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February Machinery Orders

Orders expected to remain stagnant in Jan-Mar period, but growth trend seen returning in Apr-Jun

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Summary

- According to statistics for machinery orders in February 2014, the leading indicator for domestic capex, private sector demand (excluding shipbuilding and electric power), suffered a decline for the first time in two months, falling 8.8% m/m, considerably underperforming market consensus (-2.6%). The three-month moving average was also down for the first time in two months, indicating that machinery orders seem to have taken a short break from the growth trend previously seen. It should be noted that machinery orders tend to fluctuate quite a bit, so single month results should be given a broad interpretation.

- As for performance by source of demand, manufacturing industries registered a m/m decline for the first time in two months at -11.9%, while non-manufacturing orders (excluding shipbuilding and electrical power) declined for the first time in two months at -8.4% m/m.

- Overseas orders achieved m/m growth for three consecutive months at +2.4%. Growth continues due to the recovery in overseas economies, especially in the US and EU.

- The CAO projected the first decline in four quarters in its Jan-Mar 2014 outlook, with private sector demand (excluding shipbuilding and electrical power) seen down 2.9% in comparison with the previous period. Results may already hit that level in March, having recorded -2.5% m/m as of this point. In order to achieve growth for the Jan-Mar period in comparison with the previous period, March results would have to be +6.7% m/m. Hence, we believe that Jan-Mar private sector demand (excluding shipbuilding and electrical power) will remain stagnant.

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

	2013										2014	
	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb
Machinery orders (private sector)*	14.2	-8.8	10.5	-2.7	-0.0	5.4	-2.1	0.6	9.3	-15.7	13.4	-8.8
Market consensus (Bloomberg)												-2.6
DIR estimate												-1.3
Manufacturing orders	13.3	-7.3	3.8	2.4	4.8	0.8	4.1	-0.2	6.0	-17.3	13.4	-11.9
Non-manufacturing orders*	14.3	-6.0	25.4	-17.5	0.0	6.2	-7.0	11.5	8.1	-17.2	12.1	-8.4
Overseas orders	52.1	-19.9	10.3	-16.7	1.4	22.4	12.1	-16.0	-12.2	8.6	2.7	2.4

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

February Machinery Orders Fall Considerably Below Market Expectations

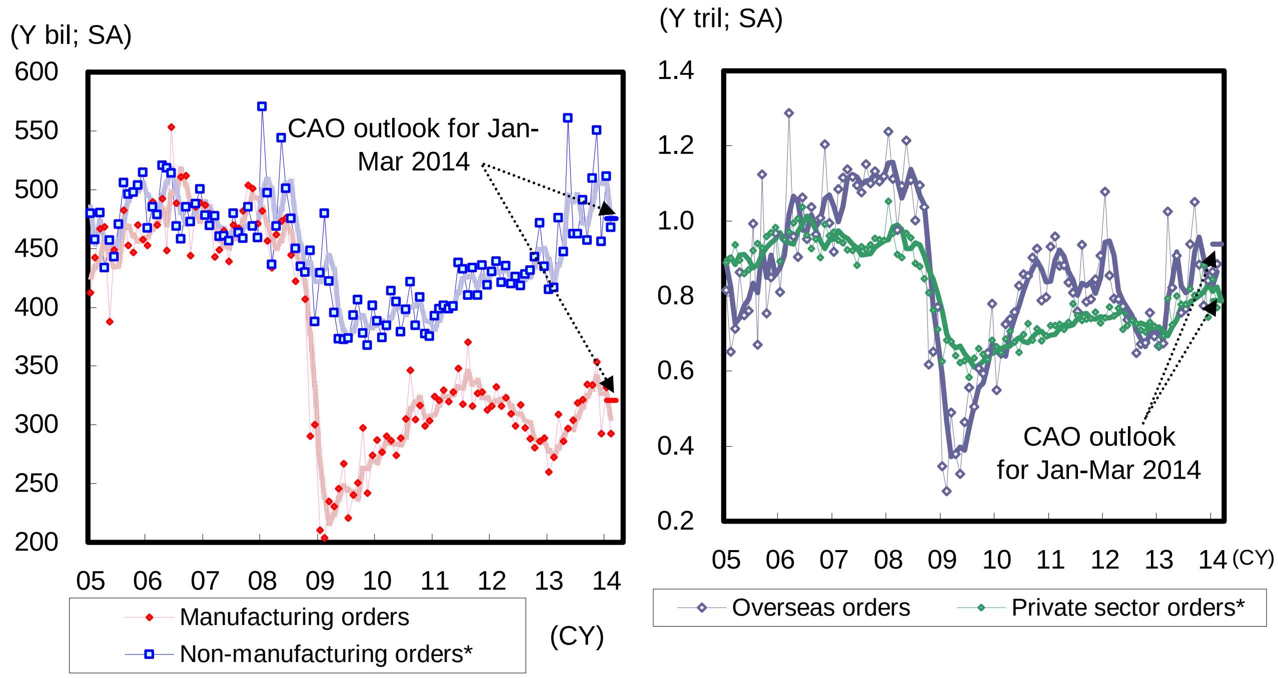
According to statistics for machinery orders in February 2014, the leading indicator for domestic capex, private sector demand (excluding shipbuilding and electric power), suffered a decline for the first time in two months, falling 8.8% m/m, considerably underperforming market consensus (-2.6%). The three-month moving average was also down for the first time in two months, indicating that machinery orders seem to have taken a short break from the growth trend previously seen. It should be noted that machinery orders tend to fluctuate quite a bit, so single month results should be given a broad interpretation.

