

30 June 2016 (No. of pages: 4)

Japanese report: 30 Jun 2016

May Industrial Production

Stagnant shipments and accumulation of inventory predominate

Economic Intelligence Team
Shunsuke Kobayashi

Summary

- The May 2016 indices of industrial production was down by -2.3% m/m, registering a decline for the first time in three months, while falling considerably below market consensus (-0.2%). Meanwhile, the shipment index also fell steeply by -2.3% m/m, its first decline in three months. The inventory index grew by +0.3% and inventory ratio was up by +1.3%, registering growth for the first time in two months. The METI production forecast survey sees modest growth for production in June (+1.7%) and July (+1.3%), but in consideration of the average realization rate in the past, as well as turmoil in the financial markets stemming from the decision of the UK to withdraw from the EU, chances are that production will continue to be weak in the future.
- Production is expected to continue its weak tone for some time. Complete recovery for domestic demand, which depends largely on consumption, will likely take time due to sluggish growth in disposable income for working families 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, the possibility of further declines is a concern, due to turmoil in the financial markets in reaction to the decision of the UK to leave the EU. As for exports to Europe, the collapse in the price of oil and quantitative easing implemented by the ECB had been encouraging a comeback until now, but the recent political decision could dampen the recovery in demand in the EU. The US economy continues to show a steady undertone especially in the household sector, but other areas are cause for concern, such as demand for capital goods and the trend in the corporate sector. 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. However, caution is required regarding the possibility that demand could decline further due to turmoil in the financial markets stemming from the situation in the EU.

Industrial Production (m/m %; SA basis)

Chart 1

	2015					2016					May
	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr		
Industrial Production	-0.7	0.3	1.2	-1.1	-1.2	2.5	-5.2	3.8	0.5	-2.3	
Market consensus (Bloomberg)										-0.2	
DIR estimate										0.2	
Shipments	0.2	-0.3	2.6	-2.4	-1.4	2.0	-4.1	1.8	1.6	-2.3	
Inventories	0.2	-0.1	-1.2	0.4	0.4	-0.3	-0.2	2.9	-1.7	0.3	
Inventory ratio	3.2	-1.0	-1.8	2.2	0.7	-0.1	-1.5	3.3	-2.2	1.3	

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

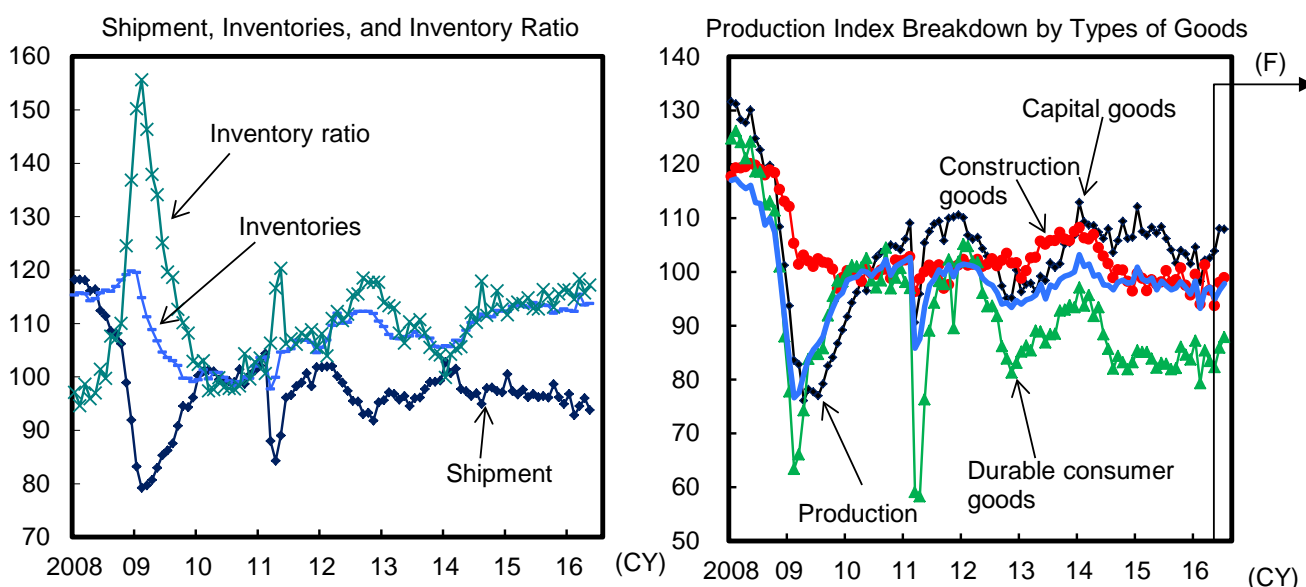
Stagnant shipments and accumulation of inventory predominate

