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May Machinery Orders

Non-manufacturers' capex becoming active

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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) advanced 10.5% m/m in May, the first gain in two months, substantially surpassing consensus expectations (up 1.9%).

- By demand source, manufacturing and non-manufacturing orders posted the first gains in two months, advancing 3.8% and 25.4% m/m, respectively. Manufacturing orders were driven by advances in those from the chemical and general machinery industries. Non-manufacturing orders exhibited a robust rise, mainly due to sharp gains in those from the financial/insurance industry and transportation/postal services.

- Overseas orders posted the first m/m gain in two months (up 10.3%). Looking at exports of general machinery, those to the US maintained an uptrend and those to China began to signal a bottoming. Considering that the effects of a weaker yen will emerge in earnest going forward, overseas orders will likely continue to grow.

- We expect machinery orders to post the first q/q gain in five quarters in Apr-Jun 2013. Given that sentiment of insufficient capacity intensified among non-manufacturers in the Bank of Japan's June Tankan survey of corporate sentiment, and looking at machinery order trends, we expect industries, centering on communication services and retailing, will probably pursue active capex going forward. Meanwhile, sentiment regarding capacity remained on the excess side among manufacturers in the Tankan survey. At the same time, the Tankan and other surveys indicate that manufacturers' earnings are likely to improve, benefitting from booming consumption and a weaker yen. However, this will not necessarily lead to production enhancement investment. Nevertheless, we expect investment to replace obsolete facilities to improve productivity will gradually increase going forward.

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

	2012							2013				
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May
Machinery orders (private sector)*	1.4	1.7	-1.0	-2.4	-0.8	3.8	-1.3	-7.5	4.2	14.2	-8.8	10.5
Market consensus (Bloomberg)												1.9
DIR estimate												4.2
Manufacturing orders	-3.4	6.1	-6.2	-3.0	-2.7	1.8	1.0	-10.0	4.9	13.3	-7.3	3.8
Non-manufacturing orders*	1.5	-1.8	2.3	0.8	2.7	6.4	-7.8	-4.5	0.3	14.3	-6.0	25.4
Overseas orders	-4.5	0.1	-12.1	3.6	0.5	11.8	-8.3	-3.7	1.0	52.1	-19.9	10.3

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

Surge in May confirming steady recovery

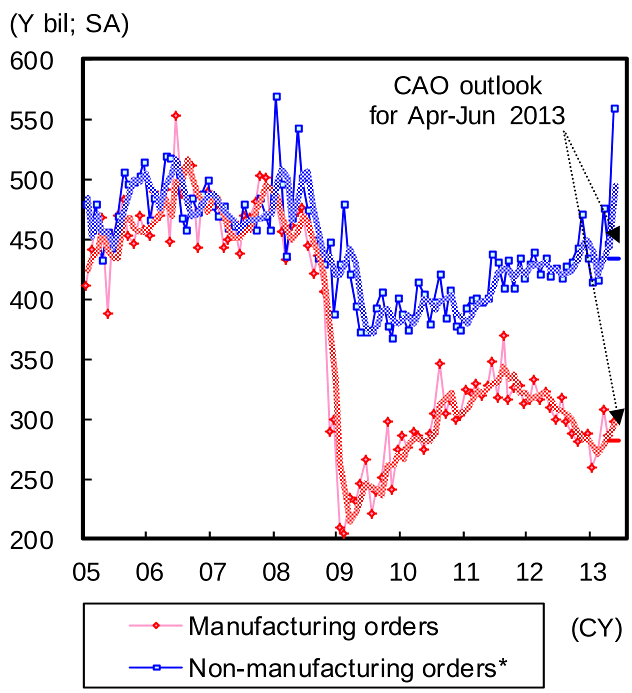
Machinery orders (CAO; private sector excl. those for shipbuilding and from electric utilities; this basis hereafter unless otherwise specified) advanced 10.5% m/m in May, the first gain in two months, substantially surpassing consensus expectations (up 1.9%). Following the favorable result in April excluding the reactionary slide, machinery orders advanced further in May, confirming a steady recovery trend.

