

31 October 2016 (No. of pages: 4)

Japanese report: 31 Oct 2016

September Industrial Production

Production marks time in m/m terms though factors causing temporary downward pressure were also present. Production growth seen in future

Economic Intelligence Team
Tsutomu Saito
Shunsuke Kobayashi

Summary

- The September 2016 indices of industrial production marked time at +0.0% m/m, meanwhile falling below market consensus at +0.9%. The September shipping index was also up for the first time in two months at +1.1%, while the inventory index fell for the first time in two months at -0.4%. Inventory ratio grew for the first time in two months at +1.5%. Overall production experienced major downward pressure from declines in the information communication & electronic equipment industry, as well as in electronic parts & devices, but both production and shipments show signs of a comeback in general-purpose, production and business related machinery, and transport equipment, bringing those industries favorable results in the end.
- The METI production forecast survey sees October performance up by +1.1% m/m with November up by +2.1%. Production is expected to continue growing in the future. One positive element is that production is expected to recover for information communication & electronic equipment, and electronic parts & devices, both which suffered major declines in production in September.
- Production is expected to continue experiencing ups and downs in December and beyond as well. 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		2016							
	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
Industrial Production	-1.2	2.5	-5.2	3.8	0.5	-2.6	2.3	-0.4	1.3	0.0
Market consensus (Bloomberg)										0.9
DIR estimate										1.2
Shipments	-1.4	2.0	-4.1	1.8	1.6	-2.6	1.7	0.7	-1.1	1.1
Inventories	0.4	-0.3	-0.2	2.9	-1.7	0.4	0.0	-2.4	0.3	-0.4
Inventory ratio	0.7	-0.1	-1.5	3.3	-2.2	1.8	-1.5	1.1	-3.2	1.5

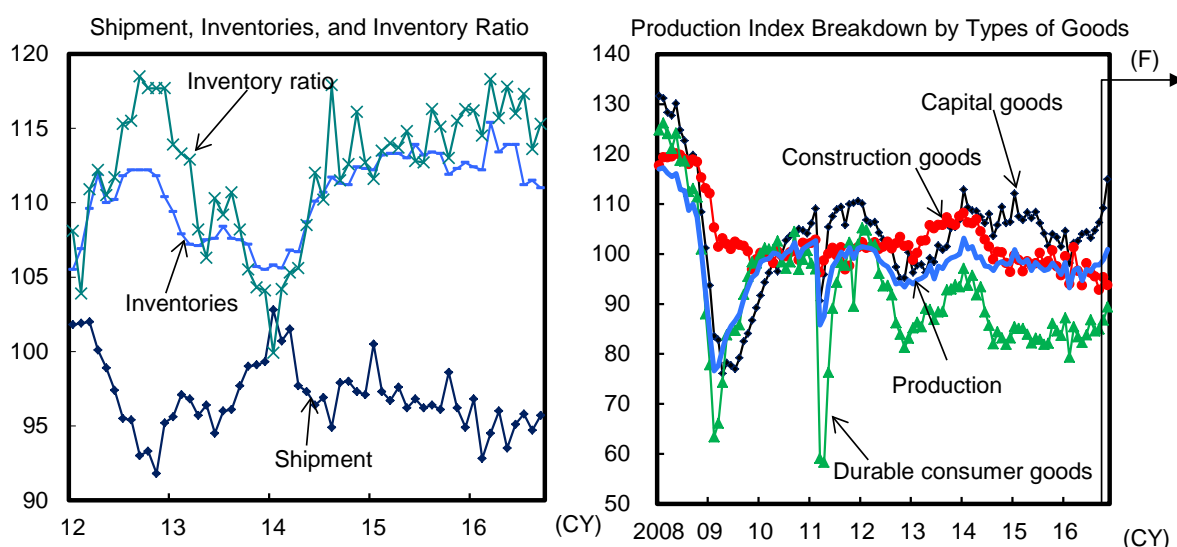
Source: Ministry of Economy, Trade, and Industry; Bloomberg; compiled by DIR.

