

AT A GLANCE | Japan

December 1, 2023

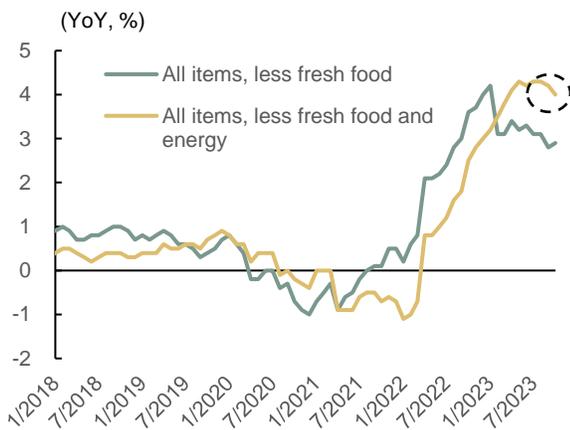
Current Price Momentum in Upstream and Downstream Stages

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Nationwide CPI Growth Has Begun to Peak Out

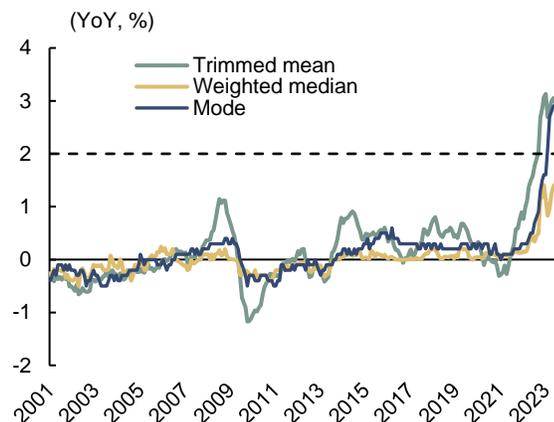
Announced on November 24, the nationwide Consumer Price Index (CPI) for October increased 4.0% year over year, down from 4.2% in the previous month (Figure 1), for “non-perishable food and energy,” the Bank of Japan’s (BOJ) core measure.¹ As a result, the average value of the BOJ’s “index for capturing underlying inflation” also decreased to 3.0% from the same level (up 3.4% from the previous month), and the modal value decreased to 2.6% from the same level (up 2.8% from the previous month) (Figure 2). As these indicators show, the underlying trend in consumer prices is starting to peak out. In the upper reaches of consumer prices, the corporate price index, a leading indicator, rose 0.8% year over year in October, confirming that prices are generally weakening. The Nikkei CPINow, which gathers sales and price information based on point-of-sale (POS) data from supermarkets, also shows a marked recent peaking out (Figure 3).

Figure 1: Nationwide CPI



Source: MIC

Figure 2: Indicators for Capturing Underlying Inflation



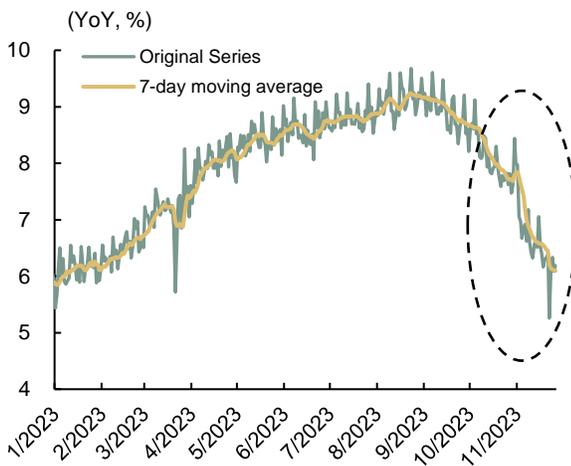
Source: Bank of Japan

However, it would be a little premature to interpret this as a situation in which price momentum is eroding, such as a rapid return to the era of deflation and low inflation. As Bank of Japan Governor Kazuo Ueda has emphasized, the effect of a temporary shock of rising import prices to boost prices (what he calls the

¹ At present, the Ministry of Internal Affairs and Communications has published a series of figures for “total excluding fresh food and energy,” but until December 2016, the Bank of Japan used the Ministry of Internal Affairs and Communications data to make its own calculations, so the name remains.

