

# Japan – Making the Most of Current Tailwinds

Does monetary policy work?

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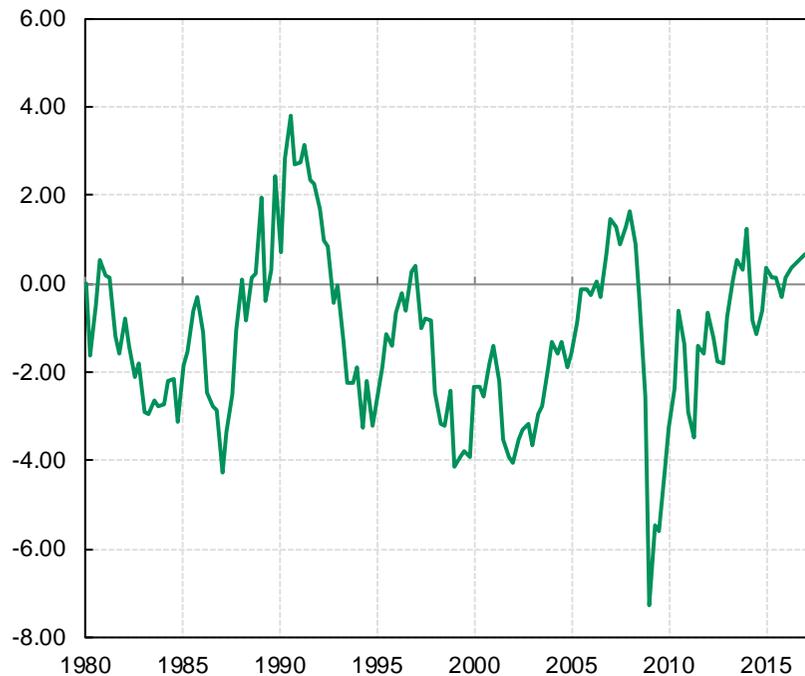


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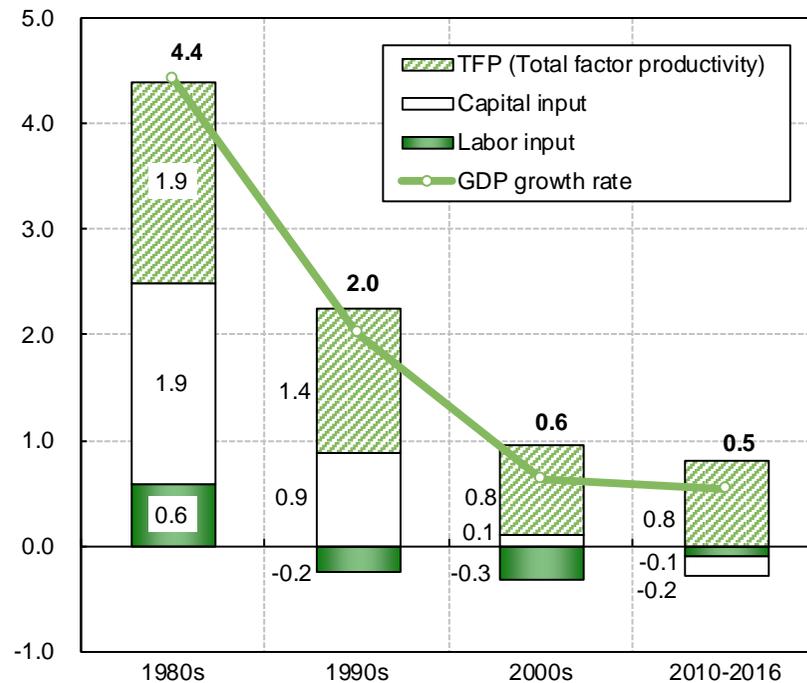
# Is monetary easing and fiscal stimulus appropriate under full employment?

