New orders fall at slowest pace since the current downturn began in February

Key findings

Signs of a turnaround continue across the service sector

Business activity and new orders decline at softer rates

Expectations for the year ahead improve again in July

Service providers in Japan indicated another tentative turnaround from disruptions due to the coronavirus disease 2019 (COVID-19) pandemic in July. While business activity and new orders continued to fall, the rates of contraction eased since June and remained much less severe than those seen in April.

The au Jibun Bank Japan Services PMI® is compiled by IHS Markit from survey responses from a panel of around 400 service sector companies. The sectors covered include consumer (excluding retail), transport, information, communication, finance, insurance, real estate and business services.

The headline figure is the Services Business Activity Index, which tracks changes in the volume of business activity compared with one month previously. A reading above 50 indicates an overall increase compared to the previous month, and below 50 an overall decrease.

At 45.4 in July, up slightly from 45.0 in June, the seasonally adjusted Japan Services Business Activity Index reached a five-month high. The latest reading also compared favourably with the survey-record low of 21.5 in April.

Around one-in-four survey respondents (26%) reported a drop in business activity during July, while 21% signalled an expansion. Among the minority reporting growth, this was primarily attributed to a gradual recovery in domestic demand since the state of emergency had been lifted.

July data indicated only a modest overall reduction in new work across the service sector, with the rate of decline the slowest in the current six-month period of contraction. Where a fall in new orders was reported, service providers often commented on low tourism numbers, event cancellations and other factors related to the pandemic.

Export sales remained especially subdued amid ongoing international travel restrictions, with the latest survey signalling a steep and accelerated reduction in new orders from abroad.

Backlogs of work decreased in July, which continued the downward trend seen since December 2019. Despite a lack of pressure on business capacity, employment numbers fell only slightly. Where lower staffing numbers were reported, this mostly reflected the non-replacement of retired employees, according to survey respondents.

Average cost burdens were broadly unchanged in July. Service providers noted a preference for cutting fixed overheads where possible, to help offset pressures on costs in other areas. Latest data indicated a sustained fall in prices charged by service sector companies. Discounting strategies have been signalled in each month since March amid intense competition for new work, but the latest fall was the slowest over this period.

Business expectations for the next 12 months meanwhile returned to positive territory, with the proportion of firms expecting growth (28%) exceeding those forecasting a reduction (26%). This represented the strongest degree of confidence since February. Anecdotal evidence mostly cited hopes of an improvement in the pandemic situation and a subsequent rebound in domestic economic conditions.
au Jibun Bank Japan Composite PMI®

Highest Composite PMI reading for five months in July

Composite indices are weighted averages of comparable manufacturing and services indices. Weights reflect the relative size of the manufacturing and service sectors according to official GDP data. The Japan Composite Output Index is a weighted average of the Manufacturing Output Index and the Services Business Activity Index.

The au Jibun Bank Japan Composite Output Index - which measures combined output in the manufacturing and service sectors - registered 44.9 in July, up from 40.8 in June and the highest reading since February. However, the index has now remained below the crucial 50.0 no-change threshold for six consecutive months.

Manufacturing production (index at 43.9) decreased to a greater extent than service sector activity in July (45.4). The performance gap nonetheless narrowed since June, reflecting a much softer drop in manufacturing output than in the previous month.

Both manufacturers and service providers are optimistic that business activity will rise in the coming 12 months. At 52.8 in July, up from 49.4 in June, the composite index signalled the strongest business expectations since January.

Comment

Commenting on the latest survey results, Tim Moore, Director at IHS Markit, said:

"Japan's service economy edged a little further along the path to recovery in July, with some firms experiencing an uplift after the state of emergency was lifted. The latest falls in business activity and new work were much less severe that those seen on average in the second quarter of 2020. Export sales were an exception in July as international travel restrictions meant that demand from overseas continued its rapid descent. "While there were some positive signs in terms of domestic sales, large parts of the service sector remained impacted by fragile customer demand and the cancellation of projects due to the pandemic. As a result, service providers commented on the need to reduce fixed overheads and an aversion to replacing departing staff. "Survey respondents are now more optimistic about the business outlook than at any time since February. However, projections of growth in the next 12 months were unsurprisingly contingent on the degree of success in suppressing the virus at home and abroad."
Methodology
The au Jibun Bank Japan Services PMI® is compiled by IHS Markit from responses to questionnaires sent to a panel of around 400 service sector companies. The sectors covered include consumer (excluding retail), transport, information, communication, finance, insurance, real estate and business services. The panel is stratified by detailed sector and company workforce size, based on contributions to GDP.

Survey responses are collected in the second half of each month and indicate the direction of change compared to the previous month. A diffusion index is calculated for each survey variable. The index is the sum of the percentage of ‘higher’ responses and half the percentage of ‘unchanged’ responses. The indices vary between 0 and 100, with a reading above 50 indicating an overall increase compared to the previous month, and below 50 an overall decrease. The indices are then seasonally adjusted.

The headline figure is the Services Business Activity Index. This is a diffusion index calculated from a question that asks for changes in the volume of business activity compared with one month previously. The Services Business Activity Index is comparable to the Manufacturing Output Index. It may be referred to as the ‘Services PMI’ but is not comparable with the headline manufacturing PMI figure.

The Composite Output Index is a weighted average of the Manufacturing Output Index and the Services Business Activity Index. The weights reflect the relative size of the manufacturing and service sectors according to official GDP data. The Composite Output Index may be referred to as the ‘Composite PMI’ but is not comparable with the headline manufacturing PMI figure.

Underlying survey data are not revised after publication, but seasonal adjustment factors may be revised from time to time as appropriate which will affect the seasonally adjusted data series.

July 2020 data were collected 13-28 July 2020.

About PMI
Purchasing Managers’ Index™ (PMI®) surveys are now available for over 40 countries and also for key regions including the eurozone. They are the most closely watched business surveys in the world, favoured by central banks, financial markets and business decision makers for their ability to provide up-to-date, accurate and often unique monthly indicators of economic trends.

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