Japan Economic Flash: First Shunto Wage Hike Data Release Indicates 3.7% Base Pay Rise; We Raise Our Wage Growth Estimates

- According to the initial *shunto* wage increase data for agreements between labor unions and companies, the base pay rise for 2024 is 3.7%, well above last year's final figure of +2.1%. Headline wage growth, including scheduled wage hikes, is 5.3% (2023 final: 3.6%).
- The data also show an increase in part-time hourly wages of 6.5%, exceeding last year's already strong growth of 5.1%.
- We raise our 2024 estimate for shunto base pay hike to 3.2% from 2.5% in view of the strong *shunto* results so far. If this is realized, we estimate that overall macro wage growth, including bonuses and part-time wages, will rise 3.2% in FY2024. Real disposable income would rise 1.2% (previous forecast +0.8%).
- The high base pay rise in the 2024 *shunto* reaffirms the relationship that in a high inflation period of more than 2%, wages respond more strongly to price rises. Based on our CPI forecast of 2.5% for 2024, our model implies *shunto* base pay rise of 2.2% in 2025, suggesting a strong possibility of achieving over 2% base pay for three straight years.
- As such, the BOJ could deem an increase in the base pay rise in the 2024 *shunto* as an important factor in achieving a virtuous cycle between wages and prices as well as sustainable inflation.

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First Data Release Indicates 3.7% Base Pay Rise, Above 3% Level for the First Time Since 1991

The Japanese Trade Union Confederation (JTUC-RENGO) released its FY2024 *shunto* initial wage negotiation data for agreements between labor unions and companies. The data indicate a base pay rise of 3.7% and a headline wage increase, including scheduled wage increases, of 5.3%. Although these figures are below the respective rises of 4.3% and 5.9% requested by the unions, they are well above last year's final wage agreement figures (+2.1% and +3.6%; data release of July 2023). Base pay rose above the 3% handle for the first time since 1991 (see Exhibit 1 and Exhibit 2).

The inflation rate, which is used as a benchmark for wage hikes, was gradually slowing in December, when many trade unions began to consider specific wage hike requests, but average headline nationwide CPI remained relatively high for the average of 2023, at 3% yoy. In addition, we believe that bullish wage requests were encouraged by high corporate profits and labor shortages, and we think companies are responding to these requests.

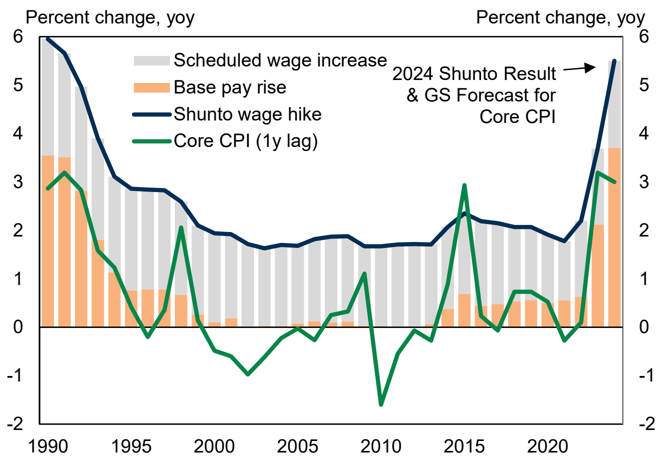
Of note, the major Japanese steel companies, which have many trade union members, have responded with base pay rises of over 10%. We estimate that these three companies alone contribute 0.4 pp to the base pay rise in the first data release. Steel majors have a tradition to negotiate wage hikes once every two years, and despite high inflation, steel majors did not hold wage negotiation in 2023, and implemented a low base pay rise (around 0.7%) which was already decided in the 2022 negotiation. Thus, this year's high wage agreement covers wage growth to complement two years' of high inflation and others. Assuming that 10%+ pay rise should have been two installments of annual 5% wage hike, this factor could overestimate the initial aggregate base pay rise by 0.2pp or so.

By company size, the initial base pay rise was 3.72% for companies with more than 300 workers and 2.98% for companies with fewer than 300 workers. The gap is eye-catching, as it was much smaller in last years' final reading (2.14% for large and 1.96% for smaller companies). SME weighting in *shunto* is just 12%. Even fewer SMEs respond to wage hikes early, and the weighting of SMEs in the initial data collection is less than 3%.

