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September 2016 Machinery Orders

September orders down by -3.3% m/m. Results for Oct-Dec period expected to shift into decline on q/q basis.

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Summary

- According to statistics for machinery orders in September 2016, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders declined for the second consecutive month by -3.3% m/m, while at the same time falling below market consensus at -1.5%. Both manufacturing and non-manufacturing suffered declines for the second consecutive month showing negative results overall, but domestic demand (excluding ships and electrical power) for the entire Jul-Sep period was up by +7.3% on a q/q basis, exceeding the Cabinet Office's outlook of +5.2%.

- Looking at orders by source of demand in September, the manufacturing industries declined for the second consecutive month by -5.0% m/m, while non-manufacturing orders (excluding ships and electric power) also declined for the second consecutive month by -0.9% m/m. Meanwhile, overseas orders grew for the second consecutive month at +1.4% m/m.

- Machinery orders, the leading indicator for capex, are expected to gradually decline in the future. With the stagnant world economy and the strong yen/weak dollar situation, as well as domestic demand lacking in strength, there is the growing sense that corporate earnings are about to peak out. Consequently, corporations are becoming increasingly cautious as regards capex spending. At the same time, however, supply and demand for labor remains tight, making investment in rationalization and labor-saving devices likely, while the non-manufacturing industries are expected to carry out investment in transport and distribution infrastructure. This should be a plus factor providing underlying support for machinery orders in the future.

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

	2015 Oct	Nov	Dec	2016 Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
Machinery orders (private sector)*	6.4	-9.7	1.0	15.0	-9.2	5.5	-11.0	-1.4	8.3	4.9	-2.2	-3.3
Market consensus (Bloomberg)												-1.5
DIR estimate												-1.0
Manufacturing orders	6.2	-6.6	-3.0	41.2	-30.6	19.7	-13.3	-6.4	17.7	0.3	-4.0	-5.0
Non-manufacturing orders*	5.2	-12.7	4.5	1.0	10.2	-6.9	-3.9	-0.3	2.1	8.6	-1.9	-0.9
Overseas orders	31.6	-20.1	-2.2	-29.4	6.3	28.5	-6.9	-14.8	10.8	-11.7	6.8	1.4

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

September orders decline for second consecutive month, showing negative results overall

According to statistics for machinery orders in September 2016, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders declined for the second consecutive month by -3.3% m/m, while at the same time falling below market consensus at -1.5%. Both manufacturing and non-manufacturing suffered declines for the second consecutive month showing negative results overall, but domestic demand (excluding ships and electrical power) for the entire Jul-Sep period was up by +7.3% on a q/q basis, exceeding the Cabinet Office's outlook of +5.2%.

Manufacturing orders decline for second consecutive month. other manufacturing and chemicals contribute to negative results

Looking at orders by source of demand in September, the manufacturing industries declined for the second consecutive month by -5.0% m/m.

