

AT A GLANCE | Japan

July 28, 2023

Shackles on Service Prices

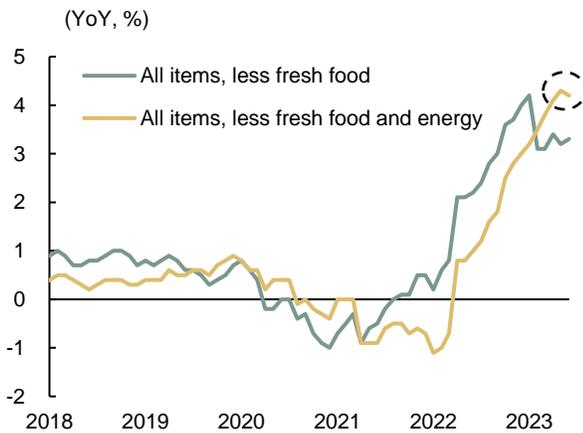
Economist: Junya Takemoto

Core Consumer Price Index Shrinks for First Time in a Long Time

According to the June Consumer Price Index (CPI) released on June 21, the core CPI (excluding fresh food and energy) increased 4.2% year over year (up 4.3% on the previous month), the first decline in 17 months (Figure 1). This is a sign of a change in the trend from the previous one, in which the rise had continued to grow. If we divide the CPI into goods and services, it can be seen that the rise in the value of goods, which had been driving the overall increase, has somewhat paused (Figure 2). The year-over-year rate of increase in the domestic corporate price index has already decreased for the sixth consecutive month since its peak in December of last year, and the pace of increase in the price of goods in the Consumer Price Index is likely to be moderate.

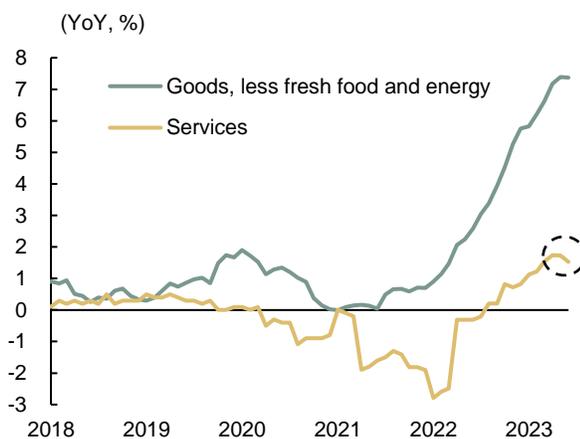
Meanwhile, what we want to focus on is the movement in service prices. Because the price of goods rises and falls due to fluctuations in costs, an increase in the price of services is essential for the Bank of Japan's target of sustained inflation. However, it is quite possible that service prices, which account for a large proportion of labor costs, will continue to rise by nearly 2% as a result of the nearly 2% wage increase resulting from the negotiations that took place this spring. However, the recent trend in service prices shows a little bit of a peak out ahead of 2% year-over-year growth. In this report, we will delve into the current trends in service prices.

Figure 1: Nationwide CPI



Source: Ministry of Internal Affairs and Communications

Figure 2: CPI (Goods and Services)



Source: Ministry of Internal Affairs and Communications

Overall Service Prices: Slow Price Revisions for Public Services

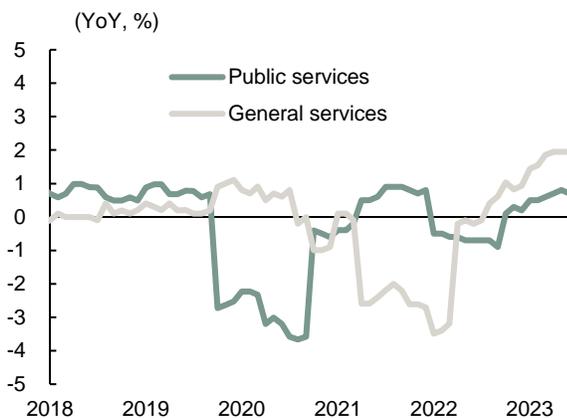
First, to get an overall picture of service prices in Japan's CPI, let's look at the movement of public services and general services. The year-over-year rate of increase for general services has risen to nearly 2%, while that for public services has increased by just under 1%. Moreover, the year-over-year rate of increase for the

most recent report (June) was reduced from the previous month (Figure 3). Public services account for less than general services in terms of weight, but have a non-negligible share of 25% (Figure 4). In this sense, the weakness of public service prices is one of the main reasons why service prices are stagnating.

