Deflation and inflation trends in japan

The current rate of inflation in Japan is minimal cause of the current trend which is a nation recovering from a period of deflation and enetering an era of inflation . Deflation which is a decline in the general prices of goods and services, in this case Japan, can be attributed to its decline in growth trend rate and flexible wage adjustment. In 2010, Japan's CPI figures in terms of percentage change, have hovered around +/- 0% and is a clear indication of the level of purchasing power being expended on goods and services by it's population. This report looks at the deflation trend and how it has evovled to a level of 0% inflation.

DISCUSSION AND ANALYSIS

The trend of deflation in japan has been on the decrease leaving the current rate of inflation at 0%. The reason for the decrease has to do with certain policies put in place by the BOJ to tackle the problem of deflation. These policies will be looked at later on in this report.

The two main causes of inflation are COST PUSH and DEMAND PULL. The former has to do with a rise in cost of production which means an increase in price while the latter has to do with an increase in aggregate demand due to changes in consumption, investment and government spending. In the case of Japan which has been in a state of deflation for a long time, the general causes of deflation are decrease in money supply, increase in supply of goods, fall in demand of goods and escalation in the demand for money. With regards to the forms of deflation, there are two forms of deflation; BENIGN DEFLATION and MALIGN DEFLATION. The first has to do with an increase in aggregate supply and productive effeciency which means a decline in unit cost of production and prices . The malign deflation which means a lack of aggregate demand, has profound implicatipons on economic activities, economic policies, business planning and wage bargaing(Nellis and Parker 2004). Japan is experiencing malign deflation attributed to its decline in trend growth rate and flexible wage structure. In the last two decades, the japenese population has aged dramatically leading to decline in work force, amount of money expended on goods and decline in future income. Since the early 2000's, the level of unemployment has declined and should translate in higher CPI figures as a result of incerase in demand and higher wages but that isnt the case. However, unemployment figures in 2009 increased to 5. 1% and remained the same in 2010 but decreased to 4. 9% as at January 2011.

Unemployment may have reduced but isnt reflected in terms of purchasing power from those employed. It is as a result of the nominal wage structure. In comparison to the United States, UK and Germany, Japan's nominal wage structure has not increased to a level that ensures low positive inflation rates. Only falling nominal wages open the floodgates to a destructive deflationary process (Herr, 2009). Although nominal wages have stopped falling since 2005, they have increased only minimally since then. Figure 1. 2 shows nominal compensation in four countries over a period of 25 years:

FIGURE 2. 3: Nominal compensation per employee, total economy, 1980-2009

SOURCE: MRINZE. ORG

It is clear to see that nominal wage in Japan over the years has remained virtually the same creating a recipe for deflation.

The effects of deflation in the ten major group index shows a negative percentage change monthly and annually for the greater part of the index groups. Looking at the effects of deflation from a service point of view, especially taking cognizance of service being labour intensive, a flexible wage structure and low wages means a decline in the prices of services . The ten major group index figure's for January 2011 are shown below:

TheJapenese government through it's Central Bank has responded to the effects of deflation by implementing certain innovative policies. Policies such as a 0% interest rate, its commitment to maintain the interst rate, balance sheet expansion and quantitative easing. It should be noted that despite the above mentioned policies, although effective in terms of ensuring financial stability, they have not been completely successful in tackling the underlying problem which is Japan's decline in trend growth. In other words, the gap between supply and demand is high. According to the Governor of The Bank Of Japan, Masaaki Shirakawa, " the monetary base of Japan was increased by 90%, between 1997 and 2010 and money supply increased by 30%". This was achieved through quantitative easing but isn't enough to solve the current problem of deflation and mild inflation. In terms of ensuring financial stability, it was successful but structural problems such as Japan's social security system, which caters for its ageing population, will become unsustainable due to high cost. Also in terms of structural adjustment, Minister of state for economy and fiscal policy, Kaoru Yosano, an advocator for higher consumption taxes, believes a sustainable social security system can be achieved through implementing a higher tax regime including consumption taxes.

CONCLUSION

Although the current rate of inflation stands at 0%, chances are there could be a decline in prices of goods and services due to the decline in household spending which fell by 1% as at January 2011(Japantoday. com). However, in terms of applicant to job ratio, which rose to 0. 61% in February, the highest since 2009, it is a clear indication of the pace of development as well as the job market being on course for further improvements. The Japanese government will raise prices of five major brands of imported wheat for its resale to flour milling companies by an average 18% starting in April and could mean higher retail price of bread. This is due to bad weather in major producing countries as well as demand from emerging economies like China. The price of energy is also set increase due to unrest in the Middle East. The increase in commodity prices is most likely going to send the CPI into positive territory which should help stem the tide of deflation sooner than later. The effects of rising commodity prices could signal the end to a long period of deflation which can be considered an external factor. In terms of ensuring self sustaining economic recovery, the Japanese economy is largely dependent on greater wages being paid to domestic workers and an increase in their willingness to spend more