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April Industrial Production

Effect of Kumamoto earthquake on overall production limited

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Summary

- The April 2016 indices of industrial production was up by +0.3% m/m, registering growth for the second consecutive month, while exceeding market consensus (-1.5%), which had expected a lower result due to the recent Kumamoto earthquake. Meanwhile, the shipment index was up by +1.5% m/m, while the inventory index declined by -1.7% and inventory ratio fell by -2.2%, the first decline in two months for both inventory measurements. The METI production forecast survey sees a continuation of the gradual comeback for production, with May seen up by +2.2% and June up by +0.3%. Overall, production in April shows favorable results, with progress observed in inventory adjustment and only limited influence from the Kumamoto earthquake.
- Production is expected to continue in a weak tone for some time. Complete recovery for domestic demand, which depends largely on consumption, will likely take time due to sluggish growth for wages and household income for pensioners. In addition, the earnings environment for corporations is worsening due to the progressively strong yen, and this will very likely narrow the focus of domestic capex to labor-saving as a means of handling the shortage in manpower, research and development, and energy-saving. As for overseas demand, while strengths and weaknesses are expected, the steady undertone should continue. The US economy continues to show a steady undertone especially in the household sector, and this is expected to compensate for Japan's ailing exports of capital goods by encouraging exports of durables.

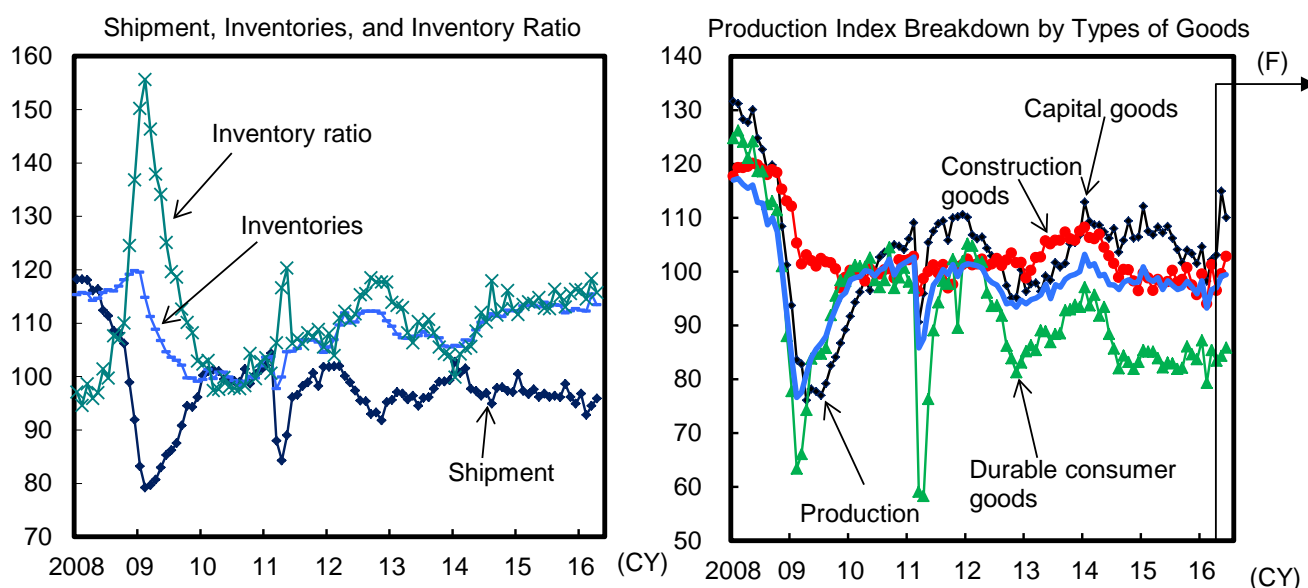
Industrial Production (m/m %; SA basis)										Chart 1
	2015						2016			
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr
Industrial Production	-0.9	-0.7	0.3	1.2	-1.1	-1.2	2.5	-5.2	3.8	0.3
Market consensus (Bloomberg)										-1.5
DIR estimate										-2.5
Shipments	-0.6	0.2	-0.3	2.6	-2.4	-1.4	2.0	-4.1	1.8	1.5
Inventories	-0.6	0.2	-0.1	-1.2	0.4	0.4	-0.3	-0.2	2.9	-1.7
Inventory ratio	-0.1	3.2	-1.0	-1.8	2.2	0.7	-0.1	-1.5	3.3	-2.2

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

Effect of Kumamoto earthquake on April production limited

The April 2016 indices of industrial production was up by +0.3% m/m, registering growth for the second consecutive month, while exceeding market consensus (-1.5%), which had expected a lower result due to the recent Kumamoto earthquake. Meanwhile, the shipment index was up by +1.5% m/m, while the inventory index declined by -1.7% and inventory ratio fell by -2.2%, the first decline in two months for both inventory measurements. The METI production forecast survey sees a continuation of the gradual comeback for production, with May seen up by +2.2% and June up by +0.3%. Overall, production in April shows favorable results, with progress observed in inventory adjustment and only limited influence from the Kumamoto earthquake.