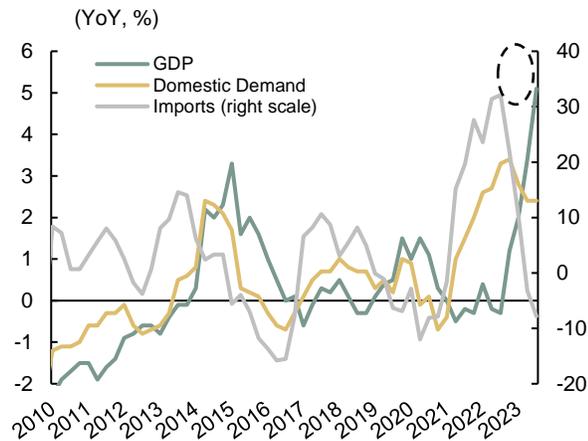
“primary force”) is of such a nature that it will eventually diminish, and this is exactly what is happening. A more important element of price momentum is the rise in wages, which leads to an increase in prices (Ueda calls this the “second force”). Therefore, it is important to consider what is happening under this element. This factor is considered to be similar to the GDP deflator, which represents the price of value added in Japan, since the impact of import price fluctuations is deducted, and this factor (as mentioned in the previous report) is currently up 5.1% year over year (Figure 4). Of course, it is important to note that the GDP deflator is likely to rise if the domestic price imputation is delayed even immediately after a decline in import prices, but it is possible that the momentum for a corresponding increase in prices is maintained.

Figure 3: Nikkei CPI Now



Source: Nowcast Co., Ltd.

Figure 4: GDP Deflator



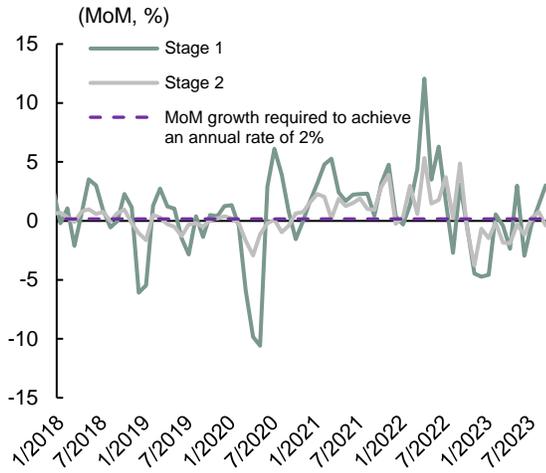
Source: Cabinet Office

FD-ID Index Trends

In this section, we will examine the final demand and intermediate demand price index (the FD-ID Index) published by the Bank of Japan, which provides a multifaceted view of upstream and downstream price movements in order to identify price momentum, including price shifting.² First, let’s look at the “aggregate” of the FD-ID Index. In order to observe the monthly momentum movements, the month-over-month trend shows that the upstream Stage 1 and Stage 2 have increased rapidly since the beginning of 2022, then started to decline in the latter half of 2022, and have been relatively calm recently (Figure 5). On the other hand, in Stage 3 and Stage 4, there was a tendency to go along with the downturn in upstream prices, but the pace has recently recovered to exceed 2% per annum again. In terms of final demand (excluding exports), the downturn was not significant even when upstream prices fell, and the trend has been relatively steady until now (Figure 6). In other words, while the upward and downward shocks that occurred upstream have affected the intermediate stages such as Stage 3 and Stage 4 in a relatively short period of time, prices in the intermediate stages have been recovering early, which suggests that price momentum is firming up. That, in turn, is likely to underpin the final price point.

