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July Industrial Production

Production shows weak tone on inventory adjustment; some industries favorable

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Summary

- The July 2016 indices of industrial production marked time at +0.0% m/m, while falling below market consensus at +0.8%. Meanwhile, the shipping index grew for the second consecutive month at +0.9%, and the inventory index declined for the first time in three months at -2.4%. Inventory ratio grew for the first time in two months by +0.9%. Production shows a weak tone with shipments growing and inventory on the decline. Progress in inventory adjustment appears to be bringing downward pressure on production. The METI production forecast survey sees August up by +4.1% m/m, but then September down again by -0.7%. Considering the fact that August production plans tend to be revised downwards considerably, it is likely that the index will generally continue to mark time. Inventory level remains high, hence there is a good chance that production will continue in a weak tone.

- Production is expected to experience ups and downs in October and beyond. Meanwhile, personal consumption is expected to mark 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, though some goods are expected to maintain a firm undertone, overall demand is expected to mark time.

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

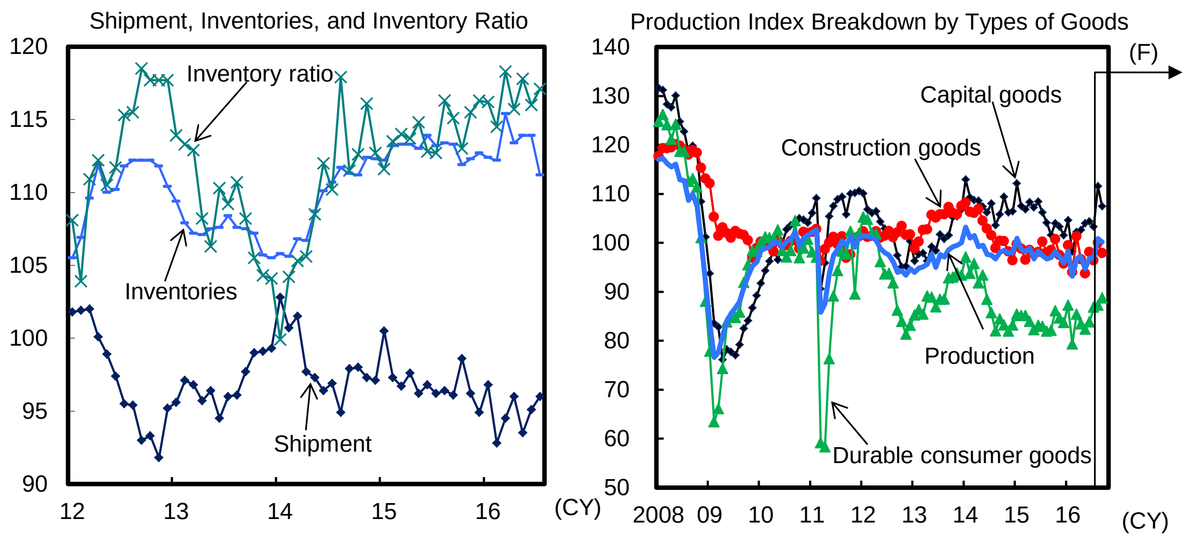
	2015 Oct	Nov	Dec	2016 Jan	Feb	Mar	Apr	May	Jun	Jul
Industrial Production	1.2	-1.1	-1.2	2.5	-5.2	3.8	0.5	-2.6	2.3	**0.0**
Market consensus (Bloomberg)										0.8
DIR estimate										0.6
Shipments	2.6	-2.4	-1.4	2.0	-4.1	1.8	1.6	-2.6	1.7	**0.9**
Inventories	-1.2	0.4	0.4	-0.3	-0.2	2.9	-1.7	0.4	0.0	**-2.4**
Inventory ratio	-1.8	2.2	0.7	-0.1	-1.5	3.3	-2.2	1.8	-1.5	**0.9**

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

Production is marking time; progress in inventory adjustment brings downward pressure on results

The July 2016 indices of industrial production marked time at +0.0% m/m, while falling below market consensus at +0.8%. Meanwhile, the shipment index grew for the second consecutive month at +0.9%, and the inventory index declined for the first time in three months at -2.4%. Inventory ratio grew for the first time in two months by +0.9%. Production shows a weak tone with shipments growing and inventory on the decline. Progress in inventory adjustment appears to be bringing downward pressure on production. The METI production forecast survey sees August up by +4.1% m/m, but then September down again by -0.7%. Considering the fact that August production plans tend to be revised downwards considerably, it is likely that the index will generally continue to mark time. Inventory level remains high, hence there is a good chance that production will continue in a weak tone.

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.

Industries with favorable exports continue growth trend, others mark time

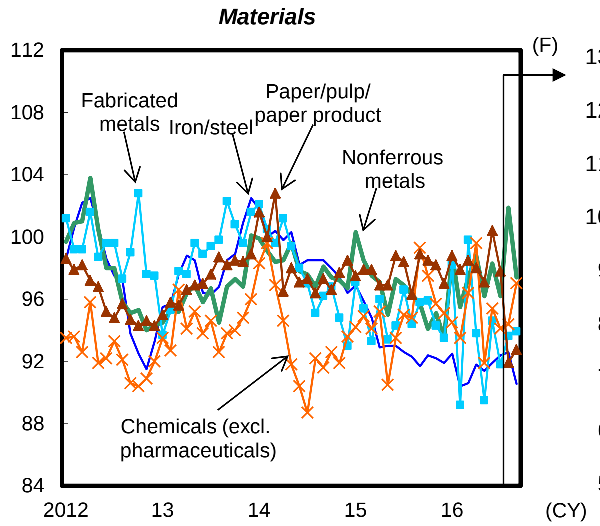
As for production index performance by industry in July, six out of the total of fifteen industries recorded production growth. Industries whose exports are currently favorable showed a continued growth trend, including transport equipment (+1.2% m/m) and electronic parts and devices (+1.5%). On the other hand, declines in production were especially large for chemicals (minus pharmaceuticals) at -1.4% m/m and fabricated metals at -3.0%, both of which registered growth during the previous month. On average, production in these industries is marking time. A few industries managed favorable performance while production marked time overall, and provided underlying support for performance.

