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March Industrial Production

Production declines by -2.1%, but growth expected in April

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Summary

- The March indices of industrial production declined for the first time in two months by -2.1% m/m, while falling considerably below market consensus (-0.8%). Meanwhile, the March shipping index was down for the first time in two months at -1.1%, with the inventory index growing for the fourth consecutive month at +1.6%, and inventory ratio growing for the first time in two months at +0.5%.
- Although results fell considerably below market consensus, the realization rate for METI's production forecast in March was +0.6%, but since the decline in production did not fall below the March outlook, there is no reason to be overly pessimistic regarding these results. All in all, production remains in a growth trend, and major growth is expected in April.
- The METI production forecast survey sees April performance up by +8.9% m/m, and then down again by -3.7% in May, but April production gains are expected to be major. METI's estimated forecast value for the April Indices of Industrial Production indicates growth of +5.3%.
- Production is expected to experience moderate growth in June 2017 and beyond. While capital goods are expected to experience a reactionary decline, construction goods are expected to maintain favorable performance. Durable consumer goods are expected to maintain a steady undertone, with major household appliances purchased when the ecopoint incentive program was introduced approaching the culmination of their replacement cycle. As for overseas demand, exports to the US appear to be taking a breather from their previous growth trend, but exports to the EU and Asia are expected to maintain favorable performance, bringing upward pressure on production.

Industrial Production (m/m %; SA basis)

Chart 1

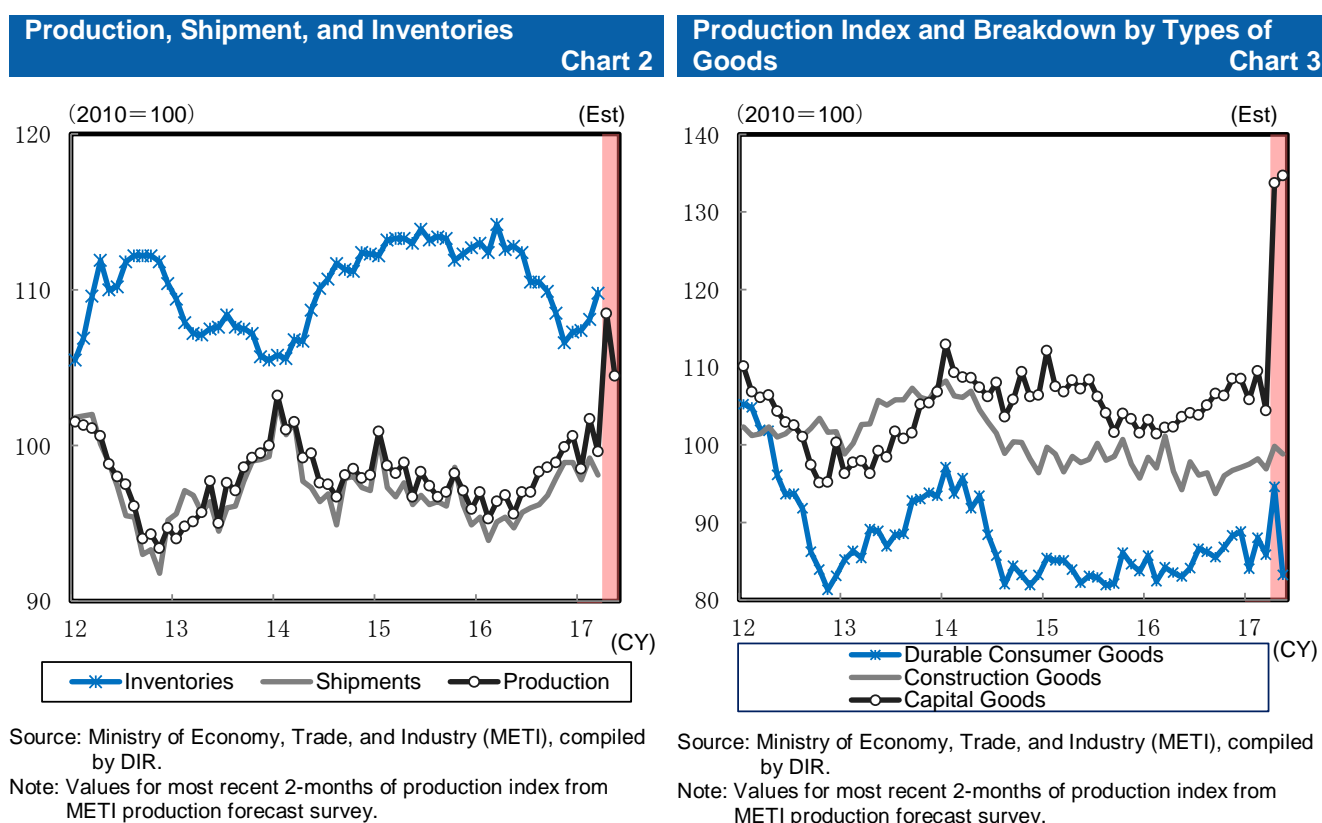
	2016							2017			
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	
Industrial Production	1.5	0.0	1.3	0.3	0.3	1.0	0.7	-2.1	3.2	-2.1	
Market consensus (Bloomberg)										-0.8	
DIR estimate										-0.1	
Shipments	1.1	0.3	0.2	0.6	1.1	1.0	0.0	-1.1	1.4	-1.1	
Inventories	-0.4	-1.7	0.0	-0.5	-1.3	-1.8	0.7	0.1	0.7	1.6	
Inventory ratio	-1.1	0.6	-2.5	0.3	-1.1	-3.7	0.8	2.5	-0.3	0.5	

