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December Industrial Production

Index continues to improve; production plans show firm undertone

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Summary

- The December 2014 indices of industrial production grew for the first time in two months at +1.0% m/m, falling a tad below market consensus (+1.2%). However, the three-month moving average has grown for four consecutive months, so we continue to believe that production is still on its way to a comeback. According to METI's production forecast survey, production plans in the manufacturing industry are expected to continue to exhibit extreme confidence.

- As for production index performance by industry in December, eleven out of the total of fifteen industries recorded growth. Contribution to overall performance was especially large from electronic parts and devices (+5.2% m/m), information and communication electronics equipment (+10.8%), and chemicals (+2.5%), helping to push overall performance up. Each of these industries was expected to see growth in production according to last month's production forecast survey, hence things went according to plan.

- According to METI's production forecast survey, industrial production is expected to grow by +6.3% m/m in January 2015, but then decline in February at -1.8% m/m. Despite the expected decline in production in February, the especially high level of production seen in January should balance things out, with production expected to continue growth beyond that point.

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

	2014 Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Industrial Production	0.7	-2.8	0.7	-3.4	0.4	-1.9	2.9	0.4	-0.5	**1.0**
Market consensus (Bloomberg)										1.2
DIR estimate										1.4
Shipments	-0.2	-5.0	-1.0	-1.9	0.7	-2.1	4.4	0.6	-1.4	**1.1**
Inventories	1.4	-0.5	3.0	2.0	0.9	0.9	-0.7	-0.4	1.1	**-0.4**
Inventory ratio	2.1	-1.6	4.0	3.4	-2.2	8.6	-6.0	0.8	4.2	**-4.1**

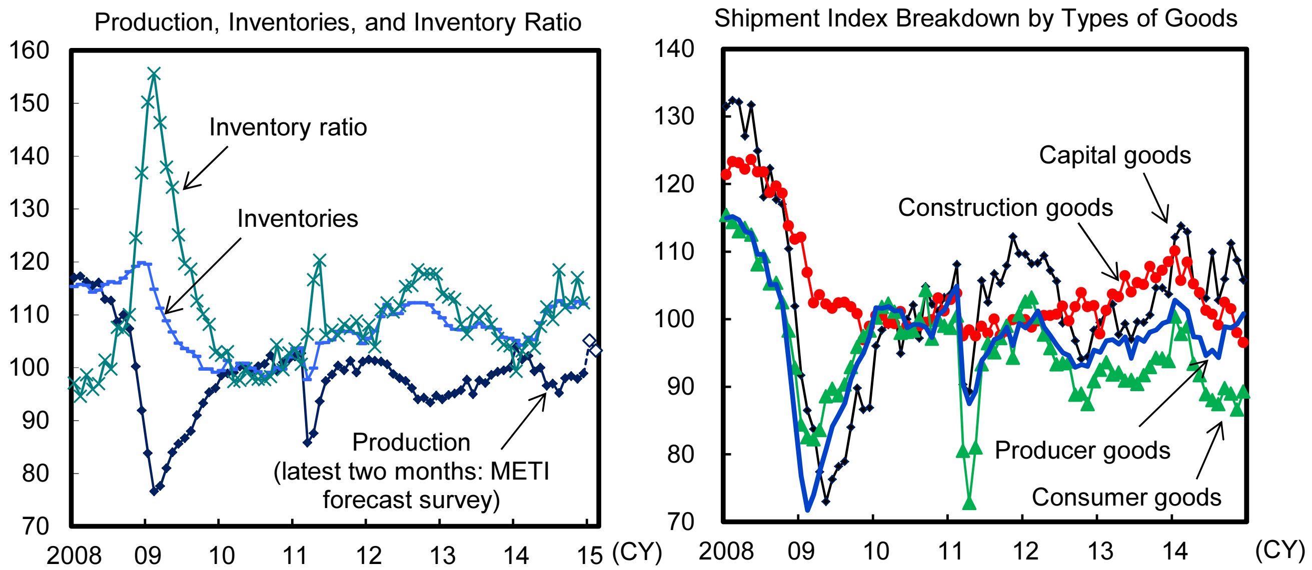
Source: Ministry of Economy, Trade, and Industry; Bloomberg; compiled by DIR.

