

Japan

PMI data point to smoother recovery trend than confusing GDP data

- **PMI data offer some insight into underlying trend in GDP.**
- **Manufacturing dependent upturn.**

Volatile trends and steep revisions in official GDP

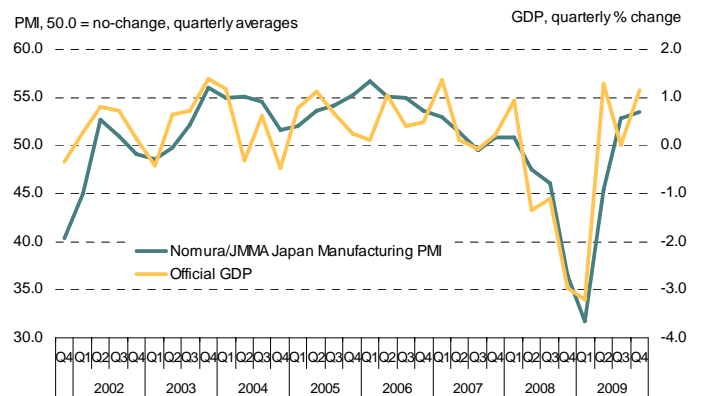
It is difficult to envisage a time in recent memory when the need for clear insights into economic growth have been more important. Policy-makers around the world are seeking to balance signs of economic recovery with stimulus measures and exit strategies. But official economic data are adding little clarity to the situation, especially in Japan.

When Japan's Cabinet Office first published its estimate of gross domestic product (GDP) growth in Q3, it portrayed an economy recovering sharply, with GDP up 1.2% on the quarter – an annualised increase of some 4.8%. However, this was later revised down to 0.3%, and more recent estimates published this week suggest that the economy in fact showed no growth at all in Q3. While larger than usual, substantial revisions to GDP data are not unusual. So their accompanying first estimate of GDP growing by a healthy 1.1% in Q4 (an annualised increase of 4.6%) was treated with understandable scepticism by economists.

The revisions and striking volatility in the official GDP series therefore offer little help to anyone trying to judge the true underlying growth momentum in the Japanese economy. However, PMI data for Japan, compiled by Markit on behalf of Nomura, can help shed some light.

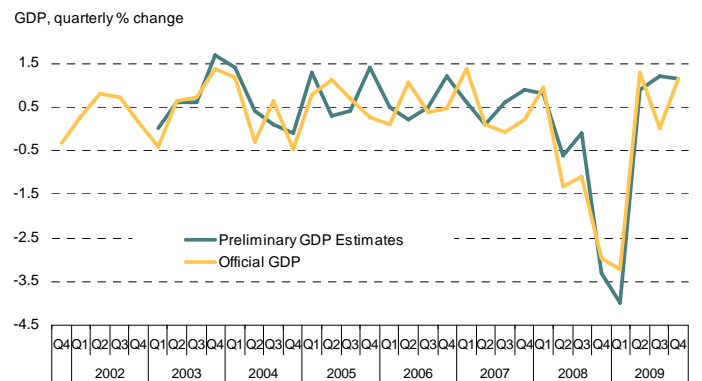
The PMI has historically shown a far less volatile path over time than GDP (something that is also observed in many other countries for which PMI data are available). This means the survey-based indicator is often unable to anticipate spurious swings in GDP, but it makes it an excellent measure of the true underlying health of the economy. The PMI is currently telling us that the Japanese economy (or, more precisely, the private sector, which is what the PMI covers) is continuing to grow, although the rate of increase is lower than that

Japan Manufacturing PMI and GDP



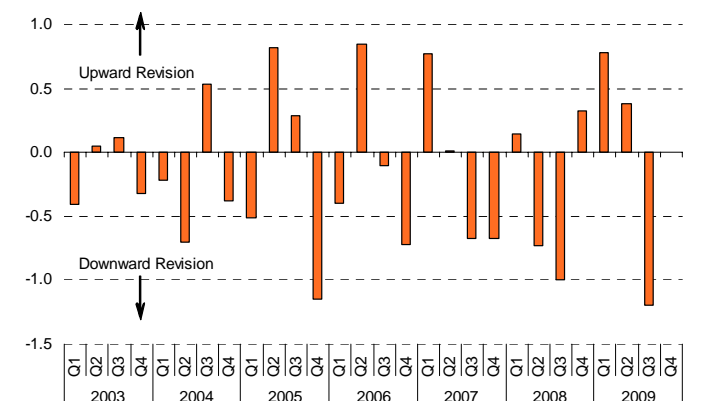
Sources: Markit, Japan's Cabinet Office.

Japan GDP (Preliminary vs. Final)



Sources: Markit, Japan's Cabinet Office.

