

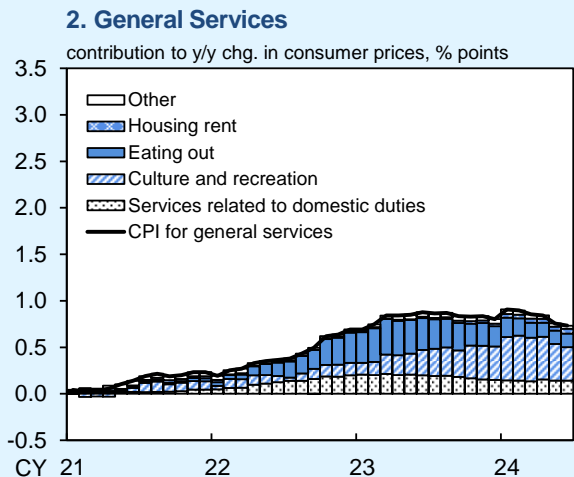
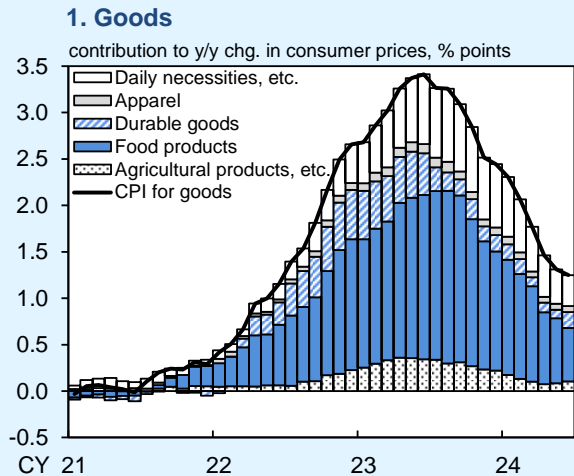
(Box 2) Developments in Services Prices: The Spread of Beginning-of-the-Period Price Hikes

The year-on-year rate of change in the consumer price index (CPI, all items less fresh food and energy) shows that goods price inflation decelerated considerably due to a further waning of upward pressure on costs led by the past rise in import prices (Chart B2-1[1]). Under these circumstances, in terms of how the gradual rise in wages affects future price developments, the key factor is developments in the prices of services, where labor costs account for a high share of selling prices. Services prices in Japan are often revised in April and October at the beginning of each period. Price developments in April 2024 warranted attention as they were considered to indicate whether spillovers from wages to prices will strengthen further going forward (Chart B2-2).

While the year-on-year rate of change in services prices has remained more or less unchanged on the whole, the rate of increase for items susceptible to the impact of changes in import prices (such as dining out and housing repair and maintenance) has been following a decreasing trend. On the other hand, the rate of increase for items susceptible to labor costs (such as culture and recreational services) has been gradually rising (Chart B2-1[2]). The following takes a closer look at services price revisions in April 2024 and shows that a spread of price changes was observed.

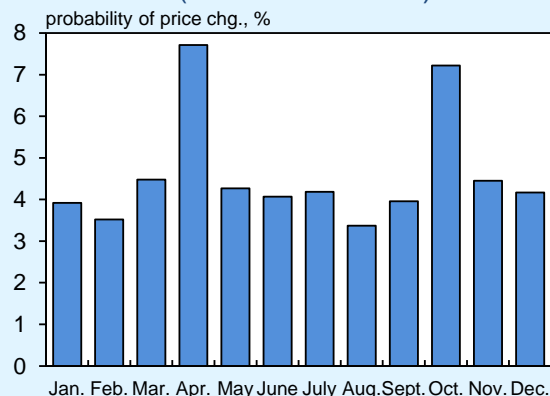
Starting with individual items, there were widespread moves to pass on higher labor costs

Chart B2-1: CPIs for Goods and Services



Source: Ministry of Internal Affairs and Communications.
 Notes: 1. Figures for goods exclude petroleum products. Figures for "agricultural products, etc." include aquatic and livestock products.
 2. Figures for services related to domestic duties include services related to housing repairs and maintenance.
 3. Figures are the contribution to changes in the CPI (less fresh food and energy). Figures are staff estimates and exclude mobile phone charges and the effects of the consumption tax hike, policies concerning the provision of free education, and travel subsidy programs.

