

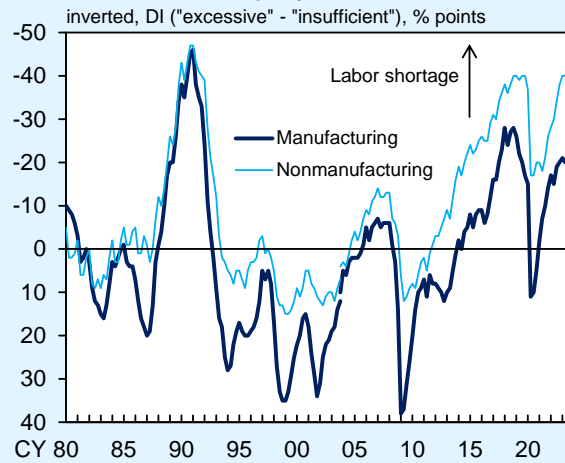
(Box 2) Current Environment Surrounding Wages and Firms' Wage-Setting Behavior

Looking at the current environment surrounding wages, labor market conditions have tightened further and corporate profits have improved and registered a historical high.

First, labor market conditions have tightened more relative to the past as the Japanese economy has continued to recover moderately. The employment conditions DI in the *Tankan* shows that an increasing number of firms has faced labor shortage, especially in nonmanufacturing, for which the DI has risen to a higher level than in the pre-pandemic period (Chart B2-1). In this situation, labor mobility seems to have been increasing gradually, as seen in, for example, the job markets rapidly growing for full-time workers looking for their next job. As a result, wages are highly likely to remain under upward pressure for the time being.²¹ This outlook is underpinned, for example, by the fact that labor supply is widely expected to be constrained mainly by the aging population in the long run.

Second, corporate profits have improved due to progress in the pass-through of cost increases to output prices and the depreciation of the yen, in addition to a recovery in economic activity. According to the *Financial Statements Statistics of Corporations by Industry, Quarterly*, current profits based on all industries and enterprises have risen

Chart B2-1: Employment Conditions DI



Source: Bank of Japan.

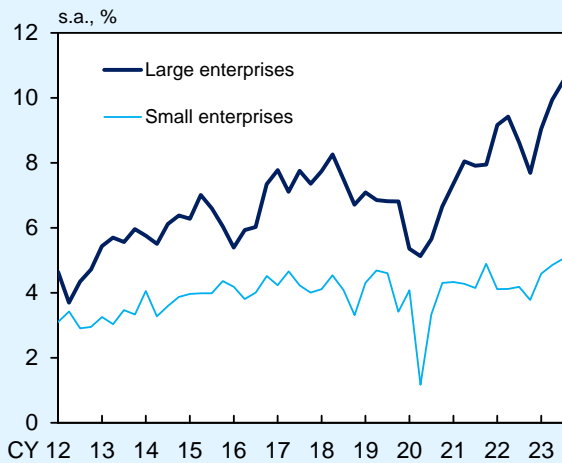
Note: Based on the *Tankan*. All enterprises. There is a discontinuity in the data for December 2003 due to a change in the survey framework.

²¹ See Box 2 of the January 2023 Outlook Report for discussion on the outlook for labor market conditions.

in four consecutive quarters, reaching the highest level since the April-June quarter of 1985, from when comparable data are available (Charts 16 and B2-2). In this situation, labor share has been declining recently (Chart B2-3).²² As for the outlook, corporate profits are likely to continue improving as the pass-through of past high raw material costs to output prices will progress for the time being, and thereafter domestic and external demand will increase moderately.

