Markit Economic Research

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Japan

Strong manufacturing growth bolsters Japanese economy in January

- **PMI indicates private sector business activity growth rate up fractionally from December**
- **Manufacturing output growth at record high**

Business activity at private sector firms in Japan grew for a thirteenth successive month in January, continuing the longest unbroken expansion since composite PMI data were first available in September 2007. Moreover, whilst the rate of growth failed to surpass October's record high, it did accelerate fractionally from December.

The Composite PMI™ Business Activity Index increased to 54.1 in January, up slightly from 54.0 in December and signalling a further solid expansion in the Japanese private sector.

The composite index is broadly consistent with quarterly GDP growth of 1.5-2.0%, suggesting the current expansion is running far faster than the surprise easing to 0.3% signalled by the latest official data for the third quarter.

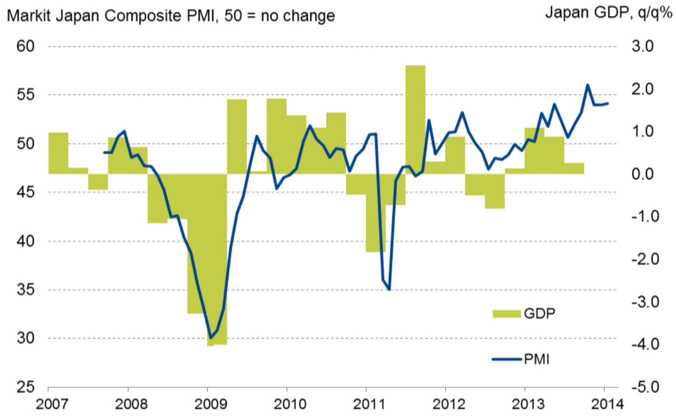
However, the PMI also highlights a wide divergence between the fast-growing manufacturing sector and the struggling services economy. Stronger growth of services is likely to be a key ingredient of a more sustainable upturn, potentially leading to rising domestic consumption and wages.

Record high manufacturing output growth

The latest survey data indicated that Japanese manufacturing output expanded for an eleventh successive month in January, and at the sharpest pace in over 12 years of data collection. Evidence from survey respondents suggested that the latest rise in output was in part a consequence of fuller order books, in turn often attributed to demand being brought forward ahead of April's sales tax hike.

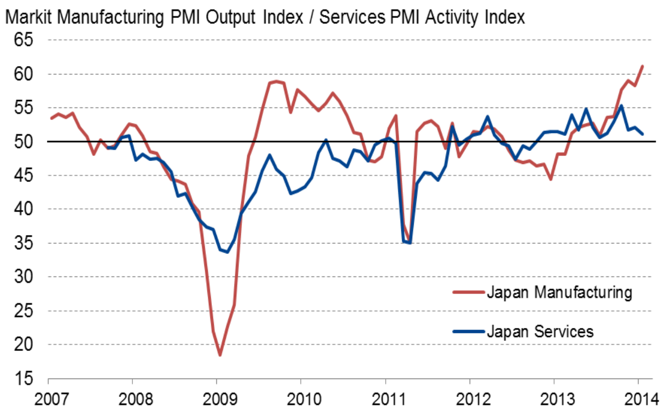
At 56.6, the seasonally adjusted Markit/JMMA Japan Manufacturing PMI™ was the highest since February 2006. Record highs in growth of production and quantity of purchases in manufacturing reflected the sharp expansions in new orders seen over the past few months.

Markit/JMMA Japan Composite PMI and GDP



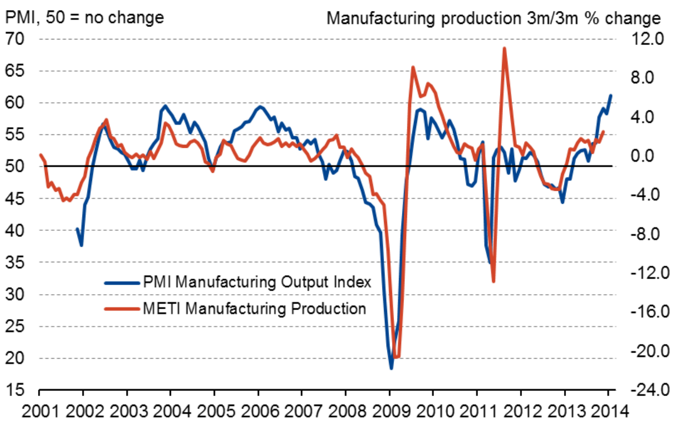
Sources: Markit, Cabinet Office (via Ecowin)

PMI Business Activity Indicators



Source: Markit

Manufacturing Output



Sources: Markit, METI (via Ecowin)

Manufacturing expansion eclipses weak service sector growth

The latest survey data revealed a further divergence between the Japanese manufacturing and service sectors. Whilst operating conditions at goods producers improved at the sharpest pace in nearly eight years in January, service providers saw only a modest expansion in business activity.

Given that the service sector is more than double the size of the manufacturing sector in Japan, a continuation of this divergence would pose a significant obstacle to continued recovery.

