

JAPAN ECONOMIC WEEKLY



September 9, 2005

***Kazuhiko Ogata**

Japan Economist
Global Economic Research

Japan Economic Perspectives

Upturn in Wages Indicates Economic Strength and Some Structural Concerns

Until the first quarter of this year, Japan's economic recovery was not accompanied by job and wage increases, leaving us skeptical about its sustainability, particularly for consumption. But more pronounced wage increases in recent months have led us to rethink this view. Moreover, for both cyclical and structural reasons, wage growth could continue to accelerate, a condition likely to boost consumption growth further which would eventually add to upward pressure on consumer prices.

Private consumption growth was up 0.7% in the second quarter and doubled to 1.8% on a year-over-year basis. This was materially supported by a significant improvement in employee compensation, which also grew 1.8% in the quarter, the largest gain in nearly eight years. And in July, the average monthly salary across all industries rose 1.7% year-over-year, the second consecutive monthly gain over 1.0% for the first time since October 1997 (**Display 1**).

The boost to salary growth over the past two months was chiefly from bonus increases which were up a significant 4.7% year-over-year (bonuses in Japan are generally paid in June and July). The rise in bonus payments no doubt was thanks to the long-awaited spillover effect from continued solid corporate profit growth, which reportedly stayed firm at 12.9% year-over-year in the second quarter, indicating a third straight year of expansion. Meanwhile, overtime pay, up by 1.3% in July, has contributed positively to salary growth for more than three years and also speaks of the continued recovery.

Even more importantly, base salaries grew 0.2% in July for the fourth consecutive month, a distinct turnaround after more than four years of decline. According to our analysis, the hike in the average

base salary has in part been the result of a shift from part-time to full-time employment. Base salaries are generally higher for full-time employees than for part-time, and after seven successive years of decline, full-time employment has registered positive year-over-year growth since January while growth in part-time employment declined in April for the first time in ten years (**Display 2**).

The Year 2007 Problem

The shift from part- to full-time employment may be natural at this stage of the current economic cycle. But it could also represent a structural shift of hiring policies in general, away from reducing full-time workers for cost-saving purposes toward securing quality workers by hiring them full time. The way we see it, the shift from part-time to full-time employment also reflects the increased awareness of a looming structural problem—i.e., how Japanese firms ultimately will cope with labor shortages caused by a rapidly aging society.

Recent tightening in the labor market as indicated by the ratio of job offers to applicants (a supply/demand indicator of labor) which climbed to a 13-year high of 0.97 in July, can be attributed to cyclical reasons, to be sure. But as this indicator has a close correlation with wage growth, both may push higher because of structural factors linked to the rapidly aging and decreasing population. Indeed, the prospect of a tightening labor market threatens in the not-so-distant future. In Japan, this is broadly recognized as the “year 2007 problem,” and could cause the labor market to tighten significantly—a critical issue for corporate management, which may already have begun to think seriously about the potential labor shortage in 2007 and after, when mass-retirement of baby boomers and a pronounced decline in the country's population is expected.

