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August Industrial Production

Shipments decline even as production grows. Performance differs widely from industry to industry

Economic Intelligence Team
Tsutomu Saito
Shunsuke Kobayashi

Summary

- The August 2016 indices of industrial production grew for the first time in two months by +1.5% m/m, while at the same time exceeding market consensus at +0.5%. Meanwhile, the shipping index declined for the first time in three months at -1.3%, while the inventory index grew for the first time in two months at +0.1%. Inventory ratio declined for the first time in two months by -3.5%. Production grew while shipments declined and inventory grew just slightly, producing results which are not necessarily positive. Inventory accumulation occurring in some industries, including general-purpose, production and business related machinery and chemicals (minus pharmaceuticals), is considered to be behind the mediocre performance. However, electronic parts and devices, as well as information communication & electronics equipment and non-ferrous metals achieved growth in both production and shipments, thereby maintaining a firm undertone. Results can be said to have shown the strengths and weaknesses of various industries.

- The METI production forecast survey sees September performance up by +2.2% m/m, with October continuing the growth in production at +1.2%. However, it is highly likely that those industries where inventory accumulation was seen on the August report will need time for inventory adjustment in the near future. Hence performance is expected to continue marking time.

- Production is expected to continue experiencing ups and downs in November 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**

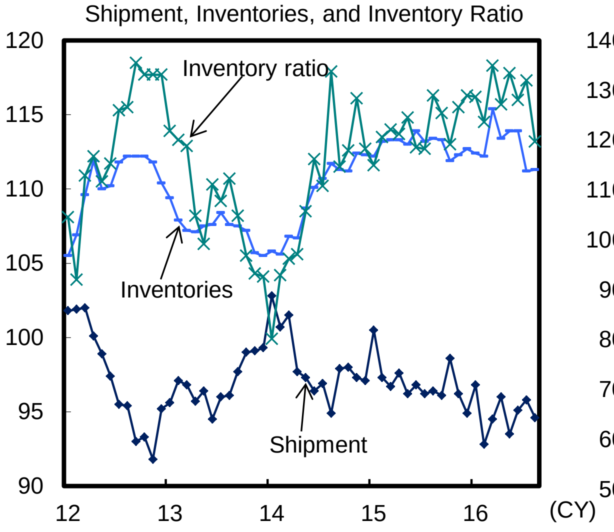
	2015 Nov	Dec	2016 Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
Industrial Production	-1.1	-1.2	2.5	-5.2	3.8	0.5	-2.6	2.3	-0.4	**1.5**
Market consensus (Bloomberg)										0.5
DIR estimate										0.1
Shipments	-2.4	-1.4	2.0	-4.1	1.8	1.6	-2.6	1.7	0.7	**-1.3**
Inventories	0.4	0.4	-0.3	-0.2	2.9	-1.7	0.4	0.0	-2.4	**0.1**
Inventory ratio	2.2	0.7	-0.1	-1.5	3.3	-2.2	1.8	-1.5	1.1	**-3.5**

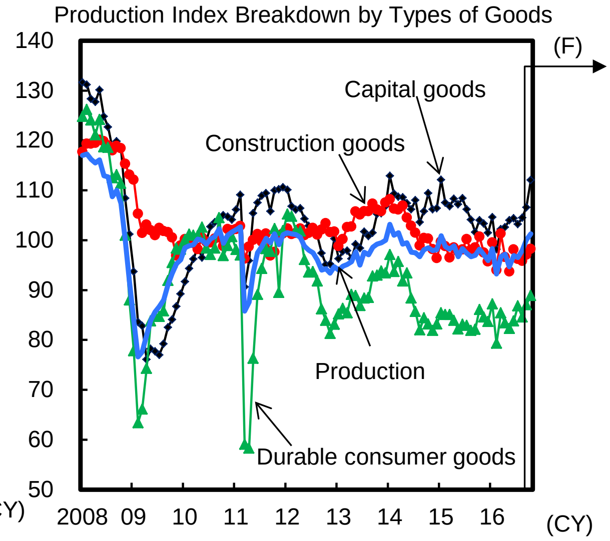
Source: Ministry of Economy, Trade, and Industry; Bloomberg; compiled by DIR.

