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December Industrial Production

Production suffers reactionary decline, but increase seen in future

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Summary

- The December 2015 indices of industrial production was down by -1.4% m/m, its second consecutive decline, while falling below market consensus as well (-0.3%). The shipment index was also down considerably by -1.7% m/m, bringing overall negative results. Inventories were up slightly by +0.4%, with inventory ratio up by +0.4% m/m, both components seeing their second consecutive month of growth. However, the METI forecast sees an increase in production in the future despite ups and downs, suggesting that Japan's economy will leave behind the recent temporary lull and begin heading toward recovery.

- Production is expected to see some ups and downs, but ultimately return to a moderate growth trend in the future. As for 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 also expected to return to a moderate recovery trend despite 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 move into 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 which is helping to bring a comeback. 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 further declines in demand can be avoided, centering on consumer goods.

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

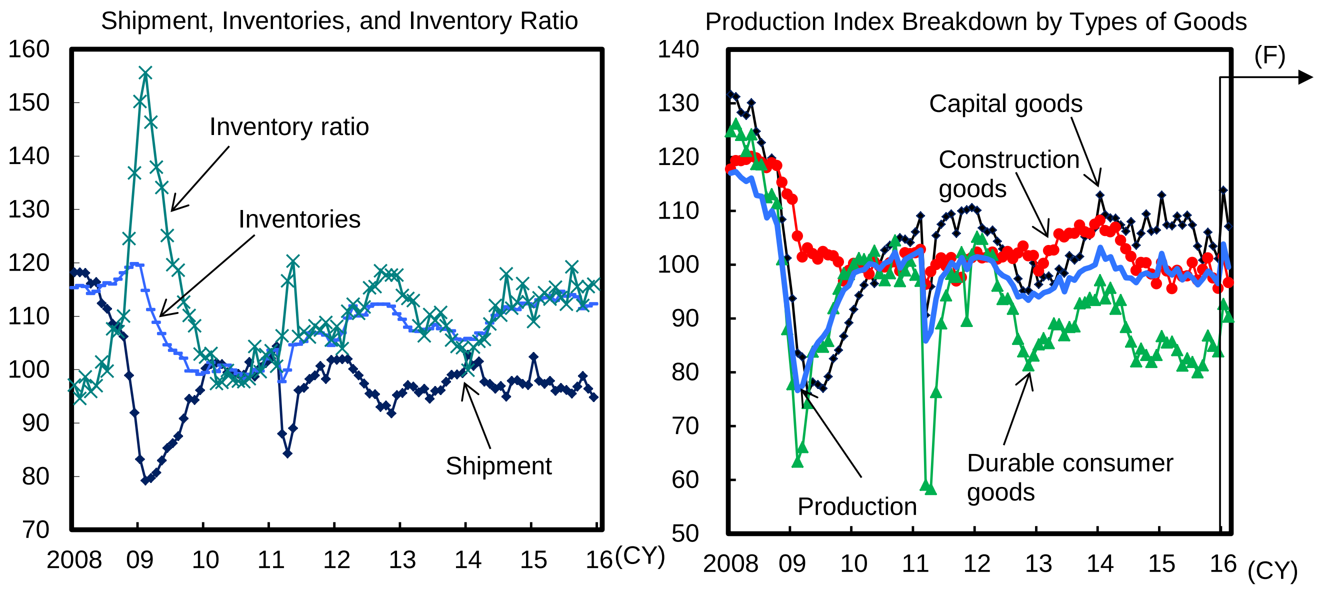
	2015 Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Industrial Production	-0.8	1.2	-2.1	1.1	-0.8	-1.2	1.1	1.4	-0.9	**-1.4**
Market consensus (Bloomberg)										-0.3
DIR estimate										-0.1
Shipments	-0.6	0.6	-1.9	0.6	-0.4	-0.7	1.4	2.1	-2.4	**-1.7**
Inventories	0.4	0.4	-0.8	1.5	-0.8	0.3	-0.4	-1.9	0.4	**0.4**
Inventory ratio	0.9	-1.0	1.9	-1.6	-1.1	6.2	-3.1	-3.0	3.1	**0.4**

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

Reactionary decline in production due to manufacturing in advance last month

The December 2015 indices of industrial production was down by -1.4% m/m, its second consecutive decline, while falling below market consensus as well (-0.3%). The shipment index was also down considerably by -1.7% m/m, bringing overall negative results. Inventories were up slightly by +0.4%, with inventory ratio up by +0.4% m/m, both components seeing their second consecutive month of growth. However, the METI forecast sees an increase in production in the future despite ups and downs, suggesting that Japan's economy will leave behind the recent temporary lull and begin heading toward recovery.

