

CPI set to continue descent

BOJ needs to do its part in deflation fight, but government faces major reform task

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The nationwide core consumer price index for February will be released by the Ministry of Internal Affairs and Communications on March 26. The index started to fall in the spring of 2009 and hit the 1993 level in January.

The Japanese economy has been gradually recovering, with a number of indicators showing improvement. The industrial production index, for example, rose by 2.7% on the month in January, while the unemployment rate fell 0.3 percentage point from the

previous month.

However, the core CPI — which excludes volatile fresh-food prices — has proved to be an exception to the rule, with prices for a wide range of goods and services falling steadily since last spring amid growing thriftiness among consumers.

The lingering of deflationary pressure for such a long period of time is uncommon by international comparison. And the service sector — including the food service industry, which employs a large number of younger workers — has shown a particularly severe



The food service industry has been hit hard by falling prices and wages.

combination of falling prices and wages. Indeed, the adverse effects of deflation are being borne disproportionately by younger generations.

Calls for the Bank of Japan to defeat deflation single-handedly, based on the idea that

falling consumer prices is solely a monetary phenomenon, seem unconvincing to me. Naturally, the BOJ must bear its fair share of the responsibility. In addition to continuing its monetary easing measures, it must communicate its assessment of the economy and its policy responses from the monetary side in easy-to-understand language on an ongoing basis. It should, for instance, clarify its definition of deflation.

That said, the primary reason for the sustained price declines is a widening gap between supply and demand, which means that the most effective measure would be to boost private-sector demand by inducing consumers and businesses to spend more. This would require the government to create stable economic conditions that allow households and companies to plan for the long term.

Bolstering Japan's social security system is one part of the solution, as it would reassure people about the future and encourage them to spend more now. Reducing the corporate tax rate and reforming labor market regulations would also improve corporate sentiment significantly, accelerating economic growth. Still another essential part of beating deflation is addressing the falling birthrate, as it is seen as the root cause of Japan's bleak economic prospects.