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July Industrial Production

Production marks time at a relative low, but inventory adjustment progresses

Economic Intelligence Team
Shunsuke Kobayashi

Summary

- The July 2015 indices of industrial production was down by -0.6% m/m, suffering a decline for the first time in two months, as well as falling below market consensus (+0.1%). The shipment index was also down for the first time in two months at -0.3% m/m, and the inventory ratio index was down for the second consecutive month at -1.1%. This month's results confirm that Japan's economy has entered a temporary lull. Stagnant exports and the resultant accumulation of inventory have pushed production into an adjustment phase, with results marking time at a relative low. However, this has also encouraged moderate progress in inventory adjustment.

- 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 is expected due to gradual improvement in 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**

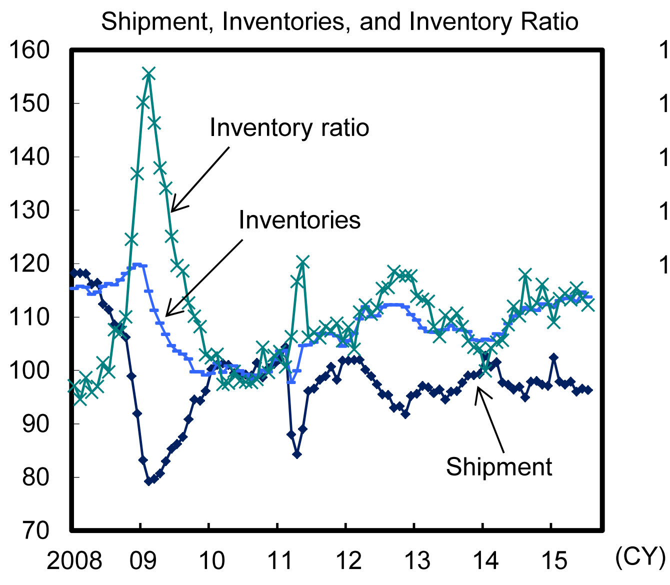
	2014			2015						
	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul
Industrial Production	0.4	-0.6	0.2	4.1	-3.1	-0.8	1.2	-2.1	1.1	**-0.6**
Market consensus (Bloomberg)										0.1
DIR estimate										-0.1
Shipments	0.1	-0.7	-0.2	5.5	-4.4	-0.6	0.6	-1.9	0.6	**-0.3**
Inventories	-0.1	1.1	-0.1	-0.4	1.1	0.4	0.4	-0.8	1.5	**-0.8**
Inventory ratio	1.0	3.1	-2.9	-3.3	4.0	0.9	-1.0	1.9	-1.6	**-1.1**

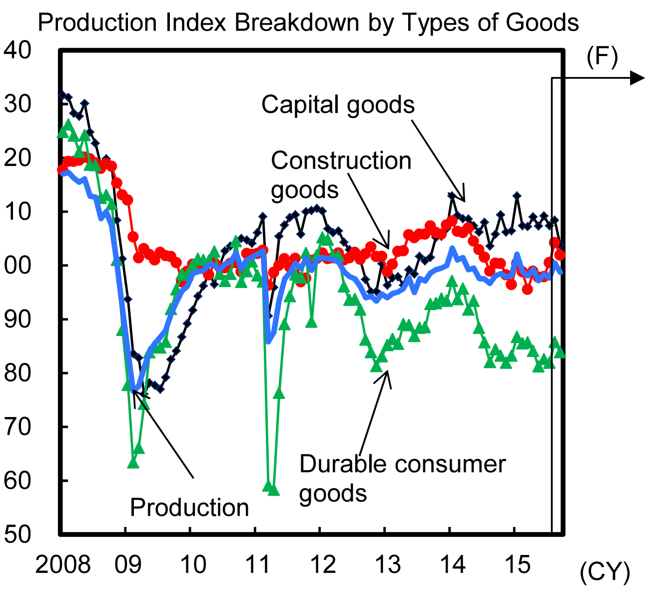
Source: Ministry of Economy, Trade, and Industry; Bloomberg; compiled by DIR.

July 2015 production index declines for the first time in two months, inventory adjustment shows moderate progress

The July 2015 indices of industrial production was down by -0.6% m/m, suffering a decline for the first time in two months, as well as falling below market consensus (+0.1%). The shipment index was also down for the first time in two months at -0.3% m/m, and the inventory ratio index was down for the second consecutive month at -1.1%. This month's results confirm that Japan's economy has entered a temporary lull. Stagnant exports and the resultant accumulation of inventory have pushed production into an adjustment phase, with results marking time at a relative low. However, this has also encouraged moderate progress in inventory adjustment.

