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Markit Economic Research

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# Japan

## Economy maintains strong growth momentum in November

- **PMI shows growth of private sector business activity ease but remain near record high**
- **Sharpest growth in manufacturing new export orders since May 2010**

Strong activity growth was sustained in November, as Markit's PMI surveys registered the eleventh successive month of expansion in the Japanese private sector. The Composite PMI Business Activity Index fell from a record 56.0 in October to 54.0, signalling an easing in the rate of growth, but still posted one of the highest readings in the series history.

Encouraging survey data signalled a broad-based upturn, with growth evident in both manufacturing and services. However, a four-year high in manufacturing output growth was offset by an easing in the pace of expansion at service providers. Meanwhile private sector employment rose for the fourth consecutive month, though the rate of growth remained modest.

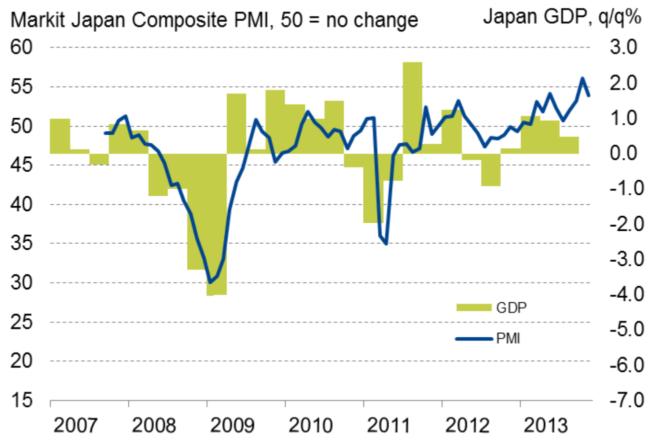
Given the ongoing strength of order books, business levels should continue to rise in December. New order growth hit a six-month high across both manufacturing and services in November, while backlogs of work showed a record rise. This in turn suggests fourth quarter GDP estimates will rise from the +0.5% preliminary estimate for the third quarter.

## Manufacturing output growth at 50-month high

Although service sector growth remained solid in November, it was eclipsed by the sharp expansion seen in the manufacturing sector. Growth in output and new orders at Japanese goods producers soared to four-year and near eight-year highs respectively.

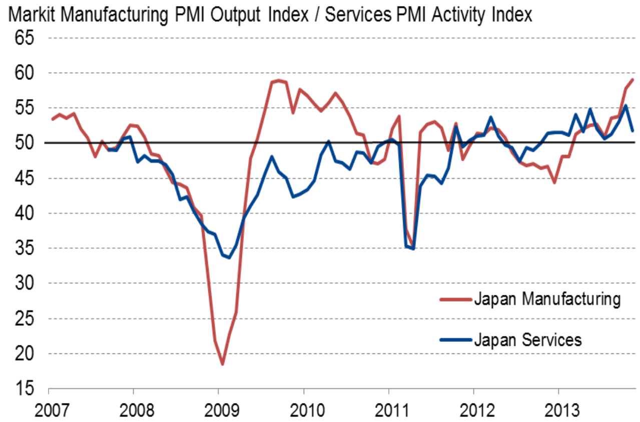
These expansions appear to have been largely driven by a three-and-a-half year high in new export order growth. Anecdotal evidence indicated that the continued weakness of the yen, combined with a revival in demand in key export markets, were the primary factors behind the surge in new orders from abroad. Exports may be further bolstered in 2014 by the Trans-Pacific Partnership deal, if it is finalised on schedule.