Shipments decline even as production grows. Performance differs widely from industry to industry

The August 2016 indices of industrial production grew for the first time in two months by +1.5% m/m, while at the same time exceeding market consensus at +0.5%. Meanwhile, the shipping index declined for the first time in three months at -1.3%, while the inventory index grew for the first time in two months at +0.1%. Inventory ratio declined for the first time in two months by -3.5%. Production grew while shipments declined and inventory grew just slightly, producing results which are not necessarily positive. Inventory accumulation occurring in some industries, including general-purpose, production and business related machinery and chemicals (minus pharmaceuticals), is considered to be behind the mediocre performance. However, electronic parts and devices, as well as information communication & electronics equipment and non-ferrous metals achieved growth in both production and shipments, thereby maintaining a firm undertone. Results can be said to have shown the strengths and weaknesses of various industries.

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.

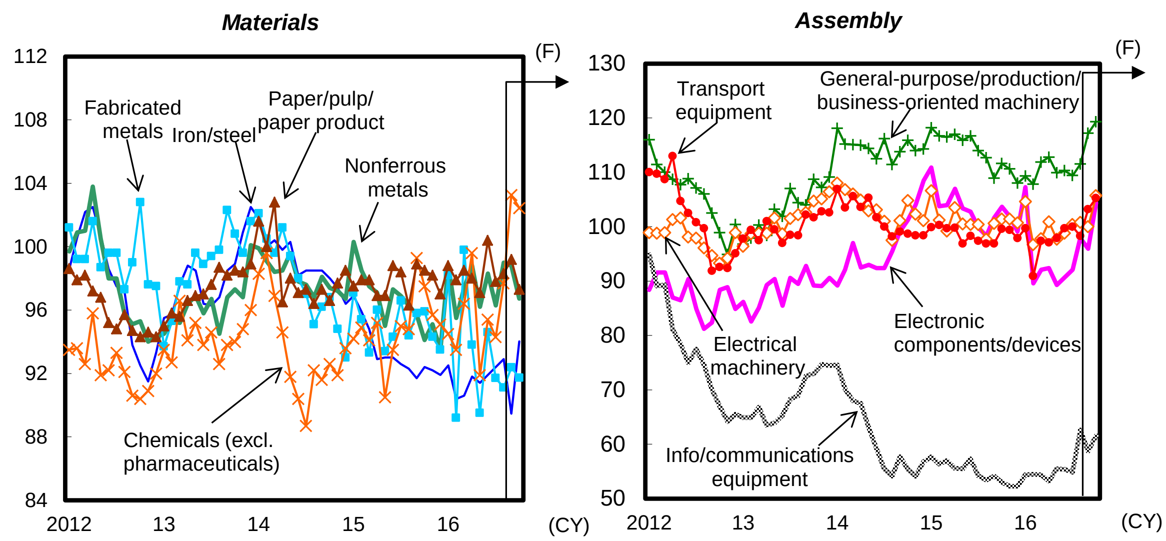
Smartphone related industries and notebook computers favorable, while inventory accumulation was seen in some industries

As for production index performance by industry in August, eleven out of the total of fifteen industries recorded production growth. The growth rate was especially high for electronic parts and devices (+6.3% m/m) and information, communication & electronics equipment (+14.0%). Production continues its growth trend in these industries due to the increase in production of parts for new model smartphones which have recently been marketed, and notebook computers, which continue to exhibit moderate growth in exports. On the other hand, production grew while shipments declined, causing inventory to grow in the areas of general-purpose, production and business related machinery (production up +1.9% m/m, shipments down -2.9%), chemicals (minus pharmaceuticals) (production up +3.6%, shipments down -2.5%), and electrical machinery (production up by +0.4%, shipments down by -1.1%). While industries maintaining favorable performance are providing underlying support for production, the fact that there are industries in which inventory accumulation is taking place despite the already high level which inventories have continued to occupy is a cause of concern. Moreover, exports of transport equipment to the US declined sharply in August with both production and shipments suffering (production down by -1.7%, shipments down by -2.9%). Close monitoring of trends in overseas demand continues to be required due to its tendency to deeply influence production.