Chart 1: Output Gap (% , our estimate)



Source: Cabinet office, METI, MIC, BNP Paribas

Chart2: Growth accounting framework analysis (annualized, % contribution)



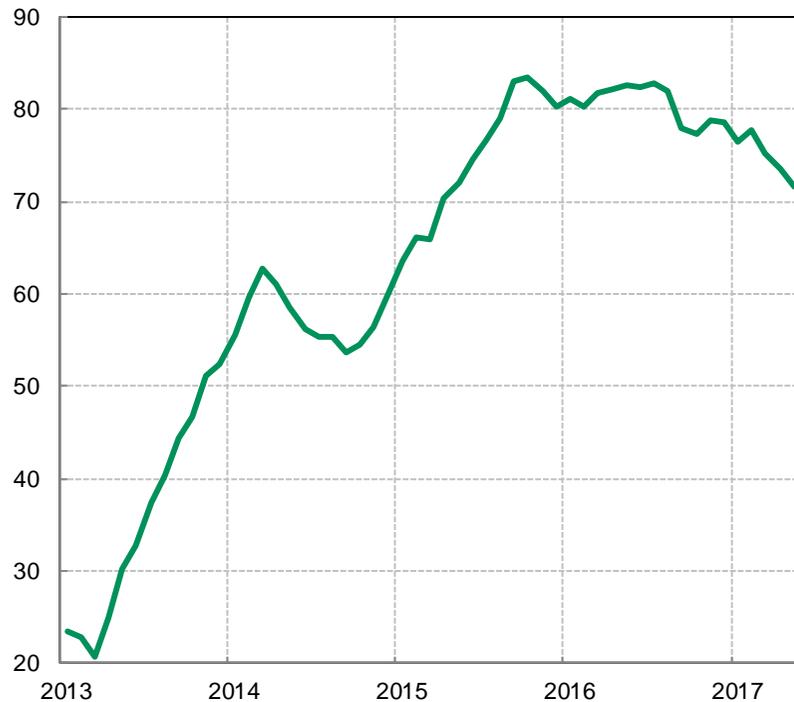
Source: Cabinet office, METI, MHLW, MIC, BNP Paribas

- The Japanese economy faces manpower shortages, not deficient aggregate demand.
- Continuing aggressive macro-stabilization policies under full employment could delay the reviving of trend growth.



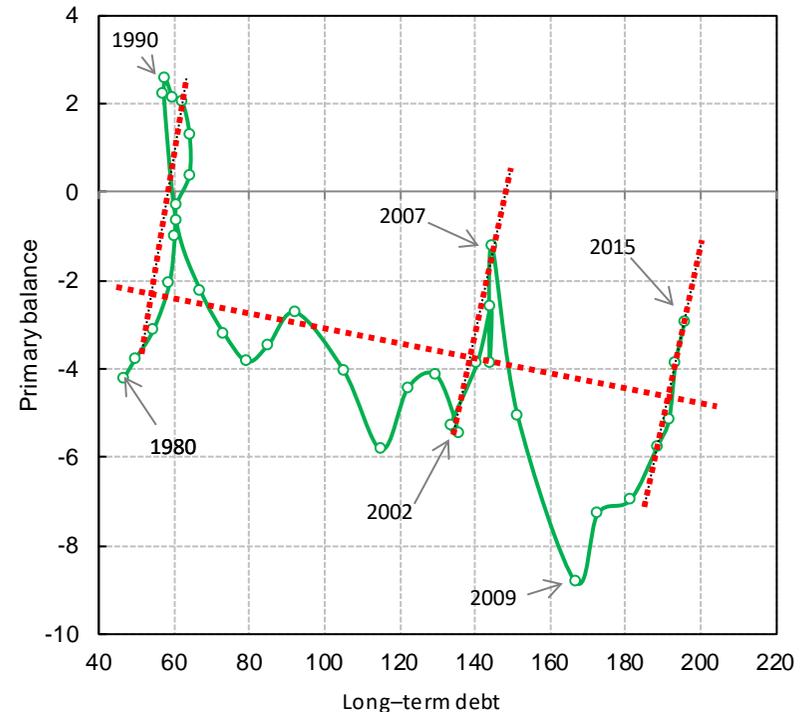
# Has the introduction of YCC made monetary policy more sustainable?

Chart1: BoJ's holding of JGBs  
(JPY trillion, difference from year earlier)



Source: BoJ, BNP Paribas

Chart2 : Balance of long-term debt and the PB of central and local governments (% of GDP, FY)