December 2014 production index grows for first time in two months

The December 2014 indices of industrial production grew for the first time in two months at +1.0% m/m, falling a tad below market consensus (+1.2%). However, the three-month moving average has grown for four consecutive months, so we continue to believe that production is still on its way to a comeback. According to METI's production forecast survey, production plans in the manufacturing industry are expected to continue to exhibit extreme confidence.

The shipment index grew for the first time in two months at+1.1% m/m due to growth in durables and producer goods. The inventory index fell for the first time in two months by -0.4% m/m, and as a result, the inventory ratio also fell for the first time in three months by -4.1% m/m, indicating that inventory adjustment is progressing.

Production, Inventories, Inventory Ratio, and Shipment Index Breakdown (2010 = 100; SA basis) **Chart 2**



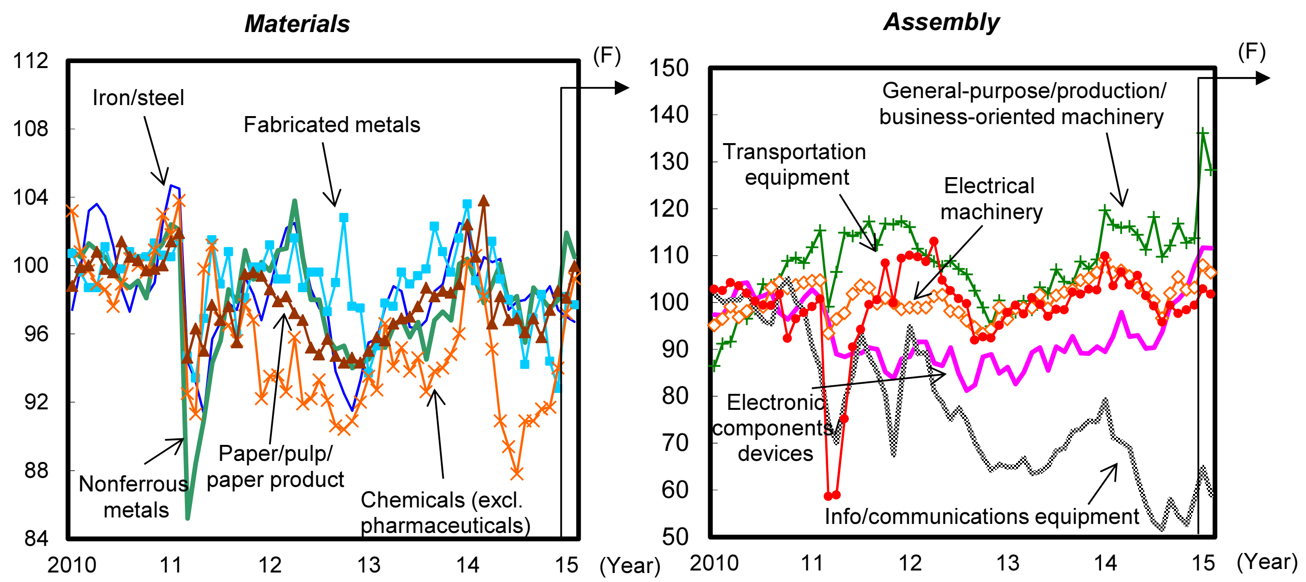
Source: Ministry of Economy, Trade, and Industry (METI), compiled by DIR.

Performance in electronic parts & devices and information & communication electronics equipment pushes overall production up

As for production index performance by industry in December, eleven out of the total of fifteen industries recorded growth. Contribution to overall performance was especially large from electronic parts and devices (+5.2% m/m), information and communication electronics equipment (+10.8%), and chemicals (+2.5%), helping to push overall performance up. Each of these industries was expected to see growth in production according to last month's production forecast survey; hence things went according to plan. Production of electronic parts and devices has achieved growth for six consecutive months, continuing an especially firm undertone, with performance especially brisk for smart phone and tablet computer parts. The information and communication electronics equipment industry had been experiencing a slowdown for some time, but has been showing signs of making a comeback more recently. The General-purpose, production and business oriented machinery industry reported an outlook for major growth in production last month, helping to increase the overall outlook for production, but results show that growth was smaller than expected at +0.9% m/m. The production outlook for January 2015 (covered in more detail later in this report) is an especially aggressive one. Hence we suspect that December performance was influenced by a delay in deliveries.

