Persistently High Prices in Japan

The momentum of the rise in consumer prices has been strengthening since the end of last year. Looking at the year-on-year increase rate in the Consumer Price Index (all items), the CPI has recorded an increase rate of 2% or more for 34 consecutive months since April 2022 (see Figure 1). The fluctuation in the rate of increase has been comparatively great with a large 4.3% rise in January 2023 followed by rises mostly holding at less than 3% from November 2023, and the rate reached 3.6% in December last year and 4.0% this January, approaching the rate recorded in January 2023. Also, the year-on-year increase rate in the CPI excluding the prices of fresh foods, which vary greatly, exceeded 3% this January at 3.2% (see Figure 1).

These developments deviate from the price outlooks previously presented by economists. Looking at the Japan Center for Economic Research ESP Forecast (compiled from around 40 leading economists) for the CPI (all items, less fresh food), the average for the October–December 2024 quarter was 1.05% two years ago in February 2023 and 2.02% in February 2024, and while it was projected that the price rises would settle down, the actual increase rate was 2.6%.

Then, why has a variance emerged between the forecasts and the actual increase rate? To examine this point, looking at the level of contribution to the price rise by item this January, among the prices of all items (a 4.0% increase), 1.24% was from food other than fresh food and 0.97% was from fresh food, so more than half the price increase was from the price of food. The next largest contribution (0.78%) was from increases in the prices of fuel, light and water charges. So, one can say that the causes of the present rise in prices are: (1) the large increase in the price of rice and other food prices (in January, the price of rice was up 70.9% year-on-year), (2) the fact that despite general predictions of yen appreciation, the yen has remained weak at more than ¥150 per dollar through mid-February and prices of imported goods have increased, and (3) the reduction of government subsidies for electricity fees, etc.

Looking ahead, what is the future outlook for price trends? Regarding food, the release of rice from the government stockpile is expected to push down rice prices, but according to a survey on the price change trends of 195 leading food manufacturers released each month by Teikoku Databank, Ltd., the number of food items for which prices will be increased this year may greatly surpass the number last year. The increase in food prices, which is playing the main role in pushing up prices overall right now, is likely to continue for the time being. Regarding the exchange rate as well, there is a strong likelihood that the correction of the depreciation of the yen will not advance very far. This is because while Federal Reserve Board (FRB) Chair Jerome Powell is saying that there is no need to be in a hurry to cut interest rates, most analysts believe that interest rate hikes by the Bank of Japan will be implemented at a slow pace, and so the interest rate differential between Japan and the US will not narrow much. Consequently, imported goods prices are likely to remain high. Also, while the Japanese government is going to resume providing assistance for the increase in electricity fees, etc., the scale of this is expected to contract, so, the upward pressure from fuel, light and water charges will likely remain. Beyond that, there are concerns that depending on the tariff policies adopted by the US, price increase pressure may strengthen on a global level, and this may spread to Japan.

Considering these developments, in Japan it is highly likely that price rises of 2% or more will continue for the next year or so, and that real wage increases will probably continue to be limited. While the price movements of food and other goods presently stand out as factors affecting the price trends, attention should be paid to the price trends of services which are hidden in the background. Figure 2 presents the year-on-year increase rates of consumer prices divided into goods and services, and while the service prices increase rate exceeded 2% from the summer of 2023 through the spring of 2024, it subsequently slowed to consistently remain below 2%, which is less than the increase rate for goods prices. This data suggests that while the passing on of raw materials and other goods costs has progressed proportionately, labor costs have not been passed on sufficiently.

A large increase in wages is expected to be achieved for the second consecutive year in this year's *shunto* spring wage negotiations, but if this is not sufficiently passed on to service prices, one cannot say that the economy has started moving onto the trajectory of a virtuous cycle. A cycle in which service prices rise reasonably from suitable passing on of labor costs and this overlaps with an easing of cost-push inflationary pressures so that the CPI increase rate remains around 2% may be considered the image of a desirable rise in prices.

Figure 1: Transition of the Consumer Price Index Increase Rates

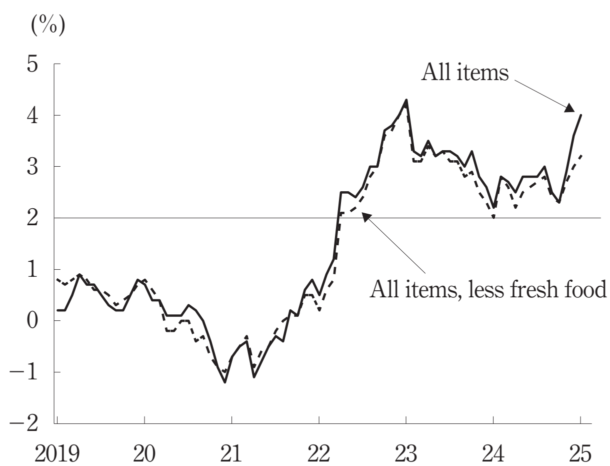
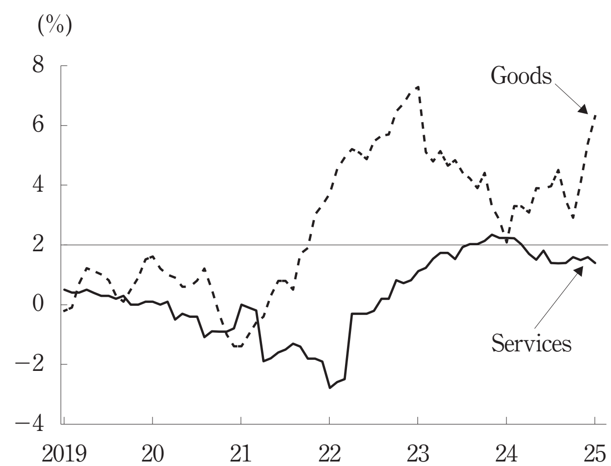


Figure 2: Transition of Goods and Services Prices Increase Rates



Note: Price increase rate is versus the same month of the previous year.

Source: *Consumer Price Index* by Ministry of Internal Affairs and Communications