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February Machinery Orders

Despite first gain in two months, underlying trend weak

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Summary

- Machinery orders (Cabinet Office [CAO]; private sector excl. those for shipbuilding and from electric utilities; this basis hereafter unless otherwise specified; leading indicator of domestic capex) posted the first m/m gain in two months in February (up 7.5%), overshooting consensus expectations (up 6.9%). On a three-month moving average basis, however, they saw a second consecutive m/m slide. In addition, non-manufacturing orders, which account for more than 60% of private sector orders, have been sluggish. Thus, the underlying trend has likely been flagging.
- By demand source, manufacturing orders posted the first m/m advance in two months (up 8.6%). Non-manufacturing orders (private sector excl. those for shipbuilding and from electric utilities; this basis hereafter unless otherwise specified) posted the first m/m gain in three months (up 0.6%). A boost seen for orders from materials industries, as well as that seen for those from electrical machinery, pushed up overall orders. Despite a gain, non-manufacturing orders were unfavorable, as declines were seen for those from many industries.
- Overseas orders posted the first m/m gain in three months (up 8.0%). The export value of general machinery has turned to an increase, mainly supported by increases in shipments to the US. This suggests that overseas orders have been on a moderate uptrend after bottoming in August 2012.
- GDP-based capex is likely to have turned to an increase in Jan-Mar 2013. However, given the ongoing weakness in machinery orders, and considering the tendency that export volume will not begin to increase until about six months later from a shift to a weaker yen, capex will not see a full-fledged recovery before 2H 2013. Thereafter, capex will continue to increase moderately, because exports will likely increase, reflecting the recovery in overseas economies and the effect of the recent shift to a weak yen being felt, and because domestic demand will likely grow steadily reflecting rises in wages.

Machinery Orders (m/m %; SA) **Chart 1**

	2012 Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	2013 Jan	Feb
Machinery orders (private sector)*	-2.8	5.7	-14.8	5.6	4.6	-3.3	-4.3	2.6	3.9	2.8	-13.1	7.5
Market consensus (Bloomberg)												6.9
DIR estimate												6.3
Manufacturing orders	-8.4	3.4	-8.0	-2.9	12.0	-15.1	2.8	-3.6	3.9	3.0	-13.2	8.6
Non-manufacturing orders*	-3.9	5.7	-6.4	2.6	-2.1	3.6	1.3	2.8	6.2	-8.0	-6.3	0.6
Overseas orders	-14.4	0.3	0.3	-9.8	3.0	-14.7	0.0	9.4	17.0	-12.6	-4.8	8.0

Source: Cabinet Office, Bloomberg; compiled by DIR.
* excl. those for shipbuilding and from electric utilities.

First gain in two months for overall orders

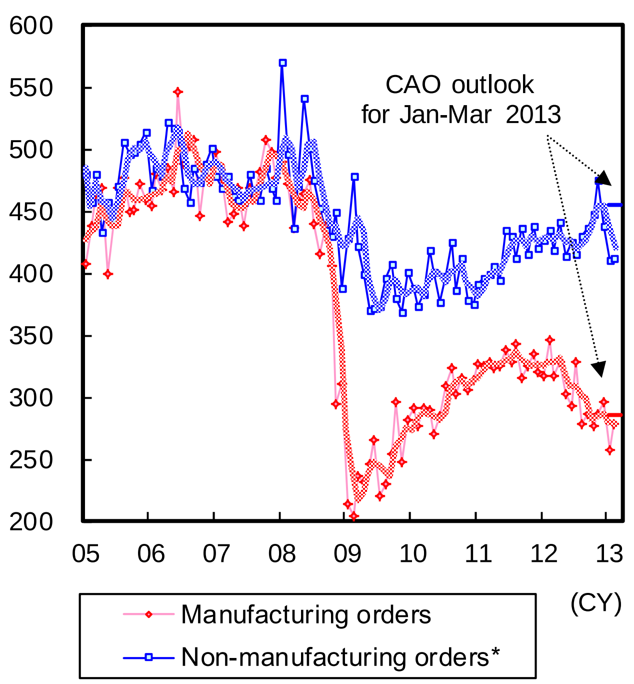
Machinery orders (Cabinet Office [CAO]; private sector excl. those for shipbuilding and from electric utilities; this basis hereafter unless otherwise specified; leading indicator of domestic capex) posted the first m/m gain in two months in February (up 7.5%), overshooting consensus expectations (up 6.9%). On a three-month moving average basis, however, they saw a second consecutive m/m slide. In addition, non-manufacturing orders, which account for more than 60% of private sector orders, have been sluggish. Thus, the underlying trend has likely been flagging.

First gain in two and three months for manufacturing and non-manufacturing orders

By demand source, manufacturing orders posted the first m/m advance in two months (up 8.6%). A boost seen for orders from materials industries—chemicals (up 15.1%), iron/steel (up 50.9%), nonferrous metals (up 170.4%), and metal products (up 34.6%)—as well as that seen for those from electrical machinery (up 34.7%), pushed up overall manufacturing orders. Meanwhile, those from general machinery (down 8.0%) and info/communications equipment (down 22.0%) posted the second consecutive m/m slide.

