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# June Industrial Production

Indications that production may be bottoming out soon

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## Summary

- The June 2015 indices of industrial production was up by +0.8% m/m, achieving growth for the first time in two months, as well as exceeding market consensus (+0.3%). The shipment index was also up for the first time in two months at +0.3% m/m, while the inventory index grew for the first time in two months at +1.3%.
- This month's results confirm that the Japanese economy has been experiencing a temporary lull. Though the month's performance ended in an increase for production, momentum was weak. Production is entering an adjustment phase due to stagnant exports and the subsequent buildup in inventory. According to the METI forecast survey, July production is expected to continue marking time at +0.5% in comparison to the previous month, with the soft patch continuing in the future. However, hints of a recovery centering on the materials industries, which had maintained a soft tone until now, provides a positive note. August production plans according to the forecast survey see relatively high growth at +2.7% m/m, indicating that production may be bottoming out in the near future.
- As for the future of industrial production, the growth trend is expected to return once the temporary adjustment has run its course. Overseas demand is expected to gradually recover. The adjustment phase has been continuing for capital goods in the US with a strong dollar and cheap crude oil, but demand for consumer goods remains favorable. In the Eurozone, the trend toward recovery is strengthening, supported by the weak Euro, cheap crude oil, and monetary policy. Meanwhile, emerging markets centering on China are beginning to show signs of bottoming out with news that US interest rates will be moving up and the effects of domestic monetary policy. As for domestic demand, recovery followed by expansion is expected due to rising consumption reflecting the continued increase in domestic capex and improvement in real income for both working households and pensioners.

## Industrial Production (m/m %; SA basis)

Chart 1

	2014				2015					
	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Industrial Production	1.4	0.4	-0.6	0.2	4.1	-3.1	-0.8	1.2	-2.1	<b>0.8</b>
Market consensus (Bloomberg)										0.3
DIR estimate										0.5
Shipments	3.2	0.1	-0.7	-0.2	5.5	-4.4	-0.6	0.6	-1.9	<b>0.3</b>
Inventories	-0.4	-0.1	1.1	-0.1	-0.4	1.1	0.4	0.4	-0.8	<b>1.3</b>
Inventory ratio	-5.4	1.0	3.1	-2.9	-3.3	4.0	0.9	-1.0	1.9	<b>-1.6</b>

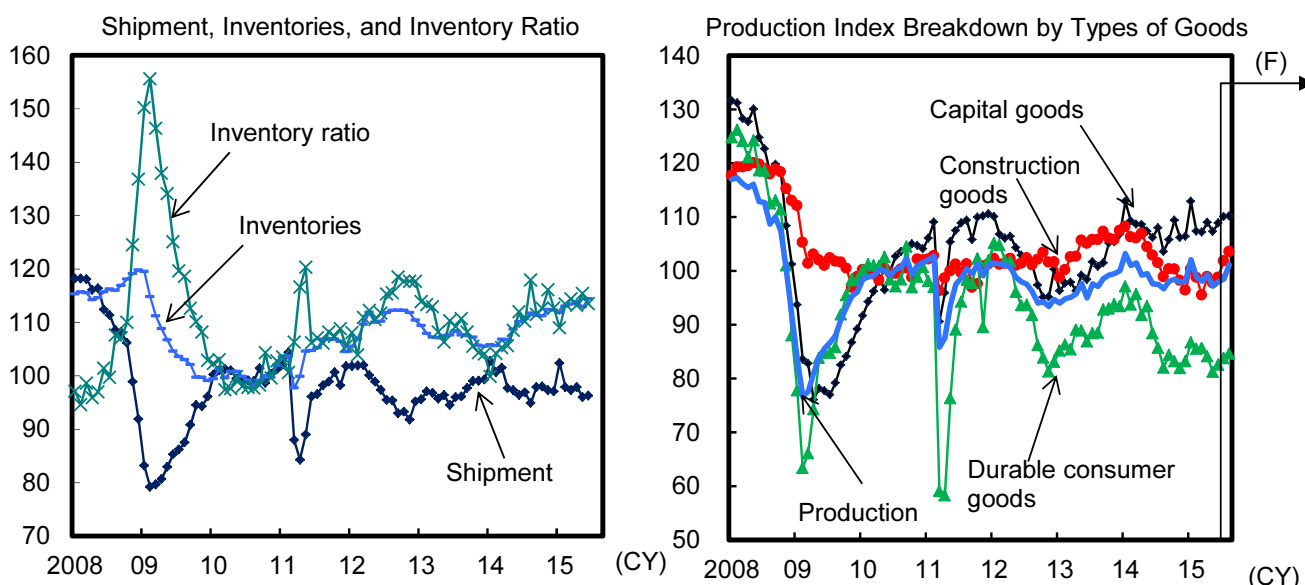
Source: Ministry of Economy, Trade, and Industry; Bloomberg; compiled by DIR.