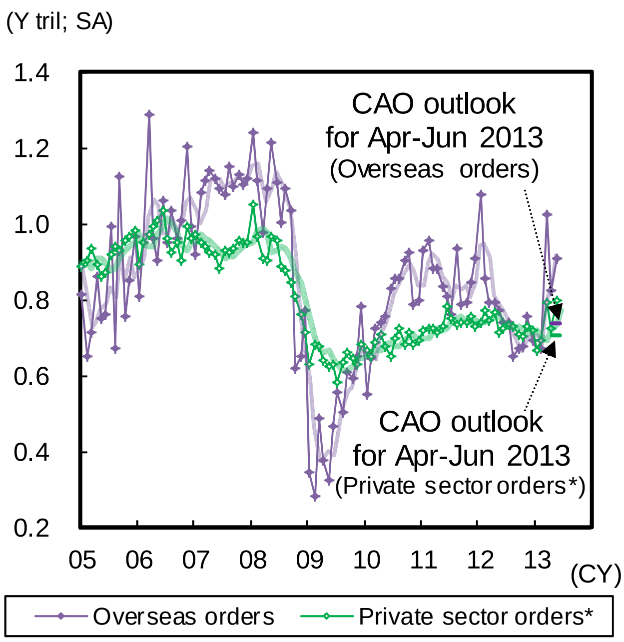
First advances in two months in manufacturing/non-manufacturing orders

By demand source, manufacturing orders posted the first gain in two months (up 3.8% m/m), driven by advances in those from the chemical (up 48.2%) and general machinery industries (up 16.0%). At the same time, a significant jump was seen for those from pulp/paper product industries (up 129.9%). Meanwhile, in contrast to an uptrend so far, a sharp slide was seen for those from electrical machinery firms (down 34.6%), a somewhat worrisome development.

Non-manufacturing orders (excl. those for shipbuilding and from electric utilities; this basis hereafter unless otherwise specified) also saw the first gain in two months (up 25.4% m/m). Behind this were sharp gains in those from the financial/insurance industry (up 106.3%) and transportation/postal services (up 70.2%). Other positives were also seen—those from the construction industry posted the eighth m/m gain in a row, accompanying increased public works projects, and those from wholesaling/retailing firms saw the fifth consecutive m/m advance. As a whole, non-manufacturing orders saw improvement on a broad basis, signaling active capex among non-manufacturers.

Orders by Demand Source **Chart 2**



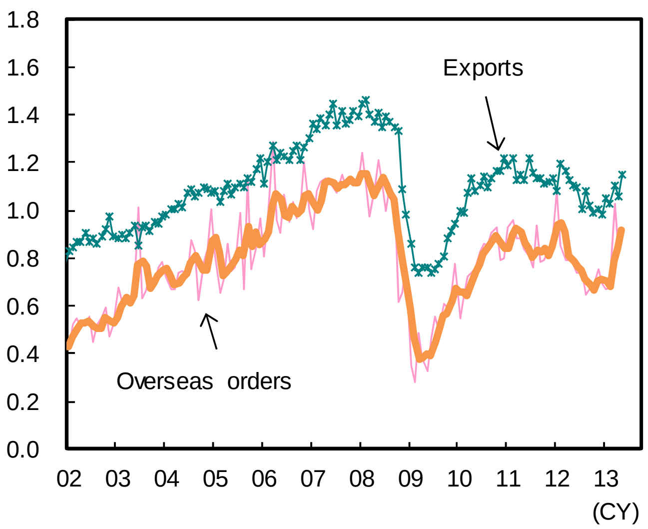


Source: Cabinet Office (CAO); compiled by DIR.
* excl. those for shipbuilding and from electric utilities.
Note: Thick lines 3MMA basis.

Overseas orders following suit, shipments to China signaling a bottoming out

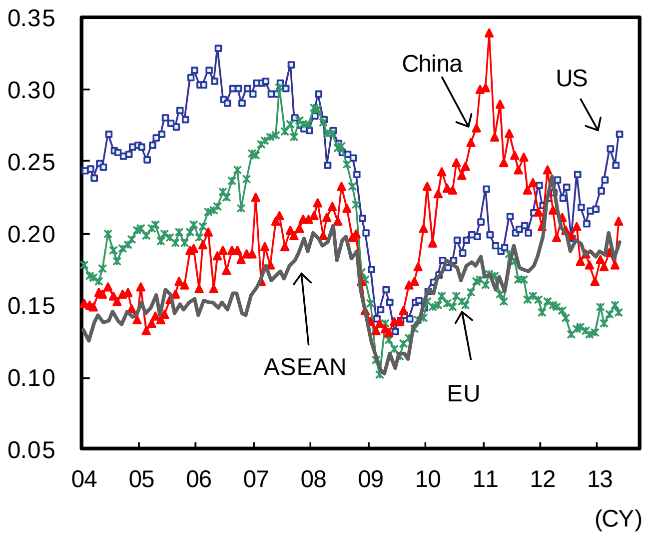
Overseas orders posted the first m/m gain in two months (up 10.3%). Looking at exports of general machinery, those to the US remained firm and those to China began to signal a bottoming out. Considering that the effects of a weaker yen will emerge in earnest going forward, overseas orders will likely continue to grow.