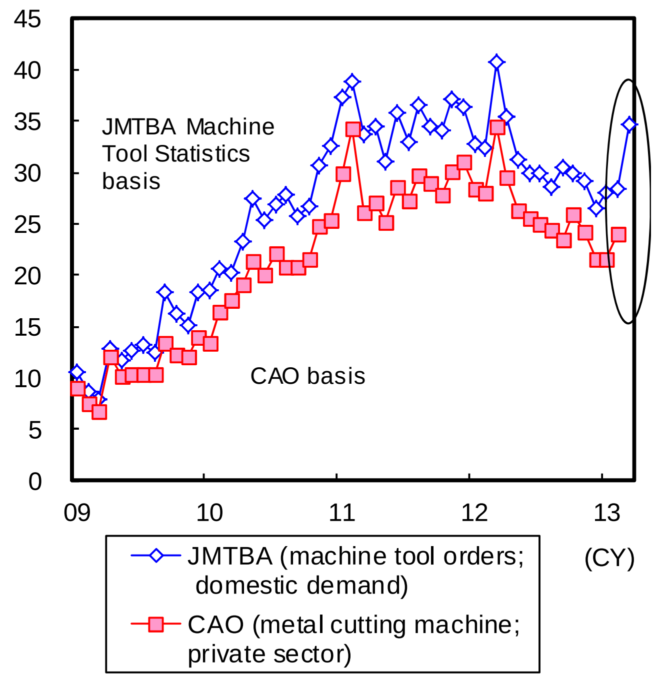
In the Monthly Machine Tool Statistics (Japan Machine Tool Builders Association), domestic orders for machine tools jumped sharply in March, signaling a turnaround for manufacturing orders. One month's data is insufficient to determine the trend so we will closely watch orders related to machine tools.

Machinery Orders by Demand Source (Y bil; SA) **Chart 2**



Source: Cabinet Office (CAO); compiled by DIR.
* excl. those for shipbuilding and from electric utilities.
Note: Thick lines denote 3M MAs.

Orders for Machine Tools (Y bil; SA) **Chart 3**



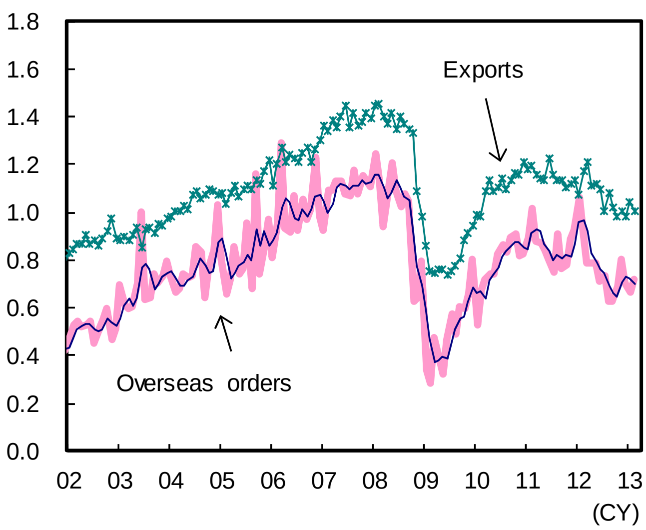
Source: Cabinet Office (CAO), Japan Machine Tool Builders Association (JMTBA); Compiled by DIR.
Note: SA by DIR.

Non-manufacturing orders (private sector excl. those for shipbuilding and from electric utilities; this basis hereafter unless otherwise specified) posted the first m/m gain in three months (up 0.6%). Results were mixed by industry. Increases were seen for orders from the retailing/wholesaling (up 5.9%) and real estate (up 13.4%) industries. Those from the communication service industry posted the third m/m slide in a row (down 0.1%), those from the financial/insurance industry saw a plunge of 24.0%, and those from information services posted the fourth consecutive slide (down 4.1%).

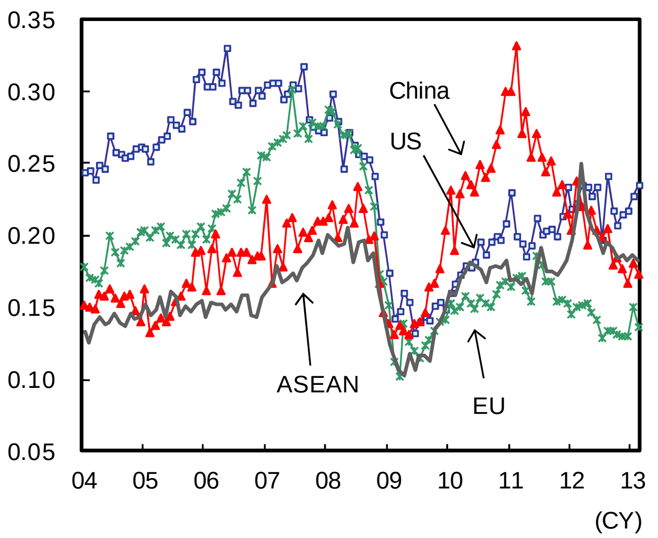
First gain in three months for overseas demand