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.

Durable consumer goods shift to decline in production, while capital goods and materials sectors continue unfavorably

As for production index performance by industry in December, eleven out of the total of fifteen industries recorded production declines. Two causes are seen behind the production declines. First, increases in the pace of manufacturing in fall ahead of planned launching of new products were seen in electronic parts & devices (-3.5% m/m), transport equipment (-0.9%), and related industry electrical machinery (-1.7%). Hence these industries, which had been performing fairly positively, are seen as having experienced a reactionary decline in comparison to the intense activity of the previous month. Meanwhile, the pace of decline seems to have slowed for general-purpose, production and business oriented machinery (-0.9%), fabricated metals (-1.3%), non-ferrous metals (-2.1%), and iron & steel (-0.2%), as well as the capital goods and materials sectors still slogging through hard times, but production declines continue.

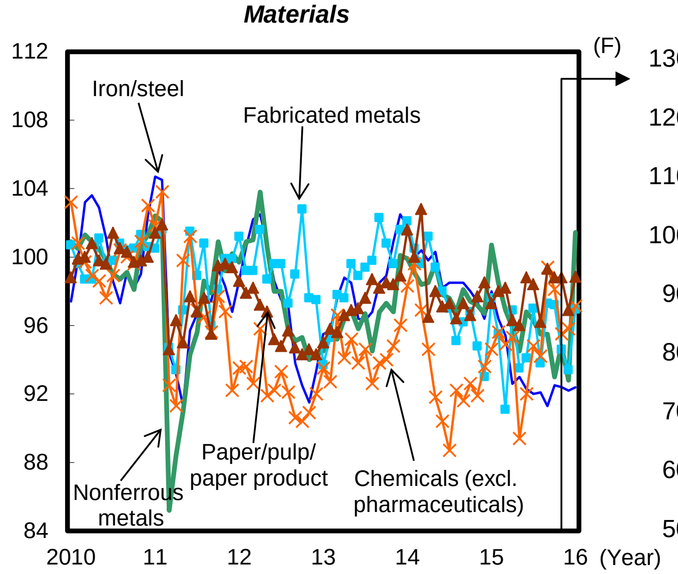
Looking at December production index performance by types of goods, we see that declines were considerable in the area of investment goods. Capital goods (-2.2% m/m) and construction goods (-1.9%) continued the previous month's trend toward decline. Durable consumer goods lacked teeth at -1.2%, while non-durable consumer goods marked time at +0.2%.

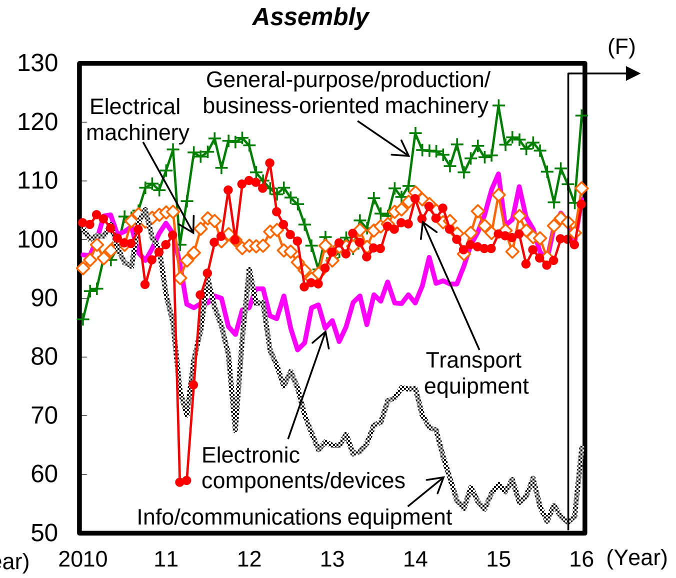
Growth in production seen with ups and downs due to Lunar New Year Holiday