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.

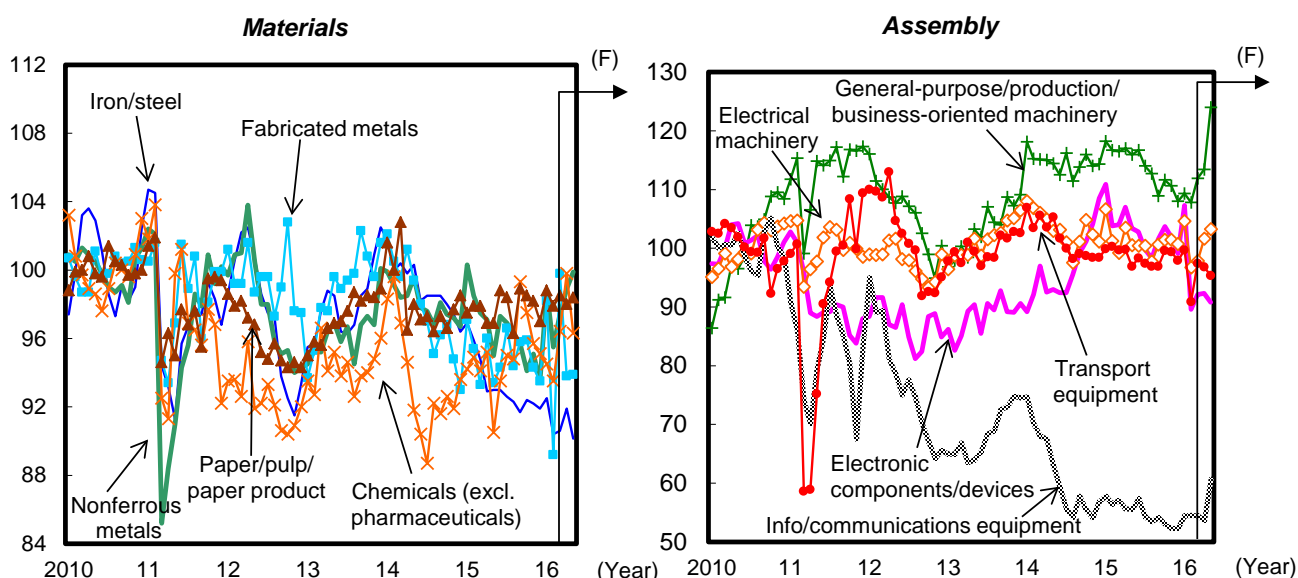
Trends by industry spotty

As for production index performance by industry in April, seven out of the total of fifteen industries recorded production growth. Sectors which recorded production growth included chemicals (minus pharmaceuticals) (+3.5% m/m), electrical machinery (+3.9%), and general-purpose, production and business oriented machinery (+1.3%). Both electrical machinery and general-purpose, production and business oriented machinery showed signs of a comeback after hitting bottom in February. On the other hand, some industries recorded production declines, including fabricated metals (-6.0% m/m) and transport equipment (-0.6%). Transport equipment found its supply chain cut off by the Kumamoto earthquake, in addition to the negative effect of a halt in production due to fraudulent practices on the part of some corporations. Even so, production fell by only a small amount. Looking at April production index performance by types of goods, we see that the influences mentioned above found themselves expressed in a decline in durable consumer goods (-2.3% m/m). In contrast, production of capital goods grew for the second consecutive month, though on the small side at +0.9%. Shipments of capital goods, a coincidental indicator for capex, showed signs of moving toward a comeback. There were also signs that capex, which has been in decline, may be about to bottom out.

