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July Industrial Production

Undershot expectations, but firming up confirmed

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Summary

- In Indices of Industrial Production (preliminary; Ministry of Economy, Trade, and Industry [METI]), July industrial production saw the first m/m gain in two months (up 3.2%). Although it undershot market expectations (up 3.6%), the gain was strong enough to offset the plunge in June. This confirmed a firming up. Shipments saw the first gain in two months (up 1.3%), while inventories increased (up 1.5%), resulting in the first decline (improving) in two months in the inventory-shipment ratio (down 0.5%).

- Production increased m/m in July for 12 industries out of 15 for which data is available on a preliminary estimate basis. Production was firm in general. Following sharp declines in June, assembling industries, such as general-purpose/production/business-oriented machinery, electronic components/devices, and transportation equipment, saw strong gains, pushing up overall production.

- We expect production to maintain the uptrend going forward. Whether production will steadily advance or not will depend on export volume. In this regard, a possible slowdown in emerging market economies raises concerns. However, reflecting economic growth in the US and the effects of a weak yen, the ongoing uptrend in export volume is likely to continue, driving production. Meanwhile, domestic demand will probably increase at a growing pace toward end-FY13, driving overall production. Behind this are increased public works projects following execution of the FY12 supplementary budget, as well as surging demand prior to a consumption tax hike scheduled for April 2014.

Industrial Production (m/m %; SA basis) **Chart 1**

	2012			2013						
	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul
Industrial Production	0.3	-1.0	1.4	-0.6	0.9	0.1	0.9	1.9	-3.1	**3.2**
Market consensus (Bloomberg)										3.6
DIR estimate										4.7
Shipments	0.3	-1.6	3.7	1.2	1.8	-0.8	-1.4	1.0	-3.2	**1.3**
Inventories	0.0	-0.4	-1.3	-1.6	-1.2	-0.7	0.8	-0.4	0.0	**1.5**
Inventory ratio	-0.7	0.0	0.0	-3.8	-2.6	2.3	-5.1	-2.1	5.9	**-0.5**

Source: Ministry of Economy, Trade, and Industry; Bloomberg; compiled by DIR.

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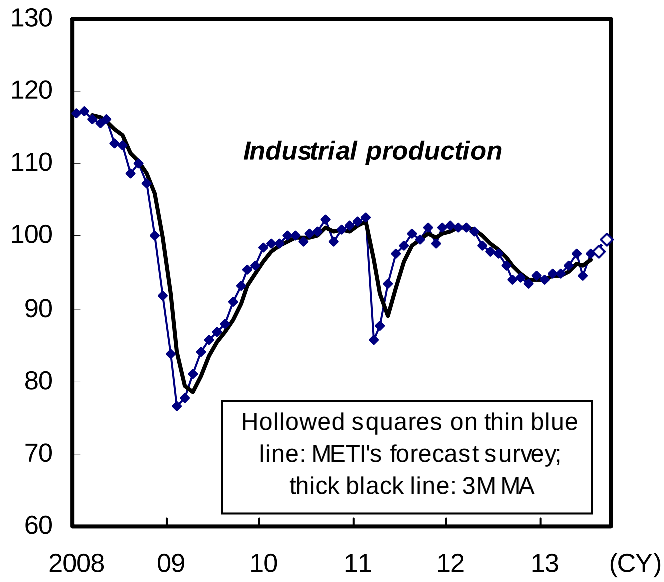
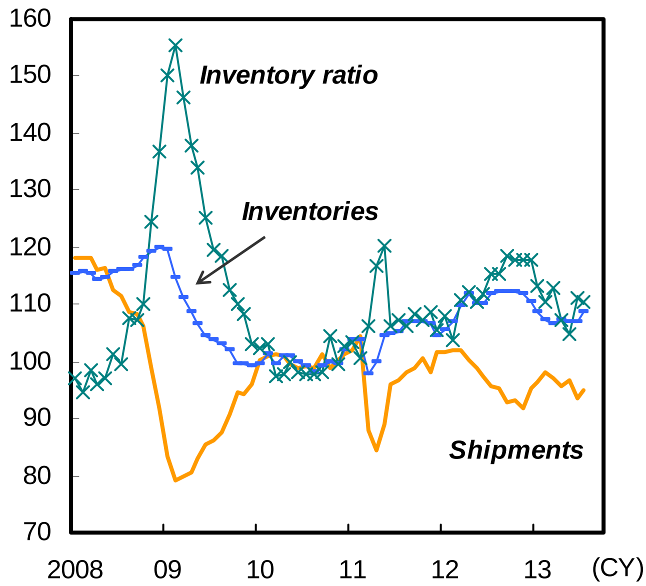
Economic Research

First gain in two months

In *Indices of Industrial Production* (preliminary; METI), July industrial production saw the first m/m gain in two months (up 3.2%). Although it undershot market expectations (up 3.6%), the gain was strong enough to offset the plunge in June. This confirmed a firming up. Shipments saw the first gain in two months (up 1.3%), while inventories increased (up 1.5%), resulting in the first decline (improving) in two months in the inventory-shipment ratio (down 0.5%).

