

# Asian manufacturing

## China and Japan see manufacturing surge

### Key findings

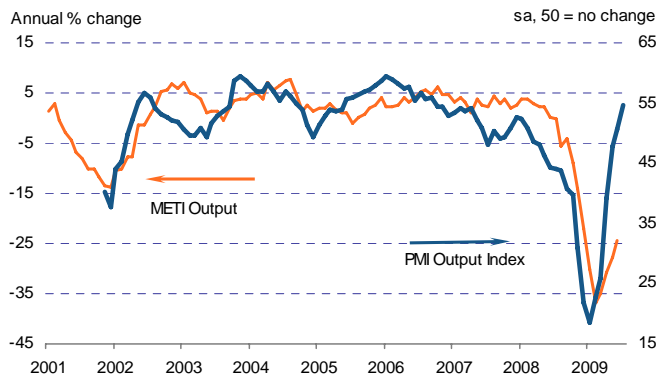
- **Manufacturing output surges in both Japan and China.**
- **Both countries see gains in export sales...**
- **...but signs of stronger domestic demand also become evident in China.**

### Surge in Japanese manufacturing output

Having hit an all-time low in January, the Nomura Manufacturing PMI, compiled by Markit, has signalled a marked and rapid turnaround in business conditions in recent months. In particular, the survey's Output Index rose to a near three-year high in July, registering a robust increase in manufacturing production on the back of improved order books.

The improvement signalled by the PMI data has been borne out by official economic data, which showed that manufacturing output sank 37% below its peak of a year ago in February, but has since recovered 16.5% since that low. These official data are currently only available up to June, and the PMI data suggest that the rate of growth continued to accelerate in July.

**Chart 1: Japan manufacturing output**



The Japanese PMI survey also showed that manufacturers' stocks of both raw materials and finished

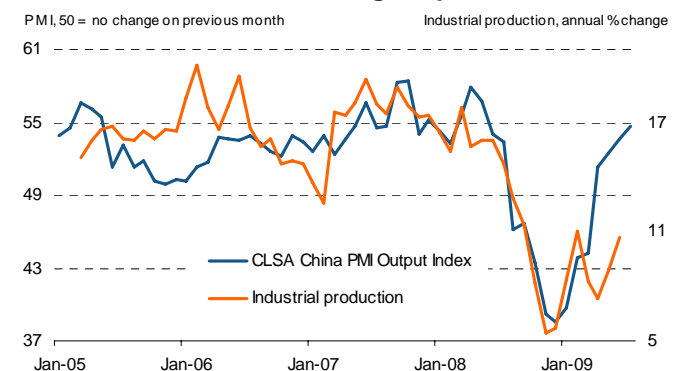
goods continued to fall at steep rates compared to the historical standards of the survey in July. These falls were due in part to ongoing efforts to keep stocks as low as possible for cost considerations, and also increasingly due to stocks being depleted by stronger than expected production and sales growth in recent months. The ratio of new orders to stocks of finished goods acts as a reliable indicator of short-term future production, and this ratio rose to a three-year high in July, therefore raising hopes of a sustained upturn in manufacturing output as we move through the second half of 2009.

### China upturn gains momentum

Meanwhile, the latest Manufacturing PMI for China, compiled by Markit on behalf of CLSA, also showed that the country's industrial recovery continued to gain momentum. The survey's Output Index rose for the seventh successive month in July to hit a 14-month peak.

As with Japan, official data have confirmed the trends indicated by the PMI. The National Bureau of Statistics report that, having slumped to a low of 5.4% last November, the annual rate of growth of industrial production in China recovered to a nine-month high of 10.7% in June.

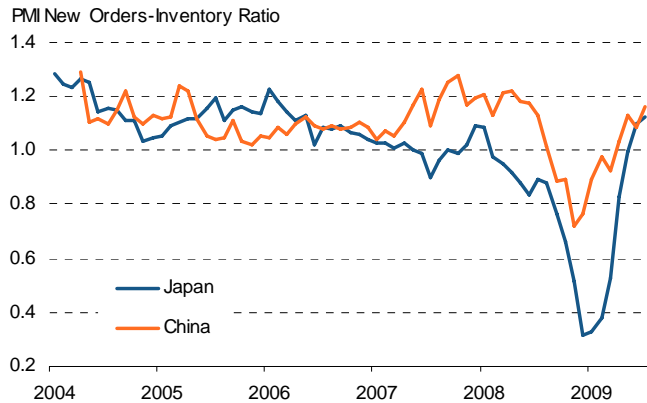
**Chart 2: China manufacturing output**



As in Japan, the orders-to-inventory ratio has risen sharply in China, although the upturn is less spectacular than the rebound in Japan (see chart 3). This is partly

because stocks of finished goods have already begun to stabilise in China. Nevertheless, the improvement in this ratio points to further production gains in China in coming months.

