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January Industrial Production

Production to see more ups and downs

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Summary

- The January 2016 indices of industrial production was up by +3.7% m/m, achieving growth for the first time in three months, while exceeding market consensus somewhat at +3.2%. The shipment index was also up +3.4% m/m in a fairly major recovery. Inventories were down just slightly at -0.3%, with inventory ratio up down by -2.1% m/m, both components seeing declines for the first time in three months. However, the METI forecast sees production experiencing ups and downs in the future.

- Production is expected to see ups and downs for a bit longer. The turmoil experienced in the global financial markets at the beginning of the year make it clear that it will take some more time before overseas demand recovers completely and shows a real sustainable recovery. Falling crude oil prices and the strong dollar are a drag on the US corporate sector, while the need to continue adjustments to handle excess capacity in Asia likely means a continuation of unfavorable conditions for Japan's exports of capital goods and materials. However, domestic demand should improve in the future, with recovery 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.

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

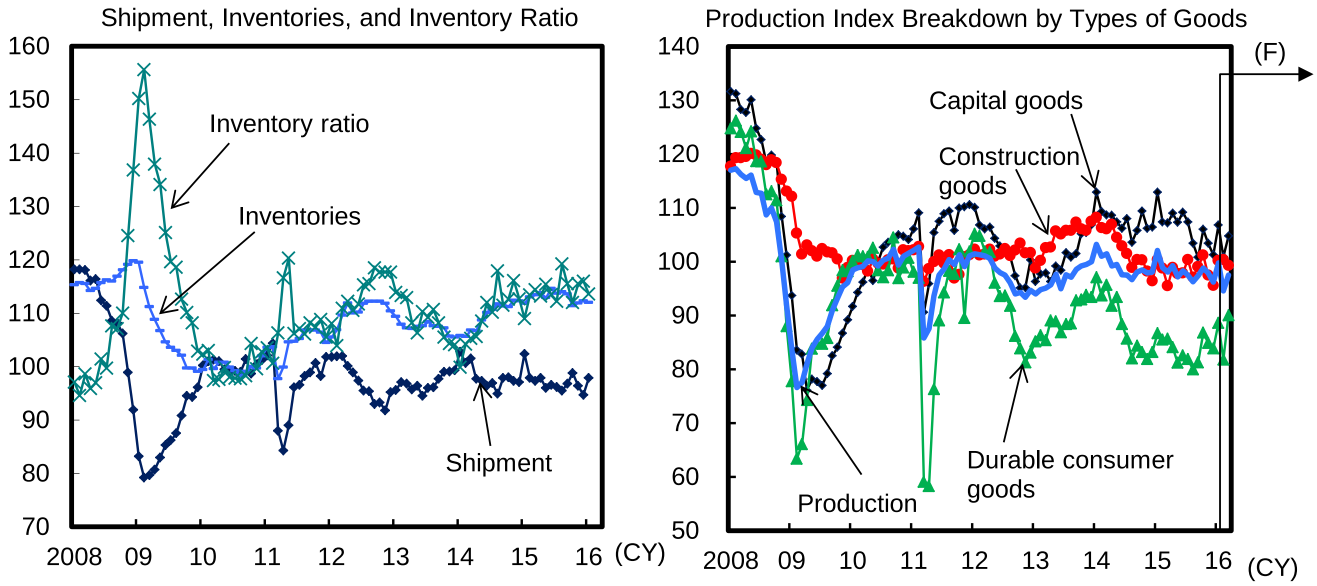
	2015									2016
	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan
Industrial Production	1.2	-2.1	1.1	-0.8	-1.2	1.1	1.4	-0.9	-1.7	**3.7**
Market consensus (Bloomberg)										3.2
DIR estimate										3.7
Shipments	0.6	-1.9	0.6	-0.4	-0.7	1.4	2.1	-2.4	-1.8	**3.4**
Inventories	0.4	-0.8	1.5	-0.8	0.3	-0.4	-1.9	0.4	0.4	**-0.3**
Inventory ratio	-1.0	1.9	-1.6	-1.1	6.2	-3.1	-3.0	3.1	0.4	**-2.1**

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

Production up due to growth in shipments; inventory adjustment progresses

The January 2016 indices of industrial production was up by +3.7% m/m, achieving growth for the first time in three months, while exceeding market consensus somewhat at +3.2%. The shipment index was also up +3.4% m/m in a fairly major recovery. Inventories were down just slightly at -0.3%, with inventory ratio up down by -2.1% m/m, both components seeing declines for the first time in three months. Though gradual, inventory adjustment is progressing, and is a positive factor.