The *shunto* negotiations also include wages negotiations for part-time workers. Agreements for part-time hourly wage increases came in at +6.5% in the initial data, above last year's already high growth rate of +5.1% (Exhibit 3). In recent years, companies have been required to shift towards equal-pay-for-equal-work and to correct the wage gap between different forms of employment, and wage increases for part-timers have been higher than for permanent employees.

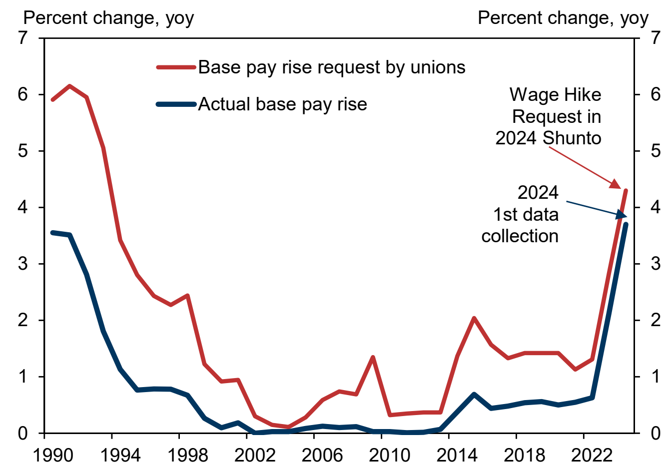
Labor union workers represented in *shunto* negotiation is around 3 million (July 2023 JUTC-RENGO final data), only 5% of all workers in the economy, including part-time workers. *Shunto* is also characterized by a high proportion of large manufacturers with large trade union organizations. As such, slower wage growth in the service sector and in SMEs which account for 80% of the economy as a whole, tends to result in gap between macro wage growth and the *shunto* agreed wage hike. We will therefore need to keep an eye on whether large wage hikes take root across service industries and SMEs as well.

Exhibit 1: Shunto Wage Increases and Consumer Price Index



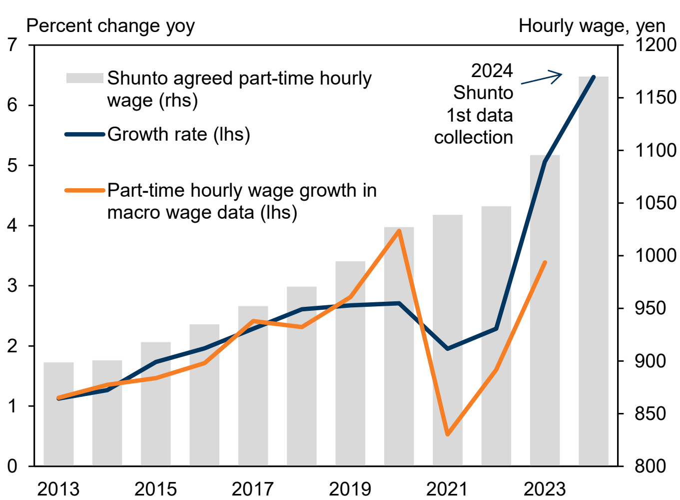
Source: JTUC-RENGO, Keidanren, Ministry of Internal Affairs and Communications, Goldman Sachs Global Investment Research

Exhibit 2: Shunto Wage Increase Requests and Actual Base Pay Rises



Source: JTUC-RENGO, Keidanren, Goldman Sachs Global Investment Research

Exhibit 3: Shunto Agreed Part-Time Hourly Wages



Source: JTUC-RENGO, Ministry of Internal Affairs and Communications, Data compiled by Goldman Sachs Global Investment Research

We Raise our Wage Growth Estimates to Reflect the Strong Shunto Wage Data

The *shunto* wage growth figures tend to be gradually revised down in subsequent data releases as the wage agreements of SMEs are added in. Even so, we expect the *shunto* wage increase in the final data collection (to be released in July) to come in above our initial estimate. We had previously forecast a base pay increase of 2.5%, which was above last year's 2.1%, but we now raise this to 3.2%.