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Economic Research

The May 2016 indices of industrial production was down by -2.3% m/m, registering a decline for the first time in three months, while falling considerably below market consensus (-0.2%). Meanwhile, the shipment index also fell steeply by -2.3% m/m, its first decline in three months. The inventory index grew by +0.3% and inventory ratio was up by +1.3%, registering growth for the first time in two months. The METI production forecast survey sees modest growth for production in June (+1.7%) and July (+1.3%), but in consideration of the average realization rate in the past, as well as turmoil in the financial markets stemming from the decision of the UK to withdraw from the EU, chances are that production will continue to be weak in the future.

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.

Overall performance weak, no clear trend seen in individual industries or goods

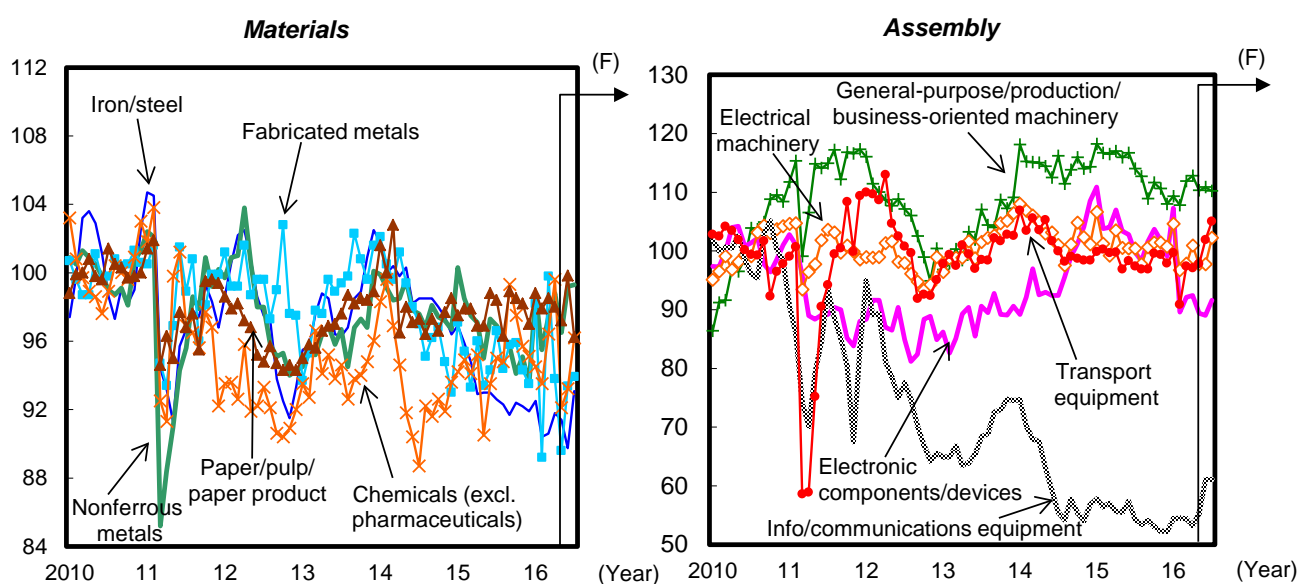
As for production index performance by industry in May, eleven out of the total of fifteen industries recorded production declines. Both the materials and processing sectors were weak overall, with declines seen in chemicals (minus pharmaceuticals) (-7.5% m/m), fabricated metals (-4.5%), ceramics, stone and clay products (-3.9%), and non-ferrous metals (-2.3%), as well as general-purpose, production and business oriented machinery (-2.2%), electronic parts and devices (-3.2%), and electrical machinery (-3.2%). Looking at May production index performance by types of goods, we see production declines in a broad range of areas, including construction goods (-3.0% m/m), durable consumer goods (-1.3%), and non-durable consumer goods (-2.3%). Although major declines were recorded for production overall, there was little evidence of a clearly negative trend in any of the individual industries or type of goods. The general sense is that multiple factors were at work, including the effects of the Kumamoto earthquake and yen appreciation.