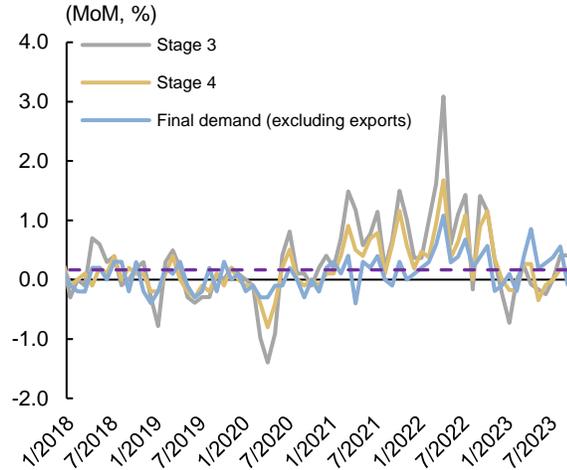
² Compiled by the Bank of Japan on a monthly basis, the Bank of Japan uses the business price index (CGPI), the business service price index (SPPI), and the consumer price index (CPI) to examine price trends by demand level.

Figure 5: FD-ID Index (Total)



Source: Bank of Japan

Figure 6: FD-ID Index (Total)

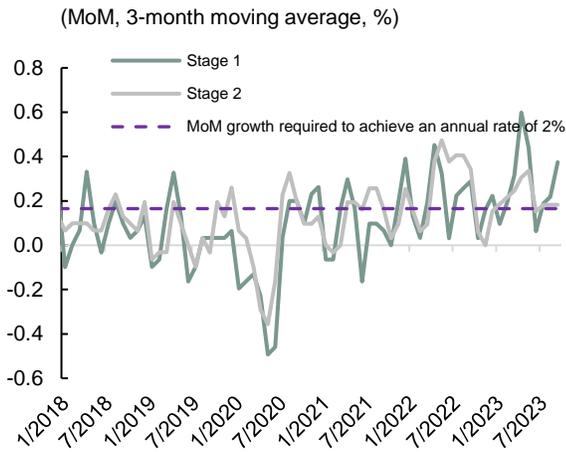


Source: Bank of Japan

One factor contributing to the resilience of price momentum is the rise in service prices. If we extract only those related to services in the upstream stages (Stage 1 and Stage 2), the annual rate of increase has continued to exceed 2% since 2022, and has been maintained recently (Figure 7). This is likely to be driven by a recovery in demand in the service sector and a rise in wages at the macro level. This rise in service prices at the upstream level is likely to continue to act as a cost push for each industry, helping to maintain the high expected inflation rate. In fact, in the final demand phase of the downstream phase of service prices (as confirmed by the nationwide CPI), the increase has been more pronounced recently (Figure 8), and goods other than energy have been increasing at an annual rate of more than 2% compared with the recent slowdown in import prices of goods (Figures 9, 10). These points are a sign that what Ueda calls the “second force” is starting to work.

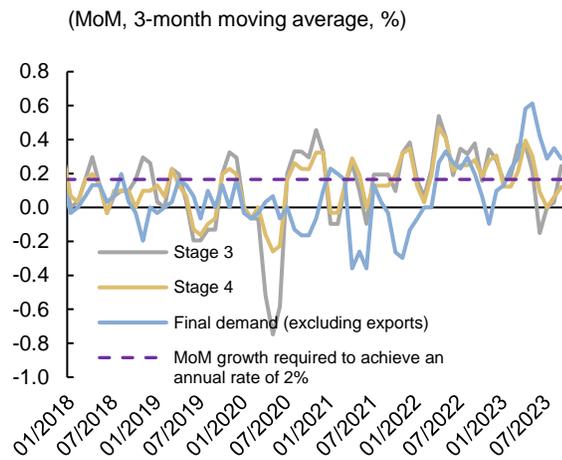
In summary, although the pace of increase in downstream prices has slowed as the rise in upstream prices has recently subsided, the momentum in prices stemming from increases in wages and service prices is sufficient to achieve the Bank of Japan’s 2% price-stability target. Of course, downside risks to consumption and to the economy remain, and there is a possibility that price momentum will collapse. But a further wage increase in next year’s spring wage negotiation cycle would reduce risks and provide more certainty about price momentum. From this point of view, we believe that our view that the Bank of Japan will move toward an exit is supported.