Meanwhile, there were declines in production in the areas of fabricated metals (-1.7% m/m) and iron & steel (-1.4%). However, this was expected, and therefore should come of no surprise.

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.

METI's production forecast survey sees continued strength in manufacturing

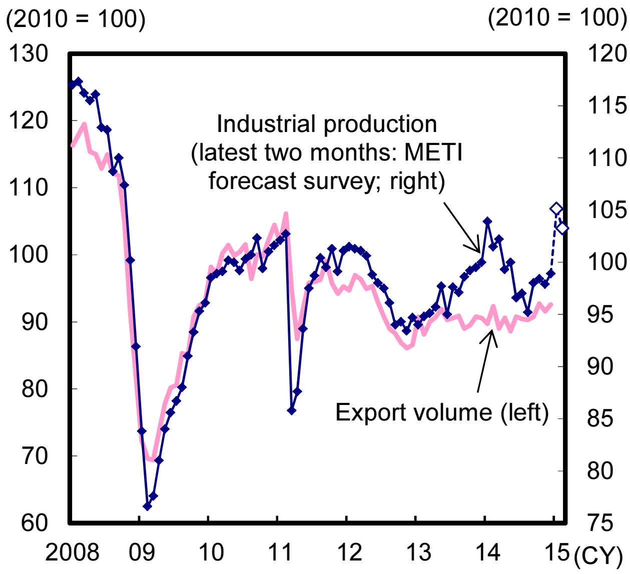
According to METI's production forecast survey, industrial production is expected to grow by +6.3% m/m in January 2015, but then decline in February at -1.8% m/m. Despite the expected decline in production in February, the especially high level of production seen in January should balance things out, with production expected to continue growth beyond that point. Growth in production is seen for all industries in January except for iron and steel, and pulp, paper and paper products. The outlook is especially strong for general-purpose, production and business oriented machinery (+19.7% m/m) and information and communication electronics equipment (+11.2%). Meanwhile in February, production declines are seen in chemicals and pulp, paper and paper products, but most industries will experience only minor declines, especially in light of the major growth expected in January. Hence, the expected slower performance in February does not warrant a pessimistic outlook.

Production expected to continue growth trend in future

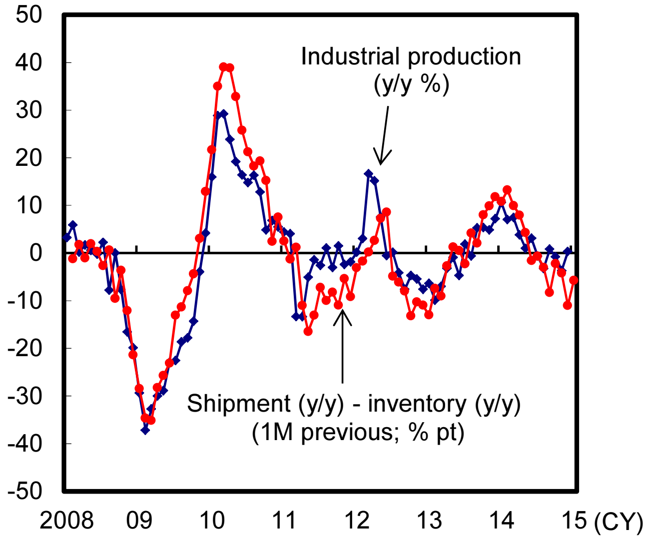
As for the future, production is expected to continue its growth trend. Production of durables appears to have hit bottom and should see a comeback as demand recovers. Meanwhile, various capex surveys, such as the BOJ Tankan, have all issued positive stances toward the future of corporate capex, and an increase in capex related demand is expected to push up results centering on production of capital goods. Exports are expected experience extremely moderate growth the economic slowdown still affecting the EU and Asian emerging nations. However, overseas economies are expected to move toward recovery led by a robust US economy, which is expected to gradually lead to a growth trend. Inventory adjustment requires continued monitoring with inventory and inventory ratio continuing at a high level, but production should move into a growth trend as both domestic and overseas demand move toward a comeback.

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

Production and Export Volume



Production and Shipment-inventory Balance



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