Production, Shipments, and Inventories (2010 = 100; SA basis) **Chart 2**





Source: Ministry of Economy, Trade, and Industry (METI); compiled by DIR.

Assembling industries firm in July

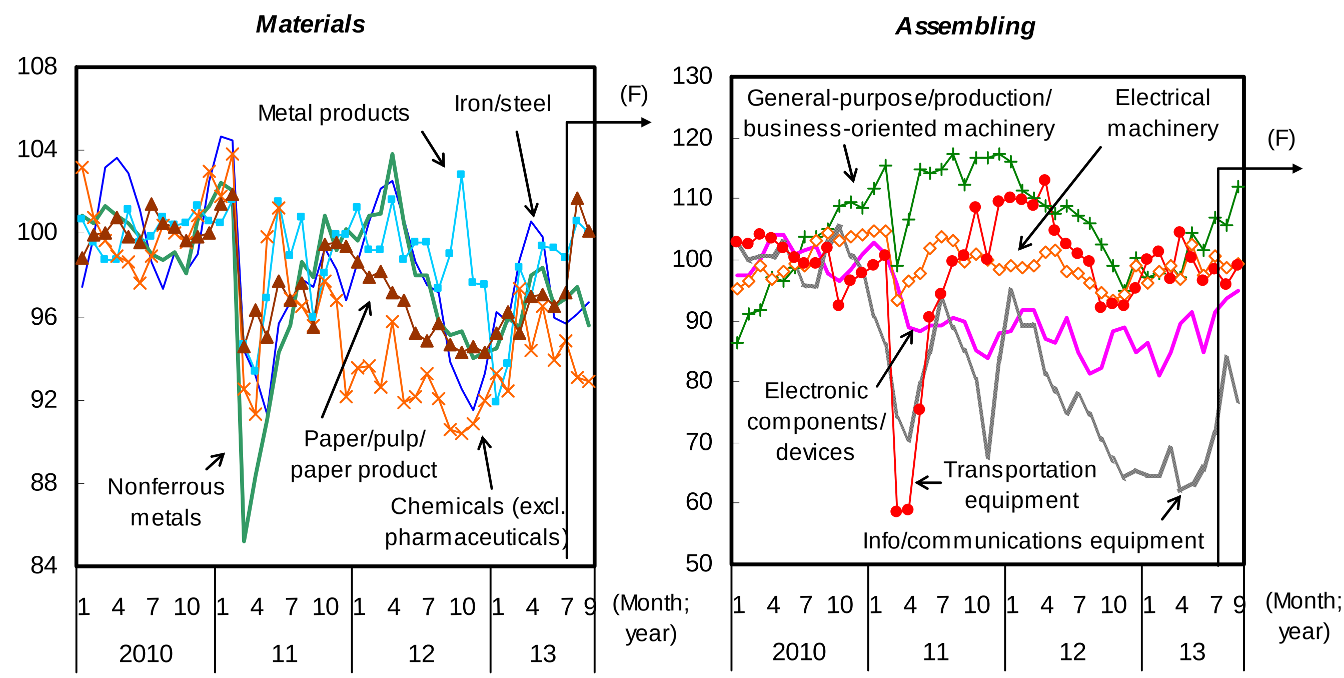
Production increased m/m in July for 12 industries out of 15 for which data is available on a preliminary estimate basis. Production was firm in general. Following sharp declines in June, assembling industries, such as general-purpose/production/business-oriented machinery, electronic components/devices, and transportation equipment, saw strong gains, pushing up overall production.

General-purpose/production/business-oriented machinery saw the first gain in two months (up 5.5% m/m), driven by steam turbine generators. Electronic components/devices also posted the first gain in two months (up 7.8%), mainly driven by smartphone-related devices/components, as witnessed by a firming up in MOS memory chips after a dip in June and higher production in active LCD panels. Transportation equipment posted the first advance in three months (up 1.9%), driven by higher production of mini-vehicles, reflecting steady domestic sales. Although it increased in July after declines in May and June, production of standard-size passenger cars has been slowing on average.