**Chart 3: Manufacturing orders:inventory ratios**

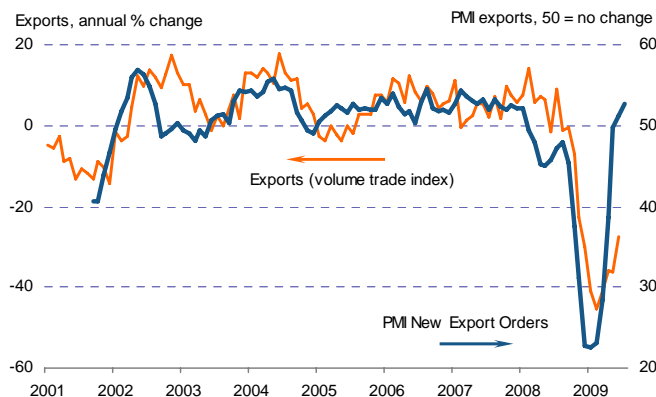


**Export sales strengthen**

PMI export indices have risen strongly for both Japan and China so far this year, again correlating well with official data.

In Japan, government-produced data indicate that exports (in volume terms) peaked in December 2007 but had halved by January of this year. By June (the latest month for which official data are available), exports had risen 34% from their January low but remained 28% down on a year ago. PMI data suggest that this recovery continued into July (see chart 4), with the annual rate of growth improving sharply again.

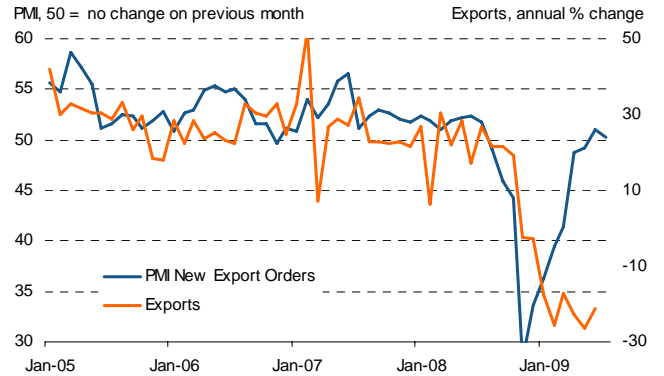
**Chart 4: Japan exports**



In China, the PMI's New Export Orders Index spent a second month above the 50.0 'no-change' level in July, signalling a strong rebound in the official export data since the lows seen earlier in the year, which have so far

shown little improvement in the annual rate of change from the 25.7% fall seen in the February (see chart 5).

**Chart 5: China exports**



**Divergent sources of demand**

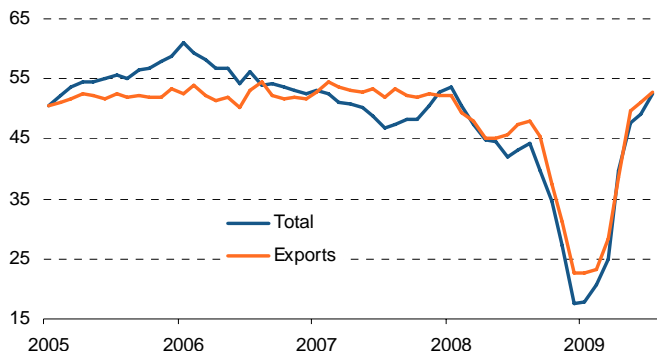
A notable divergence in trends between Japan and China, however, is the source of recent order book growth according to the PMI surveys. In particular, while Japan's order book growth appears to be driven principally by rising demand in export markets, China's manufacturing sector is being stimulated by domestic demand as well as rising export sales.

Chart 6 indicates that total new orders (which includes domestic as well as export sales) rose at a marginally slower rate than new export orders. This suggests the domestic demand component of total order book growth remained subdued (as has in fact been the case throughout much of the period since mid-2006).

In contrast, the same PMI indices for China (chart 7) show that total new orders have been rising at a significantly faster rate than export sales during the upturn. This suggests that domestic demand is providing a key source of order book growth in China. The current situation of domestic demand running ahead of export sales contrasts with the period prior to mid-2006.

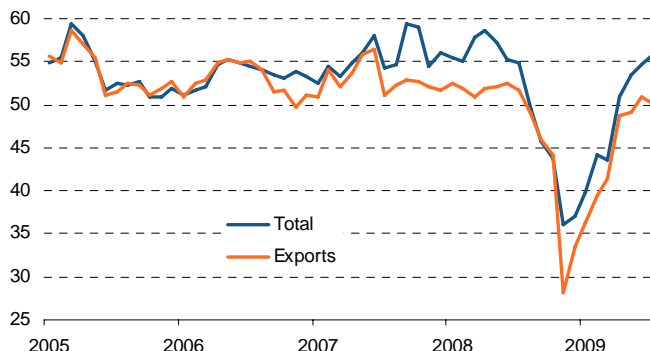
**Chart 6: Japan PMI order books**

50 = no change in new orders on previous month



**Chart 7: China PMI order books**

50 = no change in new orders on previous month



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