Now, let's take a closer look at what's inside public services. Within the category of public services, there are housework-related services (auto insurance premiums, accident insurance premiums, fire and earthquake insurance premiums, sewer premiums, etc.), medical and welfare-related services (medical care fees, childcare fees, etc.), transportation and communication-related services (fares such as rail, taxi, and air fares, highway fares, and fixed-line telephone fares), cultural and entertainment services (such as NHK [Japan Broadcasting Corporation] subscription fees), education-related services (tuition fees for public high schools and national universities), public and urban renewal organizations and public corporation fares, and food service (meal service fees) (Figure 5).

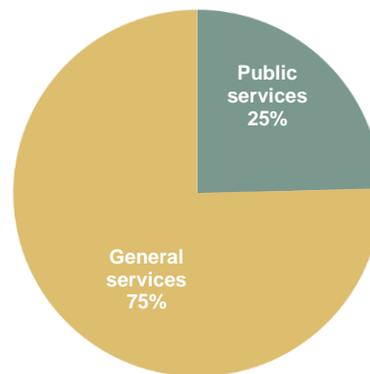
If we examine the trends among the highest-weighted components, we can see that only "transportation and communication-related services" have recently increased by more than 2% year over year (Figure 6). For other items, overall growth has been sluggish. In particular, "medical and welfare-related services", which account for as much as 25% of public services, has remained almost the same as the previous year. As a factor, "public services" include services provided by public institutions, and when rates are changed, approval from the government, school boards, and other administrative bodies is often required. In its past outlook reports, the Bank of Japan (BOJ) has pointed to the possibility of "subsidy to public enterprises' profits is common, and operating expenses and depreciation of equipment are not easily reflected in fees". "In Europe and the United States, the percentage of direct government involvement in the pricing process is small, and independent regulatory committees set prices for utilities based on the cost structure and not on the assumption that subsidies will be provided," the report said. This strong government involvement in public utilities may be holding back Japan's rising prices.

Figure 3: CPI (Public/General Services)

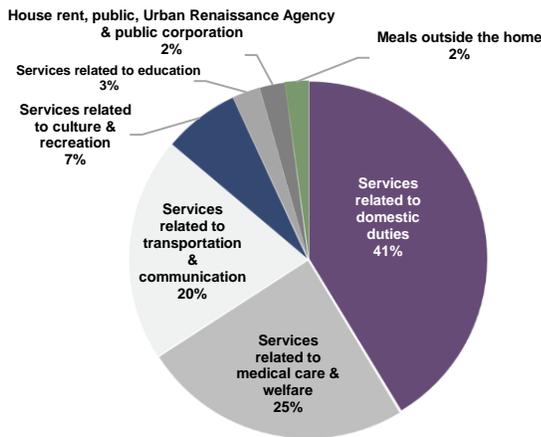


Source: Ministry of Internal Affairs and Communications

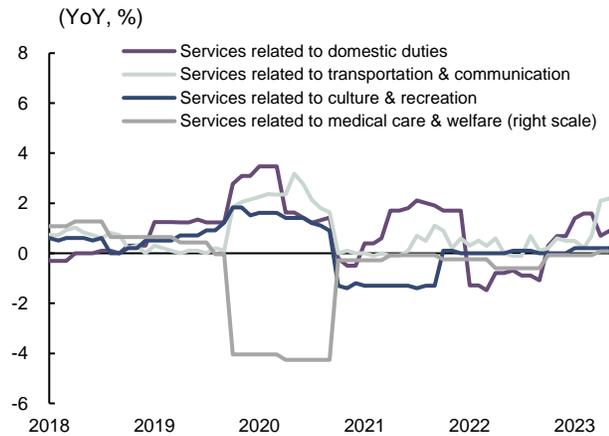
Figure 4: Weight Breakdown of Services



Source: Ministry of Internal Affairs and Communications

Figure 5: Weight Breakdown of Public Services


Source: Ministry of Internal Affairs and Communications

Figure 6: CPI (Public Services)


Source: Ministry of Internal Affairs and Communications

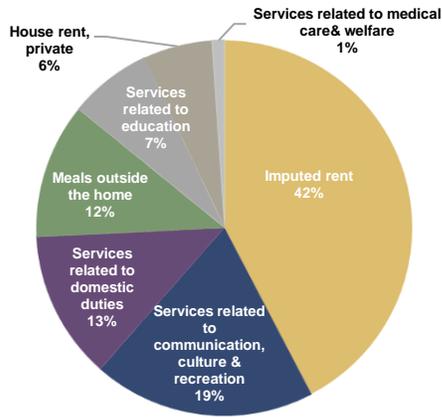
Slow Rise in Rents Holds Back General Services

Let's take a closer look at what's in the general services category. Attributable rent for owner-occupied housing accounts for the largest proportion of general services (Figure 7). Other categories include communication, education, and entertainment services (charges for cellular phone communications, internet access, lodging, lessons, golf, movies, etc.), housework-related services (remodeling and building expenses such as exterior painting expenses, automobile-related expenses such as automobile maintenance expenses, beauty expenses, etc.), food service (general food service expenses excluding school lunch expenses), education-related services (tuition fees for private high schools, private universities, cram schools, etc.), private rent, and medical and welfare services (health screening fees, massage fees, etc.).