The forecast survey for January and February 2016 expects industrial production to achieve growth in January at +7.6% m/m, but then decline again in February at -4.1% m/m. The expected decline in February is due to Lunar New Year celebrations in China and elsewhere in the Sinosphere. On average, however, a return to growth in production is seen in the future. Performance by industry is as follows, with industries listed in order of highest two-month average performance. Information communication & electronics equipment (+22.2% in January and +0.6% in February), general-purpose, production and business oriented machinery (+14.0% in January and -4.4% in February), pulp, paper and paper products (+5.0% in January and -0.5% in February), non-ferrous metals (+9.3% in January and -4.9% in February), and iron & steel (+0.2% in January and +1.9% in February). All in all, industries which had been recording weak performance until recently are expected to rebound.

Looking at the forecast survey by types of goods, we see that on average, production of consumer goods and capital goods are showing strength in the future, with expected performance as follows: non-durable consumer goods (+7.1% m/m in January and +2.1% m/m in February), durable consumer goods (+10.5% in January and -2.6% in February), and capital goods (less transport equipment) (+12.6% in January and -5.9% in February). Construction goods are also expected to recover to a moderate growth trend in production with +6.1% in January and -4.7% in February.

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



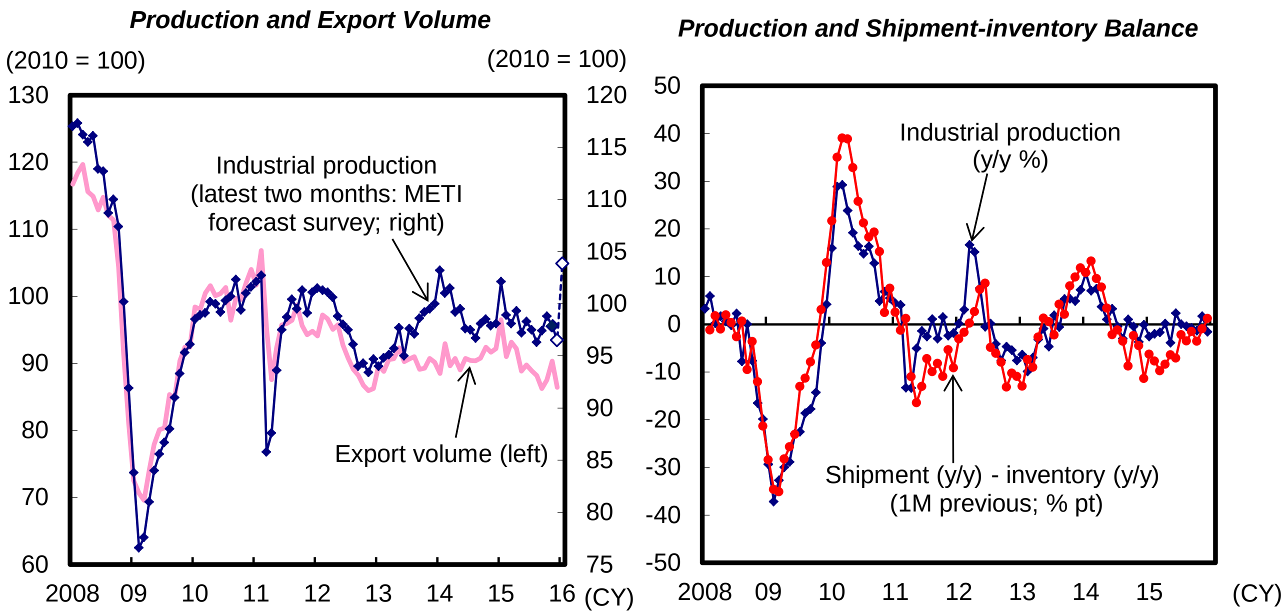


Source: Ministry of Economy, Trade, and Industry (METI); compiled by DIR.
F: METI's forecast survey.

Recovery from temporary lull begins

As can be seen in METI’s production forecast survey, production is expected to see some ups and downs, but ultimately return to a moderate growth trend in the future. 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 also expected to return to a moderate recovery trend despite 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 move into 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 which is helping to bring a comeback. 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 further declines in demand can be avoided, 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.