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

Production declines for the first time in two months at -2.1%

The March indices of industrial production declined for the first time in two months by -2.1% m/m, while falling considerably below market consensus (-0.8%). Meanwhile, the March shipping index was down for the first time in two months at -1.1%, with the inventory index growing for the fourth consecutive month at +1.6%, and inventory ratio growing for the first time in two months at +0.5%. The METI production forecast survey sees April performance up by +8.9% m/m, but then down again by -3.7% in May.

Although results fell considerably below market consensus, the realization rate for METI's production forecast in March was +0.6%, but since the decline in production did not fall below the March outlook, there is no reason to be overly pessimistic regarding these results. All in all, production remains in a growth trend, and major growth is expected in April. The METI production forecast survey was given a new seasonal adjustment in order to conform to the 2016 annual revision.



Eleven out of fifteen industries suffered declines

As for production index performance by industry in March, eleven out of the total of fifteen industries recorded declines in production. Of these, contribution to the decline was especially notable for general-purpose, production and business oriented machinery (-6.3% m/m), electronic parts and devices (-4.8%), and transport equipment (-1.0%). As for general-purpose, production and business oriented machinery, semiconductor and flat panel display production equipment suffered a major blow at -16.2% m/m. Production of semiconductor and flat panel display production equipment maintained a high level at the beginning of 2016, and it is now believed that two consecutive months of decline is a sign that the industry is suffering a reactionary decline in response to growth experienced previous to that. As for transport equipment, there is a sense that U.S. exports are about to peak out, and this contributed to the decline in production, but exports to the EU remain favorable, as well as domestic sales. April is expected to bring a return to the growth trend. On the other hand, four industries

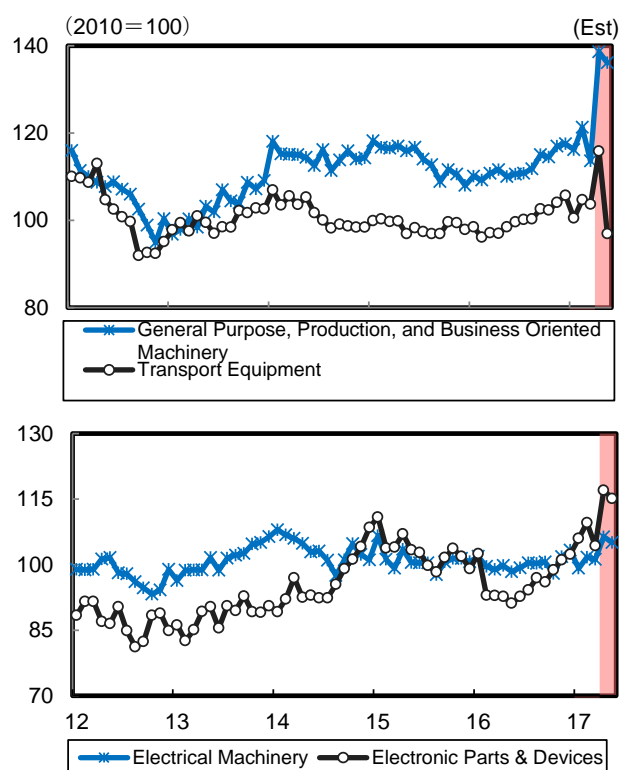
recorded growth in their production indices, including pulp, paper & paper products (+1.7%), information and communication electronics equipment (+1.4%), and non-ferrous metals (+0.4%).