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 recover from temporary declines, while capital goods and the materials sector also experience a momentary recovery

As for production index performance by industry in January, twelve out of the total of fifteen industries recorded production growth. The most notable item is durable consumer goods, whose recovery especially stands out after the previous month’s reactionary declines due to the aftermath of the year-end shopping spree. Production increases were seen in transport equipment (+2.9% m/m), electronic parts & devices (+6.3%), electrical machinery (+5.7%), and information and communications electronic equipment (+5.9%). Meanwhile, short-lived increases in production were also seen in areas which had continued to suffer declines last year, including general-purpose, production and business oriented machinery (+7.3%), fabricated metals (+6.4%), and non-ferrous metals (+6.5%).

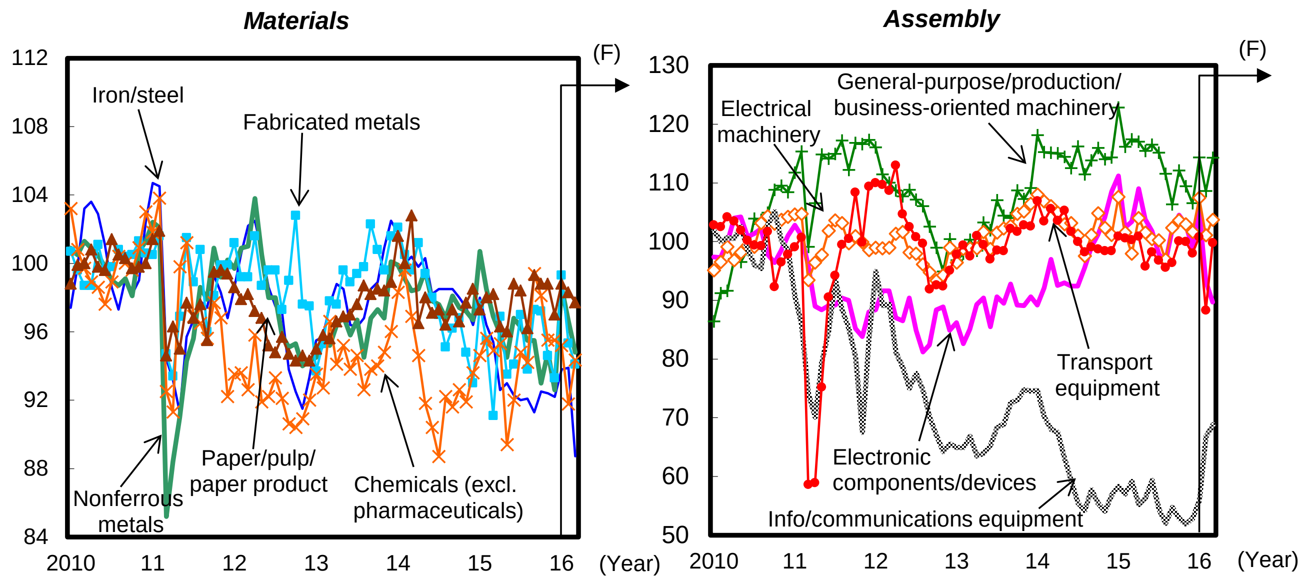
Looking at January production index performance by types of goods, we see that production increases were considerable in the area of durable consumer goods (+5.6%), capital goods (+5.4%), and construction goods (+4.8%). Other areas experienced moderate growth, including non-durable consumer goods (+0.7%) and production goods (+2.0%).

