Daiwa
Daiwa Institute of Research

11 July 2016 (No. of pages: 5)

Japanese report: 11 Jul 2016

May 2016 Machinery Orders

May results negative, with m/m decline contradicting forecast; sense that orders about to peak out.

Economic Intelligence Team
Keisuke Okamoto
Shunsuke Kobayashi

Summary

- According to statistics for machinery orders in May 2016, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders fell for the second consecutive month by -1.4% m/m. Meanwhile, results contradicted market consensus, recording a decline in comparison to the +3.2% forecast, producing a decidedly negative conclusion. Private sector demand (excluding ships and electrical power) appears to be headed toward peaking out after recording moderate growth since the middle of 2015.

- Looking at orders by source of demand in May, the manufacturing industries fell for the second consecutive month by -6.4% m/m. The manufacturing industries are experiencing stagnant orders across the board, due to the stagnant domestic economy and the strong yen. Non-manufacturing orders (excluding ships and electric power) declined slightly for the third consecutive month by -0.3% m/m. Non-manufacturing orders appear to be taking a breather after the growth trend seen up to this point.

- Machinery orders, the leading indicator for capex, are expected to mark time in the future. With supply and demand for labor remaining tight, the non-manufacturing industries, which are not so easily influenced by overseas demand, are expected to maintain stable business performance, which should encourage investment in rationalization and labor-saving devices. Meanwhile, demand for machinery is expected to expand, especially for equipment oriented toward restoration and reconstruction of production facilities lost or damaged in the recent Kumamoto earthquake. On the other hand, a worsening external environment as seen in the slowdown of the world economy and the accelerating tendency toward a strong yen/weak dollar situation will likely become a drag on the business performance of export-driven industries, especially in manufacturing, and this is cause for concern. If the assumption of good business performance, which provides the support for capex spending, should collapse, the number of corporations putting off capex spending could increase.

Machinery Orders (m/m %; SA) **Chart 1**

	2015							2016				
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May
Machinery orders (private sector)*	-6.6	-3.0	-2.9	5.9	6.4	-9.7	1.0	15.0	-9.2	5.5	-11.0	-1.4
Market consensus (Bloomberg)												3.2
DIR estimate												2.0
Manufacturing orders	-5.6	-4.0	-3.4	-3.5	6.2	-6.6	-3.0	41.2	-30.6	19.7	-13.3	-6.4
Non-manufacturing orders*	-0.9	-7.3	-1.7	13.7	5.2	-12.7	4.5	1.0	10.2	-6.9	-3.9	-0.3
Overseas orders	7.9	8.5	-17.1	4.4	31.6	-20.1	-2.2	-29.4	6.3	28.5	-6.9	-14.8

Source: Cabinet Office, Bloomberg; compiled by DIR.
*excl. those for ships and from electric utilities.
Note: Figures on market consensus from Bloomberg

May machinery orders decline for second consecutive month; sense that orders about to peak out

According to statistics for machinery orders in May 2016, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders fell for the second consecutive month by -1.4% m/m. Meanwhile, results contradicted market consensus, recording a decline in comparison to the +3.2% forecast, producing a decidedly negative conclusion. Manufacturing suffered its second consecutive month of decline, while non-manufacturing reported its third consecutive month of decline. Private sector demand (excluding ships and electrical power) appears to be headed toward peaking out after recording moderate growth since the middle of 2015.

Manufacturing orders stagnant due to stagnant domestic economy and strong yen

Looking at orders by source of demand in May, the manufacturing industries fell for the second consecutive month by -6.4% m/m. The manufacturing industries are experiencing stagnant orders across the board, due to the stagnant domestic economy and the strong yen.