Production plans show confidence, but future expected to continue marking time due to inventory adjustment

The METI production forecast survey sees September performance up by +2.2% m/m, with October continuing the growth in production at +1.2%. Looking at the METI forecast by industry, we see some industries with confident plans for production, but whose inventories have also increased, meaning that they will have to undergo inventory adjustment in the future, leaving open the strong possibility that their outlooks will ultimately be revised downwards. These areas include general-purpose, production and business related machinery (+5.1% in September and +1.8% in October), and chemicals (+5.7% in September and -0.8% in October). It is always necessary in general to take predictions of growth in production with a certain grain of salt, and the current situation is no exception. Ultimately, we expect production to continue marking time. Meanwhile, two industries which saw growth in production on the August report are expected to see declines in September and to contribute to bringing down overall results. These are information, communication & electronics equipment (-6.2% in September and +4.9% in October), and electronic parts and devices (-2.0% in September and +8.8% in October). On the other hand, transport equipment expects production growth to continue (+5.0% in September and +2.0% in October), providing a bright spot in the overall picture.

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



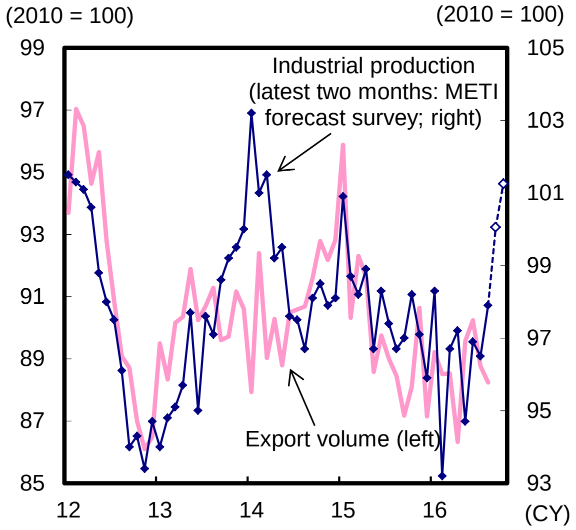
Source: Ministry of Economy, Trade, and Industry (METI); compiled by DIR.
F: METI's forecast survey.

Ups and downs expected to continue

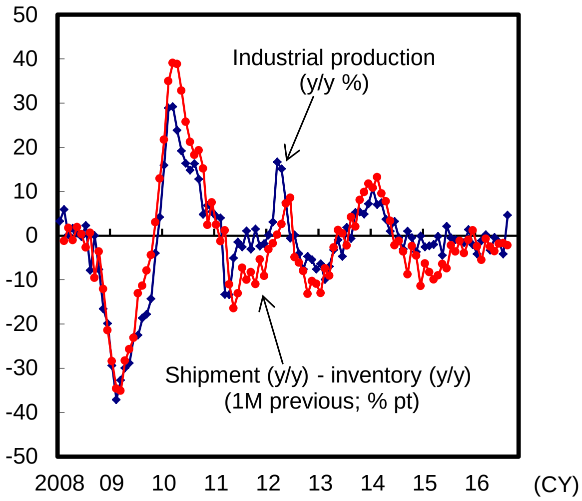
Production is expected to experience ups and downs in November and beyond. Inventory level remains high, and inventory adjustment will likely continue to act as a factor bringing downward pressure on production. Meanwhile, personal consumption is expected to mark time due to sluggish growth in disposable 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, 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**

Production and Export Volume



Production and Shipment-inventory Balance



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