Looking at performance by types of goods, we see that capital goods declined by -4.7% m/m, while construction goods were down by -1.3%, and durable consumer goods declined by -2.5%. All goods saw production declines. Although there have been ups and downs for capital goods recently, April is expected to see major growth in production, with orders received maintaining a positive level and inventory continuing to decline. Meanwhile, construction goods have continued to experience ups and downs, but durable consumer goods have maintained a growth trend since the beginning of last year.

April production plans show confidence

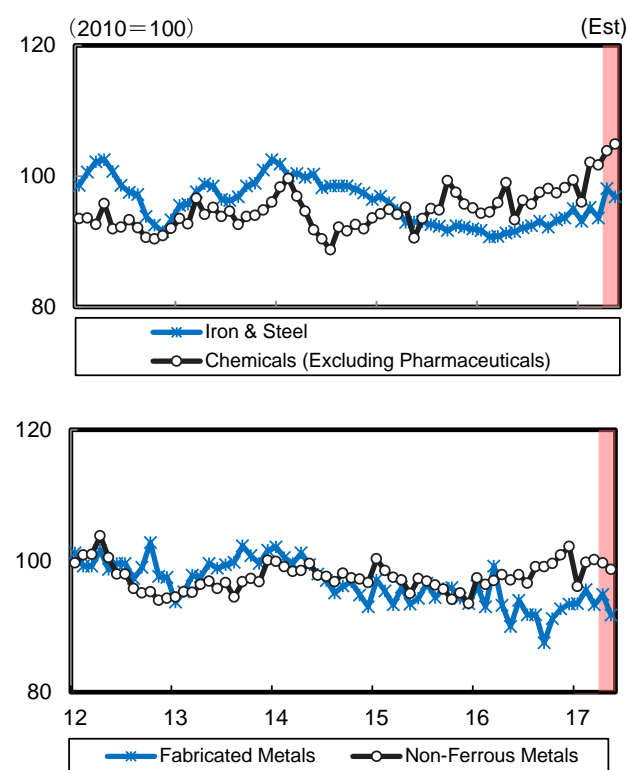
The METI production forecast survey sees April performance up by +8.9% m/m, and then down again by -3.7% in May, but April production gains are expected to be major. METI’s estimated forecast value for the April Indices of Industrial Production indicates growth of +5.3%. Looking at the production forecast survey by industry, we see that production plans are especially confident for general-purpose, production and business oriented machinery (+22.0% m/m in April and -1.8% in May). This is in contrast to March performance when this same industry contributed greatly to overall declines. However, this industry tends to experience downward revisions in production after initial plans are made public. For this reason, figures should be taken with a certain grain of salt. Meanwhile, April plans also show confidence in electronic parts and devices (+12.2% in April and -1.6% in May), transport equipment (+11.7% in April and -16.3% in May), and information and communication electronics equipment (+10.9% in April and -0.2% in May).

Production Indices (Assembly) Chart 4



Source: Ministry of Economy, Trade, and Industry (METI), compiled by DIR.
 Note: Values for most recent 2-months of production index from METI production forecast survey.

