Japan – Making the Most of Current Tailwinds

Does monetary policy work?
Is monetary easing and fiscal stimulus appropriate under full employment?

- 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?

- 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.

Chart 1: BoJ’s holding of JGBs (JPY trillion, difference from year earlier)

Chart 2: Balance of long-term debt and the PB of central and local governments (% of GDP, FY)

Source: BoJ, BNP Paribas

Source: MOF, Cabinet Office, BNP Paribas
Has Abenomics raised inflation expectations?

Chart 1: Phillips curve

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

Source: Cabinet office, MIC, BNP Paribas
Did aggressive monetary easing influence inflation expectations?

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

- 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.

Source: MIC, BNP Paribas
Will wage growth lead to higher inflation?

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

Chart2: Unit labour cost (CY2015=100)

- 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.

Source: MHLW, BNP Paribas

Source: Cabinet office, MIC, MHLW, BNP Paribas
What caused the wage Phillips curve to shift downward?

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?

Chart 1: Scale of software investment (CY2005=100)

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Source: BoJ, BNP Paribas

Chart 2: Labor’s share of corporate income (CY1980=100)

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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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Such arrangements, along with embedded policies and procedures, provide that information held in the course of carrying on one part of its business to be withheld from and not to be used in the course of carrying on another part of its business. It is a way of managing conflicts of interest whereby the business of the bank is separated by physical and non-physical information barriers. The Control Room manages this information flow between different areas of the bank where confidential information including inside information and proprietary information is safeguarded. There is also a conflict clearance process before getting involved in a deal or transaction. In addition, there is a mitigation measure to manage conflicts of interest for each transaction with controls put in place to restrict the information flow, involvement of personnel and handling of client relations between each transaction in such a way that the different interests are appropriately protected. Gifts and Entertainment policy is to monitor physical gifts, benefits and invitation to events that is in line with the firm policy and Anti-Bribery regulations. BNP Paribas maintains several policies with respect to conflicts of interest including our Personal Account Dealing and Outside Business Interests policies which sit alongside our general Conflicts of Interest Policy, along with several policies that the firm has in place to prevent and avoid conflicts of interest. The remuneration of the individual producer of the investment recommendation may be linked to trading or any other fees in relation to their global business line received by BNP Paribas and/or affiliates. IMPORTANT DISCLOSURES by disseminators of investment recommendations for the purposes of the Market Abuse Regulation:

The BNP Paribas disseminator of the investment recommendation is identified above including information regarding the relevant competent authorities which regulate the disseminator. The name of the individual producer within BNP Paribas or an affiliate and the legal entity the individual producer is associated with are identified above in this document. The date and time of the first dissemination of this investment recommendation by BNP Paribas or an affiliate is addressed above. Where this investment recommendation is communicated by Bloomberg chat or by email by an individual within BNP Paribas or an affiliate, the date and time of the dissemination by the relevant individual is contained in the communication by that individual disseminator. The disseminator and producer of the investment recommendations are part of the same group, i.e. the BNP Paribas group. The relevant Market Abuse Regulation disclosures required to be made by producers and disseminators of investment recommendations are provided by the producer for and on behalf of the BNP Paribas Group legal entities disseminating those recommendations and the same disclosures also apply to the disseminator. If an investment recommendation is disseminated by an individual within BNP Paribas or an affiliate via Bloomberg chat or email, the disseminator’s job title is available in their Bloomberg profile or bio. If an investment recommendation is disseminated by an individual within BNP Paribas or an affiliate via email, the individual disseminator’s job title is available in their email signature. For further details on the basis of recommendation specific disclosures available at this link (e.g. valuations or methodologies, and the underlying assumptions, used to evaluate financial instruments or issuers, interests or conflicts that could impair objectivity recommendations or to 12 month history of recommendations) are available at https://globalmarkets.bnpparibas.com/gmportal/private/globalTradeIdeas. If you are unable to access the website please contact your BNP Paribas representative for a copy of this document.