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December 2016 Machinery Orders

December orders up by +6.7% m/m. Growth of +3.3% q/q seen for 2017 Jan-Mar period

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Summary

- According to statistics for machinery orders in December 2016, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders grew for the first time in two months by +6.7% m/m, while at the same time exceeding market consensus at +3.0%. As a result, private sector demand (excluding ships and electrical power) fell by only -0.2% q/q for the Oct-Dec 2016 period, exceeding the Cabinet Office forecast of -5.9% for the period.

- Looking at orders by source of demand in December, the manufacturing industries grew for the second consecutive month at +1.0% m/m, though in the balance manufacturing is seen as marking time considering the trend in orders received for the industry. Non-manufacturing orders (excluding ships and electric power) grew for the first time in two months by +3.5% m/m. The trend for orders in non-manufacturing maintains a relatively high level, but as of this point in time, performance continues to experience ups and downs.

- Machinery orders, the leading indicator for capex, are expected to gradually expand in the future. Positive factors providing underlying support for machinery orders include the high level of recurring profits and investments in rationalization and labor-saving devices due to the fact that supply and demand for labor remains tight. The sense of a shortage in production facilities is growing stronger as the manufacturing industry experiences an expansion in exports due to the recovery in the world economy. Meanwhile, the non-manufacturing industries are expected to carry out investments in transport and distribution infrastructure.

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

	2016 Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Machinery orders (private sector)*	15.0	-9.2	5.5	-11.0	-1.4	8.3	4.9	-2.2	-3.3	4.1	-5.1	6.7
Market consensus (Bloomberg)												3.0
DIR estimate												1.5
Manufacturing orders	41.2	-30.6	19.7	-13.3	-6.4	17.7	0.3	-4.0	-5.0	-1.4	9.8	1.0
Non-manufacturing orders*	1.0	10.2	-6.9	-3.9	-0.3	2.1	8.6	-1.9	-0.9	4.6	-9.4	3.5
Overseas orders	-29.4	6.3	28.5	-6.9	-14.8	10.8	-11.7	6.8	1.4	1.9	37.3	-16.2

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

December orders: Growth exceeds market consensus

According to statistics for machinery orders in December 2016, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders grew for the first time in two months by +6.7% m/m, while at the same time exceeding market consensus at +3.0%. In addition to +1.0% m/m growth for the manufacturing industries, the non-manufacturing industries (excluding ships and electrical power) won growth of +3.5%, providing traction for overall growth. As a result, private sector demand (excluding ships and electrical power) fell by only -0.2% q/q for the Oct-Dec 2016 period, exceeding the Cabinet Office forecast of -5.9% for the period.

Manufacturing orders achieve growth for second consecutive month centering on the materials sector

Looking at orders by source of demand in December, the manufacturing industries grew for the second consecutive month at +1.0% m/m, though in the balance manufacturing is seen as marking time considering the trend in orders received for the industry.

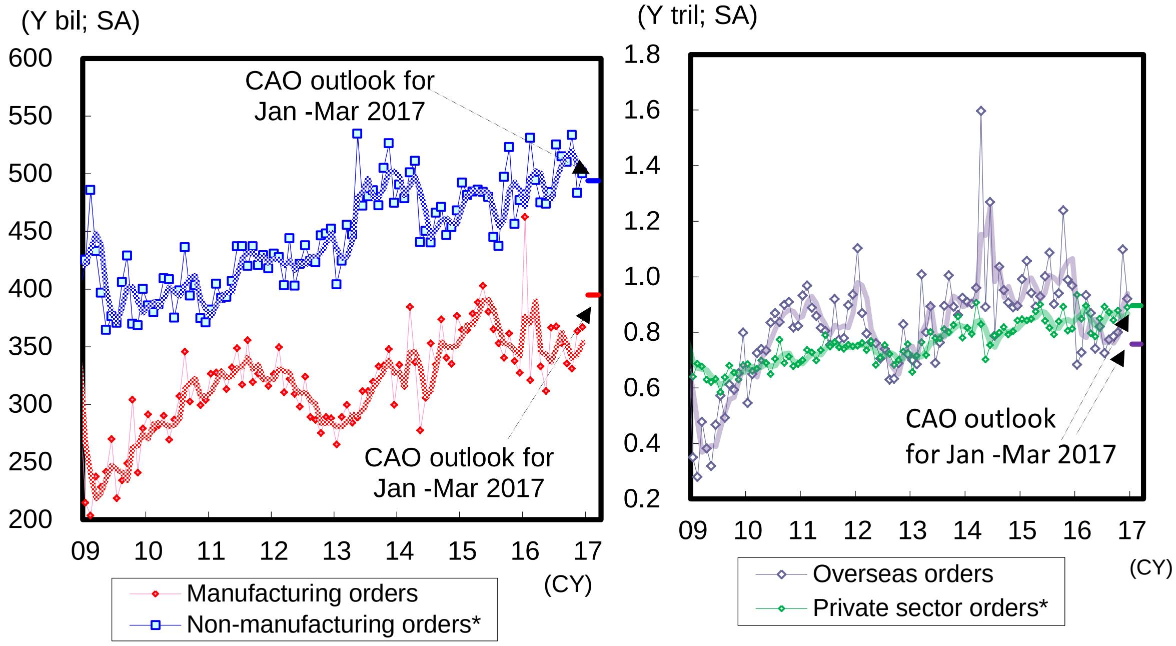
As for performance by industry, growth in comparison to the previous month was seen in the materials sector, including chemicals (+71.8%) and non-ferrous metals (+53.2%), with ceramics, stone and clay products also advancing (+131.8%). As for chemicals, the industry is seen as marking time on average. Meanwhile, non-ferrous metals grew for the second consecutive month. The industry appears to be profiting from the continuation of the previous month's large-scale orders, and is clearly experiencing a growth trend. On the other hand, m/m declines were suffered by some industries due to a reactionary decline in comparison to the previous month, including electrical machinery (-22.7%), other manufacturing (-6.1%), and pulp, paper & paper products (-40.0%).