## June 2015 production index achieved growth for the first time in two months, but momentum was weak

The June 2015 indices of industrial production was up by +0.8% m/m, achieving growth for the first time in two months, as well as exceeding market consensus (+0.3%). The shipment index was also up for the first time in two months at +0.3% m/m, while the inventory index grew for the first time in two months at +1.3%.

This month's results confirm that the Japanese economy has been experiencing a temporary lull. Though the month's performance ended in an increase for production, momentum was weak. Production is entering an adjustment phase due to stagnant exports and the subsequent buildup in inventory. According to the METI forecast survey, July production is expected to continue marking time at +0.5% in comparison to the previous month, with the soft patch continuing in the future. However, hints of a recovery centering on the materials industries, which had maintained a soft tone until now, provides a positive note. August production plans according to the forecast survey see relatively high growth at +2.7% m/m, indicating that production may be bottoming out in the near future.

**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.

## Some industries show signs of bottoming out

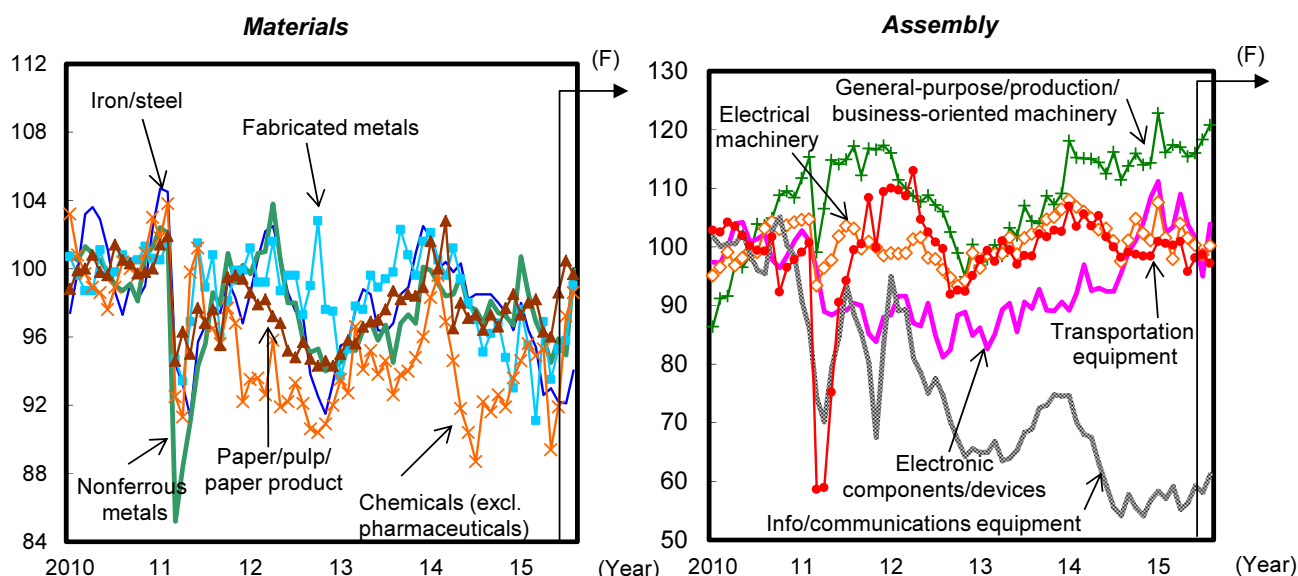
As for production index performance by industry in June, nine out of the total of fifteen industries recorded production increases. Recovery was seen in transport equipment which carried out major production adjustment during the previous month (+2.4% m/m) and chemicals (excluding pharmaceuticals) (+2.8%). Meanwhile, declines in production thought to be due to slow overseas demand were experienced in electronic parts and devices (-2.1% m/m), electrical machinery (-1.2%), petroleum and coal products (-5.0%), and iron & steel (-0.9%). However, production declines are gradually coming to a stop, with some materials industries beginning to increase production, including fabricated metals (+1.9% m/m) and non-ferrous metals (+1.5%).

Looking at June production index performance by types of goods, all areas except for production goods saw production increases. Durable consumer goods showed signs of recovery after the major decline of the previous month at +1.7% m/m, while capital goods were a sore point with rising inventories, gaining just +1.5%. However, there were some positive signs as well, with some industries

positively affected by signs of recovery in domestic demand, including construction (+1.0%) and non-durable consumer goods (+0.6%).

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.