Chart B2-2: Month When Price Changes Take Place (General Services)



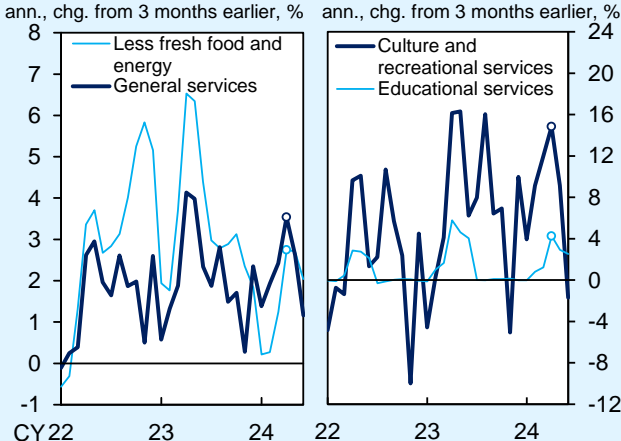
Source: Ministry of Internal Affairs and Communications.
 Note: Figures are staff estimates and show the probability of change in prices of items corresponding to those in the CPI for general services in each month, based on the estimation results of a probit model using microdata from the Retail Price Survey. The estimation period is from January 2022 to December 2023.

to selling prices, particularly for items that are susceptible to labor costs, such as lesson fees for English conversation and other schools (services related to culture and recreation), cram school fees for junior high and high school students (services related to education), charges for domestic help and automotive maintenance charges (services related to domestic duties), and charges for massage (services related to medical care and welfare). Looking at the rate of price changes relative to three months earlier makes it clear that the rate of price increases, especially for culture and recreational services and education-related services, has accelerated markedly (Chart B2-3).

Next, the distribution of price changes by item shows that the peak of the distribution has shifted from close to 0 to close to 2 percent, indicating a change in price-setting behavior in the services sector as a whole (Chart B2-4). To get a more detailed grasp, the distribution is divided into items with a high and with a low ratio of labor costs to total costs. This shows that the distribution of items with a low labor cost ratio (such as dining out) -- prices of which had been rising at a high rate due to the effects of past upward pressure on costs -- has shifted to the left, while the distribution of items with a high labor cost ratio (such as lesson fees) has clearly shifted to the right (Chart B2-5).

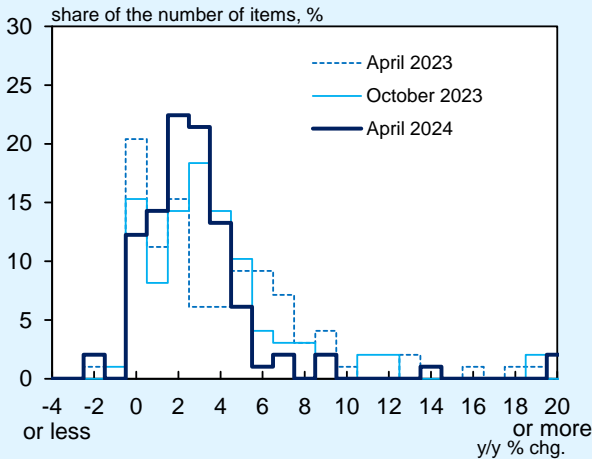
The widespread trend to raise services prices amid rising labor costs can also be confirmed from other perspectives. Using microdata from the *Tankan* to extract firms that had been cautious in changing their output prices for many years and

Chart B2-3: CPI Momentum



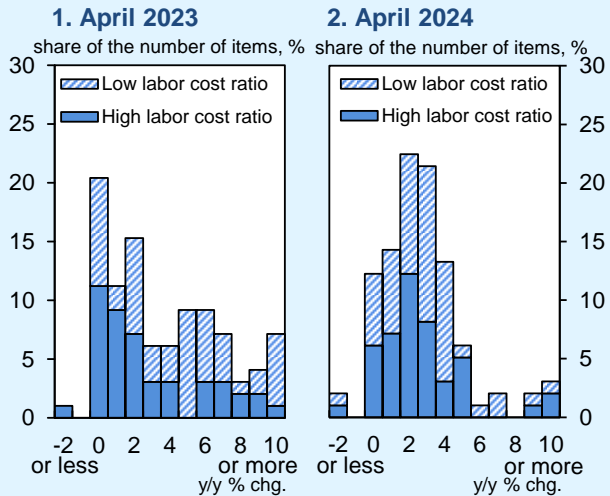
Source: Ministry of Internal Affairs and Communications.
 Note: Figures are staff estimates and exclude mobile phone charges and the effects of policies concerning the provision of free education and travel subsidy programs. Figures denoted by the round markers are for April 2024.

Chart B2-4: Price Change Distribution of General Services, Total



Source: Ministry of Internal Affairs and Communications.
 Note: Figures show the CPI for general services (less housing rent). Figures are staff estimates and exclude the effects of policies concerning the provision of free education and the effects of travel subsidy programs.

Chart B2-5: Price Change Distribution of General Services, Breakdown



Source: Ministry of Internal Affairs and Communications.
 Notes: 1. Figures show the CPI for general services (less housing rent). Figures are staff estimates and exclude the effects of policies concerning the provision of free education and the effects of travel subsidy programs.
 2. CPI items are matched to the items in the 2015 Input-Output Tables for Japan and grouped in terms of the share of "wages and salaries" and other labor costs in the domestic output of those items. Figures for items with a high (low) labor cost ratio are for items that fall into the top (bottom) 50 percent in general services (less housing rent).