Overseas orders posted the first m/m gain in three months (up 8.0%). Two successive slides were seen (Dec 2012 and Jan 2013) but this should be in reaction to the one-off large-scale orders in November 2012. The export value of general machinery has turned to an increase, mainly supported by increases in shipments to the US. This suggests that overseas orders have been on a moderate uptrend after bottoming in August 2012. In addition, given that the economies of China and ASEAN countries, major destinations of Japan’s exports, have likely bottomed out, and considering the ongoing shift to a weaker yen, overseas orders will likely continue to increase going forward.

General Machinery: Overseas Orders and Exports (Y tril; SA) **Chart 4**



General Machinery: Exports by Trading Partner (Y tril; SA) **Chart 5**



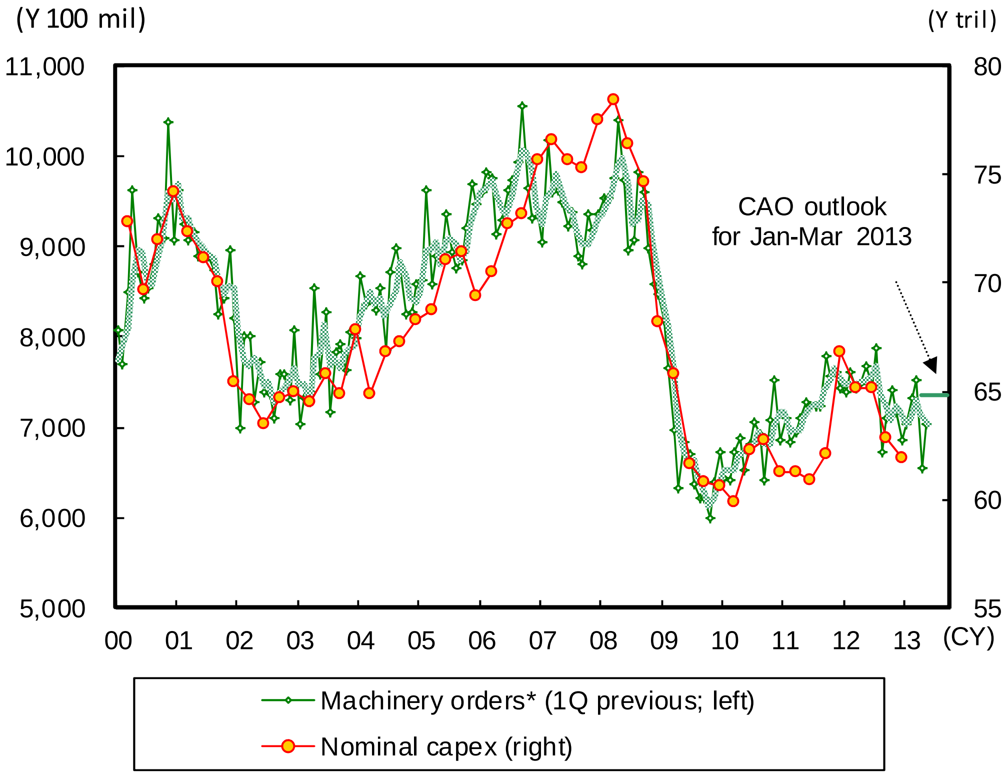
Source: Cabinet Office, Ministry of Finance; compiled by DIR.
Notes: 1) Exports seasonally adjusted by DIR.
2) Thin line for overseas orders denotes 3M MA.

Capex to see moderate recovery from 2H 2013

CAO projects that machinery orders will increase 0.8% q/q in Jan-Mar 2013, the second consecutive q/q gain. If orders meet the projection, they have to increase 20.7% in March, a very high hurdle to clear. Therefore, Jan-Mar will likely see the first q/q slide in two quarters.

Factoring in the fact that machinery orders turned to positive growth in Oct-Dec 2012, given the tendency for machinery orders to lead GDP-based capex by around three months, and taking into account that shipments of capital goods have ceased to decline, capex is likely to have turned to an increase in Jan-Mar 2013. However, given the ongoing weakness in machinery orders, and considering the tendency that export volume will not begin to increase until about six months later from a shift to a weaker yen, capex will not see a full-fledged recovery before 2H 2013. Thereafter, capex will continue to increase moderately, because exports will likely increase, reflecting the recovery in overseas economies and the effect of the recent shift to a weak yen being felt, and because domestic demand will likely grow steadily reflecting rises in wages.

Machinery Orders and Nominal GDP-based Capex (SA) — Chart 6



Source: Cabinet Office (CAO); compiled by DIR.
*excl. those for shipbuilding and from electric utilities; thick line denotes 3M MA.