

Global manufacturing

Global manufacturing sees record easing in rate of contraction in April

Key findings

- Synchronised worldwide upturn in PMIs, with growth even seen in China and India.
- Stocks to be rebuilt in coming months, but signs exist that we are in the midst of more than an inventory adjustment.

Global manufacturing output index shows largest monthly improvement on record

April's manufacturing PMIs provided further evidence of a synchronised global easing in the rate of output contraction. The JPMorgan Global Manufacturing PMI, compiled by Markit using data from all 26 countries covered by PMI surveys, showed that the rate of decline of output in the world's factories slowed for the fourth successive month in April from the record pace seen in December, registering the smallest drop in production for seven months.

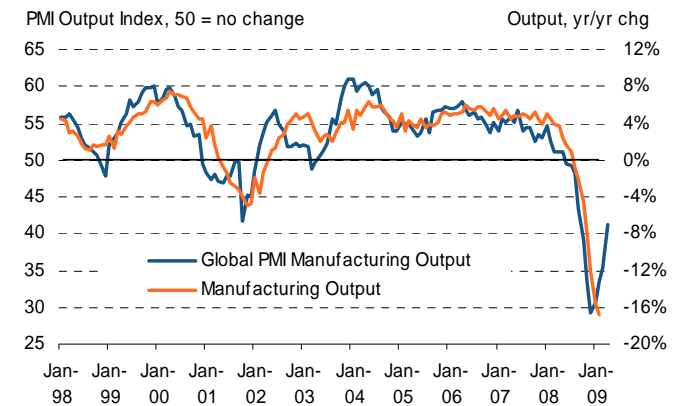
What's more, the index rose some 5.9 points in April – by far the largest monthly rise since the index was first available in 1998 and suggesting that the sector is recovering at a rapid pace.

To put the PMI in context, the latest data from official sources suggest that manufacturing output was 16.8% lower than a year ago in February. A regression analysis of PMI and official data suggests that the April PMI data point to an easing in the rate of decline to around 8% (though the lag between changes in the annual rate of decline and PMI data suggests that it may be later in Q2 that this easing is fully apparent – see top chart on right).

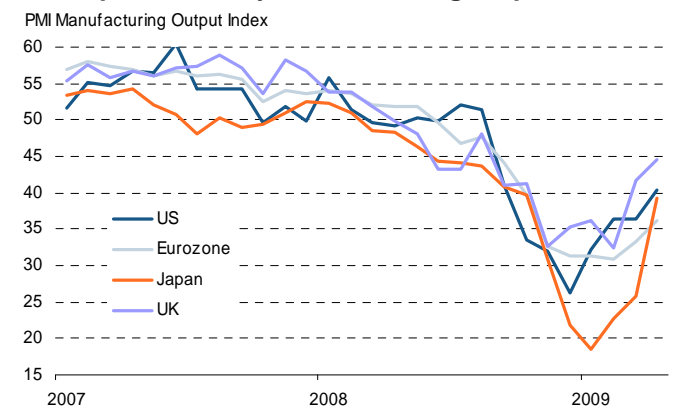
Synchronised recovery?

It is encouraging to see that PMIs have picked up in all major economies, both developed and emerging, in recent months, with Output Indices rising markedly again in April in all G4 and BRIC economies with the sole exception of Russia, where some consolidation in the Output Index was seen following strong rises in previous months.

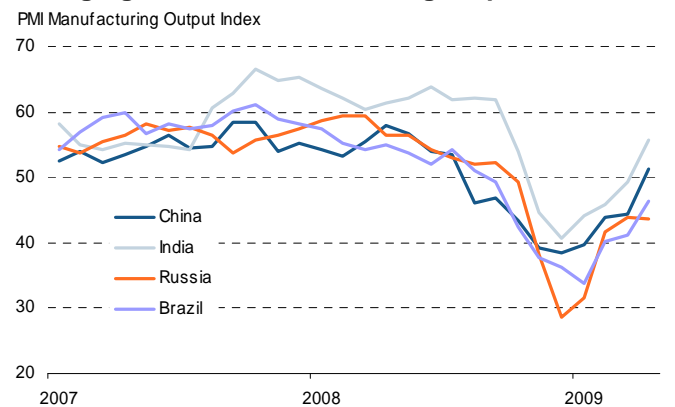
Global manufacturing output



Developed economy manufacturing output



Emerging markets manufacturing output



Most countries have seen rates of decline ease to their pre-Lehman collapse levels. In the US, the rate of decline of output slowed to a seven-month low, while

