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November Industrial Production

Results favorable at +1.5% m/m; further production growth seen in future

Economic Intelligence Team
Kazuma Maeda
Shunsuke Kobayashi

Summary

- The November 2016 indices of industrial production grew by +1.5% m/m, while falling below market consensus at +1.7%. Meanwhile, the November shipping index was up for the third consecutive month at +0.9%, with the inventory index falling for the third consecutive month at -1.5%. Inventory ratio declined for the second consecutive month at -5.5%. As for production index performance by industry, contribution to positive results was especially high for general-purpose, production and business related machinery (+3.3% m/m) and transport equipment (+2.0%). While production and shipments continue to achieve growth, inventory adjustment progresses, indicating that recent industrial production is maintaining a favorable trend.

- The METI production forecast survey sees December performance up by +2.0% m/m with January production up by +2.2% in a continuation of production increases. However, METI's estimated forecast value for the December Indices of Industrial Production is marking time at 0.0% in comparison to the previous month. Hence caution is required.

- Production is expected to continue experiencing ups and downs in February 2017 and beyond. Personal consumption is expected to mark time due to sluggish growth in disposable income for working families and household income for pensioners. In addition, while operating rates of production facilities continue to grow, levels have yet to recover completely, 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 favorability, overall demand is expected to mark time.

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

	2016 Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Industrial Production	-5.2	3.8	0.5	-2.6	2.3	-0.4	1.3	0.6	0.0	**1.5**
Market consensus (Bloomberg)										1.7
DIR estimate										2.1
Shipments	-4.1	1.8	1.6	-2.6	1.7	0.7	-1.1	1.8	2.0	**0.9**
Inventories	-0.2	2.9	-1.7	0.4	0.0	-2.4	0.3	-0.5	-2.1	**-1.5**
Inventory ratio	-1.5	3.3	-2.2	1.8	-1.5	1.1	-3.2	1.1	-0.6	**-5.5**

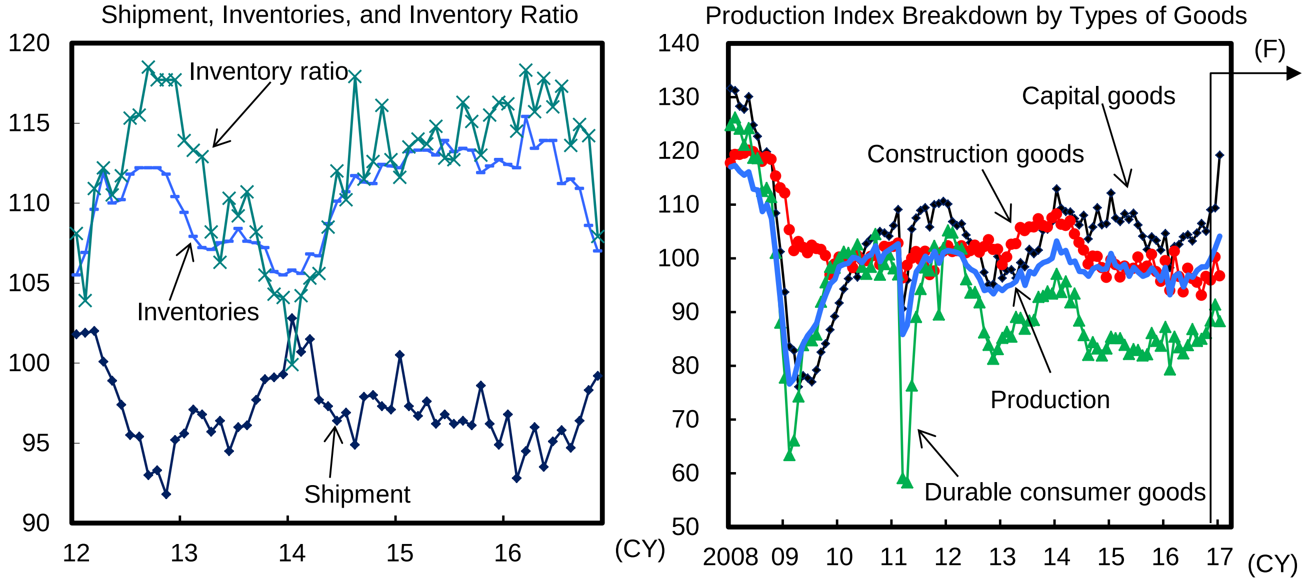
Source: Ministry of Economy, Trade, and Industry; Bloomberg; compiled by DIR.