Production declined in metal products, textiles, and iron/steel. Although gains were seen for some materials industries, they were limited in general.

The production forecast survey projects overall production to increase 0.2% and 1.7% m/m in August and September, meaning the underlying uptrend likely continues. After firm production in July among assembling industries, a wide-range of industries project declines for August. However, the info/communications equipment industry prospects a jump (up 17.0%), likely driving overall production. As for September, while the info/communications equipment industry projects a reactionary slide (down 8.5%), boosts projected by general-purpose/production/business-oriented machinery and transportation equipment industries are likely to drive overall production. Among materials industries, the iron/steel industry continued stagnating but projects gains for August and September, while chemicals projects slides for both months. Thus, the ongoing advance and retreat in materials industries is likely to continue.

Production by Industry (2010 = 100; SA basis) **Chart 3**

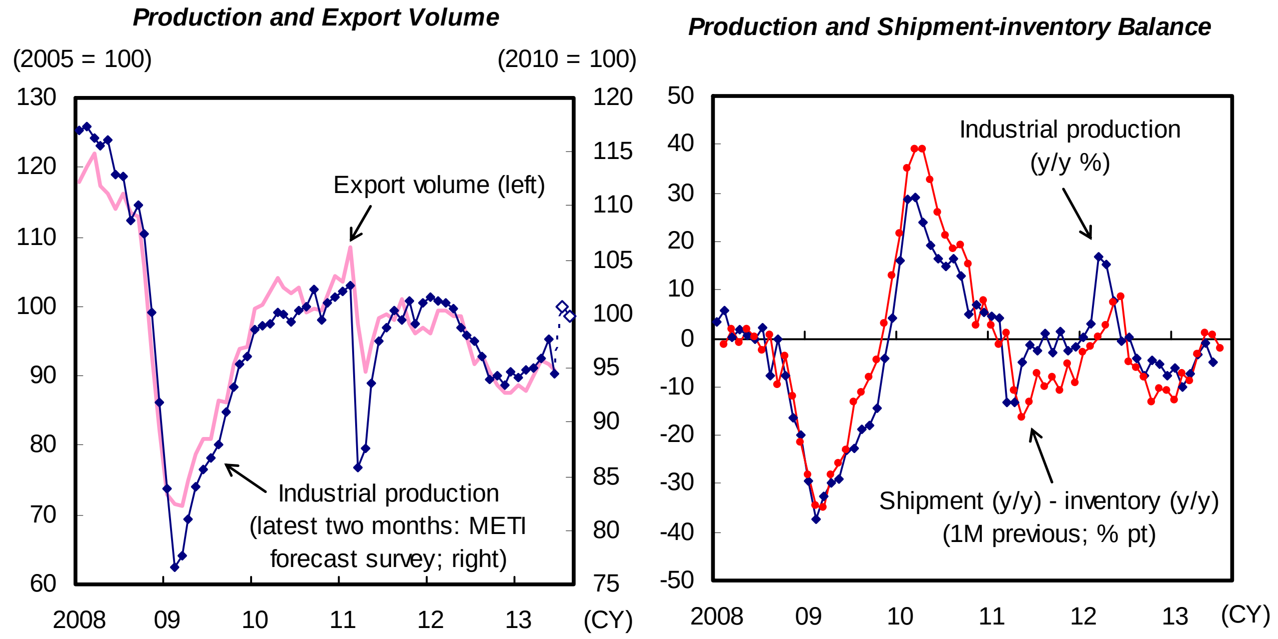


Source: Ministry of Economy, Trade, and Industry (METI); compiled by DIR.
F: METI's forecast survey.

Production to grow driven by higher exports

We expect production to maintain the uptrend going forward. Whether production will steadily advance or not will depend on export volume. In this regard, a possible slowdown in emerging market economies raises concerns. However, reflecting economic growth in the US and the effects of a weak yen, the ongoing uptrend in export volume is likely to continue, driving production. Meanwhile, domestic demand will probably increase at a growing pace toward end-FY13, driving overall production. Behind this are increased public works projects following execution of the FY12 supplementary budget, as well as surging demand prior to the consumption tax hike scheduled for April 2014.

Production, Export Volume, and Shipment-inventory Balance Chart 4



Source: Ministry of Economy, Trade, and Industry (METI); Cabinet Office; compiled by DIR.