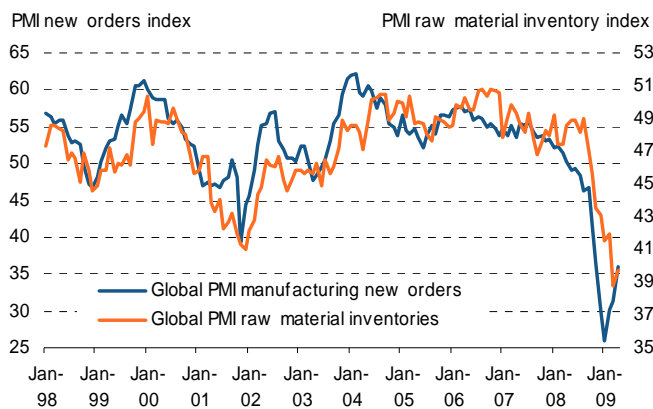
six- and eight-month lows were seen in the Eurozone and UK respectively.

However, the recoveries in Asia have been particularly impressive, with output even returning to growth in both China and India in April. The Japanese PMI meanwhile posted a huge 13.5 point gain in April (by far the largest rise of all countries) to hit a six-month high.

Upturn in part reflects inventory adjustment

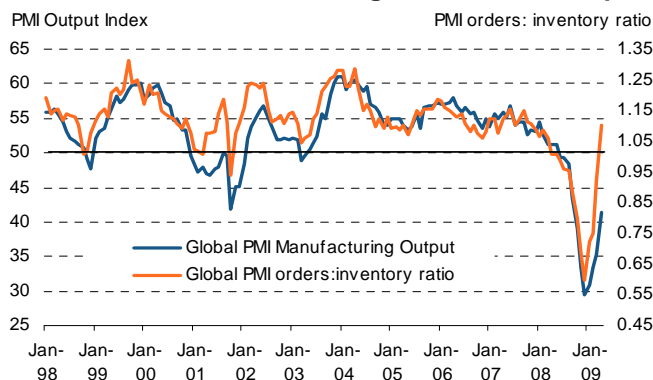
PMI data on stocks of finished goods and raw materials suggest that the severity of the downturn during the final quarter of 2008 and the first few months of 2009 was exacerbated by manufacturers winding-down stock levels in the face of weak demand (and the prospects of sustained weak demand for some time to come).

Orders and stock levels



This situation seems to be currently reversing. The ratio of new orders to manufacturers' inventories provides a reliable guide to future production trends, and the recent easing in the rate of decline of new orders, combined with the record falls in inventories in recent months, suggests manufacturing output will continue to rise in the near-term future.

Orders:inventories ratio as a guide to future output

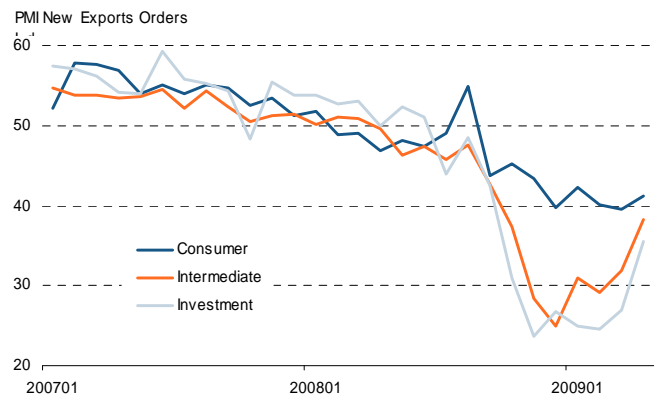


Uncertainty further ahead

The inventory adjustment at the turn of the year therefore in some respects represents a short, sharp shock to the manufacturing economy, and low levels of inventories mean any recovery in demand could swiftly translate into higher production. This seems to be what is occurring in the second quarter of 2009.

This idea is supported by PMI data on new export orders for Eurozone manufacturers, where data on trends by type of good are available. Here we can see that exports of intermediate goods (manufactured items used as inputs by other producers) and capital goods fell especially sharply in late-2008 as companies cut back on their purchasing, inventories and capital expenditures. It is these intermediate and investment goods that have seen the rate of decline slow sharply in April.

Eurozone exports*



* includes intra-euro area trade.

A concern is that once inventories are rebuilt to normal levels, production growth will taper off again. However, the easing in the rate of decline of investment goods, plus recoveries in service sector PMIs in recent months, provide hope that we are not simply in the midst of an inventory correction. Both business and consumer confidence has certainly recovered from the historic lows seen late last year and Markit's credit indices suggest that the perceived risk of corporate defaults has moderated considerably so far this year. Sector analysis of data, such as that available using the ICB sector PMIs, will provide a valuable indication of how broad-based and sustainable any recovery in Q2 is likely to be.

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