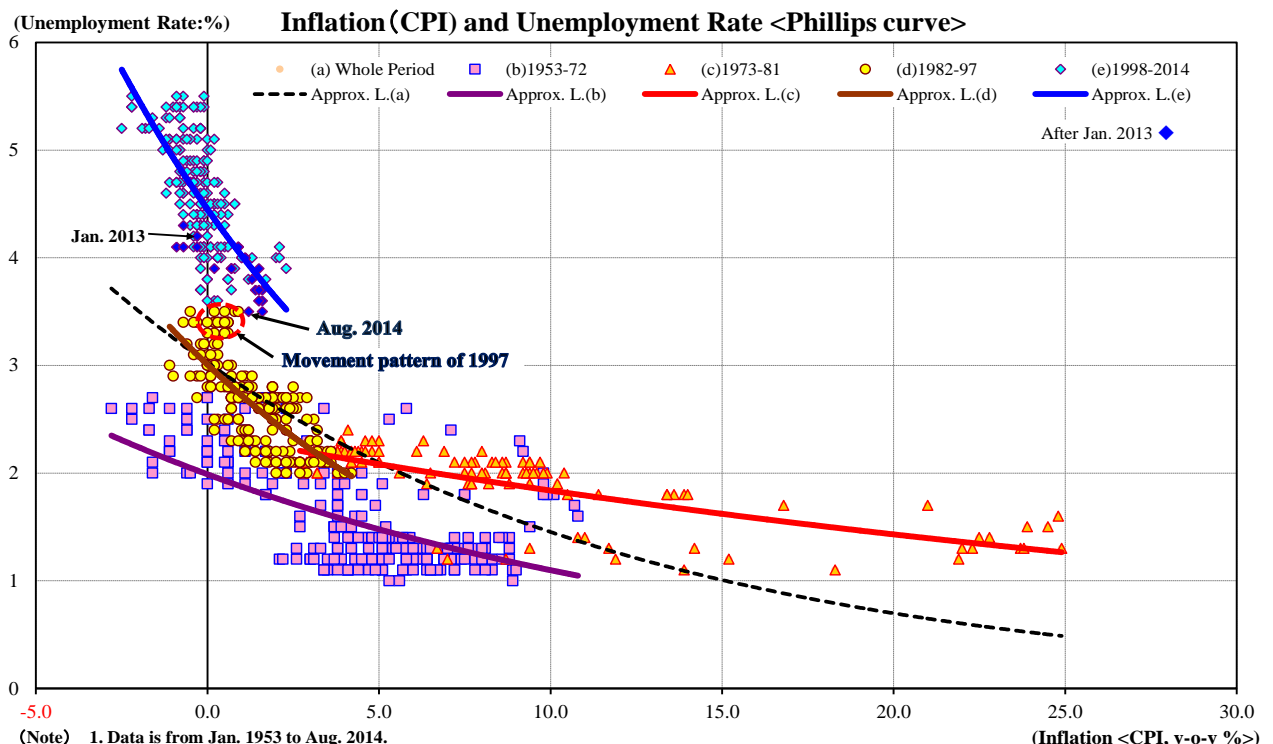


Close to Ending Deflation Judging from the Phillips Curve

Low Unemployment rate assured by moderate inflation rate and some inflation expectation

According to the economic analysis, there is a historical inverse correlation between unemployment rate and inflation rate, which is well-known as the “Phillips Curve”. (Please refer to the chart below) In Japan, the curve has been changing depending on each phase of economic conditions in the past half century.

From 1950s to earlier part of 1970s which is called “Era of rapid economic growth”, period (b)(1953-72) dotted in □ of the chart below, unemployment rates rose only to high 2% level at the most. This is because the high economic growth rates in the era consistently generated strong demand for vigorous employment. Period (c)(1973-81) dotted in △ below is a disorderly period when the Japanese economy experienced a “Oil shortage crisis” twice, with a “hyperinflation” in 1974 which caused the CPI to jump more than 20% p.a., followed by a recession for the first time after the World War II. Even in such difficult economic conditions, the unemployment rate managed to stay at 2% level at the highest during the period. My understanding of these phenomena is that the unemployment rate structure would not be affected by business cycle that much, so long as the inflation rate is kept staying above a certain level.



Keep on the policy putting first priority on domestic demand recovery to end deflation!

Contrary to the above, during period (d)(1982-97), unemployment rate rose 3% or more for the first time since 1950s as inflation rate was down to less than 2% on average under stable economic growth conditions. After year 1998 onward, plotted as period (e) in the chart, the Japanese economy went into a deflationary phase, making the unemployment rate jump up to 5% or higher. The chart shows that each approximate line of different economic phases shows the difference in growth capability in each phase, and steeper curve of the approximate line suggests a stronger deflationary pressure.

After April 2013, both prices and labour market conditions have improved as a result of an unprecedented monetary easing and aggressive fiscal policies of the Abe's government. As of August 2014, the position we are standing on is close to the position for the year of 1997, a year right before the Japanese economy entered into a long-lasting deflation. From this point, if the unemployment rate succeed in remaining unchanged or even decline a little despite of a mild slowdown of inflation, we can say the Japanese economy will take a big step forward to reach the stage of "ending deflation". In order to materialise this, I believe the Japanese government needs to maintain its economic policy which puts first priority on the economic recovery led by the domestic demand.

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