Figure 7: FD-ID Index (Service)



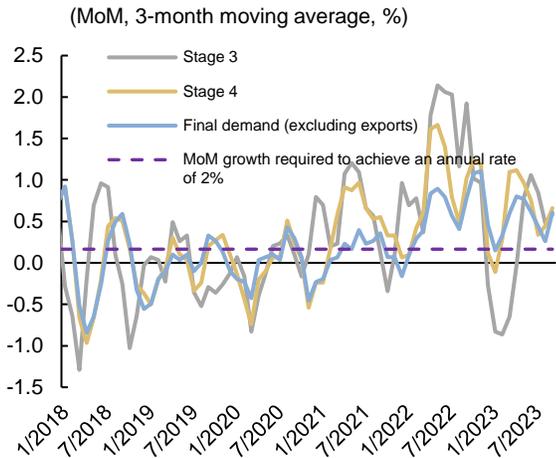
Source: Bank of Japan

Figure 8: FD-ID Index (Service)



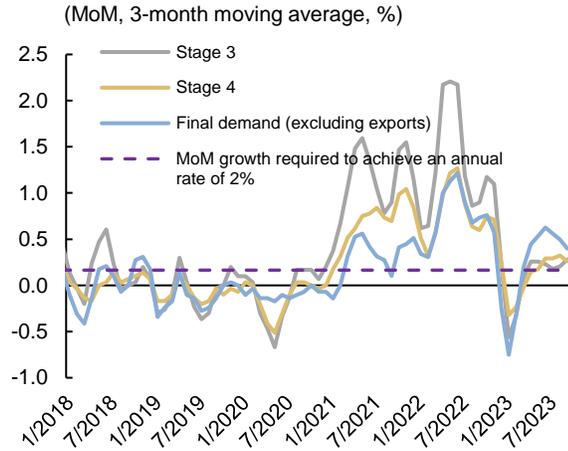
Source: Bank of Japan

Figure 9: FD-ID Index (Food)



Source: Bank of Japan

Figure 10: FD-ID Index (Other goods excluding energy and food)