**Markit/JMMA Japan Composite PMI and GDP**



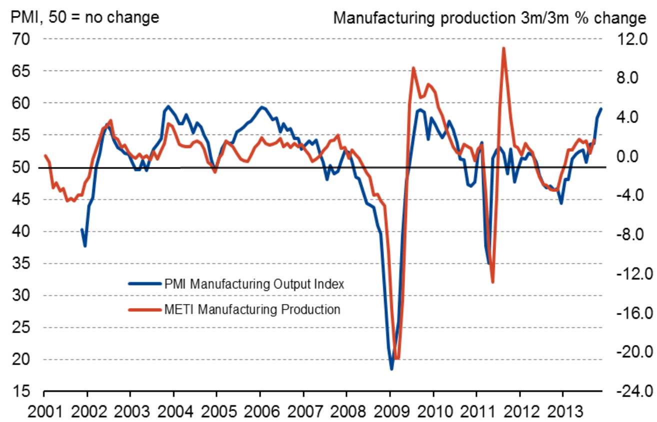

*Sources: Markit, Cabinet Office (via Ecowin)*

**PMI Business Activity Indicators**




*Source: Markit*

**Manufacturing Output**




*Sources: Markit, METI*

## Exports and the Trans-Pacific Partnership

Joining the Trans-Pacific Partnership Deal could greatly boost Japan's exports through greater access to foreign markets and increased competitiveness (from the abolition of tariffs in several key export markets). The Japanese Cabinet Office estimated the deal would increase GDP by 0.66%, but other estimates suggest the boost could be as much as 2%.

After showing interest in the TPP in 2010, it took Japan over two years to formally apply in March, though in the time since progress has developed relatively quickly. Last week, the Japanese government announced that rice subsidies will be eliminated by 2019. This emphasised Japan's commitment to trade liberalisation and the TPP deal, particularly given the entrenched nature of the forty year old gentan system of protectionism and price-support.

The TPP has the potential to boost productivity across the private sector, but particularly in the agricultural industry which is currently heavily protected. Exposed to international competition the sector will have to improve productivity and achieve economies of scale by developing larger farms.

## Could the TPP ease cost-push inflation?

The latest survey data signalled that private sector input costs rose for the twelfth consecutive month in November, and at a sharp pace. Recent cost-push inflation poses a threat to consumer demand and consequently growth in 2014. As a result of the decommissioning of Japan's nuclear plants and the interdicts on some food exports (because of possible radiation contamination); Japan has become increasingly reliant on energy and agricultural imports. The depreciation of the yen throughout 2013 has made these imports increasingly expensive for Japanese businesses and consumers and has been a key driver behind recent inflation.

The TPP deal could go some way to easing this cost-inflation, as increased competition should lower the price of domestically produced food for Japanese consumers, and the removal (or more likely reduction in the short term) of the huge import tariffs on some agricultural products, will lower the cost of imported food.

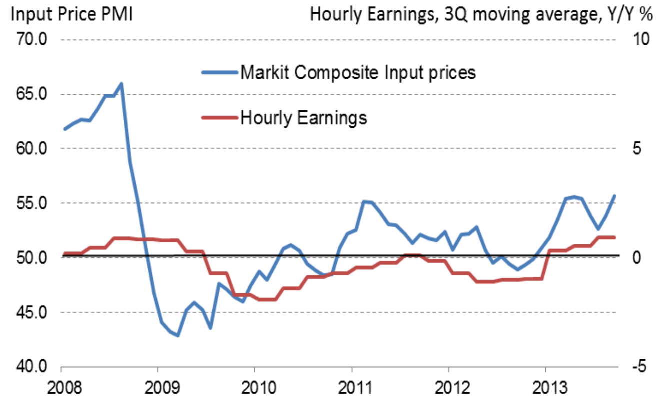
Whilst inflation is needed to a small degree in Japan, cost-push inflation can actually erode consumer demand if wages fail to keep pace, as is the case currently. The latest official data indicate inflation rose to 0.9% in October and excluding energy and food costs, 0.3%, the highest reading in 15 years, reassuringly signalling that rising prices are not solely the result of cost-push inflation.

This is reassuring because low levels of stable inflation can encourage demand as consumers anticipate higher prices tomorrow, so are incentivised not to put-off purchases. However, without concurrent growth in wages, rising prices erode real incomes. Thus any measure such as the TPP, that could ease the inflationary pressure from food and energy imports, whilst allowing underlying inflation to continue, should boost disposable income and encourage growth.

### Exports


*Sources: Markit, Cabinet Office (via Ecowin).*

### Wages and Prices




*Sources: Markit, Bank of Japan*

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