If we look at trends among the highest-weighted categories, it can be seen that food service, housework-related services, and communication and entertainment services have already increased by more than 2% year over year (Figure 8). On the other hand, there is little movement in the "rent attributable to owner-occupied houses" and "private rent". In particular, "imputed rent for owner-occupied houses" accounts for the largest proportion of general services, so the impact of this inaction is significant (In Japan, the "attributable rent of homeowners" is estimated from the rent surveyed as "private rent"). The factors pointed out are (1) problems with the measurement method of the domestic CPI and (2) difficulties in rent revision by the Land Lease Act. (1) It is often pointed out that the Japanese CPI does not take into account the quality adjustment due to the aging of houses, and that there is a technical downward bias in the statistics. Regarding (2), in Japan, under the Land and House Lease Act, the rent for continuing to live in the same property is not allowed to increase unless there is a justifiable reason (such as a change in property tax due to a change in land price or an extreme divergence from that of surrounding properties). In light of this legal system, there are some suggestions that an increasing number of landlords are opting for the "fixed-term tenancy" system, which sets the lease period, but the proportion of such properties remains small at present. In light of these factors, it is highly likely that "owner-occupied rent" and "private rent" will continue to act as a drag on service prices.

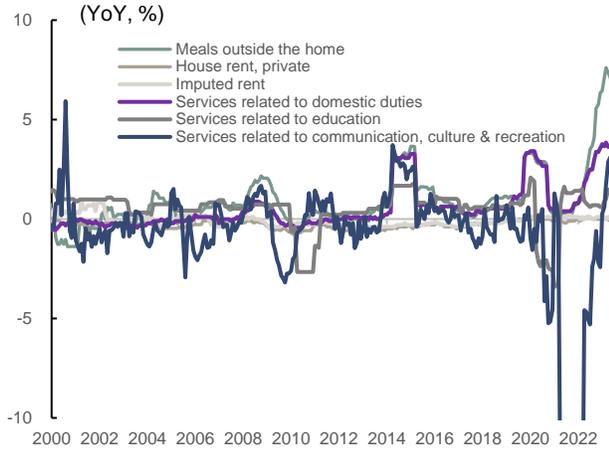
However, it is not enough to consider the underlying trend of service prices based only on the CPI, which is based on the "static rent". If you look at the survey results of private real estate companies' rents for their properties published on HP, you will often find that rents are up 2% from the previous year. This is a natural consequence of rising inflation expectations and increasing labor costs. It is not clear whether the Bank of Japan will make a fundamental assessment of prices in light of these factors, but from a perspective that excludes the impediments we have seen to prices, the Japanese economy seems to be making steady progress toward achieving the BOJ's price target.

Figure 7: Weight Breakdown of General Services



Source: Ministry of Internal Affairs and Communications

Figure 8: CPI (General Services)



Source: Ministry of Internal Affairs and Communications

Economic Outlook: 2023-2024 Forecast

Figure 1: Forecasts for Economic Growth, Inflation, and Unemployment Rates

		2022			2023				2024				2021	2022	2023	2024
		Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
US	Real GDP	-0.6	3.2	2.6	2.0	2.4	-0.8	0.6	0.9	1.4	1.8	2.2	5.9	2.2	1.4	1.0
	Inflation	5.0	5.0	4.8	4.7	4.4	4.2	3.9	3.2	2.8	2.5	2.2	3.3	5.0	4.4	2.7
	Unemployment	3.6	3.6	3.6	3.5	3.5	3.7	4.3	4.6	4.7	4.7	4.6	5.4	3.7	3.7	4.7
Euro Area	Real GDP	0.8	0.4	-0.1	0.0	0.3	0.2	0.1	0.2	0.3	0.3	0.2	5.3	3.3	0.6	0.9
	Inflation	8.0	9.3	10.0	8.0	6.2	4.8	3.2	3.1	2.9	2.7	2.5	2.6	8.4	5.6	2.8
	Unemployment	6.7	6.7	6.7	6.6	6.6	6.6	6.7	6.8	6.8	6.9	6.9	7.7	6.7	6.6	6.9
Japan	Real GDP	5.6	-1.5	0.4	2.7	1.7	1.0	0.9	0.9	0.8	0.8	0.7	2.3	1.1	1.0	0.9
	Inflation	2.1	2.7	3.8	3.5	3.2	3.0	2.5	3.0	2.8	2.5	2.1	-0.2	2.3	3.1	2.6
	Unemployment	2.6	2.5	2.5	2.6	2.5	2.4	2.4	2.3	2.3	2.3	2.3	2.8	2.6	2.4	2.3
China	Real GDP	0.4	3.9	2.9	4.5	6.3	4.8	5.5	4.5	5.0	5.1	5.1	8.4	3.0	5.3	4.9
	Inflation	2.2	2.8	1.8	1.3	0.2	1.4	1.5	1.6	1.9	2.0	2.0	0.8	1.7	1.1	1.9
	Unemployment	5.8	5.4	5.6	5.5	5.2	5.3	5.2	5.1	5.0	5.0	5.0	5.1	5.1	5.3	5.0