Source: Bank of Japan

Economic Outlook: 2024-2025 Forecast

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

		2023			2024				2025				2022	2023	2024	2025
		Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
US	Real GDP	2.1	5.2	1.2	-0.5	1.0	1.2	1.7	1.7	1.8	2.0	2.2	2.1	2.4	1.3	1.7
	Inflation	4.6	4.0	3.6	3.0	2.7	2.6	2.5	2.5	2.4	2.3	2.3	5.2	4.3	2.7	2.4
	Unemployment	3.6	3.7	4.0	4.2	4.4	4.4	4.5	4.5	4.4	4.3	4.2	3.7	3.7	4.4	4.4
Euro Area	Real GDP	0.2	-0.1	0.1	0.2	0.3	0.3	0.4	0.3	0.3	0.3	0.3	3.4	0.5	0.7	1.3
	Inflation	6.2	4.9	3.2	3.4	3.3	3.2	2.8	2.6	2.4	2.2	2.0	8.4	5.6	3.2	2.3
	Unemployment	6.5	6.5	6.6	6.7	6.8	6.8	6.8	6.9	6.9	6.9	6.9	6.7	6.6	6.8	6.9
Japan	Real GDP	4.5	-2.1	1.1	0.9	0.9	1.1	1.1	0.9	0.8	0.8	0.7	1.0	1.7	0.8	0.9
	Inflation	3.2	2.9	2.5	2.5	2.7	2.7	2.4	2.1	2.1	2.0	2.0	2.3	3.0	2.6	2.1
	Unemployment	2.5	2.4	2.4	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.4	2.6	2.4	2.3	2.3
China	Real GDP	6.3	4.9	5.2	4.7	5.5	5.4	5.5	4.9	4.9	4.9	5.0	3.0	5.2	5.3	4.9
	Inflation	0.2	0.0	0.0	1.1	1.5	1.8	2.0	2.1	2.0	1.9	1.8	1.7	0.5	1.6	2.0
	Unemployment	5.2	5.2	5.1	5.1	5.0	5.0	5.0	4.9	4.9	5.0	5.0	5.1	5.2	5.0	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		2023	2024				2025				2023	2024	2025
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
US	Policy rate	5.25 ~ 5.50	5.25 ~ 5.50	5.00 ~ 5.25	5.00 ~ 5.25	4.75 ~ 5.00	4.75 ~ 5.00	4.75 ~ 5.00	4.50 ~ 4.75	4.50 ~ 4.75	5.25 ~ 5.50	4.75 ~ 5.00	4.50 ~ 4.75
	2yr	5.00	5.00	4.75	4.75	4.75	4.75	4.75	4.50	4.50	5.00	4.75	4.50
	10yr	4.30	4.00	3.90	4.00	4.00	4.00	4.20	4.20	4.30	4.30	4.00	4.30
Germany	Policy rate	4.50	4.50	4.50	4.25	4.00	3.75	3.50	3.25	3.25	4.50	4.00	3.25
	Deposit rate	4.00	4.00	4.00	3.75	3.50	3.25	3.00	2.75	2.75	4.00	3.50	2.75
	2yr	3.00	2.80	2.60	2.40	2.30	2.20	2.10	2.00	2.00	3.00	2.30	2.00
Japan	Policy rate	-0.10	-0.10	0.10	0.10	0.10	0.10	0.30	0.50	0.80	-0.10	0.10	0.80
	2yr	0.15	0.20	0.30	0.30	0.30	0.40	0.50	0.70	0.80	0.15	0.30	0.80
	10yr	0.95	1.00	1.00	1.00	1.00	1.00	1.10	1.20	1.20	0.95	1.00	1.20
China	Policy rate	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50
	2yr	2.37	2.43	2.51	2.57	2.60	2.64	2.67	2.69	2.75	2.37	2.60	2.75
	10yr	2.72	2.78	2.83	2.87	2.90	2.94	2.99	3.04	3.10	2.72	2.90	3.10

Figure 3: Forecast for FX and Oil Price

		2023	2024				2025				2023	2024	2025
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
USD/JPY	Range	138.00 ~ 154.00	133.00 ~ 147.00	126.00 ~ 142.00	128.00 ~ 142.00	128.00 ~ 142.00	128.00 ~ 142.00	126.00 ~ 140.00	126.00 ~ 140.00	123.00 ~ 137.00	113.47 ~ 151.95	126.00 ~ 147.00	123.00 ~ 142.00
	End of quarter	145.00	140.00	133.00	135.00	135.00	135.00	133.00	133.00	130.00	145.00	135.00	130.00
EUR/USD	Range	1.0200 ~ 1.1200	1.0806 ~ 1.1200	1.0100 ~ 1.1100	1.0100 ~ 1.1100	1.0200 ~ 1.1200	1.0200 ~ 1.1200	1.0200 ~ 1.1200	1.0300 ~ 1.1300	1.0300 ~ 1.1300	1.0448 ~ 1.1276	1.0100 ~ 1.1200	1.0200 ~ 1.1300
	End of quarter	1.0700	1.0700	1.0600	1.0600	1.0700	1.0700	1.0800	1.0800	1.0900	1.0700	1.0700	1.0900
EUR/JPY	Range	152.00 ~ 166.00	124.40 ~ 159.00	138.00 ~ 152.00	136.00 ~ 150.00	137.00 ~ 151.00	137.00 ~ 151.00	136.00 ~ 150.00	135.00 ~ 149.00	134.00 ~ 148.00	137.39 ~ 166.00	136.00 ~ 159.00	134.00 ~ 151.00
	End of quarter	155.15	149.80	140.98	143.10	144.45	144.45	143.64	143.64	141.70	155.15	144.45	141.70
Crude Oil Prices (WTI)		80.50	83.00	81.50	80.50	82.50	82.00	80.00	81.50	82.00	98.74	81.88	81.38

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

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