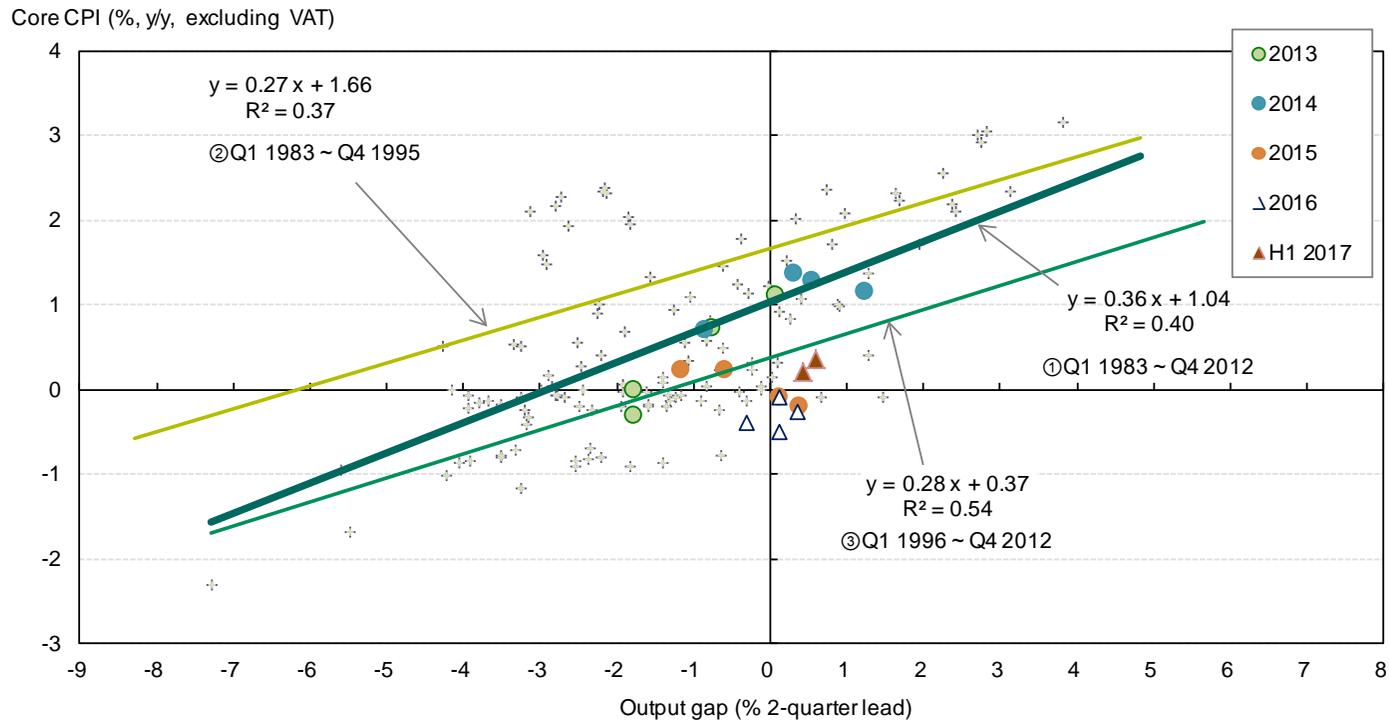
Source: MOF, Cabinet Office, BNP Paribas

- BoJ's shifting to stealth tapering is a partial success.
- Policy has become more sustainable thanks to YCC, but the risk of succumbing to fiscal dominance has also increased.



# Has Abenomics raised inflation expectations?

Chart 1: Phillips curve



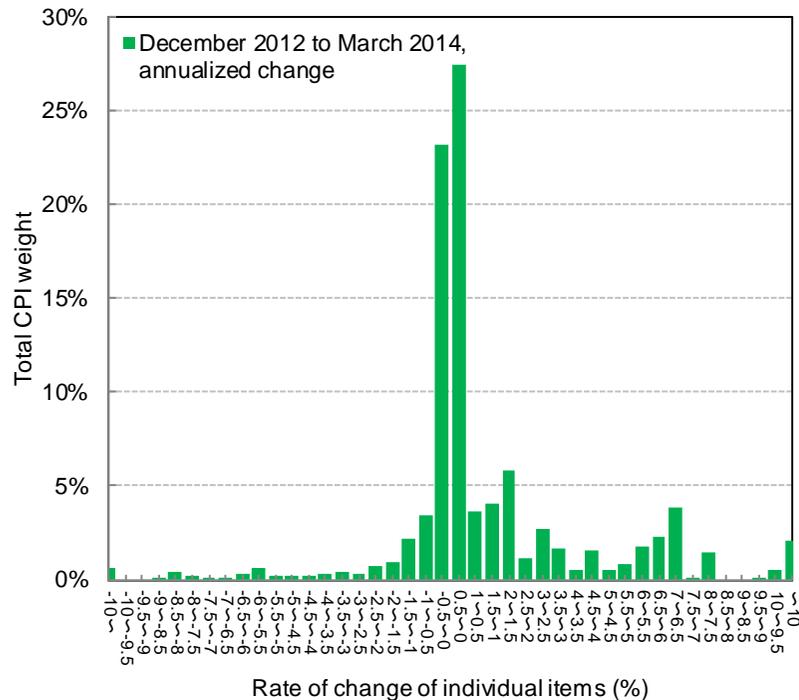
Source: Cabinet office, MIC, BNP Paribas

- The Phillips curve has not shifted upward.
- Output gap must improve more than 5% to deliver 2% inflation.