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.

Downstream industries soft, but upstream industries moving toward recovery

As for production index performance by industry in July, ten out of the total of fifteen industries recorded production declines. Tough times continue for downstream industries closer to production of final goods, with overall results pulled down by electronic parts and devices (-3.7% m/m), transport equipment (-1.4%), and information and communication electronics equipment (-8.4%). General-purpose, production and business oriented machinery, which had been continuing a trend of strong performance, experienced a decline in production (-1.1%). This suggests that overseas demand has weakened, while the trend toward holding back a certain amount of machinery in storage after production in association with the off-road law seems to have weakened. On the other hand, those close to upstream in the materials industry, including chemicals (less pharmaceuticals) (+3.4%), fabricated metals (+3.0%), and petroleum & coal products (+2.7%), continued to recover.

Looking at July production index performance by types of goods, construction goods (+2.7% m/m) and non-durable consumer goods (+2.0%) picked up the pace of production increases, showing confidence regarding domestic demand and providing a positive note to this month's results. On the other hand, durable consumer goods, which have continued slower growth, again performed unfavorably at -0.8%. As for capital goods, which had been continually increasing production up to now, production appeared to be taking a breather at -1.6%.

August is expected to see a strengthening of the upward trend, but the China factor is expected to cause a disturbance in September

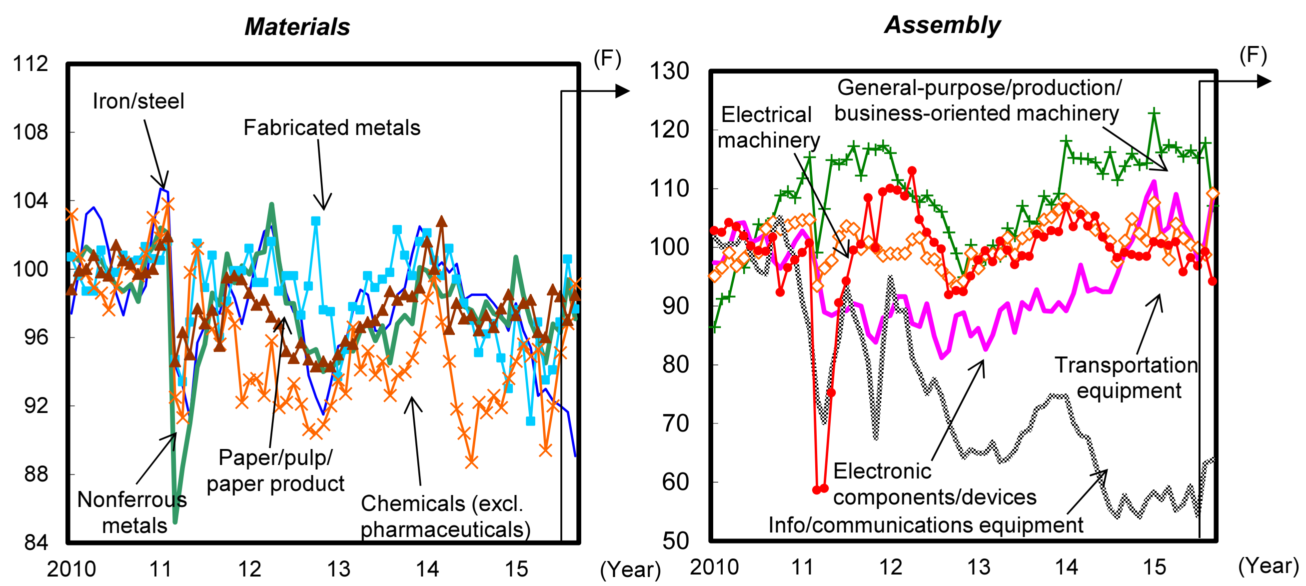
Looking at METI's production forecast survey by industry for August, a considerably major increase in production is expected overall at +2.8% m/m. Compared to the relatively weak production levels seen in July, information & communications electronics equipment (+16.2%) and electronic parts and devices (+3.0%) are expected to see a major comeback and contribute much to overall performance. However, a broad range of other industries, especially in the area of materials, are also expected to experience production increases, including non-ferrous metals (+3.2% m/m) and fabricated metals (+3.8%).

