

# Japan

## Japan to suffer double hit from sales tax rise and equity market losses

- **Manufacturing growth looks set to slow in the aftermath of the sales tax rise, but the impact could be short-lived.**
- **Perhaps more worrying is the impact of the slide in equity prices, which correlate closely with the PMI**

Weak manufacturing data were to be expected in Japan after record snowfall disrupted businesses, but any hope that there was a spending spree on goods before the country's sales tax rose from 5% to 8% on 1<sup>st</sup> April were dashed by official data showing disappointing manufacturing trends.

Official data from METI signalled a fall in factory output and shipments in February, while the Markit/JMMA PMI survey showed a further weakening in March. Goods production fell 2.2% in February and shipments dropped 1.0%. Meanwhile, the manufacturing PMI fell for a second month running, down from 55.5 in February to 53.9 in March.

Many analysts see the weak data as adding to the likelihood of the authorities seeking to offset the impact of the sales tax hike with other stimulus measures. However, the case is not so clear cut.

First, the authorities will be mindful of the weather impact, and that this could have continued to disrupt supply chains in March. Furthermore, the weakness comes in the context of strong growth in prior months. The PMI survey's Output Index, for example, had hit a record high in January. The fall in the official measure of output in February also follows robust data in prior months: output had surged 3.7% in February, building on a 1.0% rise in January. Taking the latest three months together, output was 3.0% higher than in the previous three months, the best performance since October 2011.

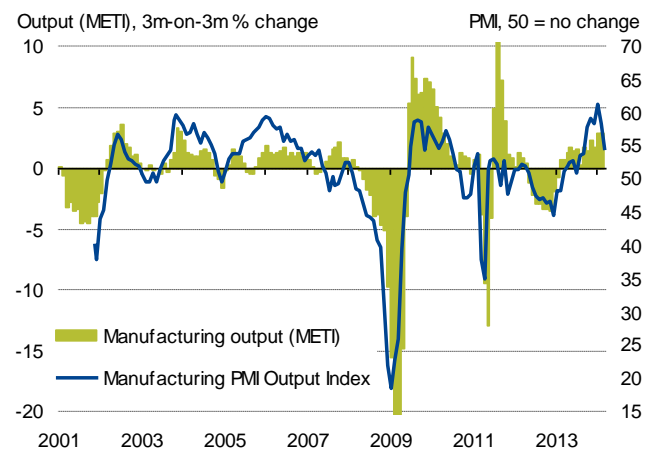
All eyes will therefore be on the production and sales trends in coming months to see if the economy follows the pattern seen after the previous tax rise of April 1997 (a rise from 3.0% to the current 5.0%). Back in 1997, manufacturing shipments rose 3.3% in the first quarter, ahead of the sales tax rise. In the second

quarter, they fell 1.7%. Shipments then rose again (+0.7%) in the third quarter, but then plummeted. By October 1998, shipments were 8.6% lower than before the sales tax rise.

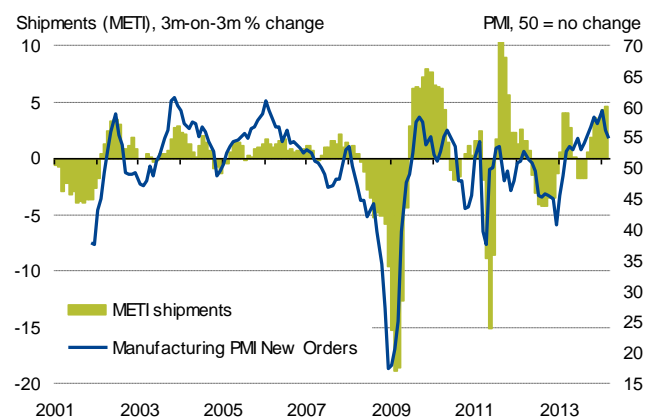
However, how much of this can be attributed to the tax rise is not known, especially as Asia was engulfed in a financial crisis that began in 1997.

It is quite possible that, this time around, the pre-sales tax rise boost to growth was seen at the turn of the year in terms of the manufacturing sector, and that payback will be seen in the second quarter. After which, in the absence of a disaster such as a financial crisis, growth should resume the solid trend that had been evident throughout much of 2013.