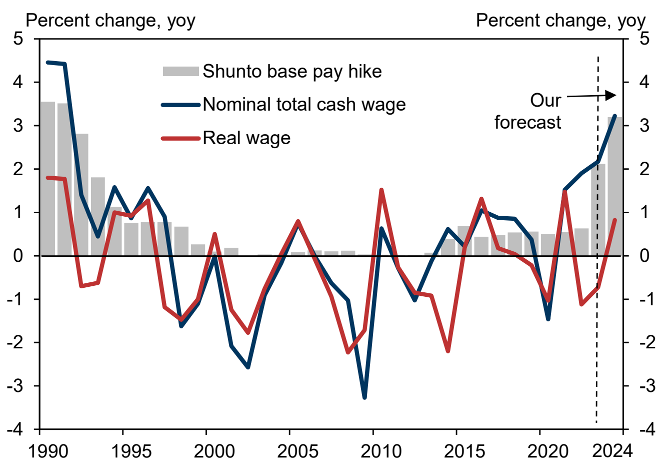
We estimate that FY2024 macro basic wage for full time workers would rise 3.1%, up from the expected 2.0% growth in FY2023. We forecast that bonuses and overtime wages will grow by around 1.3%, as in FY2023. We also factor in an acceleration in the part-time workers hourly wage growth, to 4.3% in FY2024 from 3.2% in FY2023.

Putting all together, we now estimate that nominal overall wage growth for all workers will rise 3.2% in FY2024 (our previous estimate was 3.1%), up sharply from 2.2% in FY2023[1] (Exhibit 4).

Incorporating the above higher wage growth and others, nominal disposable income would rise 3.7% in 2024[2]. Meanwhile, we expect core CPI to slow to 2.5% on average in 2024, from 3.1% in 2023, and therefore we forecast that real disposable income growth will turn positive for the first time in four years, at 1.2% (previously 0.8%), accelerating sharply from -2.8% from 2023 (Exhibit 5). However, we note that even after this increase in income, real disposable income would still be 0.8% lower than in 2019, before the pandemic (2.2% below 2019 level without the 2024 temporary tax rebate).

The improving real income environment should boost the consumption recovery. However, as the elasticity of consumption relative to real disposable income is around 0.3 pp[3], and as we had already factored in wage recovery to some extent, the upward revision to our real disposable income forecast (+0.4 pp) provides only a modest boost to our consumption outlook (+0.1 pp).

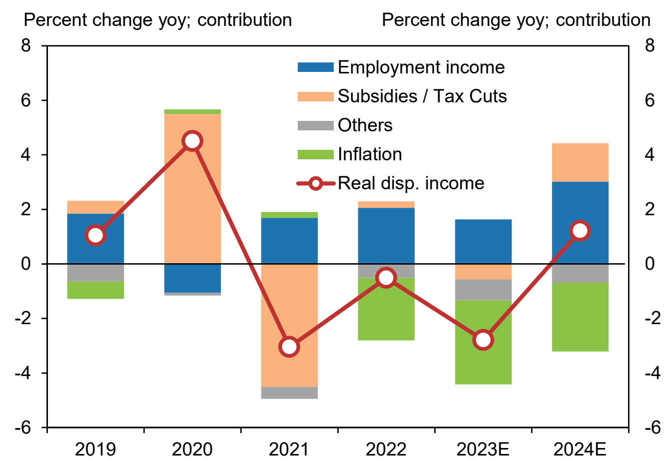
Exhibit 4: We Estimate Real Wage Growth above +1% in 2024
Shunto Base Pay Rise, Nominal/Real Wages



Real wage deflated using core CPI.

Source: Ministry of Health, Labour and Welfare, Ministry of Internal Affairs and Communications, JTUC-RENGO, Goldman Sachs Global Investment Research

Exhibit 5: Real Disposable Income Finally Turning Positive in 2024
Decomposition of Real Disposable Income Growth



Real disposable income deflated using core CPI.

Source: Cabinet Office, Ministry of Internal Affairs and Communications, Goldman Sachs Global Investment Research

With the Base Pay Rise Likely to Remain Above 2% in 2025, Continuous Price and Wage

[1] The magnitude of revision to macro nominal overall wage growth is smaller compared to the upward revision to the shunto base pay hike. Explanations are, in addition to adjusting the boost from the strong wage hikes by the steel majors and incorporating the gap wage hike between large and smaller companies, (1) our real GDP forecast for 2024 is lower compared to October 2023 when we made our previous forecast, which lowers the contribution of bonus/overtime wage by 0.3pp, and (2) running rate of wage growth upto January has been slower than we assumed in October, which reduces the FY2023 outlook for a lower starting base for FY2024.