Meanwhile, the production forecast survey for September expects an overall decline at -1.7%. This is due in part to the explosion in China, as well as political events in September and their effect on various regulations. Weakness is seen in General-purpose, production and business oriented machinery (-9.1% m/m), transport equipment (-5.1%), iron and steel (-2.8%), non-ferrous metals (-2.3%), and fabricated metals (-2.9%). Meanwhile, a continuation of the robust pace in production increases is expected in electronic parts and devices (+7.2% m/m) and electrical machinery (+10.6%).

Looking at the forecast survey by types of goods, production increases are seen for all areas in August. Showing particular strength are construction goods as they continue their momentum (+3.7% m/m) and non-durable consumer goods (+7.4%). As for the former, the high-paced progress of housing investment and public investment is seen as being behind the favorable performance. In addition, durable consumer goods (+4.7%) are also expected to see production increases.

In contrast, September is expected to see declines in production in all types of goods with the exception of production goods. Of these, the decline is expected to be largest for capital goods (less transport equipment) at -4.2% m/m. Behind the declines in production is the likelihood of reactionary behavior in regard to the recent trend toward holding back a certain amount of machinery in storage after production in association with the off-road law. As for other goods, production declines are seen in a broad range of areas, including construction goods (-2.2%), durable consumer goods (-2.2%), and non-durable consumer goods (-1.3%).

Production by Industry (2010 = 100; SA basis) **Chart 3**

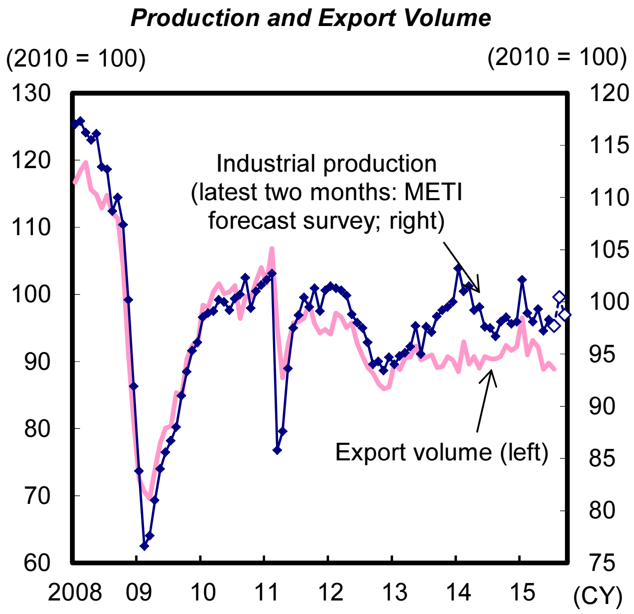


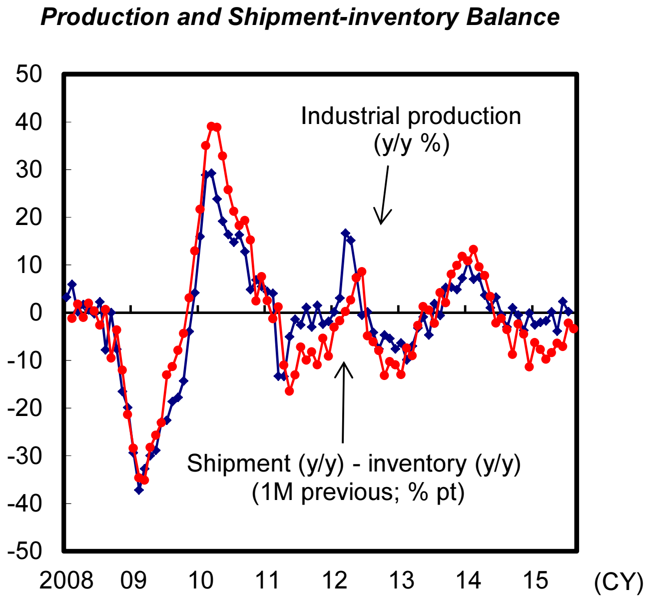
Source: Ministry of Economy, Trade, and Industry (METI); compiled by DIR.
F: METI's forecast survey.

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 is expected due to gradual improvement in 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.