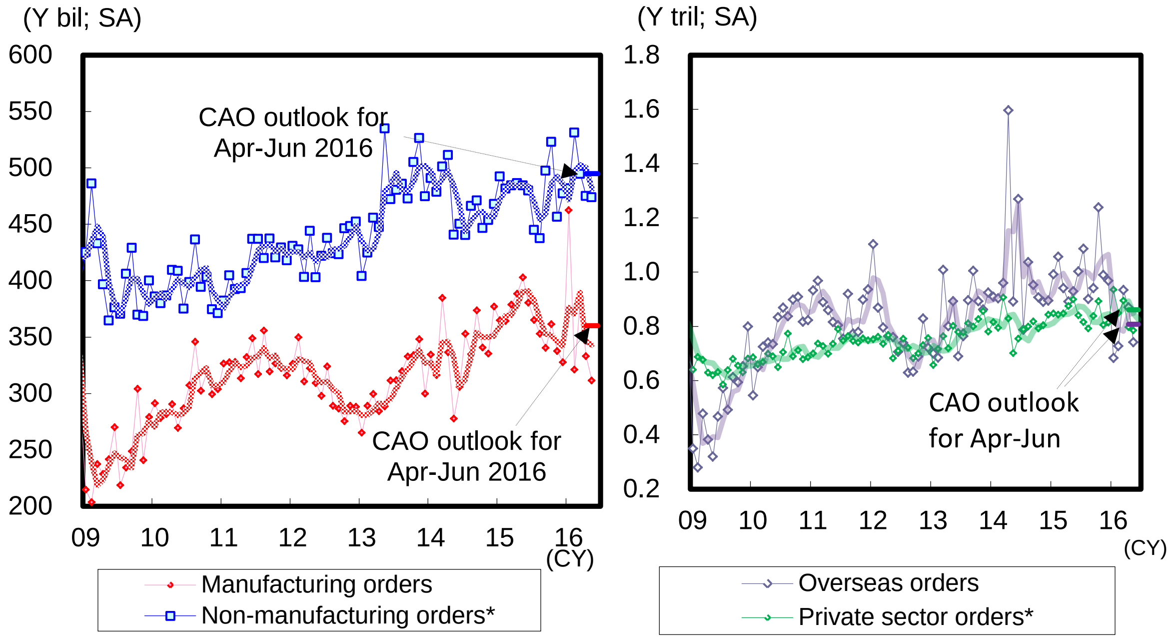
As for performance by industry, declines were experienced in information & communication electronics equipment (-40.7% m/m), general purpose and production machinery (-9.6%), and automobiles, parts and accessories (-10.3%). Information & communication electronics equipment declined for the first time in two months. It is becoming clearer that the industry is now moving into a declining trend after its peak at the beginning of the year. Meanwhile, automobiles, parts and accessories declined for the first time in three months. However, averaged out the industry is actually marking time with orders maintaining a steady undertone despite sluggish sales of light vehicles after the discovery of falsified fuel economy tests in April. On the other hand, some industries achieved month-to-month growth in orders, including non-ferrous metals (+554.4%), chemicals (+46.2%), electrical machinery (+9.1%), and shipbuilding (+31.1%). Non-ferrous metals registered considerable growth in May, most likely due to a reaction to the previous month's major decline of -86.4%. Electrical machinery registered growth for the second consecutive month, but on average, it has still not been able to shake the declining trend seen since the middle of last year. This may be due to the worldwide decline in demand for smart phones weakening demand for machinery in this industry. The future should be approached with caution here.

Non-manufacturing orders decline for third consecutive month, appear to be taking a breather after growth trend up to this point

Non-manufacturing orders (excluding ships and electric power) declined slightly for the third consecutive month by -0.3% m/m. Non-manufacturing orders appear to be taking a breather after the growth trend seen up to this point.

Looking at performance by industry, a negative contribution was seen from finance and insurance at -23.0% m/m. Declines in orders were also seen in other non-manufacturing (-4.0%), telecommunications (-4.7%), and goods leasing (-19.7%). Finance and insurance declined for the first time in two months. This industry has experienced large fluctuations on a monthly basis, but on average the amount in orders is in a moderately declining phase. On the other hand, month-to-month growth was seen in transportation and postal activities (+26.8%), construction (+14.3%), and information services (+13.4%). Transportation and postal activities achieved growth for the first time in three months, but in terms of the three-month moving average it is actually marking time. This indicates that the domestic economy has been unable to pull itself out of the lull it has been experiencing of late, quite possibly due to slow movement of freight.

Orders by Demand Source (seasonally adjusted figures) — Chart 2



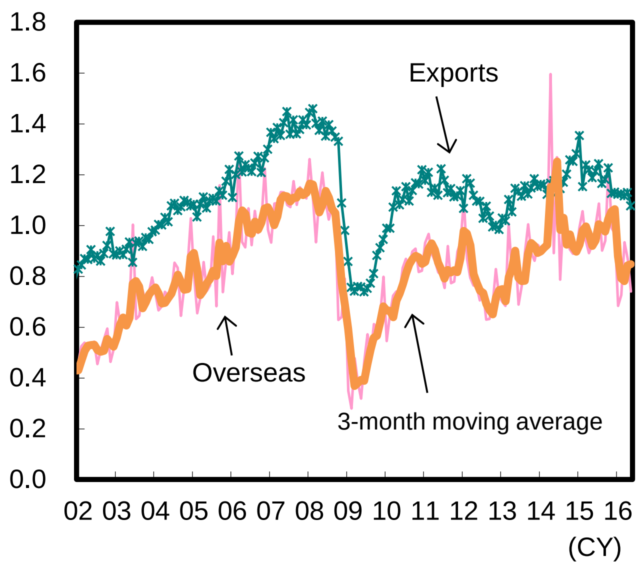
Source: Cabinet Office (CAO); compiled by DIR.
*excl. those for ships and from electric utilities.
Note: Thick lines 3M/MA basis.

Overseas orders decline for second consecutive month. Orders decline for industrial machinery and road transport vehicles

Overseas demand declined for the second consecutive month by -14.8% m/m. According to the Cabinet Office, orders grew for heavy electrical machinery, but declined for industrial machinery and road transport vehicles.