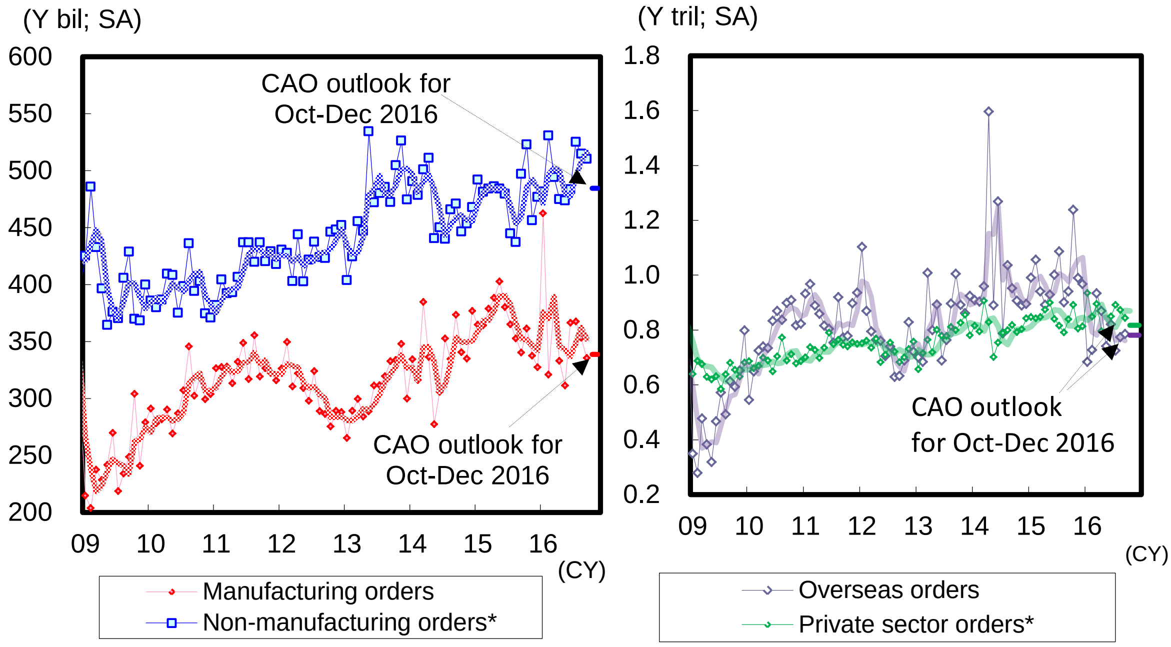
As for performance by industry, m/m declines were recorded by other manufacturing (-19.1%), chemicals (-14.9%), and petroleum & coal products (-54.4%). As for other manufacturing, the decline was in response to the previous month's rebound. On average, the industry is still in a growth trend which began at the beginning of the year. Meanwhile, orders for petroleum & coal products are at a low due to the ups and downs of the price of crude oil after OPEC's announcement of production cuts at the end of September. On the other hand, m/m growth was reported by non-ferrous metals (+335.5%), automobiles, parts, and accessories (+16.1%), and iron & steel (+18.9%).

Non-manufacturing orders decline for second consecutive month, but level of orders remains favorable

Non-manufacturing orders (excluding ships and electric power) also declined for the second consecutive month by -0.9% m/m. However, at this point in time, non-manufacturing orders are still at a relatively high level, and are expected to continue the favorable trend in the future.

Looking at performance by industry, month-to-month declines were seen in other non-manufacturing (-25.4%), information services (-9.8%), and telecommunications (-7.5%). Telecommunications declined for the second consecutive month, but on average is still considered to be in a growth trend. On the other hand, month-to-month growth was seen in wholesale and retail trade (+43.8%), transportation and postal activities (+6.3%), and construction (+10.9%). Transportation and postal activities posted its second consecutive month of growth with orders received at a high level. Transportation and postal activities may be gaining underlying support from investments in streamlining and labor-saving as the problem of the shortage in manpower continues to grow larger.

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



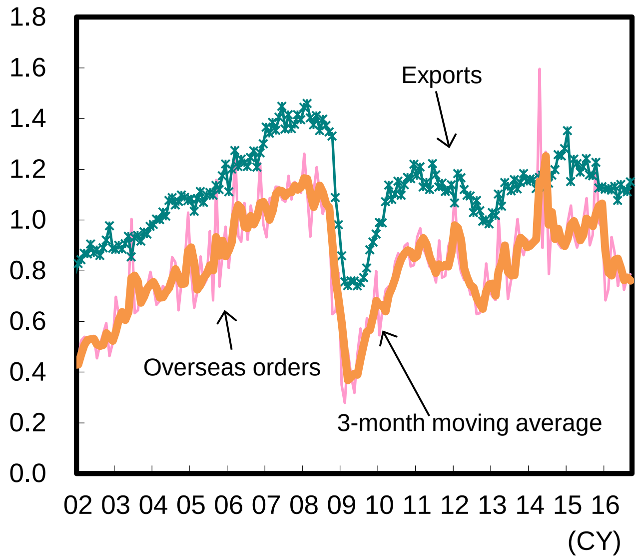
Source: Cabinet Office (CAO); compiled by DIR.
*excl. those for ships and from electric utilities.
Note: Thick lines 3M/MA basis.

Overseas orders achieve growth for second consecutive month. Orders for aircraft and engines & turbines grow

Overseas orders grew for the second consecutive month at +1.4% m/m. According to the Cabinet Office, orders for information and communication electronics equipment, as well as road vehicles declined, while orders for aircraft and engines & turbines grew.