[2] Disposable income includes tax refunds and support for low-income households (total ¥5 tn), the bulk of which will be paid out by summer 2024. On the other hand, increase in personal income tax and social security contribution, accompanying wage growth, reducing disposable income.

[3] We estimate marginal propensity to consume based on yoy changes in real disposable income and real household spending for FY1994-FY2019. Our estimation results are broadly similar to those of the Cabinet Office (2010) and the Bank of Japan (2016).

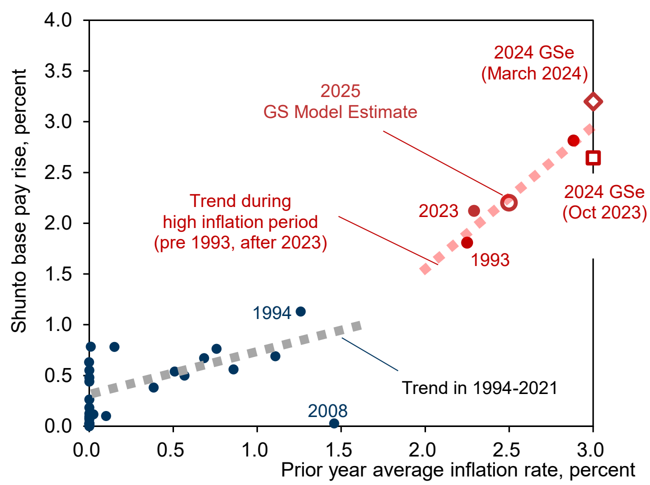
Rises Increase the Likelihood of a Virtuous Cycle Between Wages and Prices

The high base pay rise in the 2024 *shunto* reaffirms the relationship that we have noted previously that in a high inflation period of more than 2%, heightened inflation concerns change the negotiating attitude of labor and management, with wages responding more strongly to price rises (Exhibit 6).

Given this relationship, the wage increase in the 2025 *shunto* is also likely to be relatively high one year from now. As our 2024 core CPI forecast is +2.5% (the BOJ's FY2024 price outlook is +2.4%), we model for a base pay rise in the 2025 *shunto* of +2.2%, which would mark a rise of more than 2% for the third straight year.[4]

Exhibit 6: Base Pay Rise Reacts Strongly to Inflation During Periods of High Inflation Exceeding 2%

Correlation Between Inflation (Headline CPI) and Shunto Base Pay Rise



1990 and 1991 were eliminated as outliers, because these were at the peak of the bubble economy. Unemployment rate in 1990-91 was 2.1%, and the rate has not been below the level even once since then. The model estimate for 2025 is estimated with our inflation rate forecast (see the footnote 4 for the model. Nominal productivity growth in 2024 is assumed to be zero).

Source: JTUC-RENGO, Keidanren, Ministry of Internal Affairs and Communications, Goldman Sachs Global Investment Research

The high wage rise forecast for the 2025 *shunto* means that we expect prices and wages will continue to rise by more than 2% over 3 years in Japan. It is widely known that persistent inflation itself alters the mindset of consumers and companies, and increases the likelihood of this leading to higher inflation expectations (so-called adaptive expectations).

