

Why Japan's consumers are downbeat



Both official statistics and anecdotal evidence suggest that Japan's consumer confidence has deteriorated. We discuss some of the reasons why below, but suspect that circumstances should improve, contributing to a gradual recovery going forward.

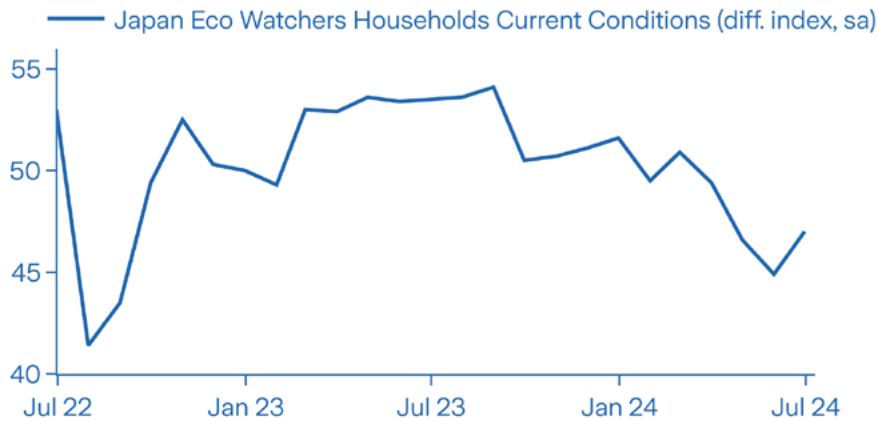
As shown in the chart, following the dramatic Covid related moves, Japan's consumer confidence picked up from a level around the 30 in 2022 to the recent high of 39.5 in March. However, it has since reversed again, falling more than three points until the end of June, and is now significantly below pre-Covid levels. Most sub-components contributed negatively, including overall living standards, income growth, asset growth, employment and willingness to buy durable goods.



Source: ESRI, Bloomberg



This mood is confirmed by the Economy Watchers Survey, conducted by the Cabinet Office and published by ESRI, which gathers sentiment from workers in various household, corporate and employment related sectors across 11 regions nationwide. From its recent high in February at 53, the expectations index fell nearly seven points to 46.3 in May, driven by household living standards and business conditions, as well as by the employment component, before recovering slightly to 47.9 in June.



Source: ESRI, Bloomberg

Let's first have a look at worker's salaries. Base salaries rose 2.5% YoY in May, the fastest growth since 1993, while on a same sample basis excluding bonuses and overtime pay wages increased a solid 2.7% YoY, clearly confirming the uptrend since 2020. We also note that following the spring 'shunto' wage negotiation round, Japan's biggest group of unions secured solid wage increases, including scheduled wage hikes of 5.1% for its workers this spring, the biggest gain since 1991. If the scheduled component is excluded, the base wage hike of 3.58% matches the outcome last seen in 1990, marking a 24 year-high.



Source: MHLW Japan, Bloomberg

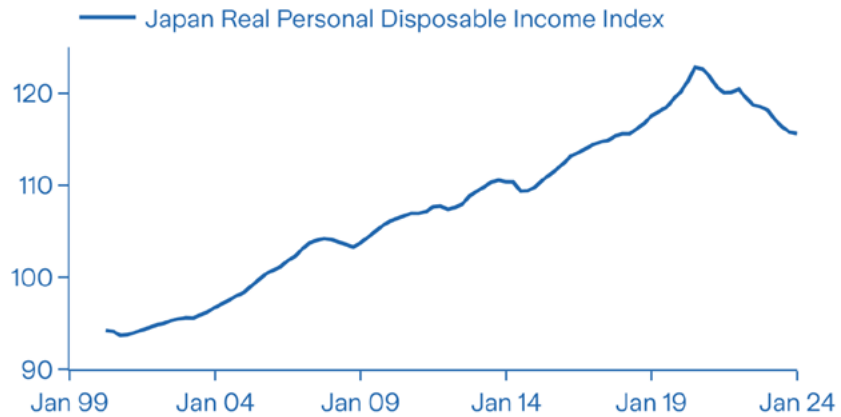
While this looks to be great news for workers, what is more decisive for consumer confidence is how real wages are developing when taking inflation into account. Focussing on monthly wages, Japan's Ministry of Health, Labour and Welfare provides real 'cash earnings' statistics, which have fallen on average 0.6% YoY since mid-1999, with monthly data meandering in a broad range. Notably, the trend has been down in the last eight years. The surge in consumer price inflation from -1.2% YoY in December 2000 to +4.3% in January 2003, has certainly contributed to the negative trend of real income. To alleviate the pressure the government is likely to introduce utility subsidies starting in August.



