

Japan manufacturing

PMI® slips from near-eight-year high but still signals strong expansion

- Manufacturing PMI® falls to 55.5
- Employment shows largest rise for seven years as backlogs of work show further sharp increase
- Factory gate inflation picks up to highest since late-2008
- Slowdown in expansions of new orders and exports suggest growth may have peaked

The Markit/JMMA PMI fell from 56.6 in January to 55.5, but remained close to the all-time high of 57.0 to signal one of the strongest expansions of business activity in the goods producing sector seen over the past decade.

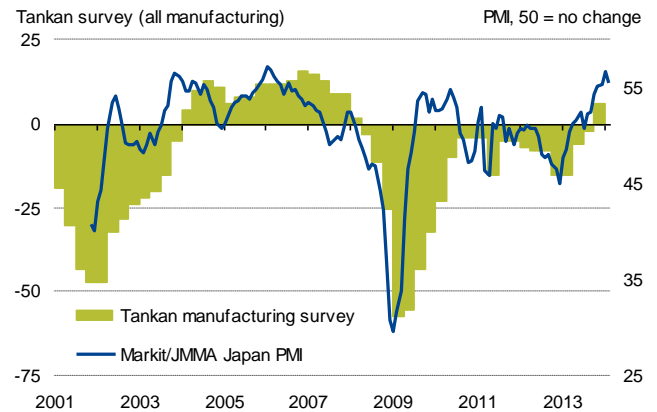
Manufacturing output rose sharply, albeit less than the record increase seen in January, pointing to a further strong production gain in the first quarter.

The recent strength of the PMI, alongside upbeat readings from the Bank of Japan's Tankan survey, suggest that the economy is faring far better in terms of domestic growth than recent gross domestic product data have suggested. Official data showed the economy expanding by just 0.3% in the fourth quarter of last year, identical to the disappointing rise seen in the third quarter. The discrepancy between the PMI and GDP may lie in part on higher imports of energy following the Fukushima incident, which are subtracted from economic growth in the GDP calculations whereas the PMI simply reflects domestic activity. However, the extent of the divergence also provides some ground to believe that the revision-prone GDP data may subsequently get revised higher.

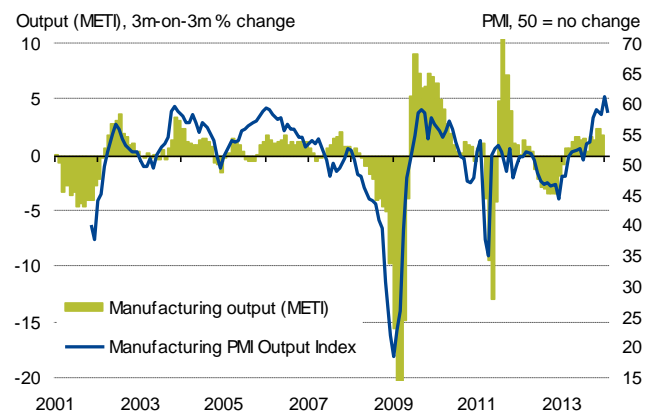
Job creation at seven-year high

The ongoing pace of manufacturing expansion remained sufficiently rapid to prompt goods producers to increase their headcounts to the greatest extent for seven years. With companies reporting one of the largest increases in backlogs of work seen over the past eight years, employment should continue to rise in coming months.

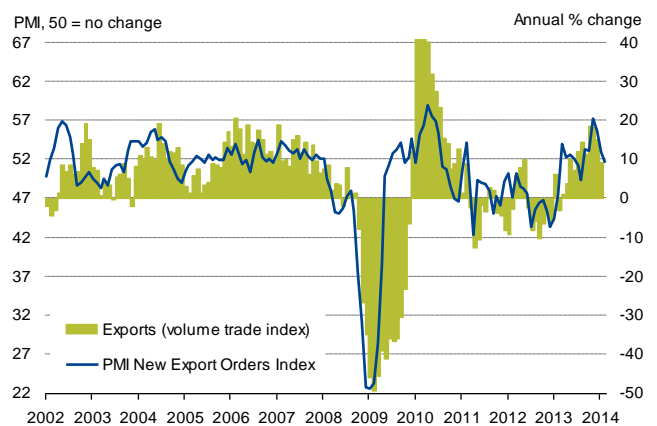
PMI and Bank of Japan Tankan surveys



Manufacturing output



Goods exports



Sources: Markit, Ministry of Finance.

