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Markit Economic Research

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Asia

Economic policy drives divergent business trends in Asia

- **Japan sees best quarter in history of PMI due to record rise in demand for goods and services**
- **China's growth weakest for over a year due to falling exports and weak growth of demand for services**
- **Prices rise in Japan, but falls in China**

Divergent economic trends are becoming apparent in Asia as Japan's policymakers stimulate growth to defeat deflation, while China seeks to engineer a slower, steady and sustainable growth path.

Japan's economy notched up the strongest growth since the financial crisis in the second quarter, according to PMI data covering manufacturing and services, but China saw growth dip to the weakest for over a year, with the economy even contracting marginally in June.

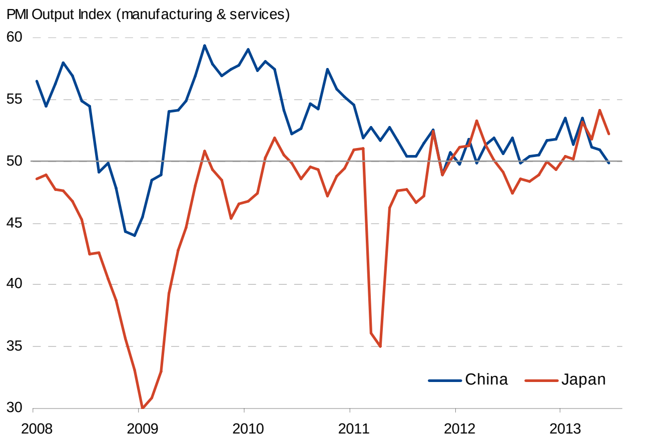
Despite the composite PMI for Japan dipping from an all-time high of 54.1 in May to 52.3 in June, the index averaged 52.7 over the second quarter, up from 51.3 in the first quarter and the highest average seen since the series began in 2007. The improvement in the index in the second quarter is roughly consistent with Japanese GDP rising at an annualised rate of around 6.0% (1.5% q/q), up from 4.1% (1.0% q/q) in the first quarter.

Meanwhile, the HSBC China Composite PMI fell to 49.8 in June, slipping below the no change level of 50.0 for the first time since last August (and to the lowest reading since the start of 2012). Over the second quarter as a whole, the PMI has averaged just 50.6, down sharply from 52.8 in the first quarter and the lowest average since the first quarter of 2012. The data therefore suggest that China's GDP growth rate will have slipped further from the already-disappointing 7.7% annual pace seen in the first quarter.

Order book variations

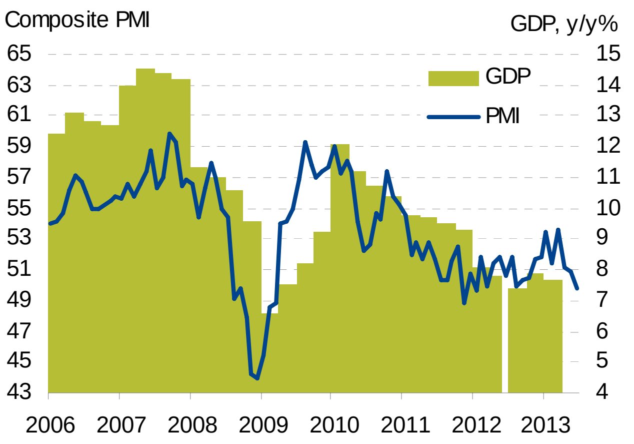
The growth differential between Japan and China partly reflects varying order book growth. Japanese

Composite PMI Output Index



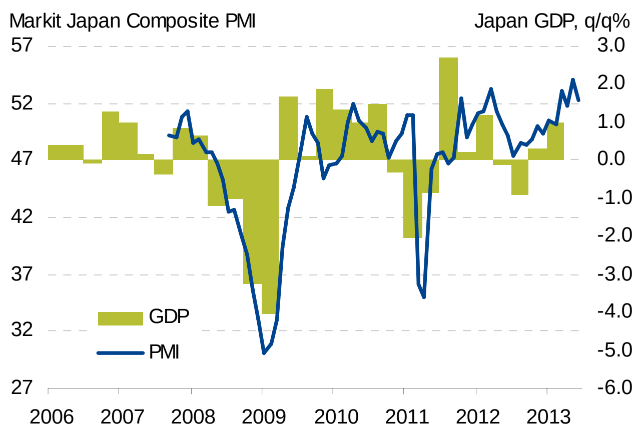
Sources: Markit, HSBC.

Chinese economic growth and the HSBC PMI



Sources: HSBC, EcoWin.

Japanese economic growth and the Markit PMI



Sources: Markit, EcoWin.

firms have seen the strongest growth of demand for goods and services in the history of the PMI survey in recent months, even after allowing for a slight slowdown in June. New orders in China are meanwhile falling at one of the fastest pace since March 2009. The latter in part reflected a steep fall in manufacturing export orders, although service sector new business also slowed to near-stagnation in June, registering the weakest increase since a marginal decline in November 2008. In contrast, Japanese manufacturing exports rose at a robust pace and domestic demand was also on the rise.

Policy divergences

The divergent trends are likely to reflect exchange rate movements, which in turn reflect policy decisions. A marked, 25% depreciation of the yen against the US dollar – caused by a severe loosing of policy as the Bank of Japan seeks to double the size of the country's monetary base – has lowered the price of Japanese exports and increased the cost of imports, boosting overseas sales and encouraging import substitution in the domestic market, the latter also buoyed by economic stimulus policies.

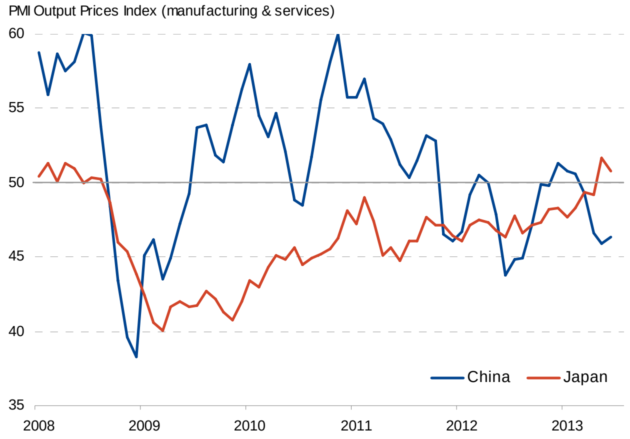
In China, on the other hand, the authorities have guided the currency higher, while at the same time allowing domestic lending to come under pressure via a liquidity squeeze.

Prices rise in Japan, but falls in China

The success of Japan's policies will rest with the impact on prices, with 'Abenomics' designed to beat the deflation that has plagued Japan for two decades by driving consumer price inflation up to 2% within two years. A second consecutive monthly rise in prices charged by manufacturing and services firms in June was therefore encouraging in this respect; the first such rises seen since the 2008-09 crisis.

Prices are rising in Japan in part due to higher costs: measured across both manufacturing and services, firms have seen the strongest growth of costs for two years in recent months. These cost increases have in many instances been linked to the weaker currency driving up import prices, and sit in marked contrast to a fall in costs in China, which reflect lower global commodity prices. Over the second quarter, China's firms saw one of the steepest drops in input costs for four years.

Prices charged



Sources: Markit, HSBC.

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