### Manufacturing output



### Manufacturing shipments



## Worry more about equity prices than the tax hike

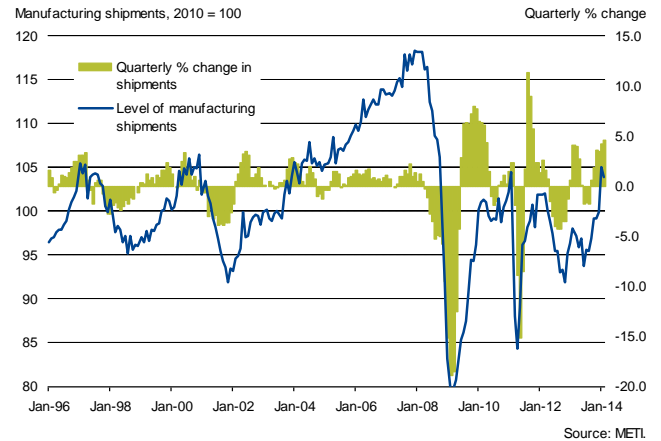
Perhaps a more worrying impact than the sales tax rise is the 9% slide in the Japanese equity market so far this year.

The relationship between equity prices and economic data can work both ways: signs of an improving economy boosts the profitability of companies and raises share prices. Rising share prices can also feed through to stronger economic growth. This is one of the theories supporting quantitative easing.

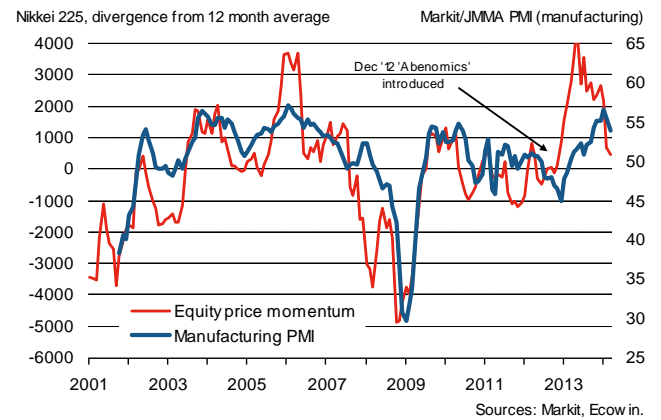
In Japan, the PMI provides the timeliest insight into business conditions, so it's not surprising that the PMI correlates closely with the Nikkei 225 benchmark share price index. Since 2001, when the manufacturing PMI was first introduced in Japan, the survey's headline index has exhibited a 71% correlation with share price momentum, calculated here as the difference between the latest month's average share price compared to the prior 12 month average.

The concern is that, while the staggering rise in the Nikkei 225 in the first half of 2013 that followed the introduction of Abenomics led to a surge in economic growth, the near-double digit fall in share prices in the first quarter of 2014 could lead to growing risk aversion and slower economic growth, just at the same time as domestic demand is hit by the sales tax rise.

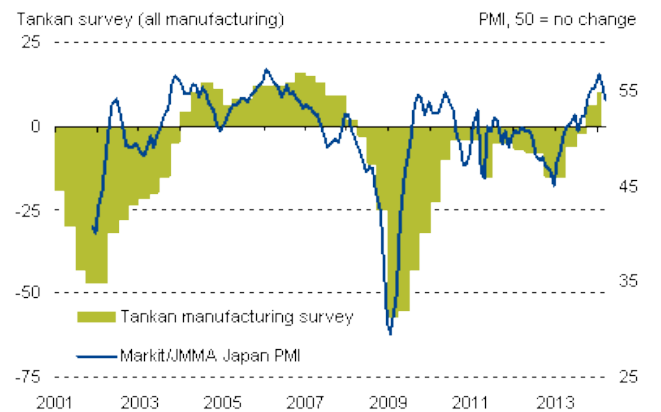
## Long-run manufacturing shipment trends



## PMI and the Japanese equity market



## Tankan and the PMI



## Chris Williamson

### Chief Economist

Markit

Tel: +44 207 260 2329

Email: [chris.williamson@markit.com](mailto:chris.williamson@markit.com)

[Click here](#) for more PMI and economic commentary.

For further information, please visit [www.markit.com](http://www.markit.com)