General Machinery: Overseas Orders and Exports (Y tril; SA) **Chart 3**



Source: Cabinet Office, Ministry of Finance; compiled by DIR.
Notes: 1) Exports seasonally adjusted by DIR.
2) Thick line for overseas orders 3MMA basis.

General Machinery: Exports by Trading Partner (Y tril; SA) **Chart 4**



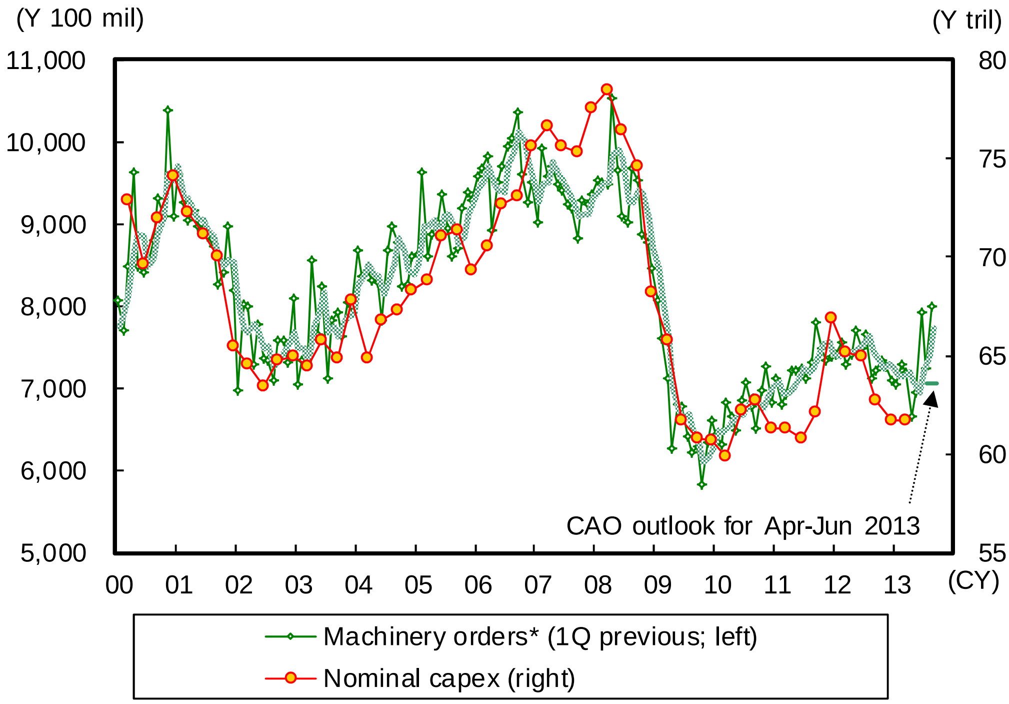
Source: Ministry of Finance; compiled by DIR.
Note: SA by DIR.

First gain in five quarters highly likely in Apr-Jun 2013

As a whole, machinery orders have been on an uptrend. CAO released a projection in May that machinery orders would decline 1.5% q/q in Apr-Jun 2013 for the fifth consecutive quarter. However, only if orders declined 25.0% m/m in June would this transpire—rather, we expect machinery orders to post the first q/q gain in five quarters in Apr-Jun 2013.

Given that sentiment of insufficient production capacity intensified among non-manufacturers in the Bank of Japan’s June Tankan survey of corporate sentiment, and looking at machinery order trends, we expect industries, centering on communication services and retailing, will probably pursue active capex going forward. Meanwhile, sentiment regarding capacity remained on the excess side among manufacturers in the Tankan survey. At the same time, the Tankan and other surveys indicate that manufacturers’ earnings are likely to improve benefitting from booming consumption and a weaker yen. However, this will not necessarily lead to production enhancement investment. Nevertheless, we expect investment to replace obsolete facilities and improve productivity will gradually increase going forward.

Machinery Orders and Nominal GDP-based Capex (SA) **Chart 5**



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