Employment grows at modest pace

Private sector output growth was complemented by an expansion of employment in January, with job creation evident for a sixth consecutive month. In addition, the growth in staffing levels was the sharpest since June.

However, reflecting the trend in business activity, there was a divergence between the growth trends at a sector level, whereby marginal service sector employment growth was overshadowed by a solid pace of expansion in manufacturing payroll numbers.

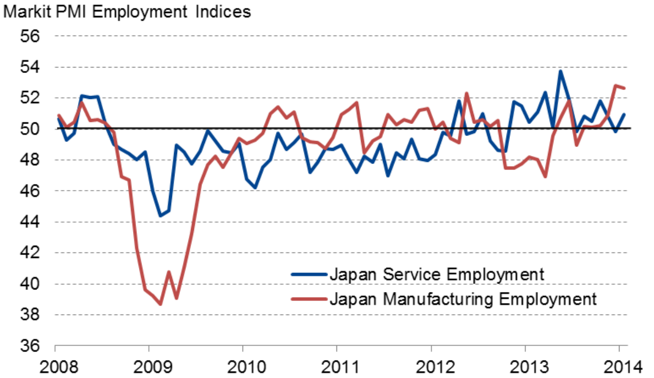
The overall picture of the labour market signalled by the PMI in January was nonetheless one of robust employment growth, with staffing levels in the private sector rising at an annual rate of 0.5-1.0%, thereby signalling a continuation of the strong employment growth recorded by official data late last year. Private sector payroll numbers rose 1.1% in the six months to November, the largest six-month rise since 2005.

2013 trade deficit highlights energy crisis

The Japanese Cabinet Office released data last week showing that the annual trade deficit in 2013 was the largest on record. This was principally a result of the muted demand in key export markets, combined with the decommissioning of Japan's nuclear power plants, which resulted in a sharp increase in imported energy.

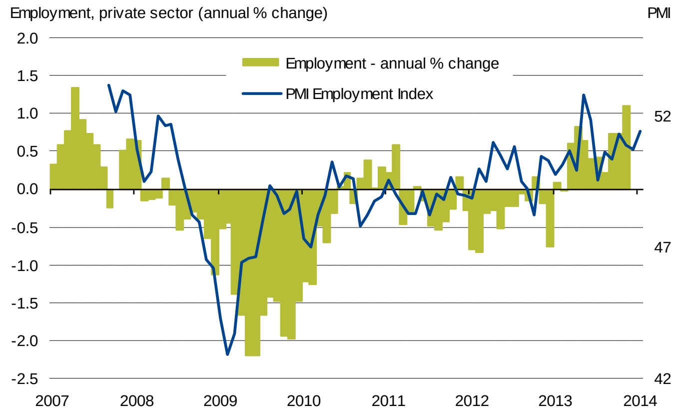
Despite a sustained and sharp depreciation of the yen throughout 2013, the impact on exporters has been subdued, as illustrated by the graph (right). The expansive monetary policy which caused the yen's depreciation was designed to help Japan escape from over a decade-and-a–half of deflation, and has for the most part been successful in terms of inflation (consumer price inflation hit a five-year high of 1.6% in November). The limited impact on exports is potentially concerning, given the relative price advantage

PMI Employment Indicators



Source: Markit

Employment

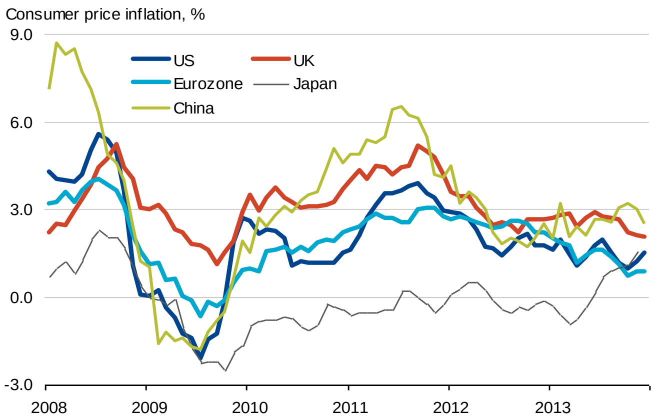


Sources: Markit, Japanese Ministry of Internal Affairs and Communication

Exports

Sources: Markit, Cabinet Office (via Ecowin)

Inflation



Source: Ecowin.

Japanese manufacturers now have over foreign competitors.

It is likely that exporters' inability to take advantage of the yen's weakness was largely due to poor economic conditions in many of their major export markets. However, evidence from survey respondents over the past few months has also suggested that a number of Japanese manufacturers have been unable to take full advantage of the weak yen because higher fuel bills have compelled them to raise output prices.

Mitigating the trade deficit will require a long term solution to the current energy issues faced by Japan. Not only does the current reliance on expensive fuel imports increase costs for businesses and consumers alike, but it also greatly increases Japan's vulnerability to exchange rate fluctuations, and as such poses a threat to the longevity of recent growth.

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