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September Industrial Production

Undershot expectations but remained on moderate underlying uptrend

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Summary

- In *Indices of Industrial Production* (preliminary; Ministry of Economy, Trade and Industry [METI]), September industrial production saw the first m/m gain in two months (up 1.5%). Although undershooting market expectations (up 1.8%), it posted the first gain in two months on a three-month moving average basis. Thus, we maintain our view that production remains on a moderate underlying uptrend.
- Production was mixed by industry, up m/m in nine, down in six. Among those that saw advances and pushed up overall production were assembling industries, such as transportation equipment, electronic components/devices, and info/communications equipment.
- The production forecast survey projects a gain in overall production in October (up 4.7% m/m) and a slide in November (down 1.2%). Behind the strong figure for October are projections of substantial gains by general-purpose/production/business-oriented machinery (up 15.8%) and info/communications equipment (up 17.3%). However, September figures show that these two industries significantly undershot the projection of substantial gains for that month, which could be the result of likely delays in shipments. Hence, the production forecast survey should perhaps be discounted to some extent.
- Going forward, we expect production to maintain the uptrend. While export volume moves in tandem with industrial production, it has slackened, centering on shipments to Asian trading partners, due to a slowdown in ASEAN economies. However, reflecting the weak yen and economic growth in the US, export volume is likely to return to an uptrend, driving production. Meanwhile, considering a likely acceleration in personal consumption centering on durable goods toward end-FY13 prior to the consumption tax hike scheduled for April 2014, and also taking into account public works projects likely maintaining the current high level, domestic demand will also lift overall production.

Industrial Production (m/m %; SA basis)										Chart 1
	2012		2013							
	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
Industrial Production	1.4	-0.6	0.9	0.1	0.9	1.9	-3.1	3.4	-0.9	1.5
Market consensus (Bloomberg)										1.8
DIR estimate										3.7
Shipments	3.7	1.2	1.8	-0.8	-1.4	1.0	-3.2	2.0	-0.1	1.6
Inventories	-1.3	-1.6	-1.2	-0.7	0.8	-0.4	0.0	1.6	-0.2	-0.2
Inventory ratio	0.0	-3.8	-2.6	2.3	-5.1	-2.1	5.9	-0.5	1.8	-2.0

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

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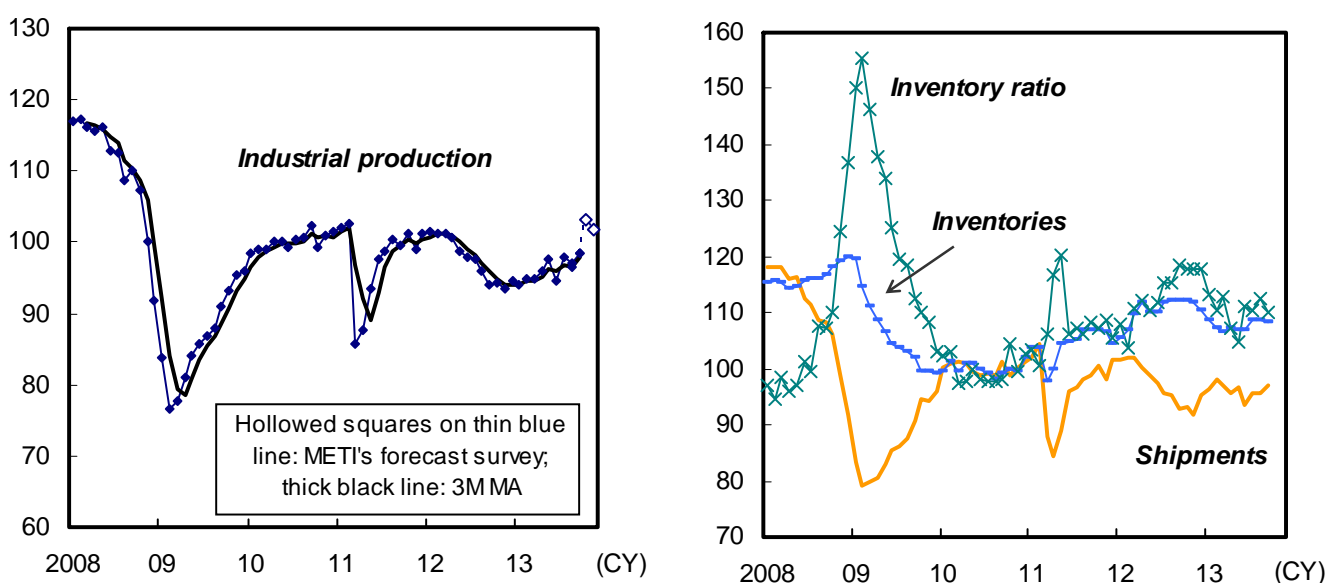
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First gain in two months

