

Japan

Inflation hits five year high

- Consumer price inflation rose to 0.9% in August
- PMIs indicate further upturn as Q3 progresses

Japan's consumer prices rose for the fifth time in the past six months in August, taking the annual rate of inflation to its highest since late 2008. The increase in prices is a welcome indication that the government's policies designed to end two decades of deflation are succeeding.

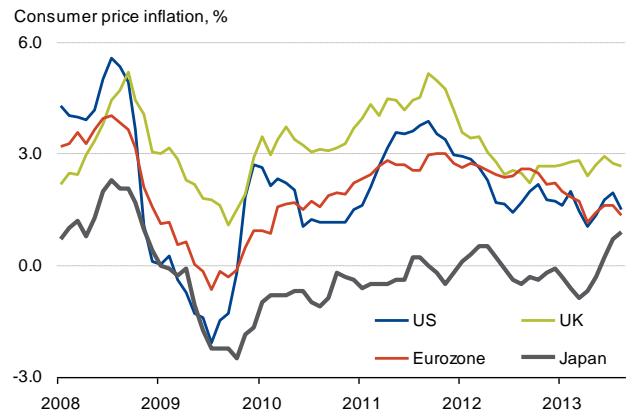
The index of consumer prices rose to 100.3 in August, rising 0.9% on a year ago to signal the largest annual jump in prices since November 2008, when record oil prices pushed worldwide inflation rates sharply higher. While high oil prices have again had an impact on consumer prices in recent months (gasoline prices hit their highest for five years in September, for example), the upturn in the rate of inflation in Japan contrasts with falling rates in other developed countries such as the US, UK and Eurozone, suggesting domestic policy factors are playing an important role in helping companies to re-establish pricing power.

Japan's target is for inflation to reach 2% within two years, achieved through a combination of doubling of the monetary base, increased public spending and structural reform.

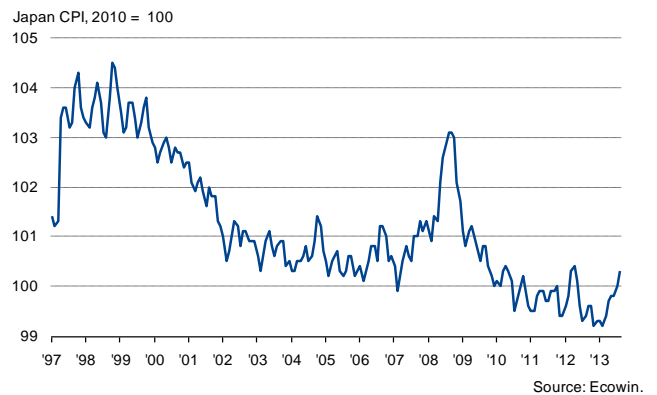
There's still a long way to go, however, with prices still 4.0% below their 1998 peak. Much will depend on how wages react to the recent increase in prices, a 1.1% rise over the past six months, to see if the upturn in the price level will be sustained. The [latest available data](#) showed wages falling for a fourteenth successive month in July, down 0.4% on a year ago.

The additional worry is that if wages fail to pick up while inflation rises, falling real incomes will hit consumption and act as a dampener on Japan's recovery, especially if a planned sales tax rise goes ahead early next year. Structural reform will be the key to whether wages can grow alongside inflation, but is so far seen as the weak link in the government's policies.

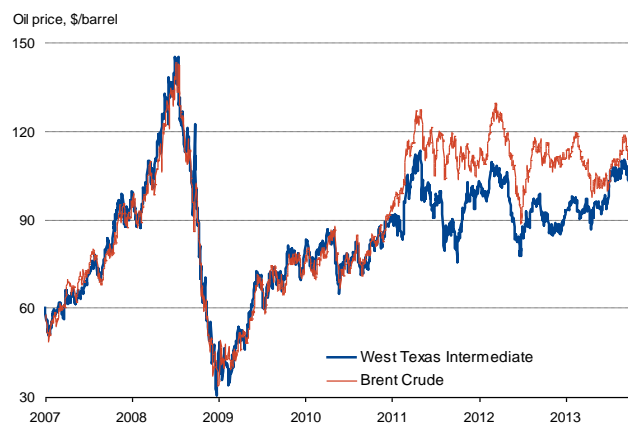
Consumer price inflation rates compared



Japan's consumer price level



Oil prices



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