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June 2016 Machinery Orders

June orders achieve growth for first time in three months; Jul-Sep period expected to win q/q growth

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Summary

- According to statistics for machinery orders in June 2016, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders grew for the first time in three months by +8.3% m/m, while also exceeding market consensus at +3.2%. As a result, Apr-Jun period private sector demand (excluding ships and electrical power) recorded a decline of -9.2% q/q, falling below the original forecast of -3.5% announced by the Cabinet Office.

- Looking at orders by source of demand in June, the manufacturing industries grew considerably for the first time in three months by +17.7% m/m. Non-manufacturing orders (excluding ships and electric power) also grew for the first time in four months by +2.1% m/m. Meanwhile, overseas orders grew for the first time in three months by +10.8% m/m.

- Machinery orders, the leading indicator for capex, are expected to win moderate growth in the future. With supply and demand for labor remaining tight, the non-manufacturing industries, which are not so easily influenced by overseas orders, are expected to maintain stable business performance, which should encourage investment in rationalization and labor-saving devices. Meanwhile, in the short-term, 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. However, 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 good business performance, a prerequisite for the support of capex spending, should collapse, the number of corporations putting off capex spending could increase.

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

	2015						2016					
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Machinery orders (private sector)*	-3.0	-2.9	5.9	6.4	-9.7	1.0	15.0	-9.2	5.5	-11.0	-1.4	8.3
Market consensus (Bloomberg)												3.2
DIR estimate												3.2
Manufacturing orders	-4.0	-3.4	-3.5	6.2	-6.6	-3.0	41.2	-30.6	19.7	-13.3	-6.4	17.7
Non-manufacturing orders*	-7.3	-1.7	13.7	5.2	-12.7	4.5	1.0	10.2	-6.9	-3.9	-0.3	2.1
Overseas orders	8.5	-17.1	4.4	31.6	-20.1	-2.2	-29.4	6.3	28.5	-6.9	-14.8	10.8

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

June orders achieve growth for first time in three months

According to statistics for machinery orders in June 2016, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders grew for the first time in three months by +8.3% m/m, while also exceeding market consensus at +3.2%. As a result, Apr-Jun period private sector demand (excluding ships and electrical power) recorded a decline of -9.2% q/q, falling below the original forecast of -3.5% announced by the Cabinet Office.

Manufacturing orders stagnant due to stagnant domestic economy and strong yen

Looking at orders by source of demand in June, the manufacturing industries grew considerably for the first time in three months by +17.7% m/m. However, the major growth in orders experienced in June was due to taking in one-time large orders for major projects in other transport equipment. The manufacturing industry overall, minus other transport equipment grew by +4.6% m/m, leading to the conclusion that orders for the manufacturing industry still lack the desired strength, due to the stagnant domestic economy and unfavorable conditions created by the strong yen.