Future to see more ups and downs

As can be seen in METI's production forecast survey, production is expected to see more ups and downs in the near future, most likely feeling the effects of the Lunar New Year celebrations in China, with the production index in February and March 2016 expecting -5.2% y/y and +3.1% y/y respectively. Looking at the two-month average growth rate, information communication & electronics equipment stands out (+19.4% in February and +3.1% in March), but major declines are expected for electronic parts & devices (-11.4% in February and -3.8% in March). Meanwhile, the materials sector is expected to move back into a growth trend, with iron & steel up by +0.1% in February and then -5.5% in March, and fabricated metals at -4.0% in February and -1.3% in March, and non-ferrous metals at -2.0% in February and -1.9% in March.

Looking at the forecast survey by types of goods, we see that on average, production increases are seen continuing for durable consumer goods (-7.7% in February and +10.1% in March) while overall weakness is expected for other areas, including capital goods (-5.5% in February and +3.8% in March), construction goods (+0.2% in February and -1.1% in March), and non-durable consumer goods (-1.8% in February and -1.5% in March).

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

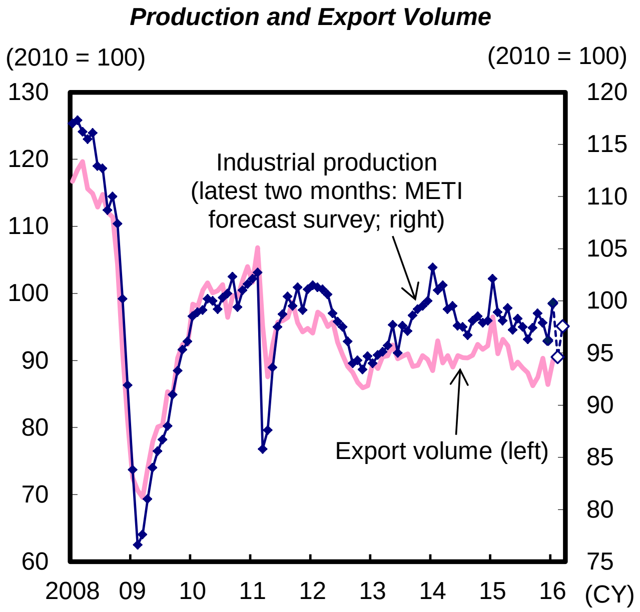


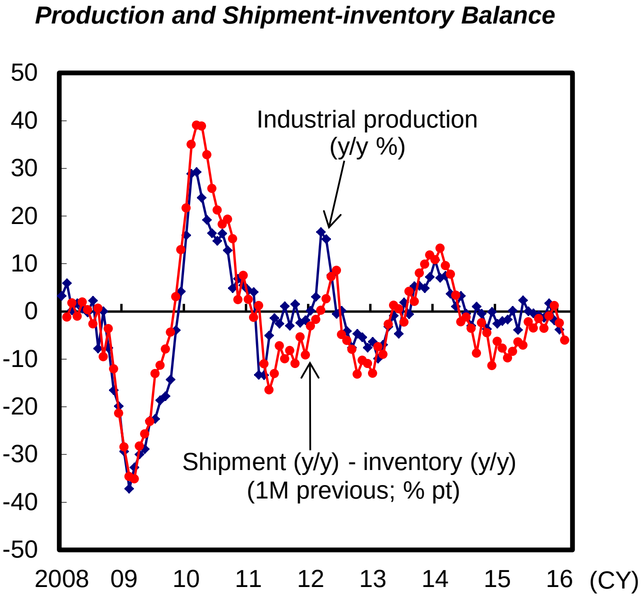
Source: Ministry of Economy, Trade, and Industry (METI); compiled by DIR.
F: METI's forecast survey.

Economic lull to continue for a while longer

Production is expected to see ups and downs for a bit longer. The turmoil experienced in the global financial markets at the beginning of the year make it clear that it will take some more time before overseas demand recovers completely and shows a real sustainable recovery. Falling crude oil prices and the strong dollar are a drag on the US corporate sector, while the need to continue adjustments to handle excess capacity in Asia likely means a continuation of unfavorable conditions for Japan's exports of capital goods and materials. However, domestic demand should improve in the future, with recovery 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.

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





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