Mizuho Research Institute

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Structural factors inhibiting earnest wage growth

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Labor supply and demand situation has been tight, but wage growth remains sluggish

Despite the ongoing tightness in labor supply and demand, wage increases are not gaining momentum. The job-to-applicants ratio which shows the number of job offers per job applicant, was 1.52 times in July 2017. It is higher than the peak of the bubble economy era and the level is not seen in around 43 years. Nevertheless, the year-on-year rate of growth in fixed wages (base pay) averaged +0.3% from January to July, indicating that wage growth continues to lack momentum. Despite improvement with a focus on the labor conditions of non-regular employees, the stagnant wage growth is conceivably due to structural factors. Specifically, the two factors mentioned below.

The pace of wage growth in the prime working generation is slowing

The first factor is that the wage curve is flattening (**Chart 1**). Comparing the wage curves for 2006 and 2016, the pace of wage growth has been slacking off, particularly among workers aged in the latter half of their 30s through to the first half of their 40s, conceivably in the prime of their working lives and highest level of productivity. This is said to reflect the impact of the amendment to the Act for Stabilization of Employment of Elder Persons, which was enacted in April 2006 and made it mandatory to extend employment up to 65 years old. In other words, this suggests that companies have attempted to avoid an expansion in their overall personnel costs by holding down wage increases for other age levels. By doing so, companies have absorbed the cost of paying workers who reached the retirement age of 60, which has increased as a result of their extended employment.

Labor share is already high, in industries facing serious labor shortages

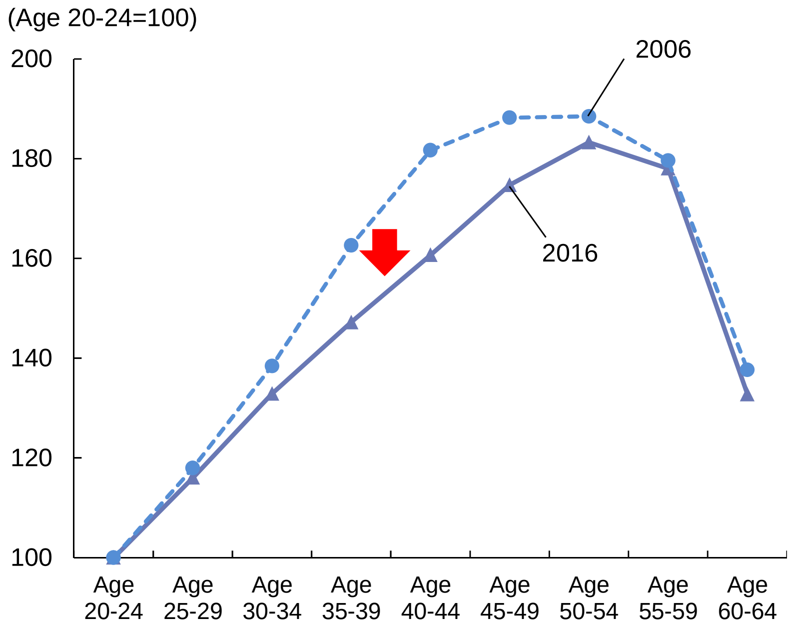
The second factor is that industries facing tighter labor supply and demand tend to have poorer available capacity for raising wages. **Chart 2** plots the rate of growth in the number of job openings (horizontal axis) in the Abenomics era (average for 2013-2016) compared to the bubble era (average for 1987-1990) for each industry, against the labor share (vertical axis) in the Abenomics era. The chart reveals that in industries where job openings are greater than during the bubble era – food service, healthcare, education and social welfare (caregiving etc.) – the labor share is already at a high level. In other words, it indicates that even if these industries want to raise wages, the available capacity is already scarce. In these industries, unless the added value that is the denominator of the labor share is raised, it is difficult to anticipate wage increases.

Wage growth is likely to continue to be slight

Based on the amended Labor Contract Act, from April 2018 fixed-term contract employees with more than five years of continuous employment will become able to convert to indefinite-term contracts ("rule of conversion into indefinite-term contracts"). This can be expected to encourage wage growth through improving the labor conditions of non-regular employees. On the other hand, for companies it will be a factor causing personnel expenses to increase. As is the case with employing elder persons, without raising the added value, there is a possibility that this change will drive down the wages of other workers in a short period.

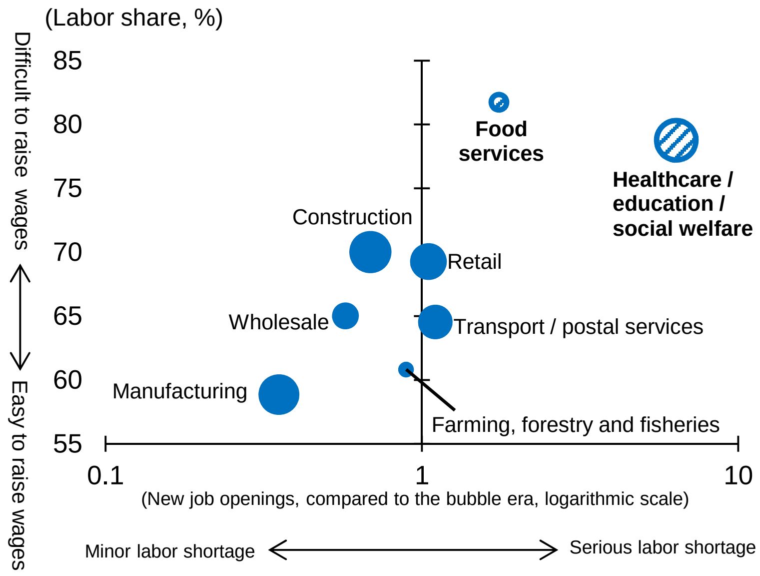
To ensure the funds for wage raising even as the number of regular employees grows, companies will need to increase the productivity through initiatives such as labor-saving investments, personnel training and capacity-development systems. But it is not easy to increase the productivity in a short period. Undoubtedly, another option would be to optimize the prices of goods and services (meaning price hikes). However, it will be also difficult to eliminate the feelings of resistance to price hikes, which has become ingrained after Japan's many years of deflation. In addition, because the aforementioned two structural factors are exerting downward pressure, more time will likely be needed before wage increases gain momentum. It would seem prudent to expect the pace of wage growth to remain slowfor the time being.

[Chart 1: Changes in the wage curve (general workers)]



Note: Fixed wages of 20-24 year olds are indexed as 100.
Source: Made by MHRI based on the Ministry of Internal Affairs and Communications, *Basic Survey on Wage Structure*

[Chart 2: Number of job openings by industry (compared to the bubble era) and labor share]



Note: Changes in the demarcation of business sectors arising from changes in industry classifications were adjusted at MHRI. This chart plots the rate of growth in the number of job openings (horizontal axis) in the Abenomics era (average for 2013-2016) compared to the bubble era (average for 1987-1990), against the labor share (vertical axis; the proportion of personnel expenses in added value) in the Abenomics era, by industry. The size of each circle demonstrates the share of the respective industry's new job openings in the 2013-2016 average for industries as a whole.

Source: Made by MHRI based on the Ministry of Health, Labour and Welfare, *The Status of General Job Placements* and the Ministry of Finance, *Corporate Statistics*