Revisions to Preliminary Quarterly GDP (% points)



Sources: Markit, Japan's Cabinet Office.

signalled by the Q4 initial GDP estimate. The manufacturing PMI is in fact consistent with GDP growth of around 0.6% in Q4, having plotted a steady recovery path throughout 2009.

Export-led growth

Of concern, however, is the country's reliance on exports, which rose 12.1% on an annual basis in December. This is consistent with the PMI New Export Orders Index, which rose to its highest level in five-and-a-half years in the final month of 2009. Evidence provided by the manufacturing PMI survey panel suggested that China and other Asian countries were key sources of new export business in Q4, and official data showed that sales to Asia as a whole were up 31.1% on an annual basis compared to a 7.6% reduction from the US.

Service sector weakness

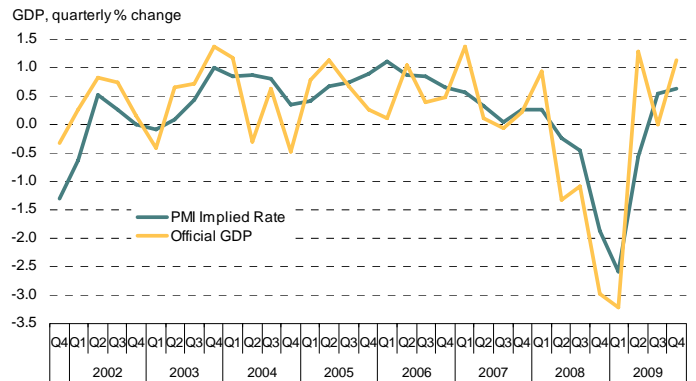
The service sector, on the other hand, continues to contract according to both official and PMI data, with the rate of decline gathering pace again late last year. Official figures for December signalled that tertiary activity fell by 0.9% on the month, which was the fastest monthly decline since last March. The composite PMI Output Index (covering both manufacturing and traded services) meanwhile registered just 46.8 in January, up slightly from 46.5 in December but still well entrenched below the 50.0 neutral line.

Slowdown in growth expected in 2010

The PMI data therefore indicate that Japan is trailing behind considerably in the global recovery story and not, like GDP estimates suggest, powering ahead. Moreover, as the impact of government stimulus measures continue to wane – public investment contributed negatively to GDP for the second successive quarter in Q4 – and deflationary pressures take hold, growth will likely be muted in 2010. Before the Q4 2009 estimate was released, a Reuter's poll had forecast growth to slow to 0.3% through January to March and post 0.4% in the following quarter.

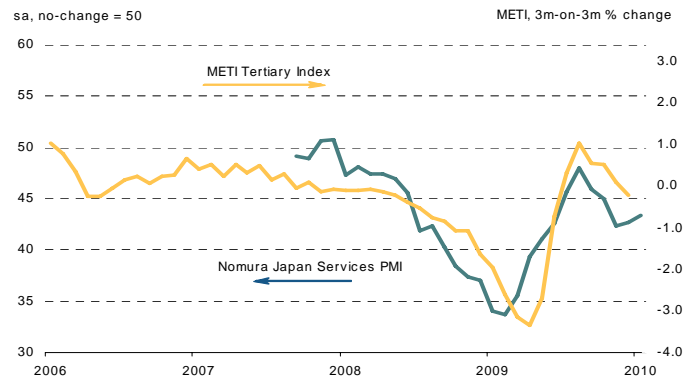
The first insight into the performance of Japan's economy halfway through Q1 2010 will be provided by the Nomura/JMMA Japan Manufacturing PMI, released 25th February, followed by the Nomura Japan Services & Composite PMI on the 2nd March. To find out how to receive PMI data for Japan, please contact economics@markit.com

PMI implied rate of GDP growth



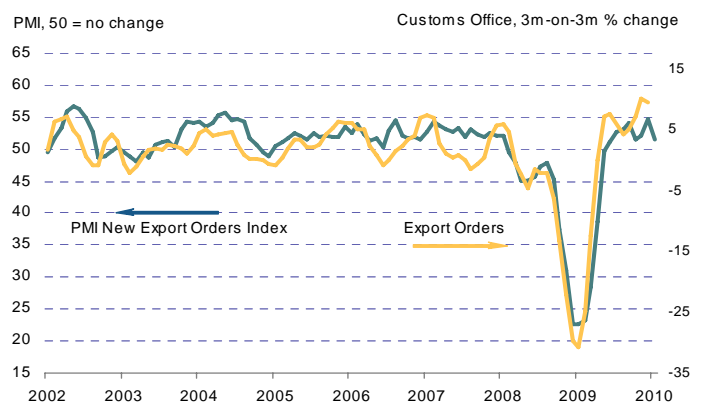
Sources: Markit, Japan's Cabinet Office.

Japan Services PMI



Sources: Markit, METI.

Japanese Exports



Sources: Markit, Japan's Customs Office.

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