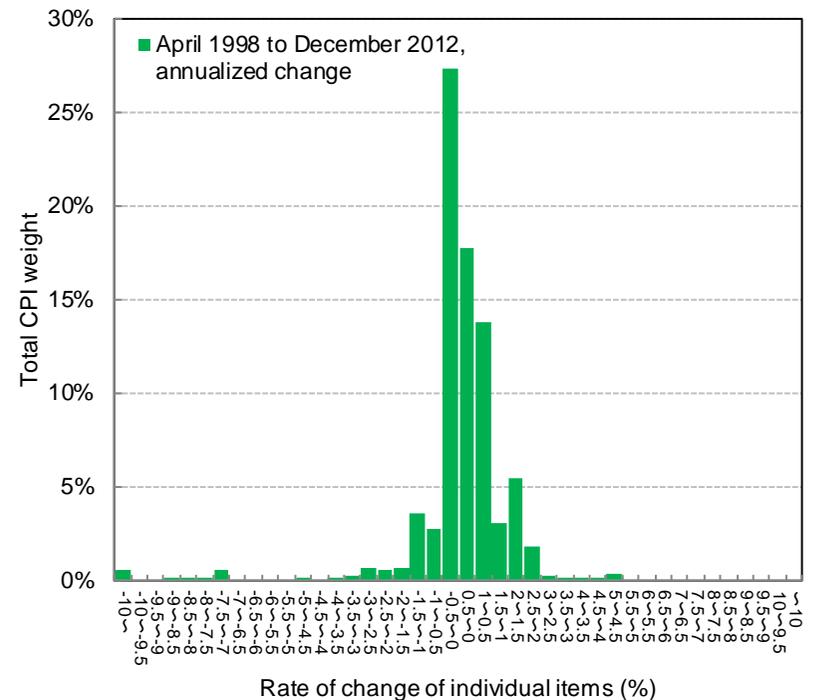
# Did aggressive monetary easing influence inflation expectations?

Chart 1: Frequency distribution of price change by item (Core CPI, weight basis)



Source: MIC, BNP Paribas

Chart 2: Frequency distribution of price change by item (Core CPI, weight basis)



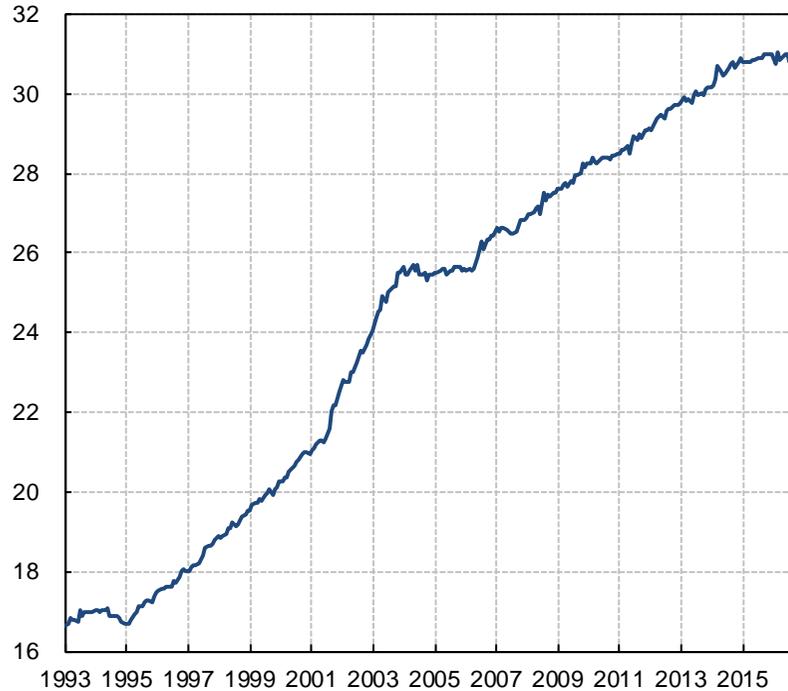
Source: MIC, BNP Paribas

- Even when inflation was rising, prices for roughly half of the CPI, centered on services, hardly moved.
- For twenty years, half of the CPI hardly moved, either up or down.



