

Prices

Deflationary pressures mount in Japan, but elsewhere companies seek to offset rising costs

- **Prices charged by Japanese manufacturers fall at fastest rate for eight years.**
- **Costs have risen in other countries, putting pressure on margins.**

Deflation in Japan

The average selling price charged by manufacturing and service sector companies in Japan fell at an increased rate in November, according to PMI data produced by Markit for Nomura. The drop in manufacturing output prices was particularly notable in being the largest since late-2001. In addition, Japanese manufacturers have now seen input prices fall for 12 consecutive months.

Falling prices have coincided with an acceleration in the rate of contraction of output in Japan, as demand for goods and services continued to slump. The combined output of the manufacturing and service sectors fell in the three months to November, reversing a return to growth than had occurred in August and encouraging firms to cut prices to stimulate sales.

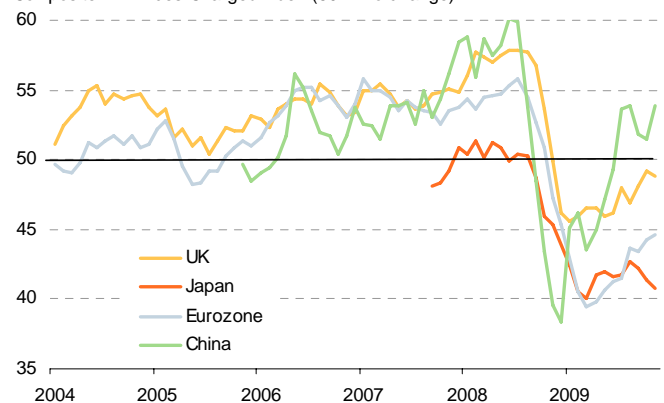
In addition to seeing by far the strongest downward pressure on selling prices, Japan was also notable in differing from other large economies in that input costs continued to fall in November, attributable to intense competition among suppliers in manufacturing and subdued staff costs in services.

Prices rise at increased rate in China

In contrast to the signs of gathering deflationary forces in Japan, prices charged by manufacturing and service companies in China rose at a markedly faster rate in November, showing the joint-largest monthly rise since the collapse of Lehman Brothers. Prices charged by manufacturers rose particularly sharply.

Output prices (manufacturing & services)*

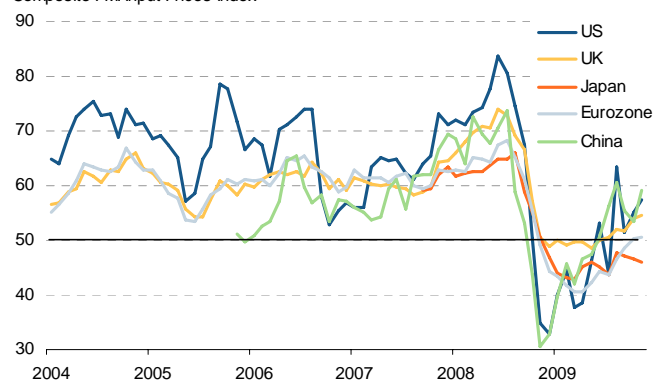
Composite PMI Prices Charged Index (50 = no change)



* Data not available from the ISM (United States) PMI survey.
Source: Markit.

Input prices (manufacturing & services)

Composite PMI Input Prices Index



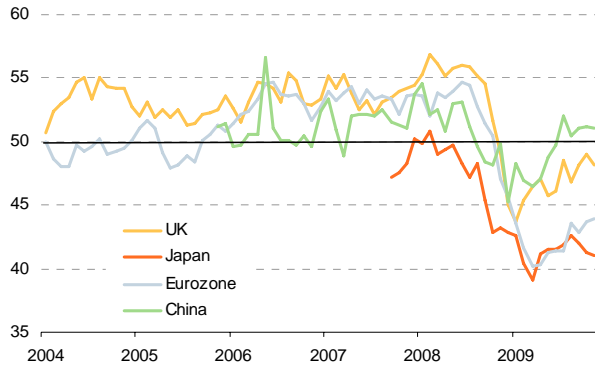
Sources: Markit, ISM.

The increase in prices charged in China reflects improved pricing power as the rate of economic expansion accelerated again in both manufacturing and services during November. However, the increase in prices also reflected a need to pass higher costs on to customers: Chinese firms saw a steeper rate of increase of input costs than companies in the US, Eurozone, UK and Japan.