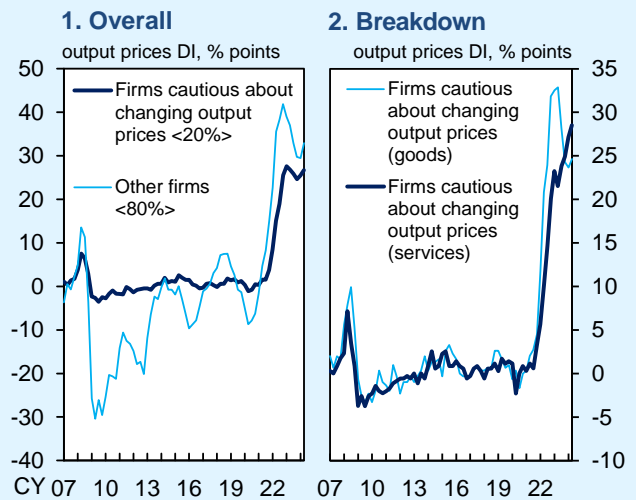
examining their price-setting behavior for goods and services separately shows that, in the case of goods, such firms have been actively revising prices since 2021 against the background of growing cost-push pressure led by the rise in import prices (Chart B2-6). On the other hand, with regard to services prices, changes in these firms' price-setting behavior thus far had been relatively moderate compared to goods prices, but price revisions have recently been gaining momentum. In this situation, "low-volatility items," "wage factors," and "the trend component in the CPI for services," which indicate how the linkage between wages and prices affects price developments -- indicators that were presented, for example, in past Outlook Reports -- have all been on a moderately increasing trend (Chart B2-7).²²

Going forward, it is necessary to continue to examine from a broad perspective whether changes in firms' price-setting behavior spread further. In particular, heading into the next period of price revisions, (1) whether the high level of wage hikes seen in this year's annual spring labor-management wage negotiations will be reflected in selling prices, particularly for services, (2) whether more firms will set selling prices in anticipation of future wage increases, and (3) whether the continuation of these trends will lead to a further strengthening of the linkage between wages and prices, needs to be examined carefully in conjunction with firms' wage-setting behavior.²³

²² For details, see "Recent Developments in the Linkage between Wages and Prices," *Bank of Japan Review Series*, no. 24-E-2, May 2024.

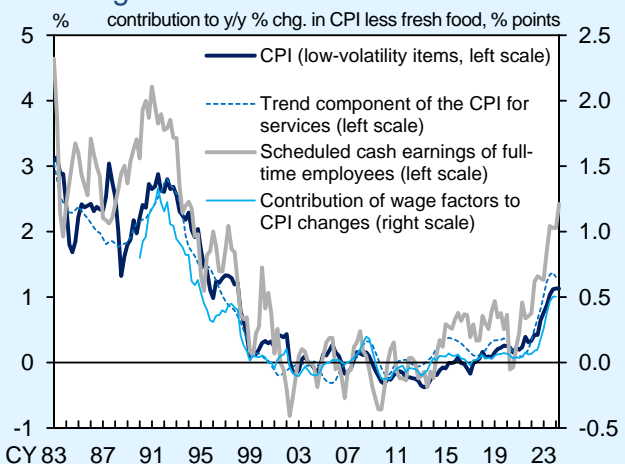
²³ For details on the 2024 spring labor-management wage negotiations, see Box 1 of this report and Box 2 of the April 2024 Outlook Report.

Chart B2-6: Change in Firms' Price-Setting Stance



Source: Bank of Japan.
 Note: Based on the *Tankan* (all enterprises). Figures for firms cautious about changing output prices are for firms that for at least about 95 percent of the period from 1991 to 2019 replied that their output prices were "unchanged." In the left-hand chart, figures in angular brackets show the share in all firms. In the right-hand chart, figures for "firms cautious about changing output prices (goods)" are for manufacturing firms, while those for "firms cautious about changing output prices (services)" are for nonmanufacturing firms.

Chart B2-7: CPI and Scheduled Cash Earnings



Sources: Ministry of Internal Affairs and Communications; Ministry of Health, Labour and Welfare; Bank of Japan.

Notes: 1. Figures for low-volatility CPI items and scheduled cash earnings of full-time employees are year-on-year percentage changes, while those for the trend component of the CPI for services are the 6-quarter backward moving averages of annualized quarter-on-quarter percentage changes. Figures for scheduled cash earnings of full-time employees before 1994 are those for regular employees. Moreover, figures from 2016 onward are based on continuing observations following the sample revisions.
 2. Figures for the contribution of wage factors to CPI changes are based on the relationship between the CPI and wages, estimated using a 4-variable VAR model comprising import prices (yen basis), the output gap, wages (scheduled cash earnings of full-time employees), and price indices for low-, medium-, and high-volatility items in the CPI. The estimates are obtained using 20-year rolling regressions for low-, medium-, and high-volatility CPI items.
 3. Figures for the trend component of the CPI for services are the composite of the sector-specific price trend for services and the common trend in services prices and wages. The figures are estimated using category-level services prices and industry-level scheduled cash earnings.