Production marks time in m/m terms though factors causing temporary downward pressure were also present

The September 2016 indices of industrial production marked time at +0.0% m/m, meanwhile falling below market consensus at +0.9%. The September shipping index was also up for the first time in two months at +1.1%, while the inventory index fell for the first time in two months at -0.4%. Inventory ratio grew for the first time in two months at +1.5%. Overall production experienced major downward pressure from declines in the information communication & electronic equipment industry, as well as in electronic parts & devices, both of which reported major growth in production during September, but production and shipments now show signs of a comeback in general-purpose, production and business related machinery, and transport equipment, bringing those industries favorable results in the end.

The METI production forecast survey sees October performance up by +1.1% m/m with November up by +2.1%. Production is expected to continue growing in the future. One positive element is that production is expected to recover for information communication & electronic equipment, and electronic parts & devices, both which suffered major declines in production in September.

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.

Semiconductor manufacturing equipment and auto exports were factors in overall growth. Industries showing growth on the previous report suffered declines.

As for production index performance by industry in September, seven out of the total of fifteen industries recorded production growth. Of these, the growth rate was especially high for general-purpose, production and business related machinery (+3.7% m/m) and transport equipment (+2.6%). Production continues its growth trend in semiconductor production equipment, which led in overall production growth. Meanwhile, growth in exports of automobiles to the US also contributed. On the other hand, the production index fell in certain other industries, including information communication & electronic equipment (+14.0% in August and -11.8% in September), and electronic parts & devices (+6.2% in August and -2.7% in September). As for information communication & electronic equipment, the reactionary decline in response to the major growth of the previous month was a major factor, especially in the area of notebook computers and desktop PCs, which suffered steep declines in production in September. However, exports of PCs are in a moderate growth phase, hence this is likely just a temporary adjustment. The decline in production for electronic parts & devices is also thought to

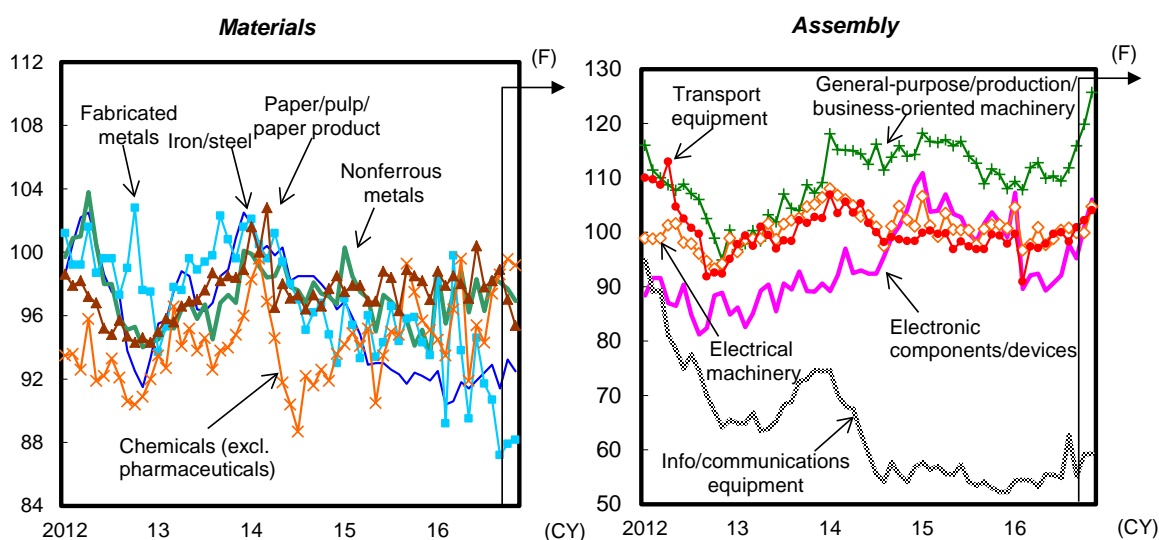
be a reactionary decline in response to the temporary spike in memory production during the previous month related to new model smartphones which went on sale in September. It appears that overall results were pushed downwards by these temporary factors.