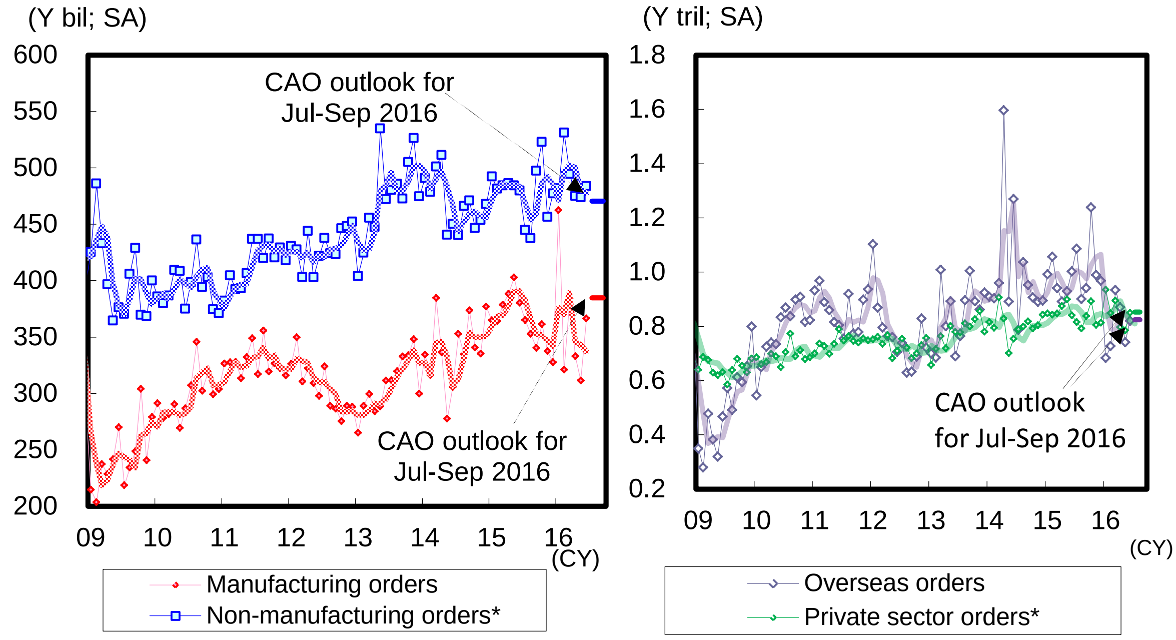
As for performance by industry, twelve industries won m/m growth, including other transport equipment (+250.4% m/m), general purpose and production machinery (+9.6%), and iron & steel (+33.4%). As for other transport equipment, as has already been mentioned, large orders for major projects were highly influential on results. General purpose and production machinery won growth for the first time in three months, though when averaged out this industry is still marking time. Both domestic and overseas orders lack real energy, revealing that capex related demand remains generally stagnant. Meanwhile, five industries suffered m/m declines, including non-ferrous metals (-40.0%), petroleum and coal products (-48.4%), and automobiles, parts and accessories (-10.2%). As for non-ferrous metals, most likely these results constituted a reactionary decline in response to the previous month's major growth (+554.4% m/m in May). In the case of automobiles, parts and accessories, this was the second consecutive month of decline in orders, a continued weak tone for this industry. This suggests that the industry is still feeling the effects of sluggish sales of light vehicles after the discovery of falsified fuel economy tests in April.

Non-manufacturing orders grow for first time in four months, but overall, continue to mark time

Non-manufacturing orders (excluding ships and electric power) also grew for the first time in four months by +2.1% m/m. Overall, non-manufacturing orders continue to mark time.

Looking at performance by industry, month-to-month growth was seen in transportation and postal activities (+36.5%), agriculture, forestry, and fishing (+21.4%), and construction (+15.0%). Transportation and postal activities achieved major growth for the second consecutive month, and on average, appears to have shifted into a growth trend. On the other hand, month-to-month declines were experienced in finance and insurance (-9.7%), information services (-8.3%), and other non-manufacturing (-3.6%). In the case of finance and insurance, this was its second consecutive month of decline. The earnings environment for finance and insurance has deteriorated due to the rapid decline in yield on government bonds, and an increasing sense of uncertainty regarding the future of business results. It is thought that financial institutions may be keeping IT industry investments in check.

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



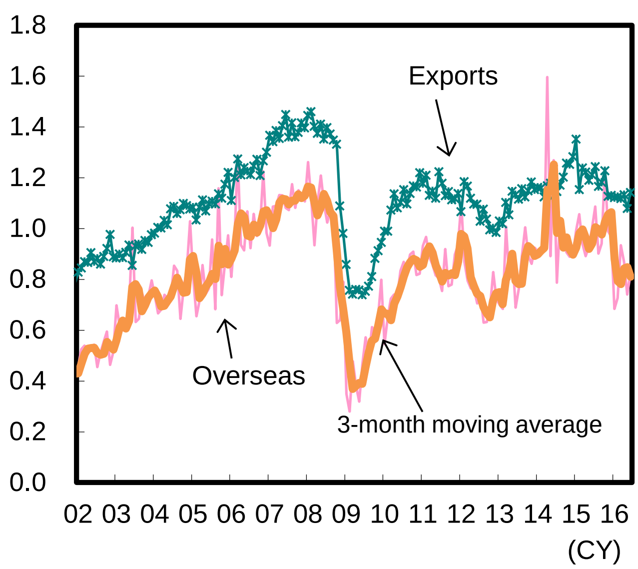
Source: Cabinet Office (CAO); compiled by DIR.
*excl. those for ships and from electric utilities.
Note: Thick lines 3M/MA basis.

Overseas orders grow for first time in three months. Orders for engines and turbines, as well as industrial machinery win growth

Overseas orders grew for the first time in three months by +10.8% m/m. According to the Cabinet Office, orders declined for machine tools and electronic communications equipment, but grew for engines and turbines, as well as industrial machinery. Overseas orders grew by +3.7% q/q during the Apr-Jun period, winning growth for the first time in two quarters.

