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October Industrial Production

Inventory reduction progresses due to growth in shipments, ups and downs expected in future

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Summary

- The October 2015 indices of industrial production was up by +1.4% m/m, its second consecutive month of growth, but came in below market consensus (+1.8%). The shipment index was also up for the second consecutive month at +2.1% m/m with a growth rate above that of the production index, also for the second consecutive month. As a result, progress was made in inventory reduction, thereby putting the inventory ratio at -1.9% m/m and the inventory ratio index at -3.0%, the second consecutive month of decline for inventory.

- As for industrial production in November and December, the growth trend is expected to return despite ups and downs along the way. First, in the area of domestic demand, recovery is expected for consumption, reflecting the improvement in real income for both working households and pensioners. Meanwhile, corporations have not lost their willingness to invest in domestic capex, and this should provide underlying support for demand in the area of capital goods. Overseas demand is expected to remain weak for the time being, but exports are expected to gradually recover with a mixture of both strong and weak points. In the US, economic growth continues with a strong undertone especially in the household sector. Exports to the US are expected to recover and reenter a growth phase centering on durable goods. In the Eurozone, the trend toward recovery is expected to continue, supported by cheap crude oil and the ECB's quantitative easing. As for the Asian economy, China's ratio of cash reserves to deposits has been lowered along with its interest rates, and there are signs that the real economy has hit bottom. It is very possible that soon there will also be signs of hitting bottom for various goods, centering on consumer goods.

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

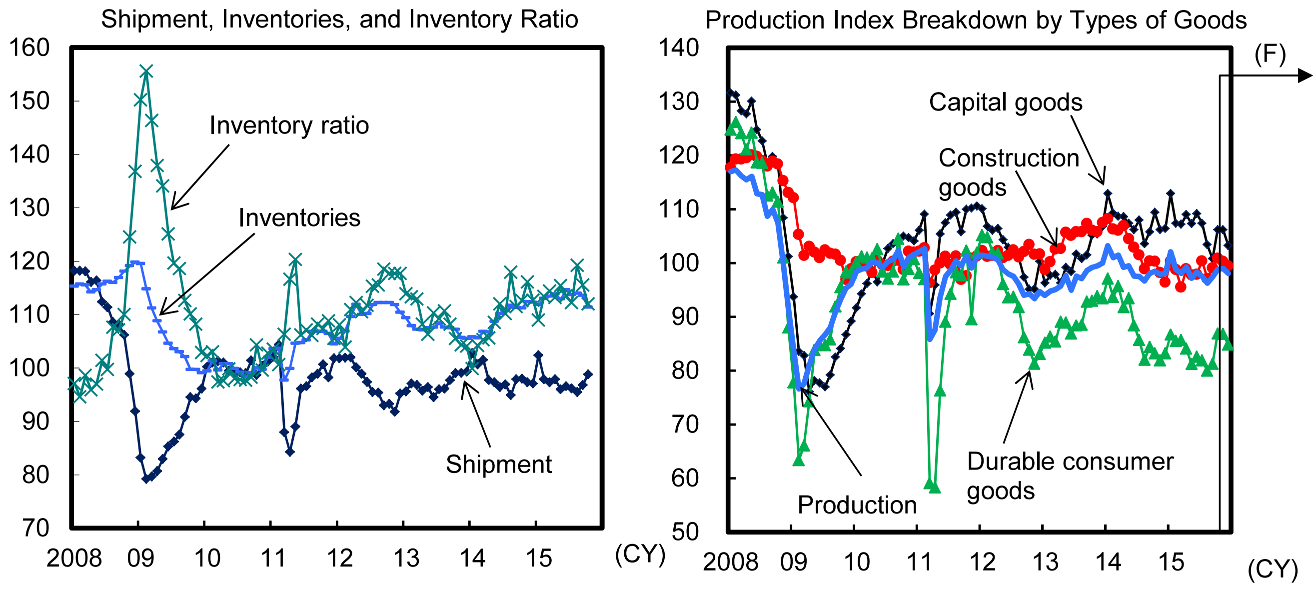
	2015 Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct
Industrial Production	4.1	-3.1	-0.8	1.2	-2.1	1.1	-0.8	-1.2	1.1	**1.4**
Market consensus (Bloomberg)										1.8
DIR estimate										2.5
Shipments	5.5	-4.4	-0.6	0.6	-1.9	0.6	-0.4	-0.7	1.4	**2.1**
Inventories	-0.4	1.1	0.4	0.4	-0.8	1.5	-0.8	0.3	-0.4	**-1.9**
Inventory ratio	-3.3	4.0	0.9	-1.0	1.9	-1.6	-1.1	6.2	-3.1	**-3.0**

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

Growth in shipments encourages progress in inventory reduction

The October 2015 indices of industrial production was up by +1.4% m/m, its second consecutive month of growth, but came in below market consensus (+1.8%). The shipment index was also up for the second consecutive month at +2.1% m/m with a growth rate above that of the production index, also for the second consecutive month. As a result, progress was made in inventory reduction, thereby putting the inventory ratio at -1.9% m/m and the inventory ratio index at -3.0%, the second consecutive month of decline for inventory.