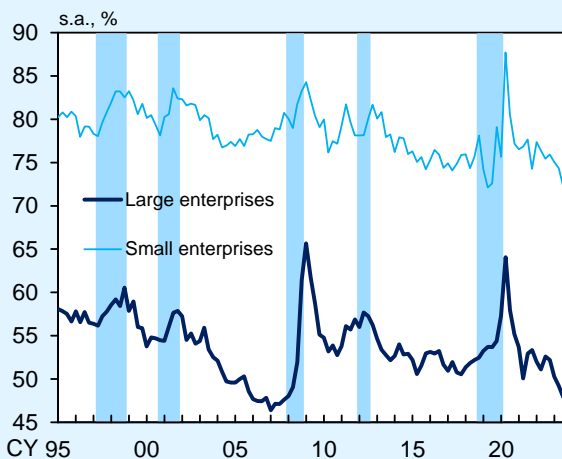
The extent of improvement in corporate profits varies depending on factors such as the firm size and industry. Consequently, there is a possibility, for example, that it will not be easy for firms with a low level of corporate profits and a high level of labor share to increase distribution to employees through wage increases. That being said, analyzing matched microdata for enterprises that responded to both the survey for the *Financial Statements Statistics of Corporations by Industry, Quarterly* and the *Tankan* survey shows that, in an environment where the perception of labor shortage is accelerating and an improvement in profits through rises in output prices is seen, firms tend to carry out relatively high wage increases, even if they have a higher labor share (Chart B2-4).²³ Going forward, corporate profits are expected to increase further and firms' wage-setting behavior is expected to change as labor market conditions continue to tighten and firms' active price-setting behavior takes hold.

Chart B2-2: Ratio of Current Profits to Sales



Source: Ministry of Finance.
 Note: Based on the *Financial Statements Statistics of Corporations by Industry, Quarterly*. Large enterprises are enterprises with a capitalization of 1 billion yen or more, while small enterprises are enterprises with a capitalization of 10 million yen or more but less than 100 million yen. Excluding "finance and insurance" and pure holding companies.

Chart B2-3: Labor Share



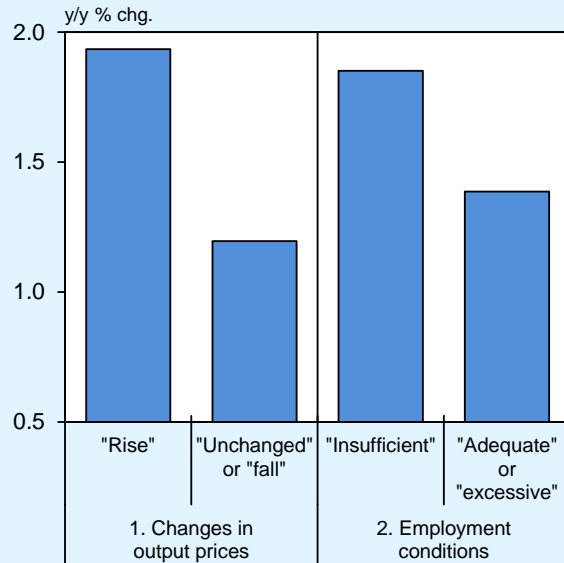
Source: Ministry of Finance.
 Notes: 1. Based on the *Financial Statements Statistics of Corporations by Industry, Quarterly*. Excluding "finance and insurance."
 2. Figures from 2009/Q2 onward exclude pure holding companies.
 3. Shaded areas denote recession periods.

²² Labor share generally moves in a countercyclical manner (in the opposite direction) to economic fluctuations, as wages, which is the numerator, tend to fluctuate less relative to the added value, which is the denominator.

²³ See Box 1 of the October 2023 Outlook Report for details of the annual spring labor-management wage negotiations in 2023.

In view of the annual spring labor-management wage negotiations in 2024, the Japanese Trade Union Confederation (Rengo) and some industrial unions have stated that they aim to achieve a larger increase in base pay than in 2023.²⁴ Although a majority of firms have not determined their stance toward this year's wage negotiations at this point, some firms, mainly among large enterprises, have already announced larger base pay increases than in 2023. The course of the wage negotiations warrants attention as labor market conditions have continued to tighten and corporate profits have been improving.

Chart B2-4: Wage Increases at Enterprises with a High Labor Share



Sources: Ministry of Finance; Bank of Japan.
 Note: Wage increases here are the year-on-year percentage changes in labor costs per employee in 2023/Q2. Figures are the medians of wage increases at enterprises with a high labor share and are calculated by matching microdata for enterprises that responded to both the survey for the *Financial Statements Statistics of Corporations by Industry, Quarterly* (wage increases) and the *Tankan* survey (the output prices DI and the employment conditions DI). Enterprises with a high labor share are enterprises whose labor share falls into the top 50 percent in their size group and industry.

²⁴ The Rengo has set the following wage increase targets for the annual spring labor-management wage negotiations in 2024: more than 3 percent for base pay and more than 5 percent for wages including seniority- and performance-related wages (for the spring 2023 wage negotiations, the targets were respectively around 3 percent and around 5 percent).