Source: MHLW Japan, Bloomberg

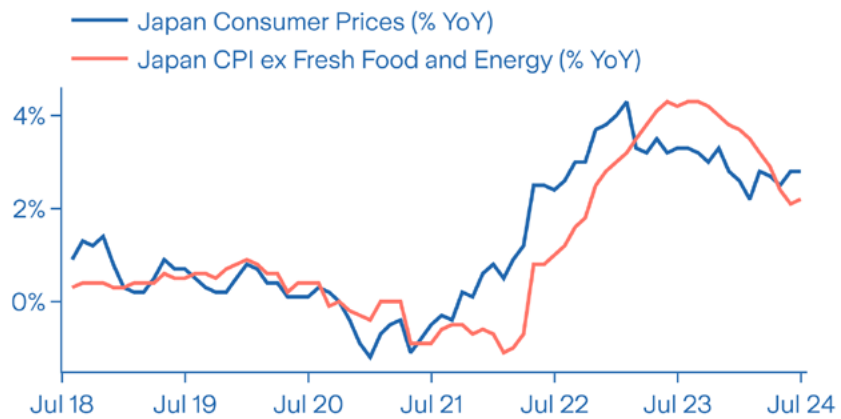
There has been a lot of talk about the positive inflation-wage spiral boosting consumer confidence back to the 45-50 range that was experienced early in the millennium. This has not happened yet, and still appears to be a very challenging target. Based on data calculated by the Dallas Fed, Japan's real personal disposable income peaked in the middle of the year 2000, and has since fallen about 6%. It had doubled in the prior 25 years. Income is based on wages and salaries as well as rental, investment, and transfer income.





Source: Dallas Fed, Bloomberg

However, the drag from rising consumer inflation on real income has stabilised at an average of 3% over the last 16 months, which has in turn contributed to the stabilisation of real wage losses. But that will not be enough to brighten the outlook for confidence.



Source: Ministry of Internal Affairs and Communication, Bloomberg

We believe consumer confidence will only improve if real income growth turns positive in a sustainable manner not only for employees working for blue chip companies, but also for the majority of employees working for SMEs. Interestingly, according to the 'shunto' wage negotiation results, small companies with less than 300 employees will raise base wages by 3.2%. Though this is less than the outcome for big companies and won't spark a spending boom, it is still up 1.2 percentage points compared to last year.



Source: JTUC-Rengo, Bloomberg

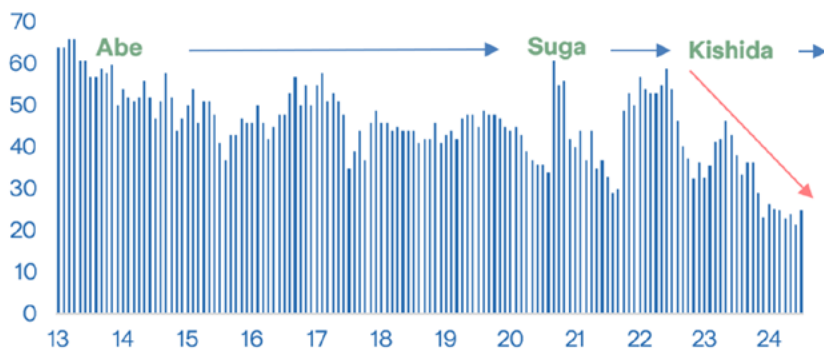
Note: The chart depicts the negotiated wage increase at each stage of the negotiations between employers (Keidanren) and labour unions (Rengo). The negotiations follow a standard pattern and last several months. The largest unions begin the process with the largest wage demands. Subsequently, smaller unions join the process, demanding slightly less and bringing the average down.

We note press reports indicating that the Bank of Japan will release analysis in late July showing that strong wage hikes are spreading from the big firms that participate in the 'shunto' wage negotiation round to smaller firms that employ the majority of Japan's workforce. Our on-the-ground channel checks in June showed that most employees that do not work for blue-chip companies like Toyota or Sony, but rather for SMEs, have not yet experienced real income growth. We believe it may take some time before any sustainable real income growth takes root and results in stronger consumer confidence and consumption growth.

The weak yen, as part of the policy to raise inflation, has helped to ignite a boom in foreign tourism and investment, which has started to have negative consequences impacting consumer confidence. According to 'Japan Tourism Agency' statistics for Q2, spending by foreign tourists was up more than 68% compared to strong pre-Covid levels, and the respective number of foreign visitors was up more than 10%. 'Overtourism' appears to be contributing to a crowding-out of domestic tourists amid surging hotel, dining and entertainment prices. Meanwhile trips abroad have become substantially more expensive for Japanese travellers. Reports about the negative consequences of 'overtourism' in Japan's TV evening news have increased significantly, fuelling discontent.

We also note that growing dissatisfaction with domestic politics may have partially and indirectly contributed to the latest deterioration in consumer confidence. With an approval rating of only 25%, down three percentage points from May, support for PM Kishida's cabinet has tumbled to a record low since the LDP has again taken over the government, according to the NHK poll conducted in June. No prior prime minister has ever experienced such a low rating since 2013. Interestingly, the most common policy issue that respondents wanted PM Kishida to handle as a priority was 'price measures' at 36%, which confirms the link between low consumer confidence due to real income losses and political dissatisfaction.

Japan PM Cabinet Approval Rate (%)



Source: NHK;

Note: Since LDP has taken over from opposition parties

While Japan battles to get inflation back up to a sustainable target level following years of deflation, the process of pushing prices higher is challenging and causing feelings of frustration for consumers.

Going forward, we expect real wage growth to slowly creep into positive territory in the second half of this fiscal year and into next year. There have been previous instances of real wage growth, though not on a sustainable basis. A longer lasting positive trend will be decisive for consumer confidence to pick up for good.



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