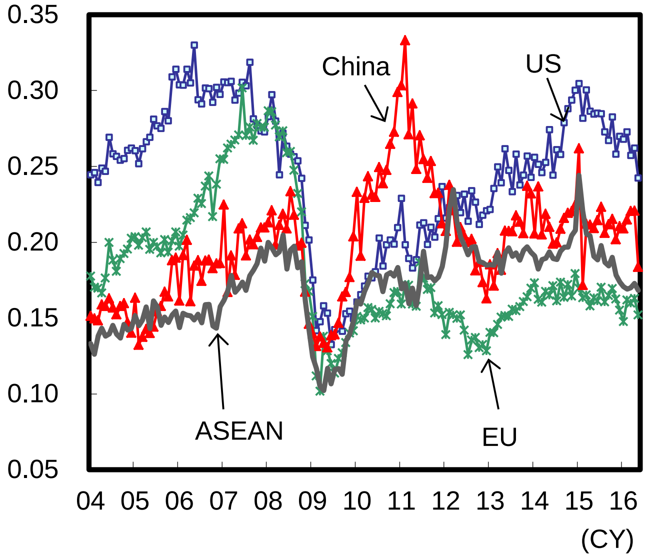
While the feeling is growing that the world economy is beginning to settle down now in comparison to the sluggish performance at the beginning of the year, the US economy is stagnating and a variety of uncertain factors have begun to surface in the world economy, such as the UK's decision to leave the EU (Brexit). As for the future of overseas demand, we expect a gradual comeback, but we advise continuing to take a cautious approach to world economic developments.

General Machinery: Overseas Orders and Exports
(Y tril; SA) **Chart 3**



Source: Cabinet Office, Ministry of Finance; compiled by DIR.
Notes: 1) Exports seasonally adjusted by CAO, general machinery exports by DIR.
2) Thick line for overseas orders 3M/MA basis.

General Machinery: Exports by Trading Partner
(Y tril; SA) **Chart 4**



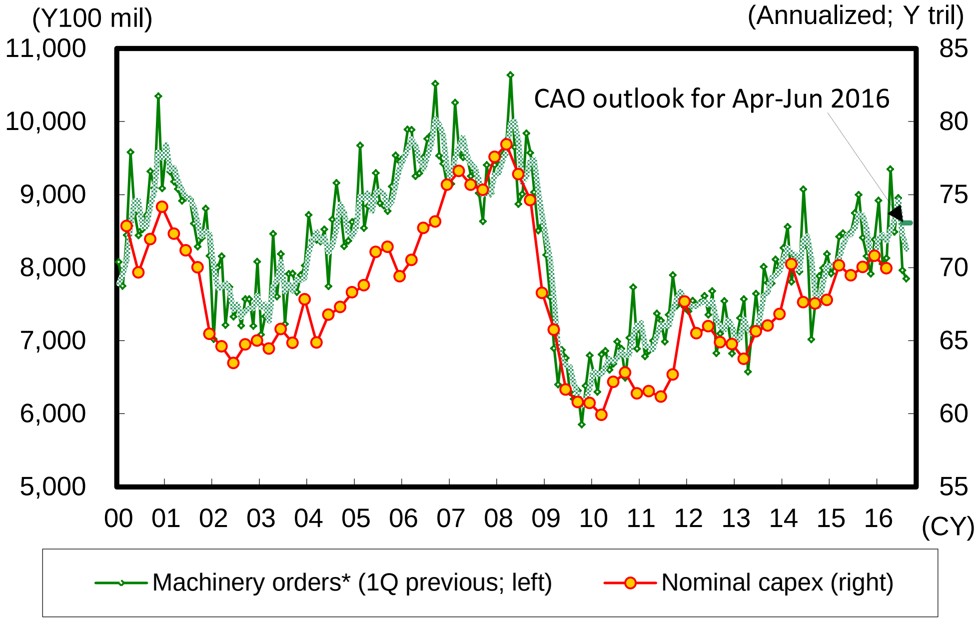
Source: Ministry of Finance; compiled by DIR.
Note: SA by DIR.

Cabinet Office outlook for Apr-Jun period difficult to achieve. Orders expected to mark time in future

The Cabinet Office outlook for the Apr-June period sees private sector demand (excluding ships and electrical power) down by -3.5% q/q. However, in light of actual performance in April and May, June orders would have to achieve growth of over +27.7% m/m in order to achieve this outlook for the period. Hence it is our opinion that it will be difficult if not impossible to achieve this outlook.

Machinery orders, the leading indicator for capex, are expected to mark time in the future. With supply and demand for labor remaining tight, the non-manufacturing industries, which are not so easily influenced by overseas demand, are expected to maintain stable business performance, which should encourage investment in rationalization and labor-saving devices. Meanwhile, demand for machinery is expected to expand, especially for equipment oriented toward restoration and reconstruction of production facilities lost or damaged in the recent Kumamoto earthquake. On the other hand, a worsening external environment as seen in the slowdown of the world economy and the accelerating tendency toward a strong yen/weak dollar situation will likely become a drag on the business performance of export-driven industries, especially in manufacturing, and this is cause for concern. If the assumption of good business performance, which provides the support for capex spending, should collapse, the number of corporations putting off capex spending could increase.

Domestic Demand and Nominal Capex (seasonally adjusted figures) Chart 5



Source: Cabinet Office (CAO); compiled by DIR.

Note: Excluding those for ships and from electric utilities; thick lines 3M/MA basis.