In *Indices of Industrial Production* (preliminary; METI), September industrial production saw the first m/m gain in two months (up 1.5%). Although undershooting market expectations (up 1.8%), it posted the first gain in two months on a three-month moving average basis. Thus, we maintain our view that production remains on a moderate underlying uptrend. Shipments saw the first gain in two months (up 1.6%), while inventories posted the second monthly slide in a row (down 0.2%), resulting in a decline (improvement) in the inventory-shipment ratio (down 2.0%).

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

Chart 2



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

Assembling industries firm

Production was mixed by industry, up m/m in nine, down in six. Among those that saw advances and pushed up overall production were assembling industries, such as transportation equipment, electronic components/devices, and info/communications equipment.

Transportation equipment saw for the gain in two months (up 3.9%), supported by firm automobile sales in the domestic market. The first gain in two months was also seen for electronic components/devices (up 4.7%)—in particular, active-matrix LCD panels (small and medium-sized) increased, indicating steady production of devices/components related to smartphones/tablet devices. Info/communications equipment saw the first gain in two months as well (up 4.9%), mainly owing to advances in external memory storage devices and mainframe computers, benefitting from substantial demand for such equipment from financial institutions, perhaps in preparation for the introduction of Nippon individual savings accounts (NISAs) in January 2014.

Among those that saw declines was general-purpose/production/business-oriented machinery, where production declined despite the projection of a substantial advance in the previous month's production forecast survey (subcomponent of *Indices of Industrial Production*), a likely factor responsible for overall production undershooting market expectations.

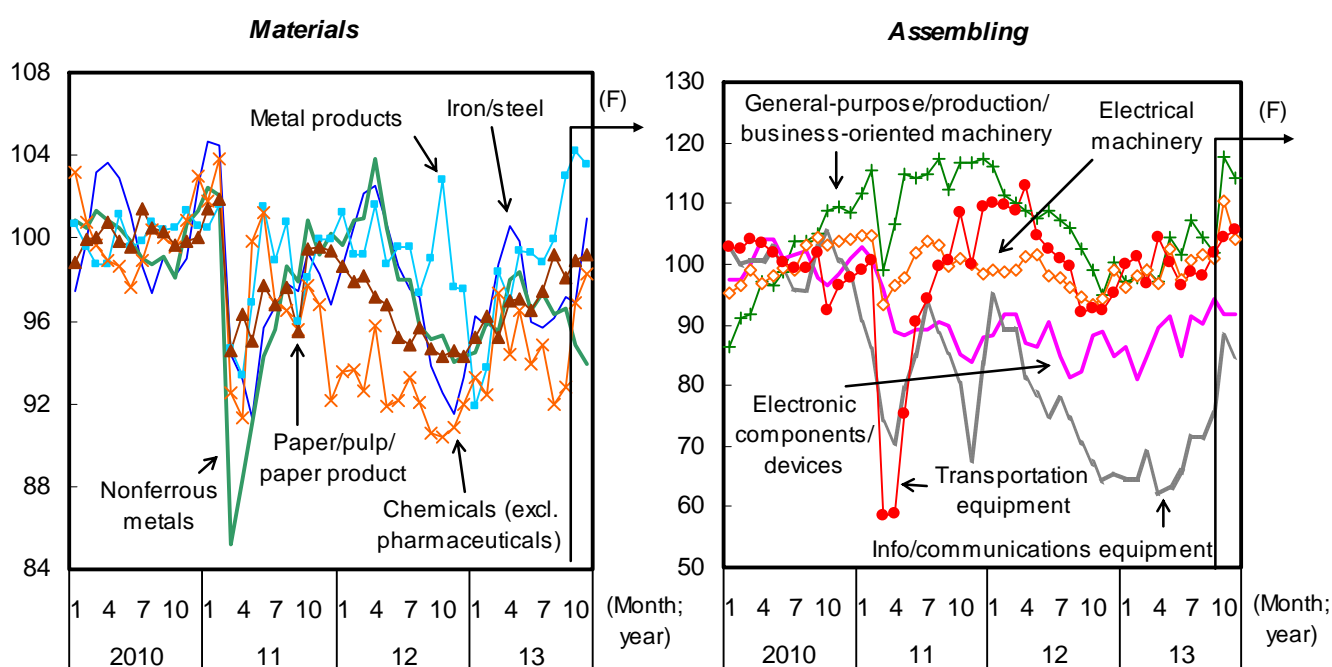
Meanwhile, shipments of capital goods, a coincident index for capex, posted the first gain in two quarters in Jul-Sep (up 1.2% q/q). Thus, following a turnaround in Apr-Jun, GDP-based capex is likely to post the second quarterly advance in a row in Jul-Sep.