Manufacturing Industries Register First Decline in Two Months

As for performance by source of demand, manufacturing industries registered a m/m decline for the first time in two months at -11.9%. Manufacturing industries registering month-to-month declines were as follows: chemicals -34.9% m/m, general machinery -11.3%, non-ferrous metals -78.3%, and other manufacturing industries -12.8%. Slow performance in these industries helped to push down overall results for this sector. As for non-ferrous metals, this month's downturn appears to be a reactionary decline in the wake of highs experienced during the previous month due to especially large projects. On the other hand, automobiles, parts, and accessories (+14.4%) and iron and steel (+22.0%) registered notable gains in comparison to the previous month.

Non-manufacturing orders (excluding shipbuilding and electrical power) also registered declines for the first time in two months at -8.4% m/m. As for performance by industry, declines in the following industries served to drag down overall results. These were telecommunications (-22.9% m/m), finance and insurance (-17.9%), agriculture, forestry, and fishing (-11.0%), and information services (-13.3%). Non-manufacturing industries reported month-to-month declines in a broad range of areas, reporting especially negative results.

Orders by Demand Source (seasonally adjusted figures) **Chart 2**

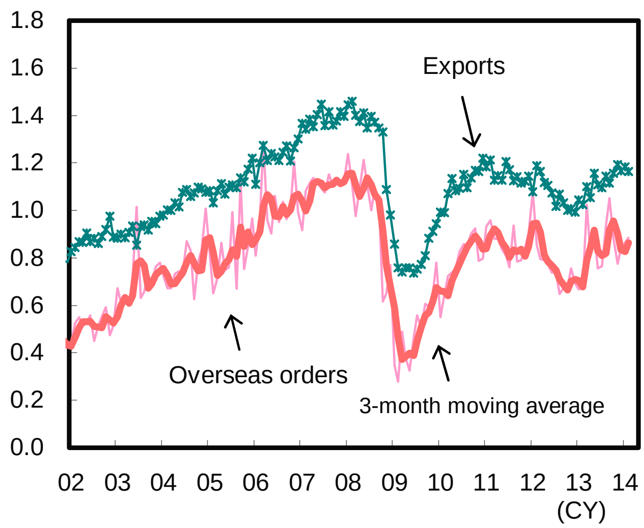


Source: Cabinet Office (CAO); compiled by DIR.
*excl. those for shipbuilding and from electric utilities.
Note: Thick lines 3MMA basis.