Prices charged

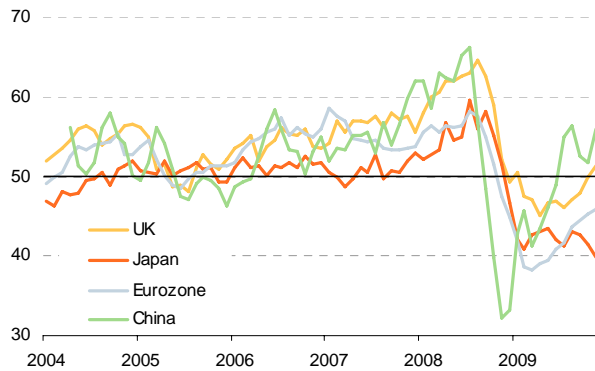
Service sector output prices

Services PMI Prices Charged Index (50 = no change)



Manufacturing output prices

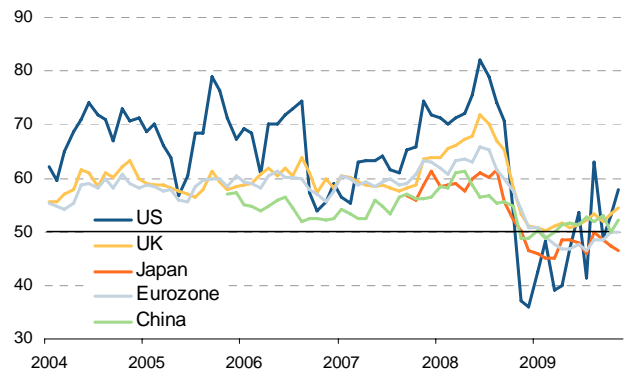
Manufacturing PMI Prices Charged Index



Input prices

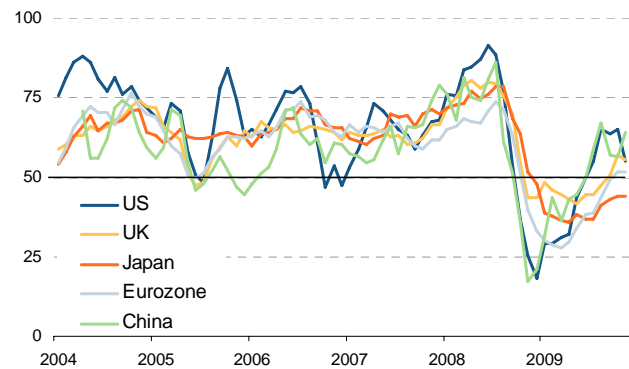
Service sector input prices

Services PMI Input Prices Index



Manufacturing input prices

Manufacturing PMI Input Prices Index



Sources: UK, Japanese, Eurozone and Chinese data from Markit, US data from ISM.

Rising costs evident in Europe and US

Prices charged by manufacturing and service companies in the Eurozone fell at the slowest pace for 11 months in November, but still continued to decline sharply. Similarly, charges fell in the UK, driven down by falling rates levied for services. UK manufacturers reported the first rise in selling prices since January, though the rate of increase was only very modest.

Companies in the Eurozone and the UK have been under pressure to raise their selling prices in order to improve margins which have been squeezed by higher costs. Input costs (measured across both manufacturing and services) rose at the fastest rates for 13 months in both the Eurozone and the UK in November, the latter seeing the steeper rate of increase by a wide margin.

Output price data are not collected in the ISM survey of the US, but input price data are. With input costs having risen sharply across manufacturing and

services in the US in November (the latest rise was the second-strongest seen over the past 14 months, exceeded only by a spike in costs seen in August), it seems that pricing power among suppliers at least has improved compared to earlier in the year.

Price outlook

The extent to which companies have been able to raise prices has depended upon the strength of 'final' demand, hence stronger growth of prices in China but still falling prices in Japan.

With PMI data showing output levels continuing to fall in Japan, and at an increased rate, deflationary forces appear to be intensifying and corroborate the need for the new stimulus measures announced by the government and Bank of Japan in early December.

In other countries, most notably China but also in the US, UK and Eurozone, input costs are now rising. These cost increases are putting pressure on companies to raise their selling prices and restore

margins. However, it would appear that final demand for goods and services needs to strengthen considerably further before selling prices begin to rise to any significant extent. Instead, companies are looking to reduce other costs, such as staff pay, to boost profit margins (for further information on how companies are boosting labour productivity see http://www.markit.com/assets/en/docs/commentary/markit-economics/dec%2009/EU_ICBprod_09-12-07.pdf).

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