Strong gain projected for October

The production forecast survey projects a gain in overall production in October (up 4.7% m/m) and a slide in November (down 1.2%). Behind the strong figure for October are projections of substantial gains by general-purpose/production/business-oriented machinery (up 15.8%) and info/communications equipment (up 17.3%). However, September figures show that these two industries significantly undershot the projection of substantial gains for that month, which could be the result of likely delays in shipments. Hence, the production forecast survey should perhaps be discounted to some extent. November production is expected to decline in reaction to a projected gain in October.

Production by Industry (2010 = 100; SA basis)

Chart 3

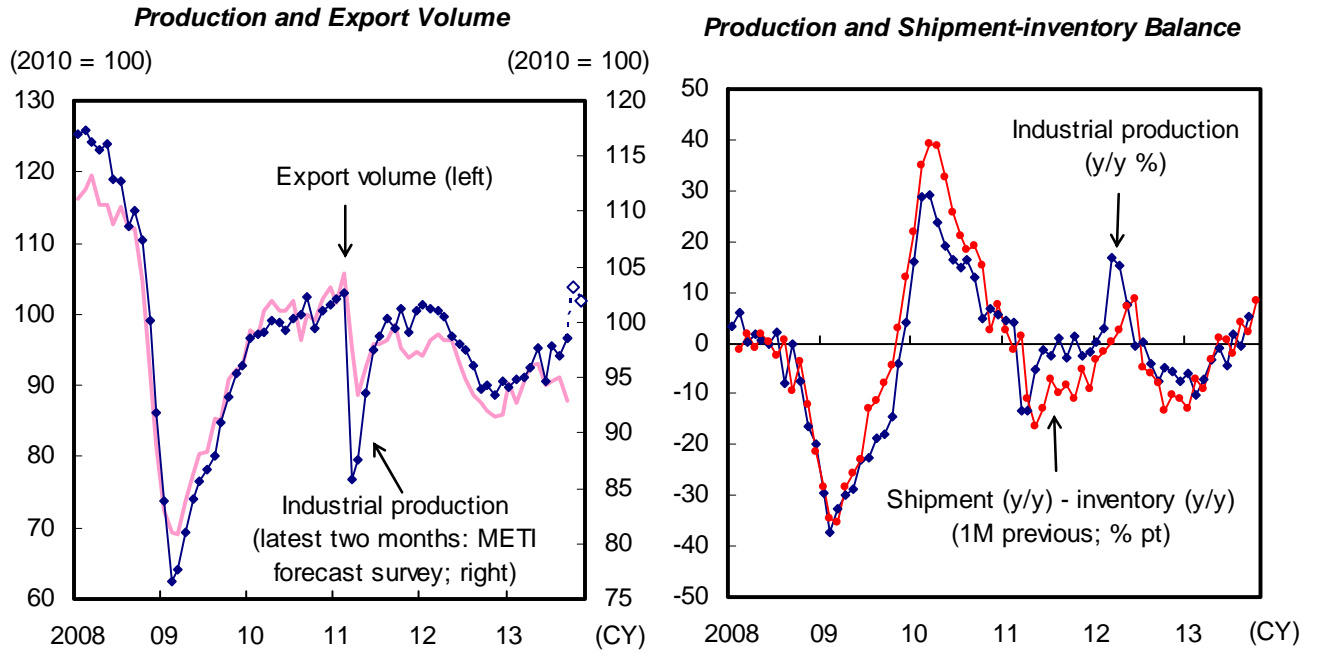


Source: Ministry of Economy, Trade, and Industry (METI); compiled by DIR.
F: METI's forecast survey.

Domestic demand to gain momentum, exports to increase

Going forward, we expect production to maintain the uptrend. While export volume moves in tandem with industrial production, it has slackened, centering on shipments to Asian trading partners, due to a slowdown in ASEAN economies. However, reflecting the weak yen and economic growth in the US, export volume is likely to return to an uptrend, driving production. Meanwhile, considering a likely acceleration in personal consumption centering on durable goods toward end-FY13 prior to the consumption tax hike scheduled for April 2014, and also taking into account public works projects likely maintaining the current high level, domestic demand will also lift overall production.

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



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