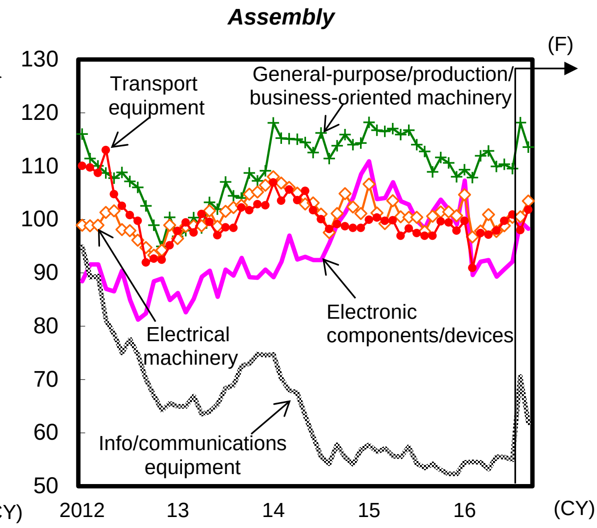
Looking at July production index performance by types of goods, we see production growth for durable consumer goods (+3.6%) and non-durable consumer goods (+0.5%), while declines were seen for production goods (-0.3%) and capital goods (-1.1%). Goods related to personal consumption continue to be favorable, while production associated with capex exhibited a weak tone.

Production plans show strength in August, but downward revision is expected. Production expected to continue marking time

The METI production forecast survey sees August up by +4.1% m/m, while September is expected to be down by -0.7%. When adjustments are made for prediction errors, the METI forecast survey sees a small amount of growth for August at +0.1% m/m. However, considering the fact that August production plans tend to be revised downwards considerably, it is likely that the index will generally continue to mark time. Looking at the METI forecast by industry, we see strength in August for some industries, but these figures may be revised downwards. This includes information communication & electronics equipment (+28.4% in August and -12.3% in September), and general-purpose, production and business related machinery (+7.9% in August and -3.9% in September). On the other hand, favorable production plans are seen for electronic parts and devices (+8.2% in August and -1.4% in September), and electrical machinery (+0.1% in August and +2.9% in September), with production growth seen continuing in the future. Transport equipment is seen continuing its ups and downs (-2.9% in August and +3.9% in September).

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



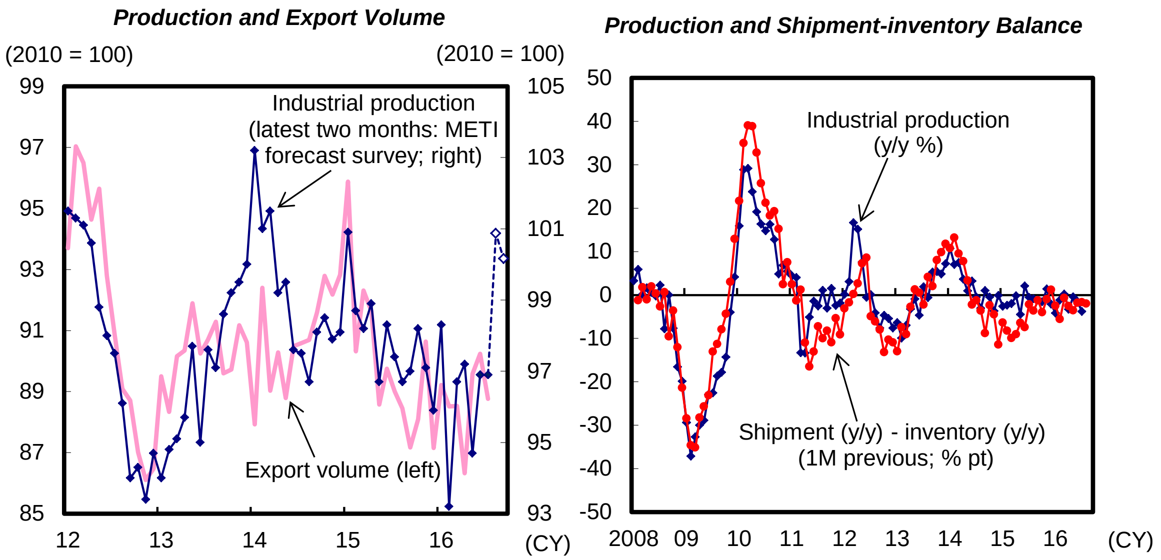


Source: Ministry of Economy, Trade, and Industry (METI); compiled by DIR.
F: METI's forecast survey.

Ups and downs expected to continue

Production is expected to experience ups and downs in October and beyond. Inventory level remains high, and inventory adjustment will likely continue to act as a factor bringing downward pressure on production. Meanwhile, personal consumption is expected to mark 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, though some goods are expected to maintain a firm undertone, overall demand is expected to mark time. 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 decision of the UK to withdraw from the EU and the influence of turmoil amongst financial institutions due to the problem of nonperforming loans could cause the economy to weaken. Hence caution is required. The US economy continues to show a steady undertone especially in the household sector, but growth in capex is sluggish and there is little chance that exports of capital goods will pick up speed. 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 Europe.

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



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