

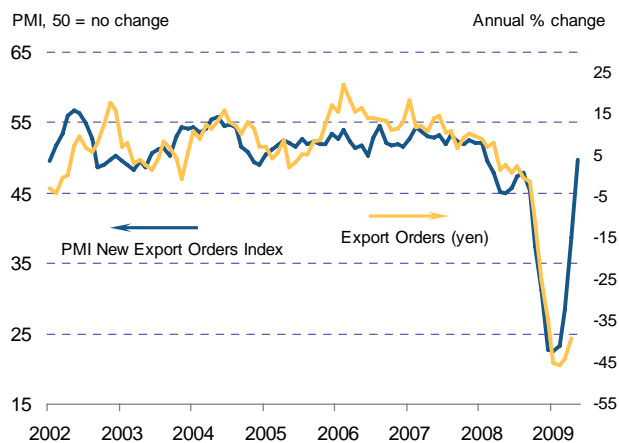
Japan

Both PMI and official data show Japanese manufacturing output falling at a slower rate as improvement in export demand gathers momentum

Contraction of Japanese exports moderated, in line with PMI data

Official data for April provided further evidence to suggest that the slump in Japanese exports is easing, sparking hopes that the most intense phase of the recession may have passed. Despite dropping by a significant 39.1% on the year, shipments from abroad rose 1.9% from a month earlier – a second successive monthly gain. The improvement was signalled in advance by the PMI (see chart 1), with the survey's New Export Orders Index up some 27.2 points from the survey low registered at the start of 2009. The PMI has historically been an accurate indicator of movements in export flows, displaying a **correlation of 0.88** against official figures.

Chart 1: Exports Orders (yen)

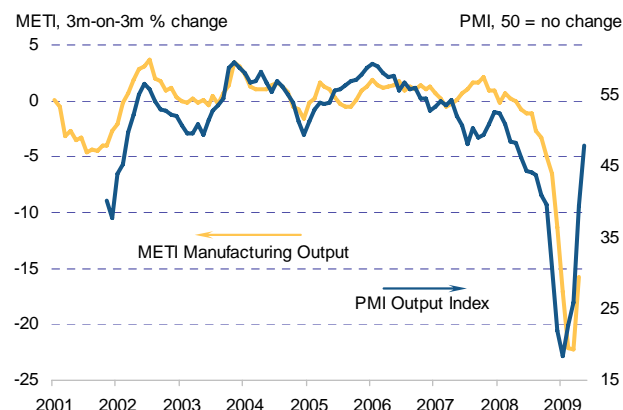


Slower drop in exports spurs optimism in manufacturing

Official estimates for April showed that Japanese manufacturing output increased by 5.2% on the month, the most pronounced monthly rise in fifty-six years and the second increase in as many months. On an annual basis, production was still down by 31.2%, but this was slower than the equivalent declines registered in each of the previous two months. The reduced rate of

contraction suggests that the recession in manufacturing has passed its peak and that the sector is now in a tentative state of recovery. This is supported by the PMI Output Index, which has risen by 29.4 points since posting a record low of 18.5 in January. The PMI has correctly tracked the underlying trend in manufacturing output since its inception, achieving a **correlation of 0.86** with official METI figures.

Chart 2: Manufacturing Output

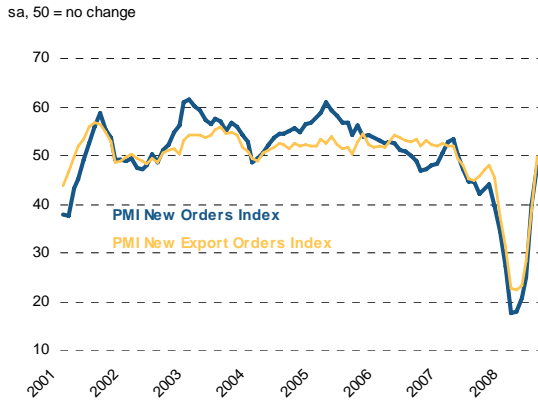


The extent to which any recovery is likely to depend on the sustainability of the rebound in external demand is illustrated by chart 3. This shows that total manufacturing order books have disappointed relative to exports, pointing to particularly subdued domestic demand.

This implies a further possible extension of the recession into Q2. GDP was revised up for Q1, posting a 3.8% annual decline rather than the previously estimated 4.0% drop, but chart 4 shows that the composite PMI (covering both manufacturing and services) indicates that the annual rate of change of GDP is likely to remain in negative territory in Q2 as domestic demand continues to act as a severe drag on the economy. However, the rate of contraction looks to

have eased considerably between Q1 and Q2 in response to the improvement in global trade flows.

Chart 3: Manufacturing order books

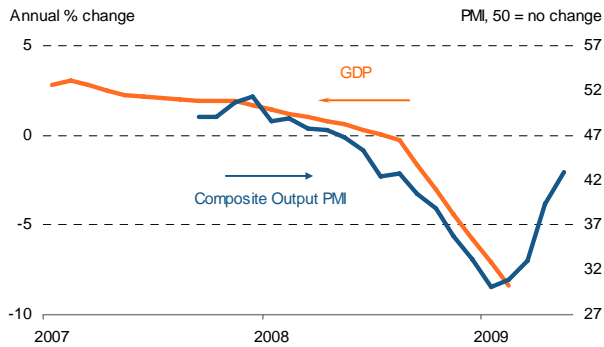


Upcoming releases

The Japan Manufacturing PMI is released on 30 June, followed by the Japan Services and Composite PMIs on 3 July. To find out how to receive data from the surveys or obtain copies of the reports, please contact economics@markit.com

For further information, please visit www.markit.com

Chart 4: GDP



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