Production forecast survey sees gradual comeback, but actual situation more likely to be up and down

The METI production forecast survey sees both May and June up on a month-to-month basis by +2.2% and +0.3% respectively. The gradual comeback in production is expected to continue. However, forecast survey results have a tendency to be revised downwards by the time actual performance is publicly announced. Hence it is more likely that there will be some ups and downs. Looking at the METI forecast by industry, we see production performance being led by two industries – general-purpose, production and business oriented machinery (+9.3% in May and -3.5% in June), and information communication & electronics equipment (+13.2% in May and -0.2% in June). Meanwhile, transport equipment is expected to shift back into production growth, with -1.5% in May and +5.0% in June. The effects of the Kumamoto earthquake on this industry may prove to be short-lived.

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



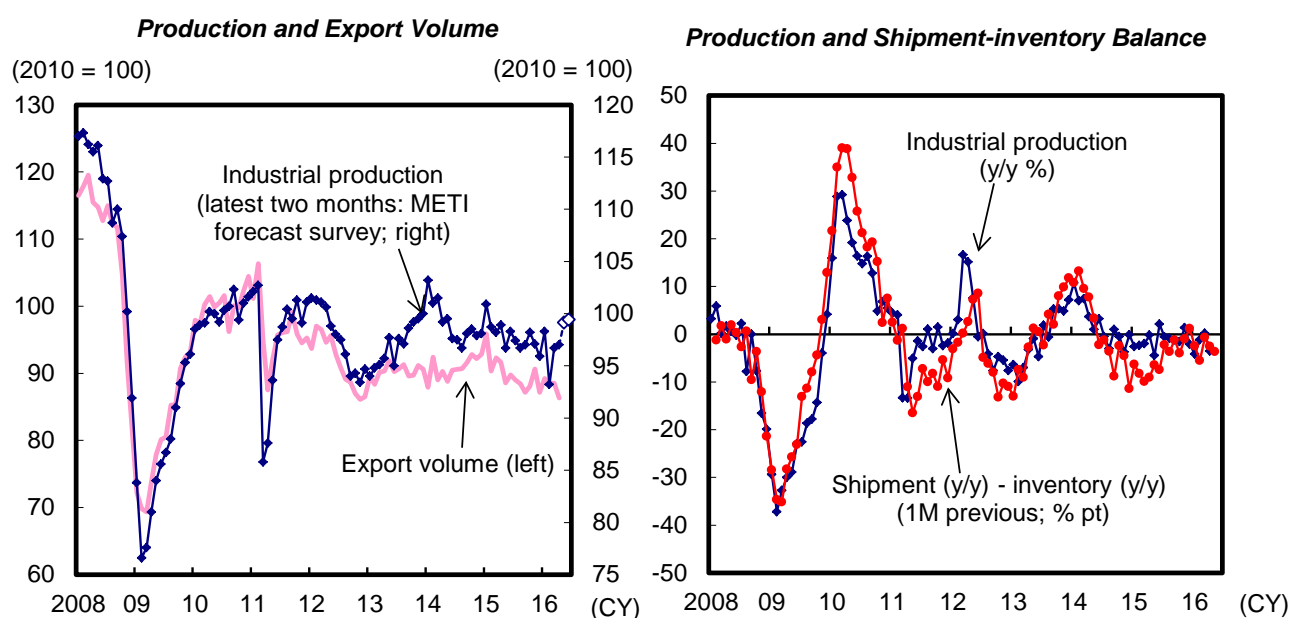
Source: Ministry of Economy, Trade, and Industry (METI); compiled by DIR.
 F: METI's forecast survey.

Weak tone to continue for a while longer

Production is expected to continue in a weak tone for some time. Complete recovery for domestic demand, which depends largely on consumption, will likely take time due to sluggish growth for wages and household income for pensioners. In addition, the earnings environment for corporations is worsening due to the progressively strong yen, and this will very likely narrow the focus of domestic capex to labor-saving as a means of handling the shortage in manpower, research and development, and energy-saving. As for overseas demand, while strengths and weaknesses are expected, the steady undertone should continue. The US economy continues to show a steady undertone especially in the household sector, and this is expected to compensate for Japan's ailing exports of capital goods by encouraging exports of durables. As for exports to the EU, the European economy is making a comeback thanks to the effects of falling crude oil prices and the ECB's quantitative monetary easing, and the recovery trend is expected to continue in the balance. Meanwhile, in regard to the Asian economy, fears associated with the tightening of US monetary policy are on the wane, and the negative influence of capital outflows in association with this factor are gradually abating. Chances are good that this will help to avoid any more declines in demand.

Production, Export Volume, and Shipment-inventory Balance

Chart 4



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