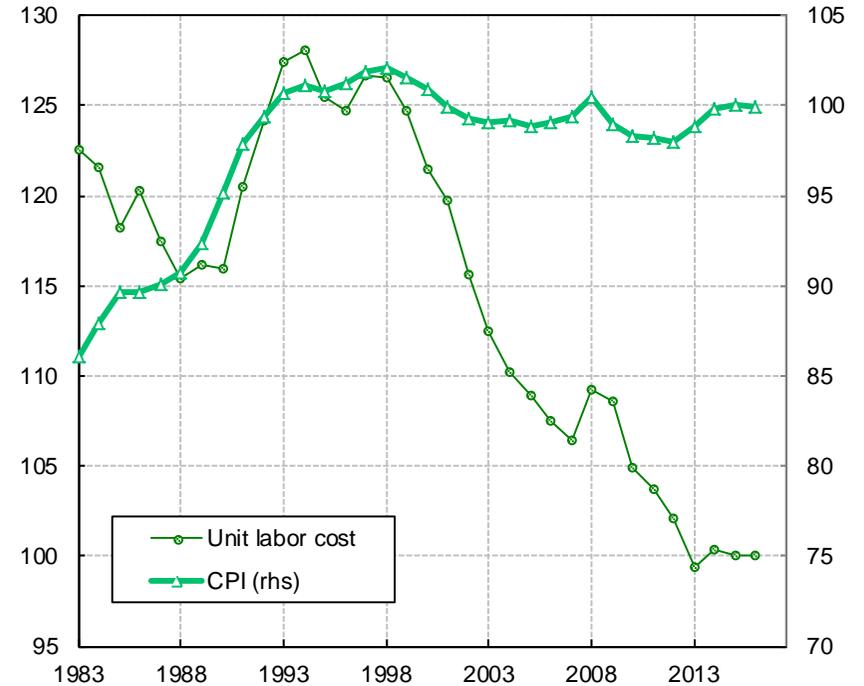
# Will wage growth lead to higher inflation?

Chart1: Share of non-regular (sa, %)



Source: MHLW, BNP Paribas

Chart2: Unit labour cost (CY2015=100)



Source: Cabinet office, MIC, MHLW, BNP Paribas

- Corporations created a buffer to absorb costs during the period of wage deflation.
- Even if wages pick up, it won't quickly result in price pass-through.



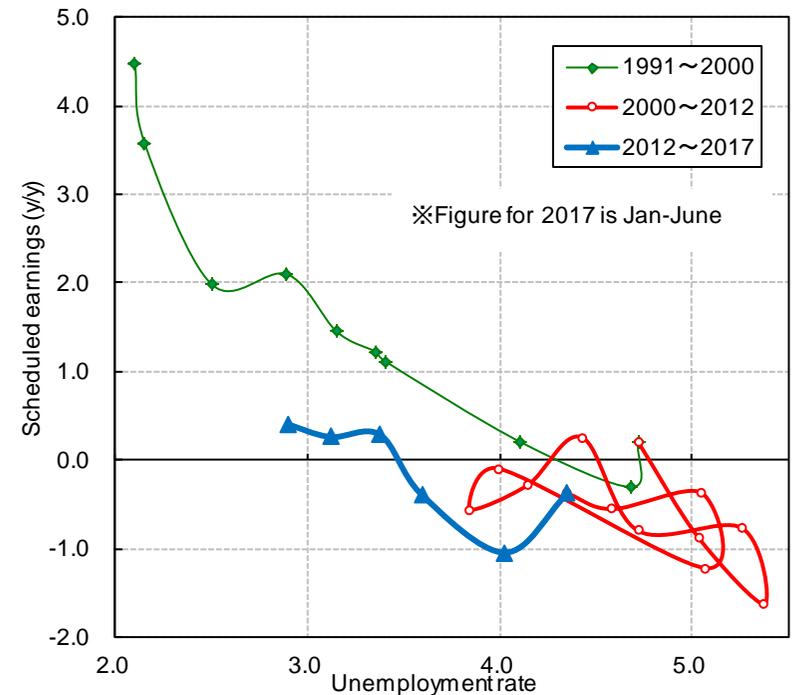
# What caused the wage Phillips curve to shift downward?