Production wins favorable results at +1.5% m/m

The November 2016 indices of industrial production grew by +1.5% m/m, while falling below market consensus at +1.7%. Meanwhile, the November shipping index was up for the third consecutive month at +0.9%, with the inventory index falling for the third consecutive month at -1.5%. Inventory ratio declined for the second consecutive month at -5.5%.

The METI production forecast survey sees December performance up by +2.0% m/m with January production up by +2.2% in a continuation of production increases. While production and shipments continue to achieve growth inventory adjustment progresses, indicating that recent industrial production is maintaining a favorable trend.

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.

Industrial robots and auto exports were factors in overall growth.

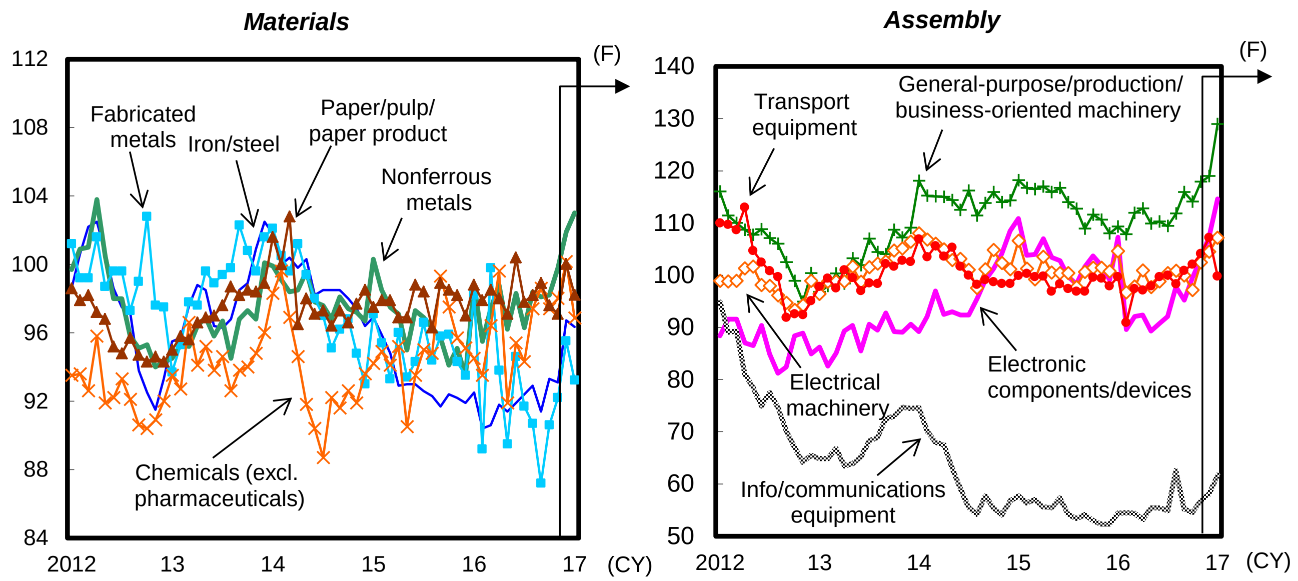
As for production index performance by industry in November, eleven out of the total of fifteen industries recorded production growth. Of these, contribution to positive results was especially high for general-purpose, production and business related machinery (+3.3% m/m) and transport equipment (+2.0%). Overall results were pulled along by production increases in industrial robots (especially numerically controlled robots), and metalworking machine tools. Meanwhile, growth in export volume of automobiles to the US also contributed. In the area of automobile exports, sales of SUVs in the US were especially favorable, helping to push up overall results. On the other hand, the production index fell in certain other industries, contributing to overall decline, including ceramics, stone & clay products, which exhibited production growth in the previous month (+2.1% in October and -0.9% in November), and plastic products (+1.9% in October and -0.3% in November). As for ceramics, stone & clay products, fine ceramics did poorly, while in plastic products, plastic machinery and equipment parts brought a negative contribution to overall results.

