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March Industrial Production

Orders briefly hit bottom in export-driven performance

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Summary

- The March 2015 indices of industrial production fell for the second consecutive month by -0.3% m/m, while at the same time exceeding market consensus (-2.3%) and the previous month's outlook (-1.4%). Performance was positive overall, confirming that production is now in a growth trend after having hit bottom in August 2014. According to METI's production forecast survey, production plans for the month of April are expected to see production increases of +2.1% m/m. A minor decline is expected in May at -0.3% m/m, but there is essentially no change in our view that there will be a continuation of the moderate recovery.

- However, the major factor in improvement seemed to be overseas demand, with domestic demand driven industries exhibiting weak performance. Plus production declines are expected to continue in the area of transport equipment, which tends to have a ripple effect on domestic demand. Our basic scenario sees a continuation of the growth trend for production supported by strong exports, but the question of whether overseas demand, the mainstay for industrial production, can continue its firm undertone on into the future will become increasingly important.

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

	2014							2015		
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
Industrial Production	-1.9	-0.1	-0.8	1.4	0.4	-0.6	0.2	4.1	-3.1	**-0.3**
Market consensus (Bloomberg)										-2.3
DIR estimate										-1.8
Shipments	-0.9	0.5	-2.1	3.2	0.1	-0.7	-0.2	5.5	-4.4	**-0.3**
Inventories	1.3	0.5	0.9	-0.4	-0.1	1.1	-0.1	-0.4	1.1	**0.3**
Inventory ratio	3.2	-1.6	7.0	-5.4	1.0	3.1	-2.9	-3.3	4.0	**0.4**

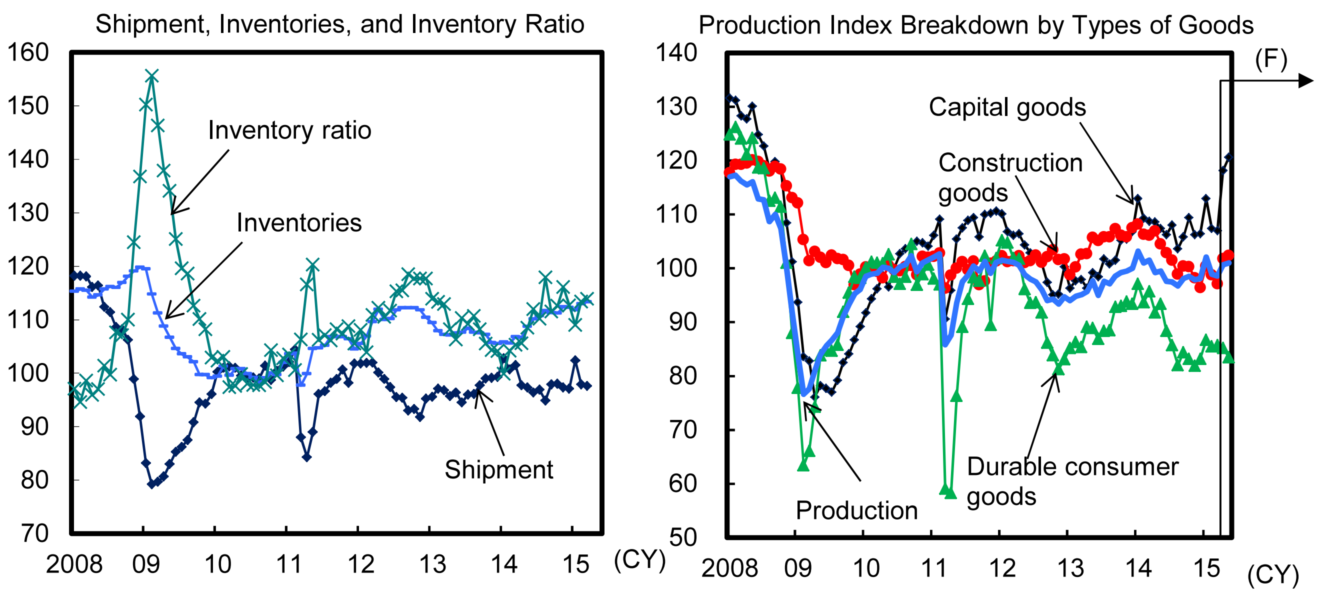
Source: Ministry of Economy, Trade, and Industry; Bloomberg; compiled by DIR.

March 2015 production index declines for second consecutive month, but performance was far better than expected

The March 2015 indices of industrial production fell for the second consecutive month by -0.3% m/m, while at the same time exceeding market consensus (-2.3%) and the previous month's outlook (-1.4%). The shipment index also declined for the second consecutive month at -0.3% m/m, but this is thought to be due mostly to seasonal factors (end of the spring season), and is actually a big improvement over the previous month (-4.4%). On the other hand, the inventory index was up for the second consecutive month at +0.3% m/m, and the inventory ratio also grew for the second consecutive month at +0.4% m/m.

