non-residential investment. The return of foreign tourists (+71% q/q in Q1) also enabled activity to rebound after two disappointing quarters. Although slowing, growth should continue in Q2 (+0.5% q/q) and throughout the second half of the year, reaching 1.1% in 2023.

Japanese inflation continues to rise. The BoJ's main measurement, which excludes fresh food products, resumed its increase in April (3.4% year-on-year) after two months of decline due mainly to energy subsidies put in place by the government. The measurement of prices excluding fresh food and energy has increased more rapidly for the 15th consecutive month to 4.1% year-on-year. In April, 44% of the basket of consumer goods consisted of products whose prices were up more than 4% year-on-year, compared with 13% a year earlier. Services inflation also rose (1.7% year-on-year), which illustrates the growing domestic nature of the rise in prices.

The BoJ's inflation forecasts for the 2023-2024 fiscal year were revised upwards on 1 May and the central bank now expects inflation to remain around its 2% target until at least 2025. Recent surveys indicate that companies are adjusting to this new inflationary environment. According to the Tankan survey, 18.8% of respondents now expect inflation of between 3% and 6% on a 5-year horizon, compared with 5.7% 3 years ago These upward revisions could maintain a positive price momentum that would help the BoJ reach its target.

Another factor indicating more persistent inflation is tensions on the labour market. The unemployment rate has increased since December (2.8% in April) but remains at a level not seen since the 1990s (except in 2018 and 2019). Tension on the labour market is also illustrated by the ratio of new job vacancies to the total job applicants, which has remained close to its highest level for 50 years reached in 2018/2019 (0.48 in April 2023). Finally, the activity rate – low after the 2008 financial crisis, particularly among women – increased (75.2% in April), with Japan now catching up with other G7 members. As it is, the country will not be able to count on a new influx of labour, which should contribute to a more significant increase in wages. This was still up only +1% year-on-year in April. However, the annual salary negotiations (*shuntō*) led to an agreement in April providing for an average annual increase in remuneration of 3.7%, which should be gradually reflected in the monthly statistics.

A REBOUND TO BE PUT INTO PERSPECTIVE

The Japanese economy grew by 0.7% q/q in Q1 and should now have exceeded its pre-Covid level by 0.4%. This growth nevertheless follows two disappointing quarters (-0.4% q/q in Q3 2022 and +0.1% q/q in Q4) and must therefore be put into perspective. The upturn in Q1 was mainly explained by the contribution of household consumption (for 0.3 points) and that of non-residential investment (0.2 points). Households significantly increased their purchases of durable goods (+5.4% q/q), which can be linked to their renewed confidence since January (the index is up to 35.7 in May compared to 30.9 in January). Conversely, foreign trade (-0.3 points) weighed on growth.

GROWTH & INFLATION

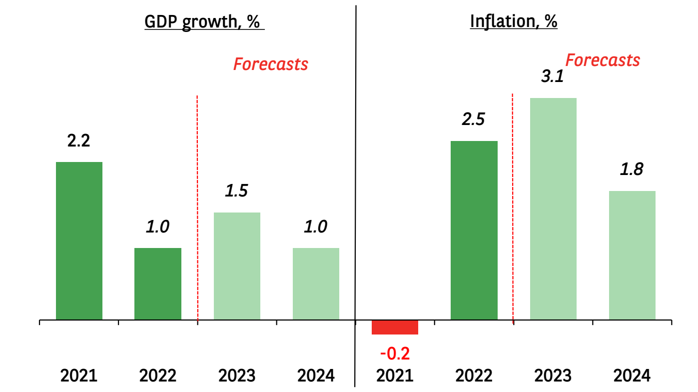

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

The number of foreign visitors recovered two-thirds of its level in April 2019, but the potential for further improvements remains significant.

Exports to China have rebounded sharply since January (+38.6% in May) thanks to the reopening of the economy, but remain 3.4% below their May 2022 level. This rebound was limited by the weak economic recovery in China[1] . The Japanese manufacturing industry has therefore not made much progress over the past year (+0.4% year-on-year in April) and even fell in Q1 (-1.8% q/q). The tertiary sector held up better over the first four months of the year, up 1.5% in April compared to December 2022.

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1 China: Running out of steam, EcoWeek, May 22 2023