Overseas Orders Achieve Growth for Third Consecutive Month

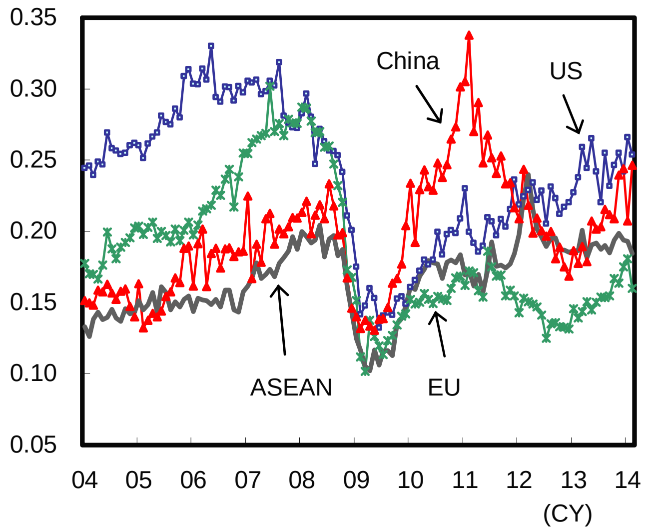
Overseas orders achieved m/m growth for three consecutive months at +2.4%. Growth continues due to the recovery in overseas economies, especially in the US and EU. Exports of general machinery according to trade statistics indicate that the growth trend should continue thanks to the continued recovery for the US and EU economies. On the other hand, exports to China are expected to maintain their growth trend despite fluctuations, but the latest economic indicators show that China's economy is in for a slowdown in the future, hence caution is required.

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, general machinery exports by DIR.
2) Thick line for overseas orders 3MMA basis.

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



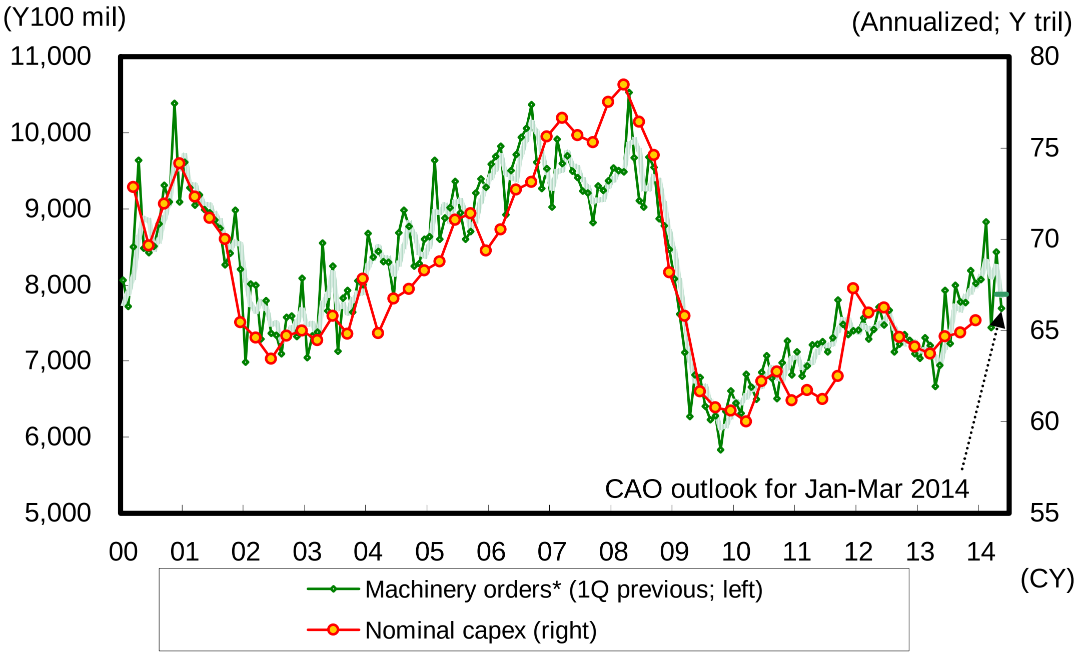
Source: Ministry of Finance; compiled by DIR.
Note: SA by DIR.

Machinery Orders Expected to Remain Stagnant in the Jan-Mar Period

The CAO projected the first decline in four quarters in its Jan-Mar 2014 outlook, with private sector demand (excluding shipbuilding and electrical power) seen down 2.9% in comparison with the previous period. Results may already hit that level in March, having recorded -2.5% m/m as of this point. In order to achieve growth for the Jan-Mar period in comparison with the previous period, March results would have to be +6.7% m/m. Hence, we believe that Jan-Mar private sector demand (excluding shipbuilding and electrical power) will remain stagnant.

As for the Apr-Jun period and beyond, both the manufacturing and non-manufacturing industries show corporate business results as clearly improving, while operating rates of production facilities continue to increase. This provides plenty of material to support an increase in capex. Therefore, we expect to see a strengthening of the growth trend in capex in the future. Although a reactionary decline in personal consumption and housing investment will be unavoidable after the raising of the consumption tax, capex is still expected to provide the main impetus for further growth after the increase has gone into effect.

Machinery Orders and Nominal Capex (SA) Chart 5



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