Production forecast survey somewhat muted

The METI production forecast survey sees both June and July registering moderate month-to-month growth by +1.7% and +1.3% respectively. Looking at the METI forecast by industry, we see favorable performance for information communication & electronics equipment (+10.4% in June and +0.0% in July), and transport equipment (+4.2% in June and +3.1% in July), while production performance is expected to recover for some industries after the weak tone seen in May, including electrical machinery (+0.0% in June and +4.6% in July), chemicals (+1.2% in June and +3.2% in July), and fabricated metals (+4.2% in June and +0.6% in July). Looking at the METI forecast by types of goods, production plans show strength after recent weakness in construction goods (+4.6% in June and +0.9% in July), and durable consumer goods (+4.4% in June and +2.3% in July).

Production by Industry (2010 = 100; SA basis)

Chart 3



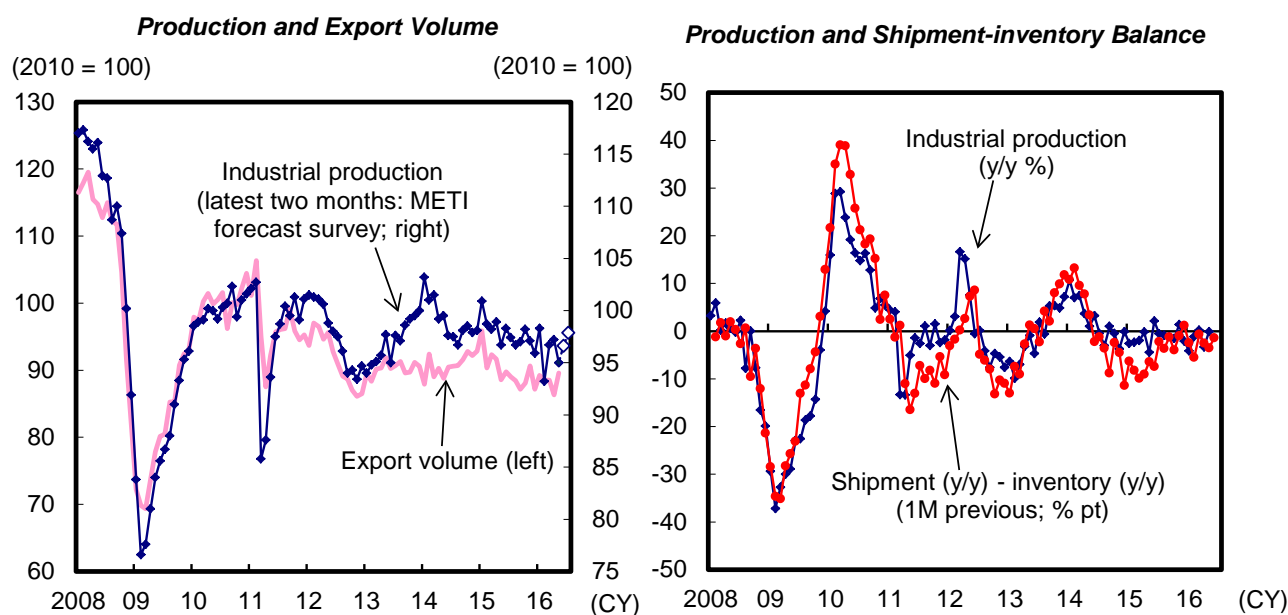
Source: Ministry of Economy, Trade, and Industry (METI); compiled by DIR.
F: METI's forecast survey.

Weak tone to continue due to turmoil in the financial markets stemming from the UK's decision to leave the EU

Production is expected to continue its weak tone for some time. Complete recovery for domestic demand, which depends largely on consumption, will likely take time due to sluggish growth in disposable income for working families 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, the possibility of further declines is a concern, due to turmoil in the financial markets in reaction to the decision of the UK to leave the EU. As for exports to Europe, the collapse in the price of oil and quantitative easing implemented by the ECB had been encouraging a comeback until now, but the recent political decision could dampen the recovery in demand in the EU. The US economy continues to show a steady undertone especially in the household sector, but other areas are cause for concern, such as demand for capital goods and the trend in the corporate sector. 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. However, caution is required regarding the possibility that demand could decline further due to turmoil in the financial markets stemming from the situation in the EU.

Production, Export Volume, and Shipment-inventory Balance

Chart 4



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