Real GDP growth is in QoQ annualized for U.S. and Japan, QoQ for euro area and YoY for China and India. Inflation rate is in YoY%. Inflation rate is YoY, % of core index (ex. fresh food) for Japan, YoY % of PCE deflator for U.S., and total YoY% for the rest.

Figure 2: Forecast for Rates

Interest rate		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
US	Policy rate	4.25	4.75	5.00	5.25	5.25	5.00	4.75	4.50	4.25	4.25	5.25	4.25
		4.50	5.00	5.25	5.50	5.50	5.25	5.00	4.75	4.50	4.50	5.50	4.50
	2yr	3.43	4.03	4.90	4.20	4.00	3.80	3.60	3.40	3.20	3.43	4.00	3.20
	10yr	3.87	3.47	3.84	3.60	3.60	3.60	3.60	3.50	3.50	3.87	3.60	3.50
Germany	Policy rate	2.50	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	2.50	4.25	3.75
	Deposit rate	2.00	3.00	3.50	3.75	3.75	3.75	3.75	3.50	3.25	2.00	3.75	3.25
	2yr	2.50	2.68	3.20	3.20	3.00	2.80	2.60	2.40	2.30	2.50	3.00	2.30
	10yr	2.20	2.29	2.39	2.30	2.30	2.30	2.20	2.10	2.10	2.20	2.30	2.10
Japan	Policy rate	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	0.10	0.10	0.10	-0.10	-0.10	0.10
	2yr	0.04	-0.06	-0.07	0.10	0.15	0.20	0.30	0.30	0.30	0.04	0.15	0.30
	10yr	0.42	0.35	0.40	0.65	0.75	0.80	0.90	0.90	0.90	0.42	0.75	0.90
China	Policy rate	2.75	2.75	2.65	2.55	2.55	2.55	2.55	2.55	2.55	2.75	2.55	2.55
	2yr	2.39	2.41	2.11	2.16	2.24	2.32	2.39	2.49	2.59	2.39	2.24	2.59
	10yr	2.83	2.85	2.64	2.64	2.69	2.74	2.79	2.84	2.89	2.83	2.69	2.89

Figure 3: Forecast for FX and Oil Price

		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
USD/JPY	Range	130.58	127.23	130.64	128.00	125.00	121.00	119.00	116.00	116.00	113.47	125.00	116.00
		151.95	137.91	145.07	147.00	138.00	135.00	133.00	130.00	130.00	151.95	147.00	135.00
	End of quarter	131.12	132.86	144.31	137.00	133.00	130.00	128.00	126.00	123.00	131.12	133.00	123.00
EUR/USD	Range	0.9633	1.0806	1.0635	1.0300	1.0200	1.0100	1.0000	1.0100	1.0100	0.9536	1.0200	1.0000
		1.0735	1.1033	1.1095	1.1300	1.1200	1.1100	1.1000	1.1100	1.1100	1.1495	1.1300	1.1100
	End of quarter	1.0705	1.0839	1.0909	1.0700	1.0600	1.0500	1.0500	1.0600	1.0600	1.0705	1.0600	1.0600
EUR/JPY	Range	138.81	124.40	142.55	145.00	136.00	131.00	128.00	127.00	123.00	124.40	136.00	123.00
		148.40	145.67	158.00	159.00	150.00	145.00	142.00	141.00	137.00	150.00	159.00	145.00
	End of quarter	140.41	144.01	157.43	146.59	140.98	136.50	134.40	133.56	130.38	140.41	140.98	130.38
Crude Oil Prices (WTI)		82.64	75.99	73.67	75.00	80.00	80.00	75.00	77.00	78.00	98.74	76.17	77.50

※ Crude oil prices are averages for each period. Source: SMBC.

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