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.

Rebound in capital goods and favorable durable consumer goods contribute to overall positive results

As for production index performance by industry in October, seven out of the total of fifteen industries recorded production increases. General-purpose, production and business oriented machinery, which recorded major cuts in production during the previous month, bounced back to record growth of +5.8%. Meanwhile transport equipment grew by +4.0 m/m, an advance thought to be due to the fact that the industry is now beginning to manufacture new products. A related industry, electrical machinery, also grew by +1.3% for much the same reasons. Electronic parts & devices continued favorable performance at +2.4% thanks to special iPhone related demand. On the other hand, the materials industries continued to decline reflecting the stagnation being experienced by heavy industry in both the domestic and overseas markets. Amongst these, chemicals (less pharmaceuticals) were down by -1.1% m/m, while non-ferrous metals (-2.8%) and ceramics, stone & clay products (-0.9%) also brought in weak results.

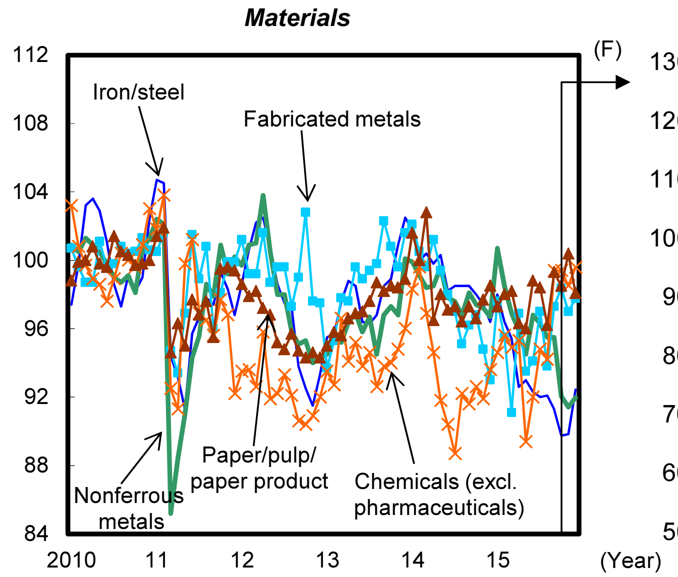
Looking at October production index performance by types of goods, we see that investment goods experienced a rebound at +4.8% m/m, while consumer goods continued to perform favorably at +2.8%, pulling overall performance along with it in the positive direction. Amongst investment goods, capital goods, which had continued declines in production up until last month, rebounded at +5.4%, while construction goods continued their favorable performance at +1.8%. Consumer goods, especially durable consumer goods, experienced a major increase in production at +6.9%. Most likely this was due to contributions from the transport equipment industry mentioned earlier in this section.

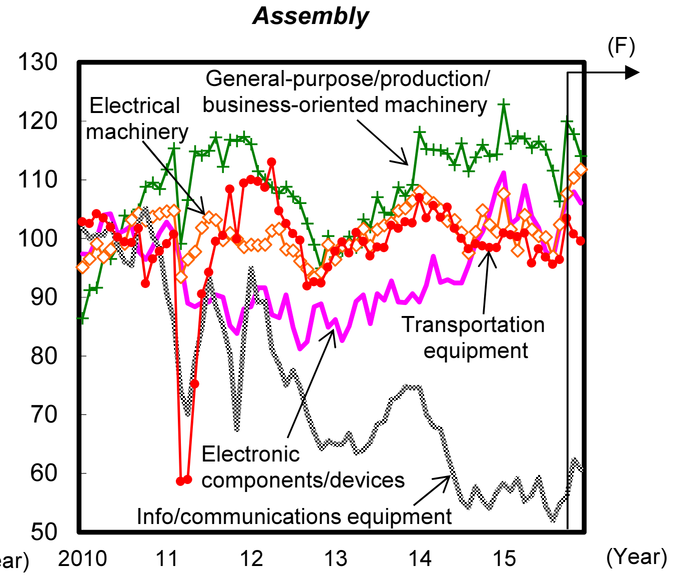
Ups and downs expected in November and December

The November forecast survey expects growth of +0.2% m/m, while December is seen at -0.9%. Ups and downs are expected to continue in the near future. In performance by industry, information communication & electronics equipment is seen up +11.0% m/m, but then is expected to fall back by -2.7% in December. Electrical machinery is noticeably favorable for both coming months with November up by +2.5% and December up by +1.3%. On the other hand, general-purpose, production and business oriented machinery, which saw growth in production in October, is expected to decline in the coming months with November down by -1.8% and December down by -3.2%. Meanwhile, transport equipment will also see declines in the near future with November down by -2.6% and December down by -1.2%. Production levels are expected to peak out in the near future.