Production plans show confidence, but caution is required regarding errors in forecast

The METI production forecast survey sees December performance up by +2.0% m/m, with January 2017 continuing the growth in production at +2.2%. Looking at the METI forecast by industry, we see electronic parts and devices with confident production plans (+4.2% in December and +6.6% in January). However, the forecast as of this point should probably be taken with a certain grain of salt, since these industries have a tendency for production plans to be revised downwards at a later date. But in either case, these industries are expected to lead in overall growth for industrial production in the future. Meanwhile, another positive factor for the future is the strength of production plans in the area of general-purpose, production and business related machinery, which recorded major gains in November (+0.9% in December and +8.4% in January).

However, METI's estimated forecast value for the December Indices of Industrial Production is marking time at 0.0% in comparison to the previous month. Hence caution is required. Meanwhile, transport equipment (+3.0% in December and -6.9% in November), which has been performing favorably up to this point, is expected to suffer production declines beginning in January 2017, and is therefore a factor causing concern.

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



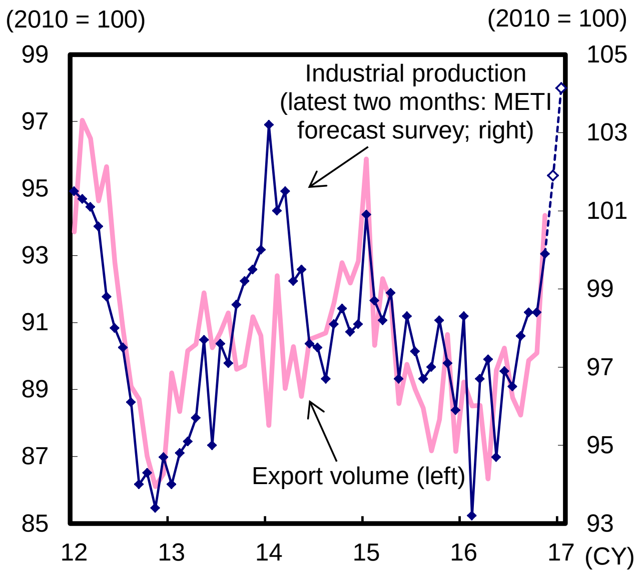
Source: Ministry of Economy, Trade, and Industry (METI); compiled by DIR.
F: METI's forecast survey.

Ups and downs expected to continue in future

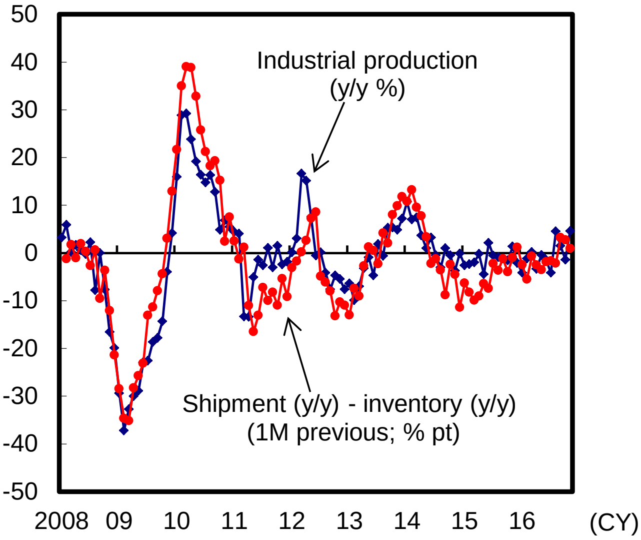
Production is expected to continue experiencing ups and downs in February and beyond. Personal consumption is expected to mark time due to sluggish growth in disposable income for working families and household income for pensioners. In addition, while operating rates of production facilities continue to grow, levels have yet to recover completely, 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 favorability, 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 chances that exports of capital goods will pick up speed are not good. 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**

Production and Export Volume



Production and Shipment-inventory Balance



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