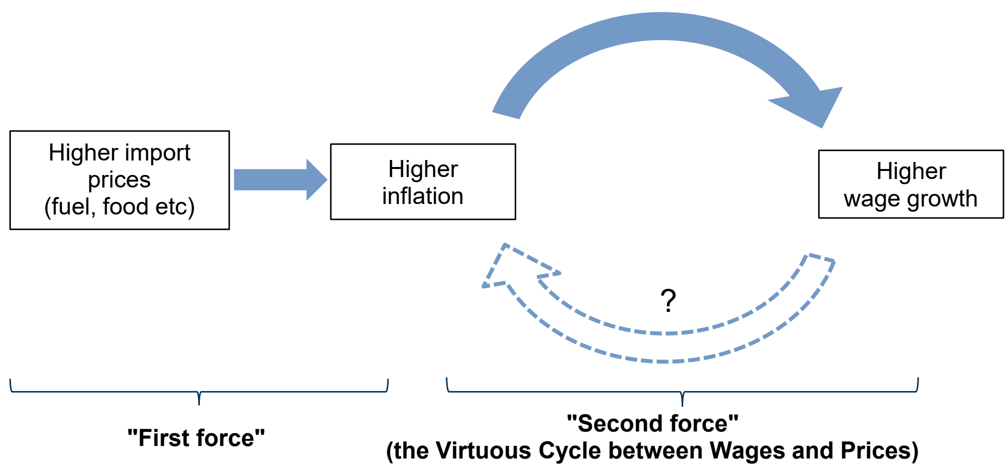
A rise in inflation expectations is a decisive factor in the creation of a virtuous cycle between wages and prices. Trade unions that expect prices to rise take wage hikes seriously, and companies that expect wage increases to continue are more likely to choose to raise sales prices. In other words, persistent inflation could increase the likelihood of achieving a virtuous cycle.

[4] This estimate is derived from the following model. *Shunto* base pay rise = 0.23*** + 0.15** x previous year's core CPI + 0.64*** x high-inflation period dummy x previous year's core CPI + 0.08** x previous year's nominal labor productivity growth rate. All regression coefficients have a 1-period lag. The estimation period is 1992-2024. *** and ** are statistically significant at the 1% and 5% levels respectively. Our 2025 *shunto* model estimate assumes zero nominal labor productivity growth in 2024.

As such, the BOJ could deem an increase in the base pay rise in the 2024 *shunto* as an important factor in achieving a virtuous cycle between wages and prices as well as sustainable inflation.

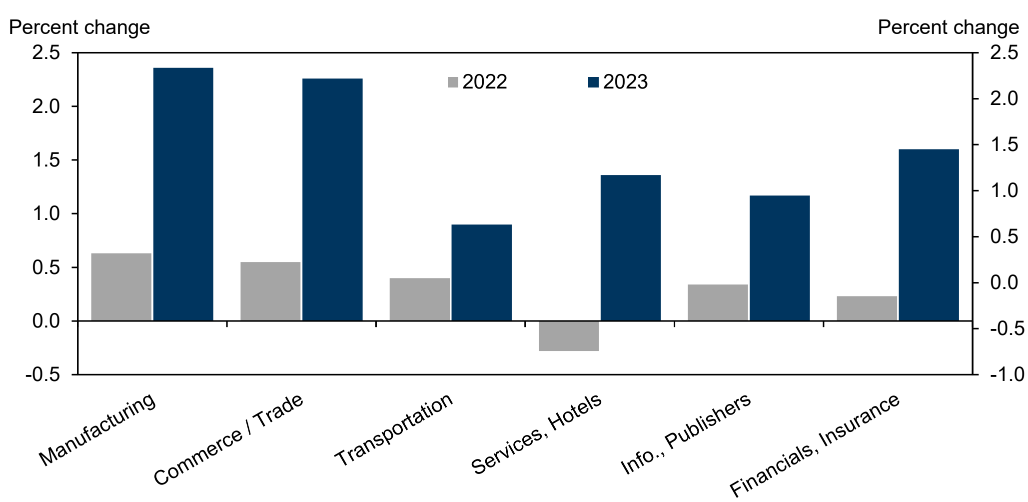
However, as we have noted previously, we think it is essential for wage growth to increase in the labor-intensive services industry in order to create a channel for wage increases to flow to price increases (Exhibit 7). Indeed, in the 2023 *shunto* the base pay rise in the services industry was only around 1% (Exhibit 8), and this could have prevented the BOJ from confirming the aforementioned channel. Therefore, we believe the breakdown of wage increases by industry in the third *shunto* data release on April 4 will be the next key indicator to watch, especially to consider the timing for the second rate hike, which we expect in October 2024.

Exhibit 7: Virtuous Cycle Between Wages and Prices



Source: Goldman Sachs Global Investment Research

Exhibit 8: Services Industry Base Pay Rise Was Only Around 1% in the 2023 Shunto
Shunto Base Pay Rise by Industry



Source: JTUC-RENGO, Goldman Sachs Global Investment Research

Yuriko Tanaka and Tomohiro Ota

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