Chart1: Components of real wage growth  
(hourly basis, annualized, %)



Source: Cabinet office, MIC, BNP Paribas

Chart2: Wage-version Phillips curve (CY)



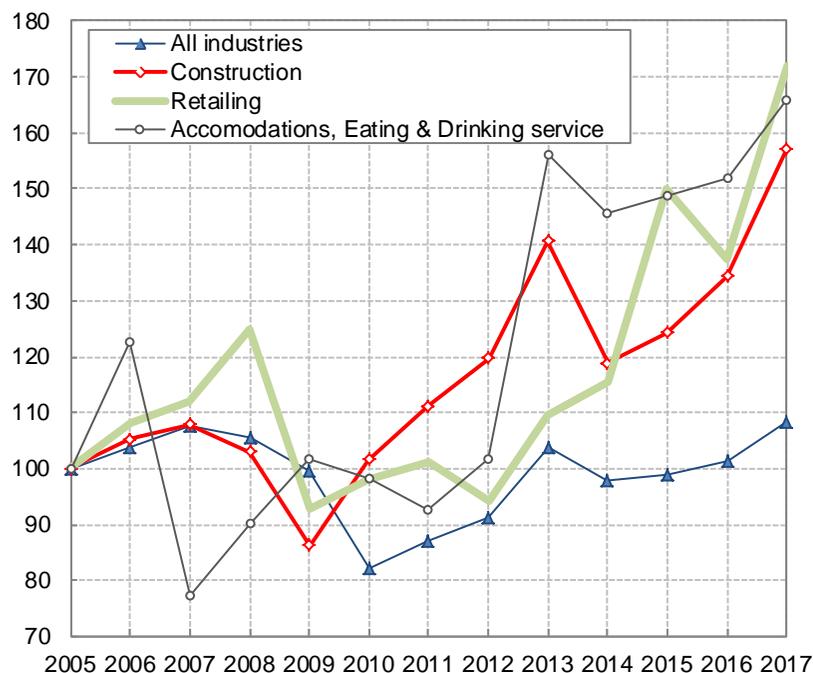
Source: MHLW, MIC, BNP Paribas

- Primary reason for floundering real wages is declining productivity growth.
- Downward shift in the wage Phillips curve reflects not only falling inflation, but also the weakness of real wage growth.



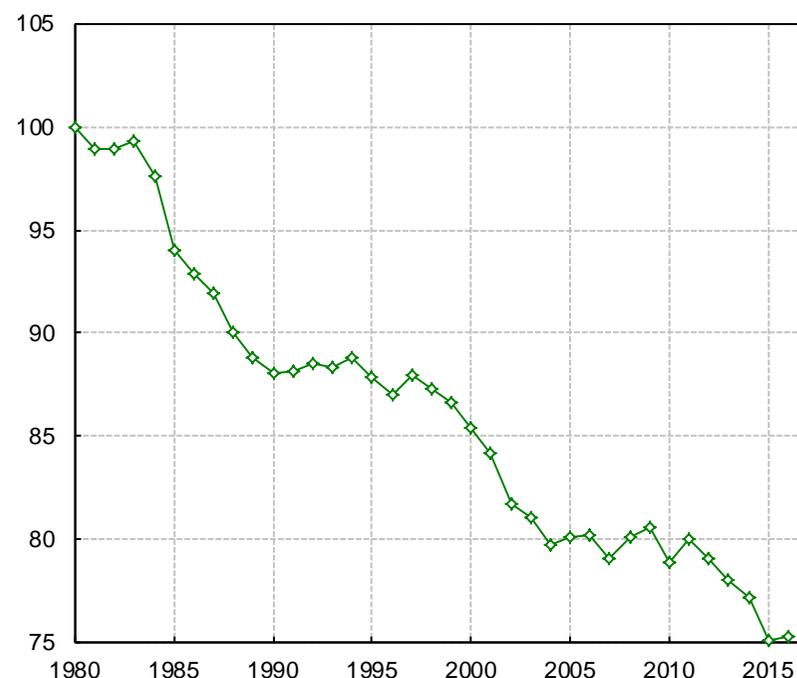
# Will the decline in labor's share keep wages and inflation from rising?

Chart1: Scale of software investment (CY2005=100)



Source: BoJ, BNP Paribas

Chart2: Labor's share of corporate income (CY1980=100)



Source: MIC, MHLW, BNP Paribas

- If elasticity of substitution exceeds 1, replacing costly labor with cheaper capital will lower labor's share.
- The lack of increase in real wages reflects the decline in labor's share resulting from skill-biased innovation



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