Headliners were positive overall, confirming that production is now in a growth trend after having hit bottom in August 2014. On average, the industrial production for the Jan-Mar 2015 period was +1.7% in comparison with the Oct-Dec 2014 period. In addition, production plans for the month of April are expected to see production increases of +2.1% m/m according to METI's production forecast survey. A minor decline is expected in May at -0.3% m/m, but there is essentially no change in our view that there will be a continuation of the moderate recovery. However, the major factor in improvement seemed to be overseas demand, with domestic demand driven industries expected to exhibit weak performance. Plus production declines are expected to continue in the area of transport equipment, which tends to have a ripple effect on domestic demand. The question of whether overseas demand, the mainstay for industrial production, can continue its firm undertone on into the future will become increasingly important.

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



Source: Ministry of Economy, Trade, and Industry (METI); compiled by DIR. (latest two months: METI forecast survey)

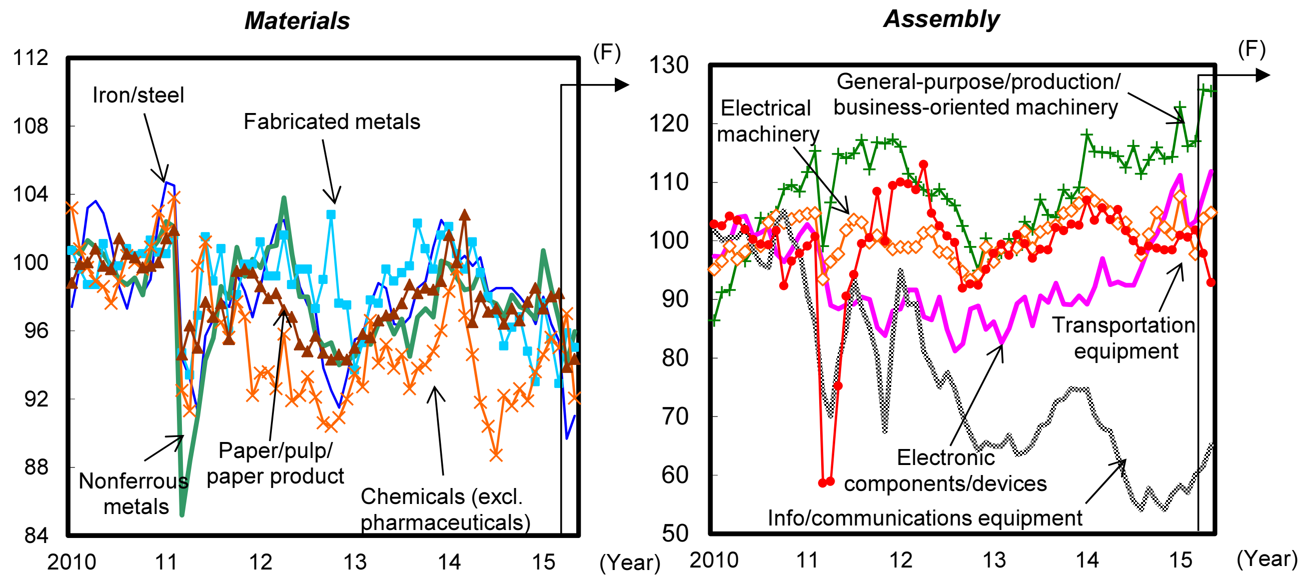
Source: Ministry of Economy, Trade, and Industry (METI), compiled by DIR.

Import-driven materials industries exhibit weak performance, while export-driven processing industries show strength

As for production index performance by industry in March, nine out of the total of fifteen industries recorded declines. Overall, production in the materials industries was weak. Contribution to overall decline was especially noticeable in electrical machinery (-3.7% m/m) and petroleum and coal products (-7.7%). Meanwhile, fabricated metals saw declines in production (-2.7% m/m) despite the previous month's expectations of production increases, while the same was true for chemicals as well (-0.6%). On the other hand, processing industries with high export ratios achieved growth, contributing to the month's favorable export volume. These included transport equipment (+1.2% m/m), information and communications electronics equipment (+5.4%), General-purpose, production and business oriented machinery (+0.8%), and electronic parts and devices (+1.0%).

As for March production index performance by types of goods, durable consumer goods were up by +0.2% m/m, while production goods also grew slightly at +0.5%. However, production of other goods suffered declines. Capital goods and non-durable consumer goods were expected to experience m/m declines according to the previous month's forecast, hence declines in these areas were according to expectations. However, capital goods (excluding transport equipment) suffered only a slight decline of -0.9% m/m in comparison with the forecast of -7.9%. Meanwhile, non-durable consumer goods performed somewhat below their original forecast (-3.2% m/m in comparison to the original forecast of -1.8%).