Non-manufacturing orders achieve growth for first time in two months.

Non-manufacturing orders (excluding ships and electric power) grew for the first time in two months by +3.5% m/m. The trend for orders in non-manufacturing maintains a relatively high level, but as of this point in time, performance continues to experience ups and downs.

Looking at performance by industry, month-to-month growth was seen in transportation and postal activities (+60.9%), construction (+16.9%), and leasing (+50.8%). As for transportation and postal activities, growth was achieved for the first time in three months. Meanwhile, construction has been in a growth trend since the spring of 2016. We believe that underlying strength in demand for infrastructure projects is behind this trend. On the other hand, three industries, though a limited number, stand out as having suffered declines. These are finance and insurance (-40.3%), telecommunications (-4.3%), and mining, quarrying of stone, and gravel (-3.6%). Finance and insurance has been in a declining trend since the beginning of 2016. It is believed that this represents a reactionary decline in response to large-scale IT investments carried out in 2015.

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



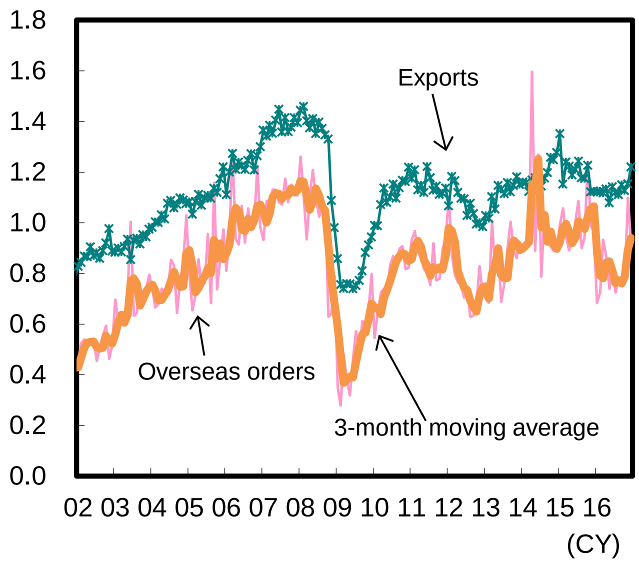
Source: Cabinet Office (CAO); compiled by DIR.
*excl. those for ships and from electric utilities.
Note: Thick lines 3M/MA basis.

Overseas orders suffer decline for first time in five months

Overseas orders suffered a decline for the first time in five months at -16.2% m/m. According to the Cabinet Office, orders for industrial machinery and electronics & telecommunications equipment grew, while orders for engines and turbines, as well as railway cars declined. This represents a reactionary decline in response to the gains of +37.3% m/m experienced in November. However, more recently overseas orders have been maintaining favorable performance.