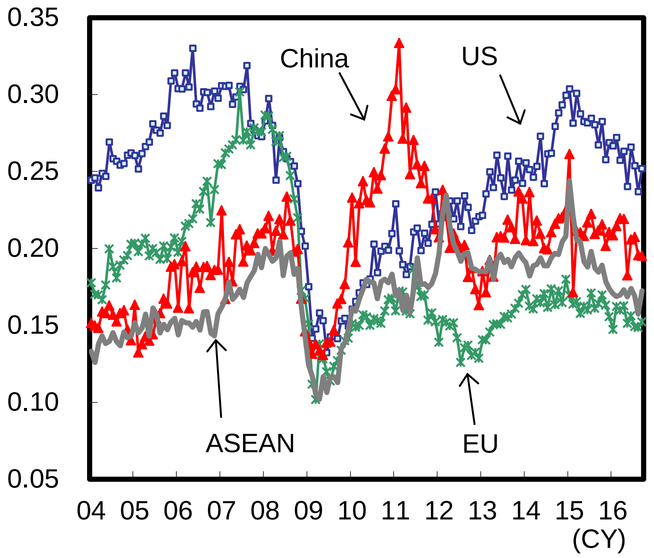
In a betrayal of expectations, Republican candidate Donald Trump emerged victorious in the November 8 US presidential election. The future of the world economy has become increasingly uncertain due to Trump's inward-looking policies, which include his opposition to the Trans-Pacific Partnership (TPP) and his declaration that he would take action against countries using the economic strategy of keeping the value of their currencies low. According to our main scenario for the future of overseas demand, we expect a gradual comeback. However, we continue to take a cautious view as we move forward.

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**



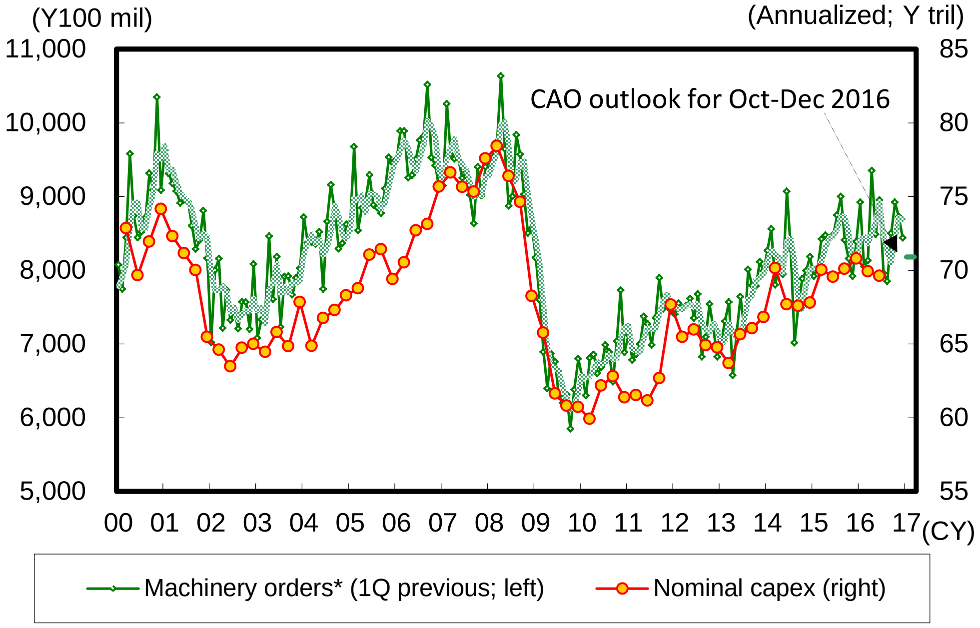
Source: Ministry of Finance; compiled by DIR.
Note: SA by DIR.

Gradual decline seen for machinery orders in future

The Cabinet Office outlook for the Oct-Dec period sees private sector demand (excluding ships and electrical power) down by -5.9% q/q.

Machinery orders, the leading indicator for capex, are expected to gradually decline in the future. With the stagnant world economy and the strong yen/weak dollar situation, as well as domestic demand lacking in strength, there is the growing sense that corporate earnings are about to peak out. Consequently, corporations are becoming increasingly cautious as regards capex spending. At the same time, however, supply and demand for labor remains tight, making investment in rationalization and labor-saving devices likely, while the non-manufacturing industries are expected to carry out investment in transport and distribution infrastructure. This should be a plus factor providing underlying support for machinery orders in the future.

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.