The upturn in employment is particularly important for Japan, but the improvement in the labour market also needs to drive an upturn in wages if the country is going to defeat the deflationary trend that has plagued the economy.

While the PMI does not cover wages, an encouraging signal for prices was provided by the February survey showing the largest monthly increase in manufacturers' selling prices since October 2008. However, much of this increase merely reflected the need to pass higher costs, especially import costs, on to customers. Input prices continued to rise at a steep pace, often linked to higher import costs (notably energy), in turn linked to the exchange rate.

Order book inflows point to slowdown in production growth

While the pace of manufacturing expansion remained strong, a slowing in growth of new orders to the weakest since September suggests that the pace of production growth could slow further in March.

New export order growth slowed to a particularly modest pace in February, showing the smallest monthly gain in overseas business in the current six-month sequence of expansion. Export order growth has now slowed for three successive months from the near-record peak seen last November. This has in part reflected an appreciation of the yen, which gained just over 4% against the US dollar in January. However, the currency has since weakened again slightly, which could provide a further lift to exports. Even after the modest appreciation seen so far this year, the yen remains some 25% weaker than late-2012.

Chris Williamson

Chief Economist, Markit

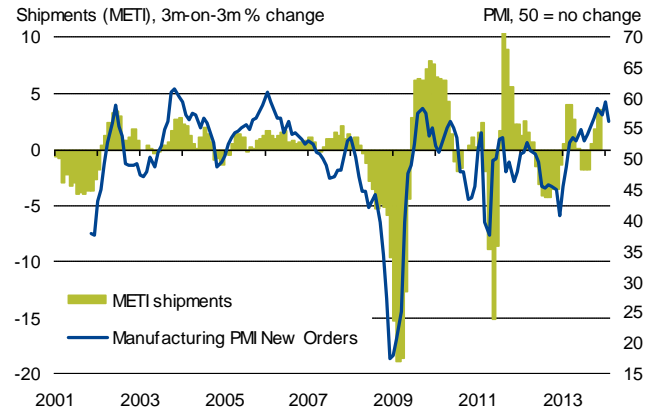
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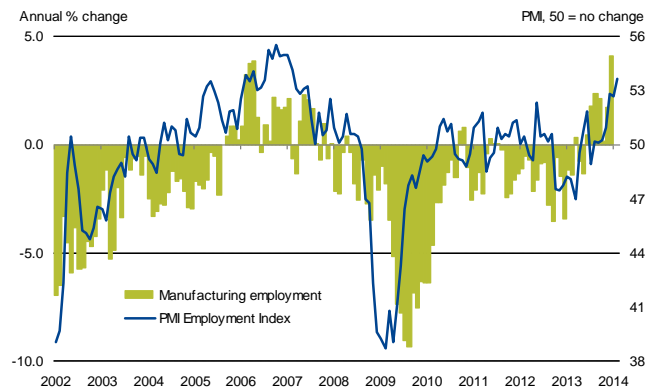
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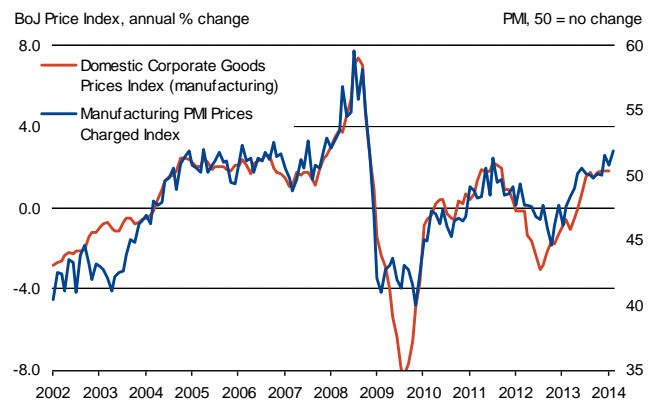
New orders and goods shipments



Manufacturing jobs



Producer price inflation



Exchange rate