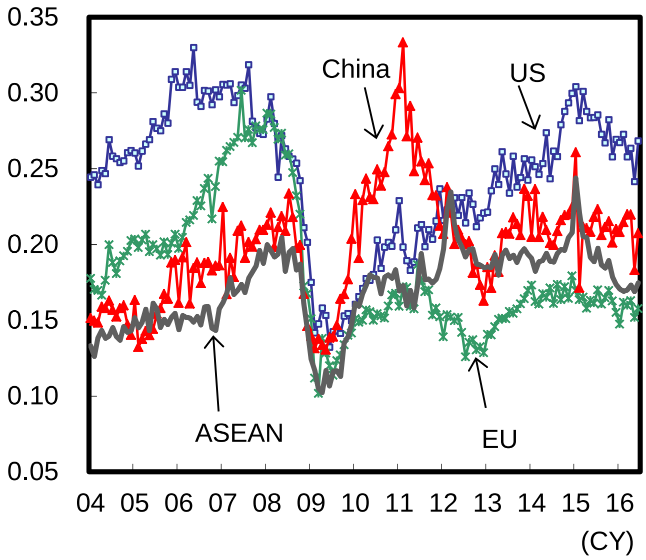
While the feeling is growing that the world economy is beginning to settle down now in comparison to the sluggish performance at the beginning of the year, new worrisome factors have emerged. The US economy is stagnating and a variety of uncertain factors have begun to surface in the world economy, such as the UK's decision to leave the EU (Brexit). As for the future of overseas orders, 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



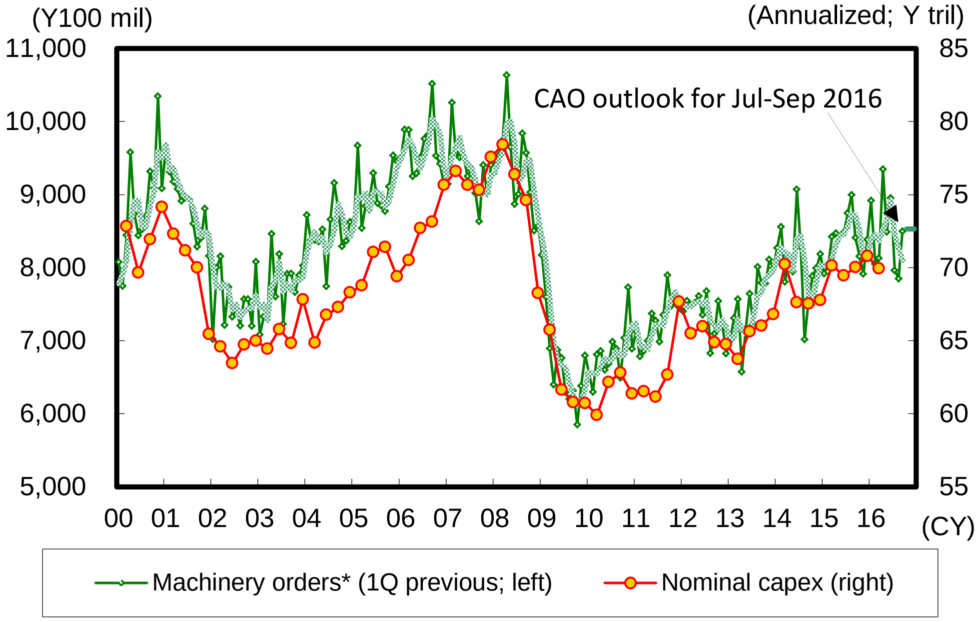
Source: Ministry of Finance; compiled by DIR.
Note: SA by DIR.

Moderate growth seen for machinery orders in future

The Cabinet Office outlook for the Jul-Sep period sees private sector demand (excluding ships and electrical power) up by +5.2% q/q, a shift back to growth in comparison to the Apr-Jun period which saw q/q declines.

Machinery orders, the leading indicator for capex, are expected to win moderate growth in the future. With supply and demand for labor remaining tight, the non-manufacturing industries, which are not so easily influenced by overseas orders, are expected to maintain stable business performance, which should encourage investment in rationalization and labor-saving devices. Meanwhile, in the short-term, 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. However, 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 good business performance, a prerequisite for the support of 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.