Production plans show confidence, but caution is required regarding goods which tend to experience large fluctuations

The METI production forecast survey sees October performance up by +1.1% m/m, with November continuing the growth in production at +2.1%. Looking at the METI forecast by industry, we see confident plans for production in industries which suffered declines in September, including information, communication & electronics equipment (+7.2% in October and +0.2% in November), and electronic parts and devices (+6.3% in October and +4.8% in November). However, the forecast as of this point should probably be taken with a certain grain of salt, since when plans were drawn up these industries were still experiencing a downtrend. But in either case, it has been confirmed that September's production declines were only temporary, and these industries are expected to lead in gaining overall growth for industrial production in October. Meanwhile, another positive factor for the future is the strength of production plans in the area of general-purpose, production and business related machinery (+3.4% in October and +4.9% in November), and transport equipment (+1.3% in October and +1.8% in November), both of which reported major growth in production during September as well. As for general-purpose, production and business related machinery, the forecast is based on the positive trend in capex amongst semiconductor manufacturers, which is leading to a growth trend in the production of semiconductor manufacturing equipment. As for transport equipment, exports of both automobiles and auto parts are continuing a growth trend, hence leading to the positive forecast for the future.

Production by Industry (2010 = 100; SA basis)

Chart 3



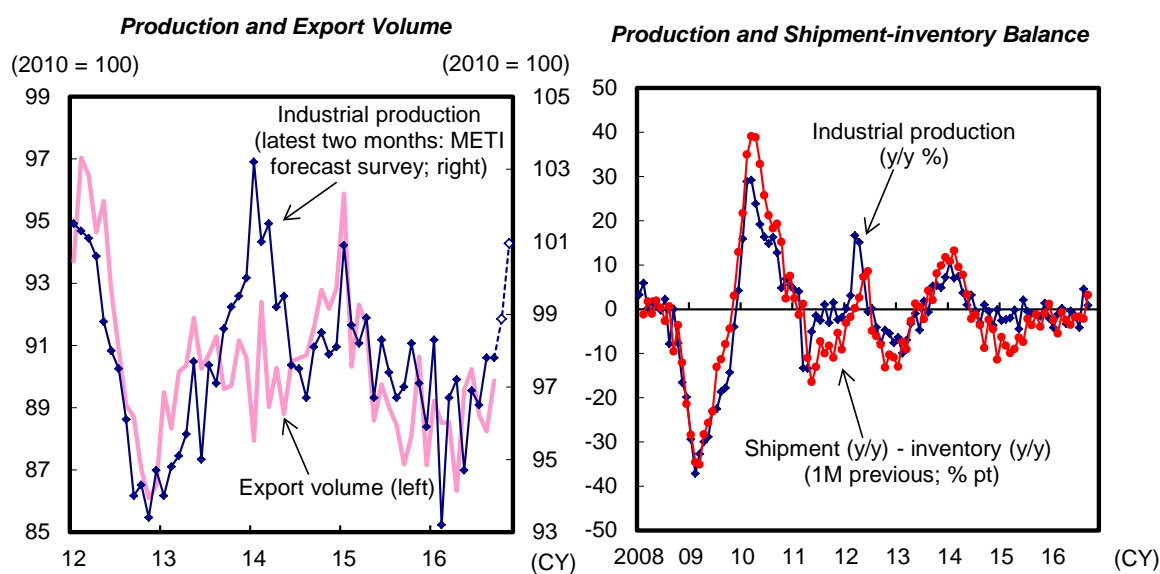
Source: Ministry of Economy, Trade, and Industry (METI); compiled by DIR.
F: METI's forecast survey.

Ups and downs expected to continue in future

Production is expected to continue experiencing ups and downs in December and beyond as well. 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, the slowdown in capex spending is expected to continue causing a soft tone in the export of capital goods. In addition, there is a 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.