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 favorable overall, but weak transport equipment industry is worrisome

Looking at METI's production forecast survey by industry, expected declines on the part of the transport equipment industry are worrisome (-3.9% m/m in April and -5.1% in May). Other industries are expected to be robust overall, with April expecting production increases in the areas of electrical machinery (+6.2% m/m), information and communications electronics equipment (+2.4%), general-purpose, production and business oriented machinery (+7.5%), and electronic parts and devices (+4.1%). As for May, plans for production increases are expected to continue, with electrical machinery up +1.0%

m/m, information and communications electronics equipment up +5.9%, and electronic parts and devices up by +3.9%.

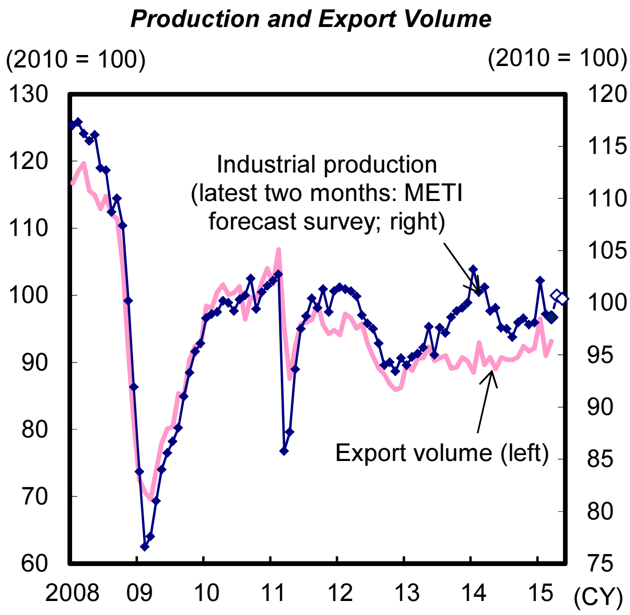
Looking at the forecast survey by types of goods, April is expected to see a continuation of production increases for capital goods (excluding transport equipment) at +10.4% m/m and construction goods at +4.8%. Meanwhile, a recovery is seen for non-durable consumer goods at +7.8% m/m. Production increases are expected to continue in May with capital goods (excluding transport equipment) up +2.1% m/m and construction goods up +0.6%. Meanwhile, durable consumer goods are expected to suffer a decline of -2.0% m/m, with non-durable consumer goods also down by -3.4%.

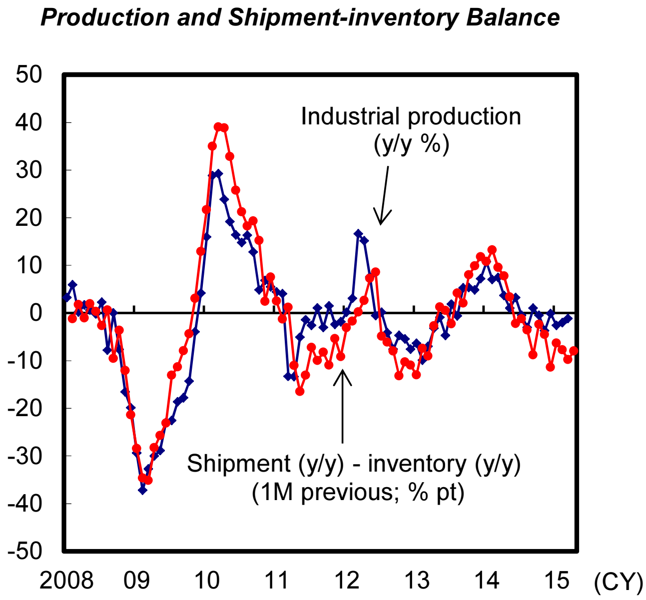
Mixture of strengths and weaknesses seen in future, but growth trend expected to continue

Our basic scenario sees a continuation of the growth trend for production supported by strong exports. It has just been confirmed that the US economy was treading water, but if this most recent stagnant period merely ends up stalling interest rate hikes a bit longer, it may actually end up having a positive effect on the world economy. A bright spot appeared in the EU economy which had been in a downtrend up to this point due to support of the monetary easing policy. Furthermore, a new policy in China reducing the ratio of cash reserves to deposits is expected to bring a certain amount of support to the economy, which had been in a slowdown.

Meanwhile, domestic demand is expected to gradually improve, gaining support from the positive employment environment and an increase in real income associated with the collapse in energy prices. However, both performance and forecasts have recently been on the weak side for domestic demand driven industries. Hence continued vigilance is required regarding the forecast for further declines in production in the area of transport equipment, which tends to have a strong ripple effect on domestic demand.

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





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