Looking at the forecast survey by types of goods, construction goods, which has recorded favorable performance until now, is seen experiencing a moderate decline (-0.6% in November and -0.8% in December). Meanwhile, production is expected to continue to be on the weak side in the capital goods sector (less transport equipment) at +0.0% m/m in November and -2.8% in December. As for durable consumer goods, here too production declines are seen, with November at -0.1% and December at -2.3%.

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



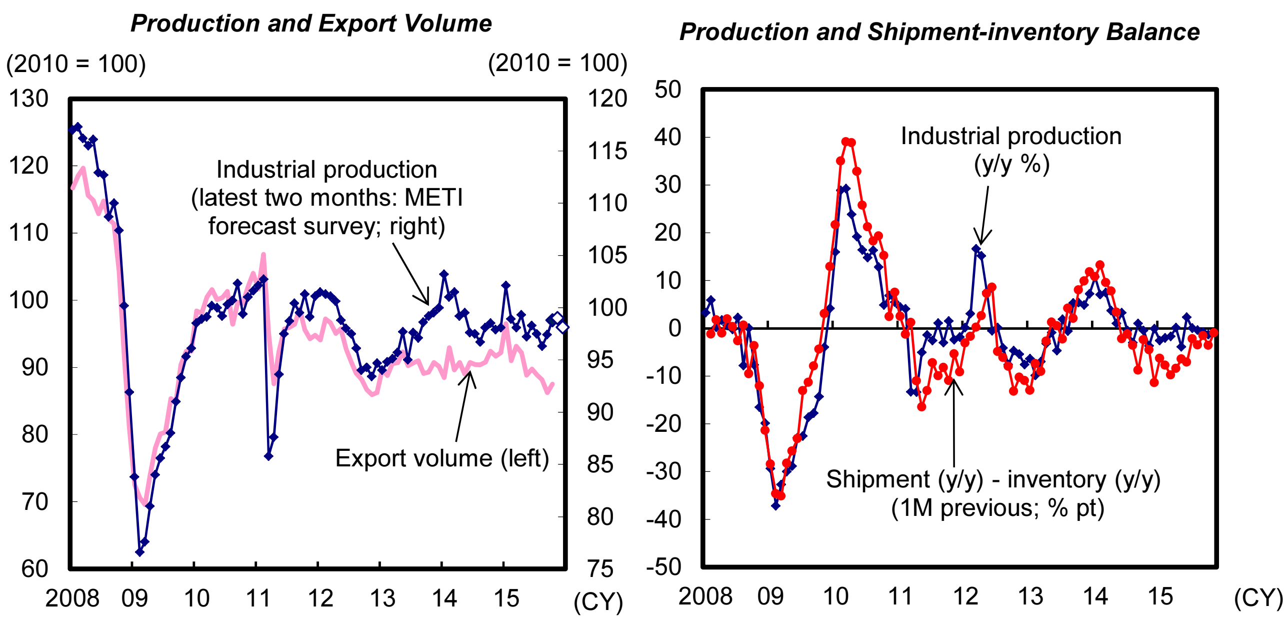


Source: Ministry of Economy, Trade, and Industry (METI); compiled by DIR.
F: METI's forecast survey.

Production to move toward a comeback in the future

As for industrial production in November and December, the growth trend is expected to return despite ups and downs along the way. First, in the area of domestic demand, recovery is expected for consumption, reflecting the improvement in real income for both working households and pensioners. Meanwhile, corporations have not lost their willingness to invest in domestic capex, and this should provide underlying support for demand in the area of capital goods. Overseas demand is expected to remain weak for the time being, but exports are expected to gradually recover with a mixture of both strong and weak points. In the US, economic growth continues with a strong undertone especially in the household sector. Exports to the US are expected to recover and reenter a growth phase centering on durable goods. In the Eurozone, the trend toward recovery is expected to continue, supported by cheap crude oil and the ECB's quantitative easing. As for the Asian economy, China's ratio of cash reserves to deposits has been lowered along with its interest rates, and there are signs that the real economy has hit bottom. It is very possible that soon there will also be signs of hitting bottom for various goods, centering on consumer goods.

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



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