Production Indices (Materials) Chart 5



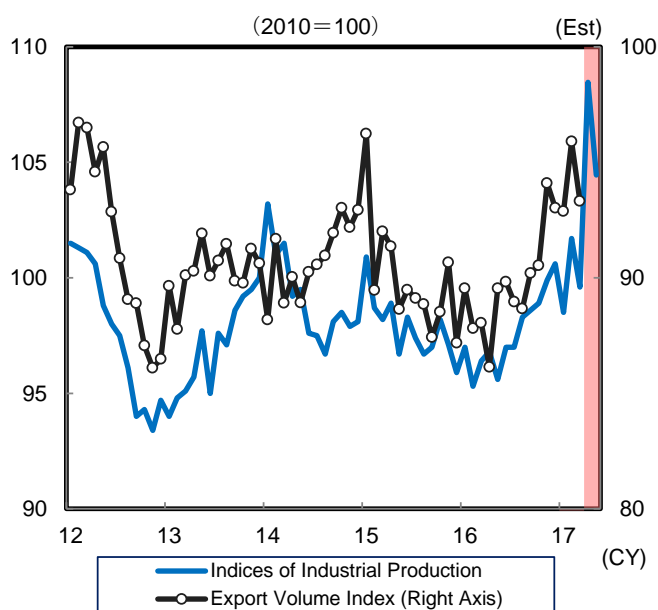
Source: Ministry of Economy, Trade, and Industry (METI), compiled by DIR.
 Note: Values for most recent 2-months of production index from METI production forecast survey.

Moderate growth seen in future

Production is expected to experience moderate growth in June 2017 and beyond. Capital goods are expected to experience a reactionary decline due to the major production increases experienced up to the month of May. Construction goods are expected to maintain favorable performance due to infrastructure demand associated with the 2020 Tokyo Olympics and Paralympics. Durable consumer goods are expected to maintain a steady undertone, with major household appliances purchased when the ecopoint incentive program was introduced approaching the culmination of their replacement cycle. In addition, the negative effects of preconsumption over demand as a result of last minute demand prior to the increase in consumption tax are gradually falling away. As for overseas demand, exports to the US appear to be taking a breather from their previous growth trend, but exports to the EU and Asia are expected to maintain favorable performance, bringing upward pressure on production. This is especially the case for exports to China, where orders for construction equipment and electronic parts are expected to maintain favorable performance. Expansion in exports to China is expected to take the lead in encouraging overall growth in production. However, there are some downside risks, including the protectionist policies of the Trump administration in the US and the UK's withdrawal from the EU, both of which could bring an increase in uncertainty regarding the future in the global economy. Meanwhile, geopolitical risk has increased due to the increasingly tense situation with North Korea, requiring caution.

Industrial Production & Export Volume

Chart 6

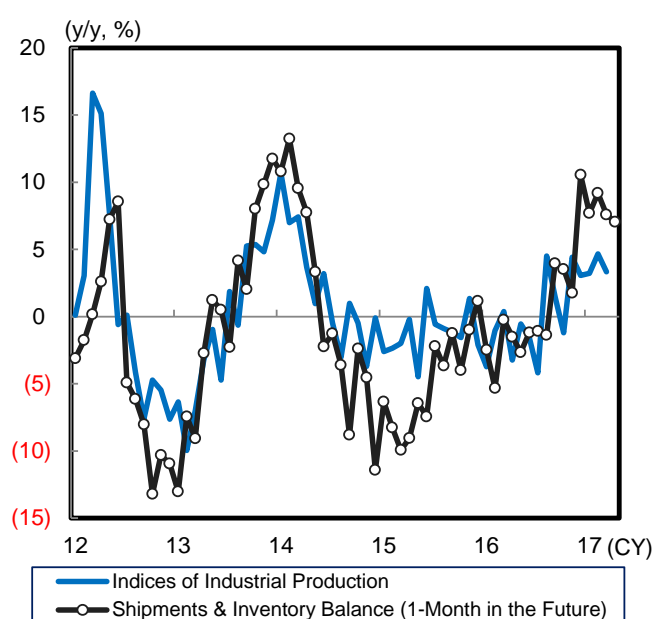


Source: Ministry of Economy, Trade, and Industry (METI), compiled by DIR.

Note: Values for most recent 2-months of production index from METI production forecast survey.

Shipments, Inventory Balance & Production

Chart 7



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