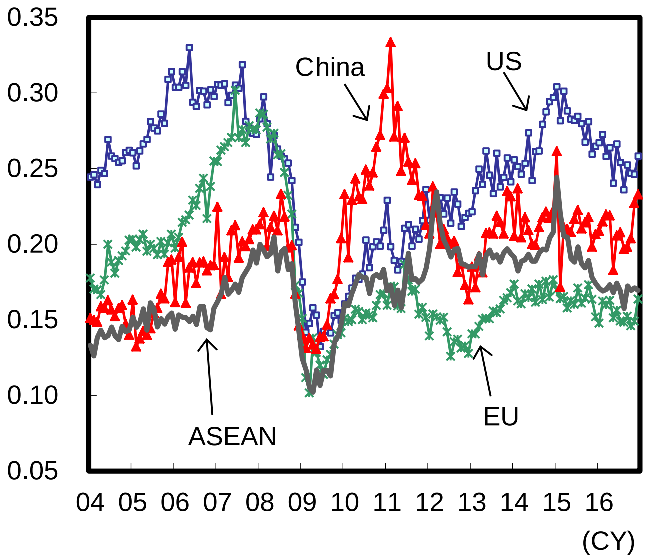
As for the future for overseas orders, out main scenario sees a continuation of the moderate growth trend due to the recovery in the world economy. On the other hand, the yen has begun to strengthen recently, while in the mid to long-term, the world economy may become increasingly uncertain due to US President Trump’s inward-looking policies. Therefore, 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**



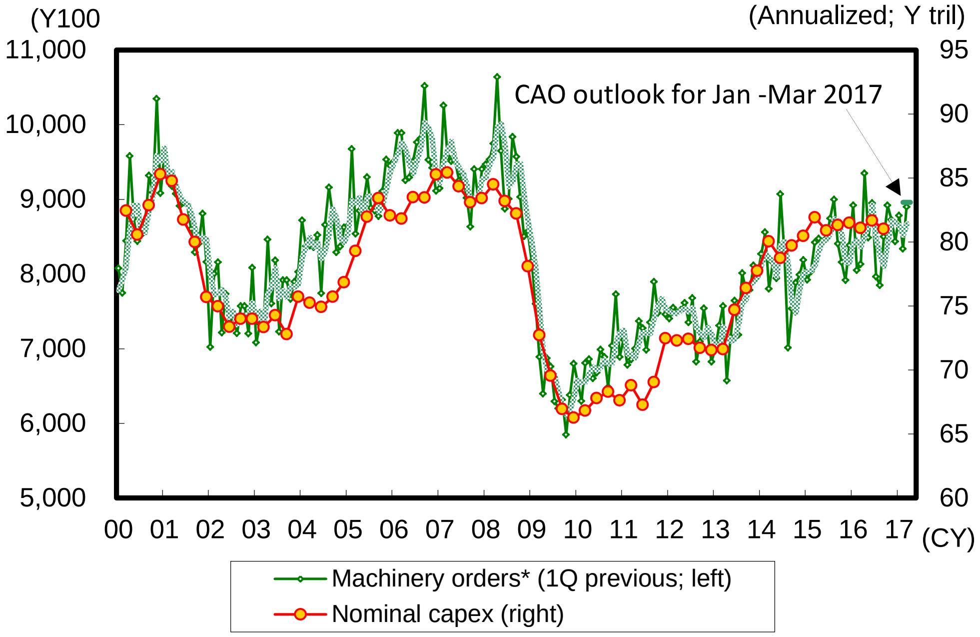
Source: Ministry of Finance; compiled by DIR.
Note: SA by DIR.

Machinery orders expected to gradually expand in the future

According to the Cabinet Office forecast for the Jan-Mar 2017 period, private sector demand (excluding ships and electric power) is expected to grow by +3.3% q/q. Manufacturing is expected to achieve major growth at +11.6% q/q, while non-manufacturing (excluding ships and electric power) is expected to suffer a decline of -2.3. If orders received during the Jan-Mar period grow by +3.3% q/q, FY2016 private sector demand (excluding ships and electric power) is expected to grow by +1.4% in year-to-year terms and register growth in comparison to the previous fiscal year.

Machinery orders, the leading indicator for capex, are expected to gradually expand in the future. Positive factors providing underlying support for machinery orders include the high level of recurring profits and investments in rationalization and labor-saving devices due to the fact that supply and demand for labor remains tight. The sense of a shortage in production facilities is growing stronger as the manufacturing industry experiences an expansion in exports due to the recovery in the world economy. Meanwhile, the non-manufacturing industries are expected to carry out investments in transport and distribution infrastructure with the continuing growth in foreign visitors to Japan, as well as expectations regarding the 2020 Tokyo Olympics and Paralympics.

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.