

## Labour shortages are weighing on activity

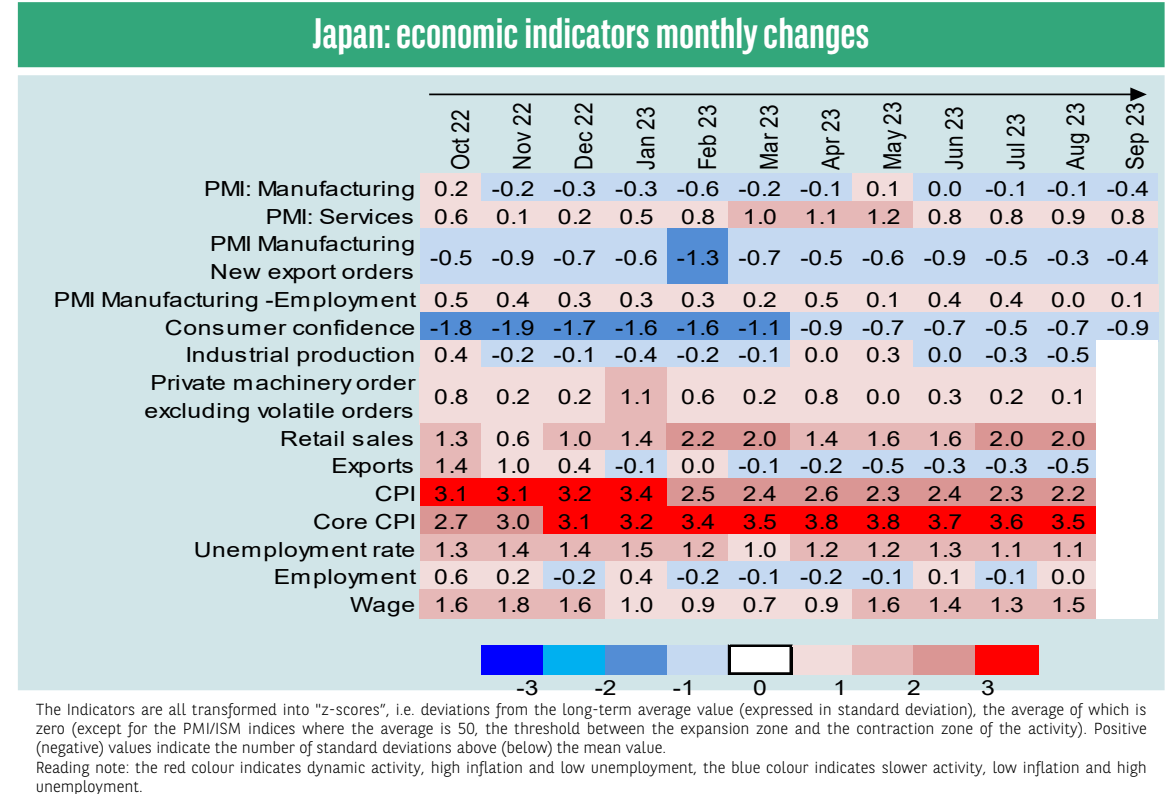
Japanese economic surveys are sending out mixed signals. On the positive side, the business condition index from the Tankan survey improved from 8 in Q2 to 10 in Q3, driven by services: business confidence in the sector was the highest since 1991. The PMI for services is also proving resilient. Although down 0.5 points in September, it remains in expansionary territory at 53.8. Conversely, the manufacturing PMI fell further into the contraction zone for the fourth consecutive month (-1 point to 48.5). As a result, the composite PMI dipped to 52.1 in September. The Economy Watchers Survey dropped from 3.7 points to 49.9 points in September.

Japanese inflation fell slightly to 3.2% y/y in August (compared to 3.3% in the previous month). Food products remain the main contributor to price rises (+8.8% y/y for a contribution of 2.3 pp to headline inflation). Conversely, energy deflation is intensifying (-9.8% y/y), subtracting, as a result, nearly 1 pp from headline inflation. Core inflation, excluding fresh food and energy, continues to rise, up from 4.6% y/y to 4.7% y/y. However, pressure on production prices is easing. The PPI index slowed by 1.3 pp to 2% y/y in September, suggesting a stabilisation or even a drop in consumer price inflation in the coming months. This signal is in line with the fall in inflation in the Tokyo region to under 3% in September. However, the yen's historic depreciation continues, and the exchange rate with the US dollar is now close to USD/JPY 150, which is likely to fuel more imported inflation.

The historic labour shortage represents a further challenge. The employment diffusion index from the Tankan survey dropped to -33 in Q3 and could reach -37 in Q4 according to the latest forecasts. If this were to happen, this would be the lowest level seen since 1991. At 2.7% in September, the unemployment rate remained stable and 0.5 pp above the 2.2% low posted in December 2019. Despite the tight labour market, nominal wages are still not rising, and real wages remain in negative territory, at -2.5% y/y in August. This is impacting household confidence, as well as household consumption, which fell year-on-year in August for the 6<sup>th</sup> consecutive month (-3.4% y/y), according to the monthly survey by the Ministry of Labour.

Against this backdrop, we anticipate a slowdown in activity in Q3 (growth of 0.1% q/q after reaching 1.0% on average per quarter in H1), before a slight recovery in Q4 (0.3% q/q). However, favourable carry-over effect in 2022 should keep growth at a relatively high level of 2.0% y/y for 2023 as a whole.

Guillaume Derrien (completed on 16 October 2023)



### GDP growth

Actual				Carry-over	Forecast		Annual forecasts (y/y)		
Q3 2022	Q4 2022	Q1 2023	Q2 2023	Q4 2022	Q3 2023	Q4 2023	2022 (observed)	2023	2024
-0.3	0.1	0.8	1.2	0.2	0.1	0.3	1.0	2.0	1

Source: Refinitiv, BNP Paribas



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