Japan: Flee from Deflation

ECO365 FALL 2020

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The Japanese economy has been combating chronic deflation for decades. With the success of "Abenomics" policies, the sustained price decreasing came to an end in 2013. Recently, Japan perceived a disturbing signal as its market expects another deflation due to plunging oil prices and raging pandemics.[1] The price deflation indicates upcoming economic stagnation. To avoid the slip back, reducing the food sector's consumption tax is recommended.

Deflation is a continuing decrease in general prices. When it's prolonged, people will save and reduce spending, leading to less production alongside lower wages. With less income, consumers and businesses will further lessen expenditure, ultimately causing stagnation. According to government statistics, Japan's monthly consumer price index decreased by 0.4% on an adjusted seasonally basis in October 2020.[7] Among major group indexes, food (-0.5%), fuel (-0.8%), and goods (-0.2%) presented influential negative impacts.[7] Alongside the latest 10.2% shrinkage in household spending, this implies declining consumption demand.[3] Moreover, Japan's unemployment rate increased gradually from 2.4% in January to 3% in September, aggravating the deflation damage.[5] Statistics also showed decreasing real wages, with another 1.1% contraction in September.[4]

To prevent further price drops, decreasing the consumption tax on food is optimal. As depicted above, it is urgent to incentivize household expenditure. A tax reduction is similar to an autonomous drop in prices, where the government takes the loss. People will increase spending on consumption as tax rates contract. More importantly, Japanese households are susceptible to food price changes.[6] Companies will increase production to meet demand and profit from surging sales at the same prices. Consequently, firms will be able to make more investments and expand, which will reduce unemployment. Thus, the economy would experience higher production and more money flows in the market.

Given the pandemic, this policy can effectively alleviate Japan's economic problems. It targets the food sector specifically to best incentivize expenditure. Food is a necessity and takes up 23.8% of Japanese household spending.[2] The approach also utilizes households' high sensitivity to food prices to maximize fiscal payoff. Comparatively, the government will attain worse performances if they distribute money to households directly. People tend to save money when they expect falling prices. Hence, it leads to suboptimal consumption stimulation. However, the tax reduction would only be practical in the short term. Governments finance spending with tax revenues. Losses from tax cuts may accumulate and result in massive unresolved debts in the long run. In short periods, the loss will be inconspicuous as some will be recovered from additional production tax, sales tax, and potentially income tax generated. Despite that, Japan should only implement the policy under current situations to prevent immediate deflation.

In conclusion, Japan is on the brink of a deflationary spiral. A reduction in the food consumption tax rate could pull the economy back from the vicious circle. It is the most effective measure due to households' sensitivity to food prices. Nonetheless, the policy should be applied to resolve emergencies as it's unsustainable in the long run.

(word count: 494)

Annotated Bibliography

[1] Al Jazeera. (2020, May 01). Japan could return to deflation as prices, factory activity slump. Retrieved December 01, 2020, from https://www.aljazeera.com/economy/2020/05/01/japan-could-return-to-deflation-as-prices-factory-activity-slump/?gb=true

The article assesses the drop in Tokyo CPI in April alongside the shrinking factory activity. It identifies the main driver as the plummets in fuel costs resulted from plunging oil prices and the outbreak of COVID-19. Tokyo Core Price Index is an indicator of nationwide inflation, which works similar to the standard CPI. With attacks from both oil prices and pandemics, the economy is hit with price deflation and lower productivity. The paper supports my analysis of the causes of price deflation from the perspective of businesses.

[2] Diep, C. (2020, May 18). Japan: Increased household spending on goods 2020. Retrieved December 01, 2020, from https://www.statista.com/statistics/647774/japan-increased-household-expenditure-on-goods-services/

The horizontal bar chart of statistics displays the breakout of Japanese consumer spending in March 2020. Among all categories, food takes up 23.8% of the total consumption. The numeric numbers prove that the Japanese tend to spend one-fourth of their income on food. The data is in March 2020, which is amid the pandemic. Hence, the source can reflect real conditions by including the pandemic influence. This info helps build my argument on how the food sector changes will achieve the most considerable impact.

[3] Ministry of Internal Affairs & Communications. (2020). Japan Household Spending2001-2020 Data: 2021-2022 Forecast: Calendar: Historical. Retrieved December 01, 2020, from https://tradingeconomics.com/japan/household-spending

The bar chart of statistics displays the percentage of changes in household spending in Japan yearly. In September 2020, there is a 10.2% decrease in real terms compared to September 2019. In general, household spending in Japan shows a decreasing trend as the percentage changes are all negative. The numeric numbers prove that the consumption demand is currently decreasing in Japan. The data is collected by the Japanese Ministry of Internal Affairs & Communications. Hence, the source is trustworthy and can reflect real conditions. This info helps build my argument of the signal on deflation reflected in consumer demand.

[4] Ministry of Internal Affairs & Communications. (2020). Japan Total Cash Earnings Growth1972-2020 Data: 2021-2022 Forecast: Calendar. Retrieved December 01, 2020, from https://tradingeconomics.com/japan/wage-growth

The bar chart of statistics displays the percentage of changes in nominal cash earning in Japan yearly. In September 2020, there is a 1.1% decrease in real wages. The numeric numbers prove that the real income is currently decreasing in Japan. The data is collected by the Japanese Ministry of Internal Affairs & Communications. Hence, the source is trustworthy. This info helps build my argument on the signal of deflation reflected in wages.

[5] Ministry of Internal Affairs & Communications. (2020). Japan Unemployment Rate1953-2020 Data: 2021-2022 Forecast: Calendar: Historical. Retrieved December 01, 2020, from https://tradingeconomics.com/japan/unemployment-rate

The bar chart of statistics displays the unemployment rate in Japan. In general, there is a gradually increasing trend since January 2020. The numeric numbers prove that the unemployment rate is rising in Japan. The data is collected by the Japanese Ministry of Internal Affairs & Communications. Hence, the source is trustworthy. This info helps build my argument on the signal of deflation reflected in the unemployment rate and, thus, earnings.

[6] Scattergood, G. (2017, February 23). Japan's household food spending the highest for 20 years as ready-to-eat sales rocket. Retrieved December 01, 2020, from https://www.foodnavigator-asia.com/Article/2017/02/23/Japan-s-household-food-spending-the-highest-for-20-years-as-ready-to-eat-sales-rocket

The author argues that the Japanese consumer spending on the food sector increases, though the total consumption amount is in sustained decline. A quote in the article states that states households in Japan are susceptible to price changes in the food sector. Changes in food prices will result in the largest effect comparing to other goods or sectors. This info helps build my argument on how the food sector changes will be the most effective measure.

[7] Statistics Bureau, M. (2020, November 20). Japan, October 2020. Retrieved December 01, 2020, from https://www.stat.go.jp/english/data/cpi/1581-z.html

The statistics table shows the yearly and monthly changes in the Japanese consumer price index in October 2020 with breakdowns. On a seasonally adjusted basis, Japan's CPI decreased by 0.4% in October from the previous month. Among the monthly changes in 10 major group indexes, food (-0.5%), fuel (-0.8%), medical care (-0.1%), transportation (-0.1%), culture & recreation (-0.1%) and goods (-0.2%) sector experienced shrinkages. Food, Fuel, and Goods sectors consist of the main influences. The Statistics Bureau of Japan collects the data. Hence, the source is trustworthy. This piece of info helps build my argument on the signal of deflation and the main causes.