## July seen marking time, but production increases expected in August

Looking at METI's production forecast survey by industry for July, it appears that the soft patch will continue. A major increase in production is seen for the chemicals industry (+5.8% m/m) with increases also expected in general-purpose, production and business oriented machinery (+2.0%) and pulp, paper and paper products (+1.9%). However, electronic parts and devices is expected to see a major decline in production at -6.5% m/m, with declines also seen for electrical machinery (-1.6%) and information & communications electronics equipment (-1.9%).

Meanwhile, the production forecast survey for August expects eight out of a total of eleven industries to carry out production increases. The rebound is expected to be especially pronounced for electronic parts and devices (+9.4% m/m) and information & communications electronics equipment (+5.3%). But especially of note will be the materials industries, with fairly major production increases seen for iron and steel (+2.1% m/m), non-ferrous metals (+5.3%), and fabricated metals (+3.4%).

Looking at the forecast survey by types of goods, production increases are seen overall, but the extent of increase is expected to differ quite a bit depending on the area. Favorable performance is seen for construction goods (+3.1% m/m in July and +1.7% in August) and non-durable consumer goods (+6.5% m/m in July and +4.0% in August), while a gradual recovery is seen for durable goods (+1.4% m/m in July and +1.0% in August), and an even more gradual pace for capital goods (+1.1% m/m in July and +0.1% in August).

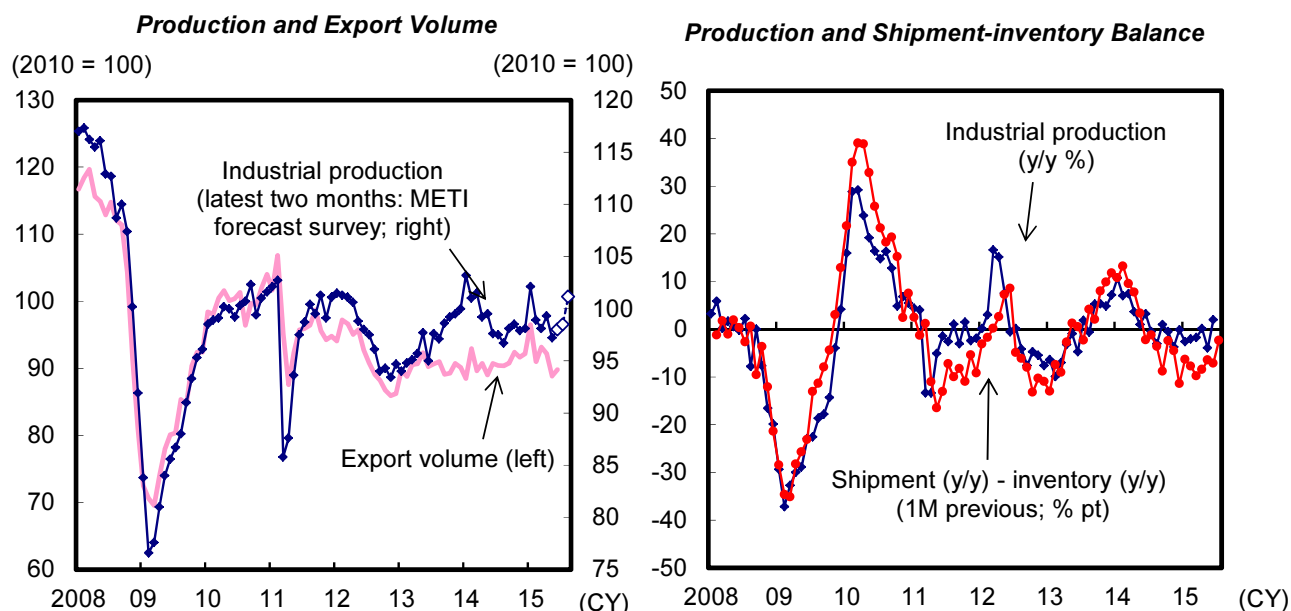
## Once temporary adjustment has passed, a gradual recovery trend is seen for both domestic and overseas demand

As for the future of industrial production, the growth trend is expected to return once the temporary adjustment has run its course. Overseas demand is expected to gradually recover. The adjustment phase has been continuing for capital goods in the US with a strong dollar and cheap crude oil, but demand for consumer goods remains favorable. In the Eurozone, the trend toward recovery is strengthening, supported by the weak Euro, cheap crude oil, and monetary policy. Meanwhile,

emerging markets centering on China are beginning to show signs of bottoming out with news that US interest rates will be moving up and the effects of domestic monetary policy. As for domestic demand, recovery followed by expansion is expected due to rising consumption reflecting the continued increase in domestic capex and improvement in real income for both working households and pensioners.

#### Production, Export Volume, and Shipment-inventory Balance

Chart 4



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