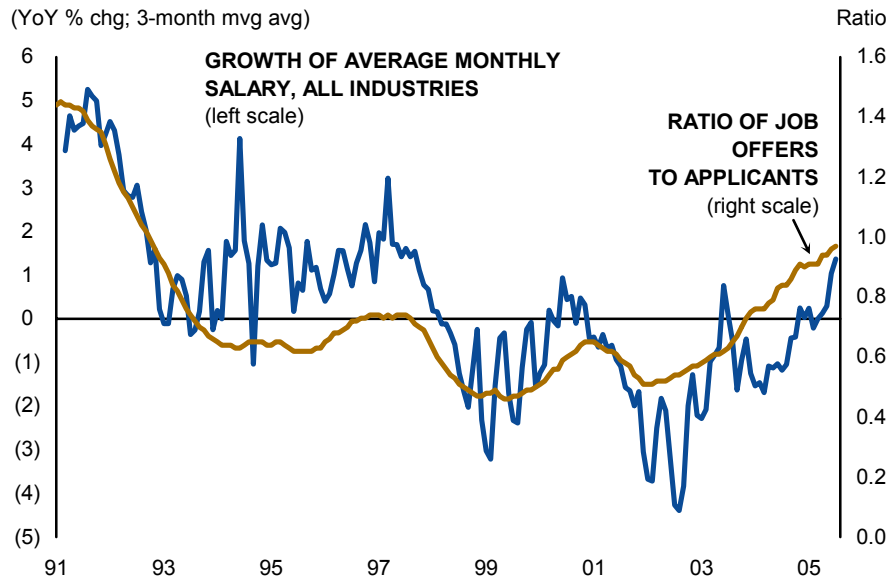
*Kazuhiko Ogata
Global Economic Research
September 9, 2005*

The information contained herein reflects, as of the date hereof, the views of Alliance Capital Management and sources believed by Alliance Capital Management to be reliable. No representation or warranty is made concerning the accuracy of any data compiled herein. In addition, there can be no guarantee that any projection, forecast or opinion in these materials will be realized. The views expressed herein may change at any time subsequent to the date of issue hereof. These materials are provided for informational purposes only and under no circumstances may any information contained herein be construed as investment advice. Neither may any information contained herein be construed as any sales or marketing materials in respect of any financial instrument, product or service sponsored or provided by Alliance Capital Management or any affiliate or agent thereof.

These materials are often prepared in the English language and provided only upon request to certain authorized financial representatives and institutions. Alliance Capital Management, its affiliates and third-parties, make no representation or warranty relating to the quality or accuracy of any foreign language translation of these materials.

Display 1: Labor Market Tightening May Intensify, Bringing Wage Growth Higher

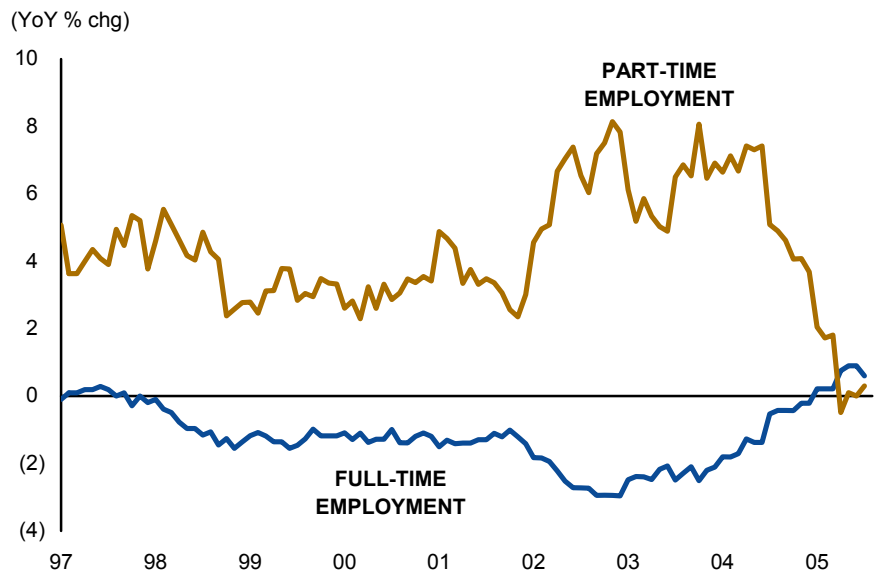
Growth of the Average Monthly Salary for All Industries and the Ratio of Job Offers to Applicants



Source: Ministry of Health, Labor and Welfare; September 9, 2005

Display 2: Shift from Part-Time to Full-Time Employment Has Helped Raise Base Salaries

Growth in Full- and Part-Time Employment



Source: Ministry of Health, Labor and Welfare; September 9, 2005