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Japanese report: 31 May 2017

April Industrial Production

FY2017 starts off on an optimistic note with production up by +4.0% m/m

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Summary

- The April indices of industrial production recorded major growth at +4.0% m/m, while at the same time falling below market consensus at +4.2%. Results were especially strong, starting FY2017 off on an optimistic note. Meanwhile, the April shipping index grew for the first time in two months at +2.7%, with the inventory index growing for the fifth consecutive month at +1.5%, and inventory ratio growing for the second consecutive month at +2.9%.
- The METI production forecast survey sees May performance down by -2.5% m/m, but then back up again in June at +1.8%. Assuming this projection can be upheld, the Apr-Jun period will reach +2.7% q/q. Growth was sluggish during the Jan-Mar period at +0.2% (+1.8% during the Oct-Dec period), but production is expected to get a lift in the future due to the recovery in the global economy, which should encourage exports to expand, while personal consumption is expected to hit bottom. Meanwhile, investments in labor-saving and rationalization to deal with the continued shortage of manpower is also expected to bring upward pressure on production.
- Production is expected to experience moderate growth in July 2017 and beyond. Capital goods are expected to gain an upward push overall due to investments in labor-saving and rationalization to deal with the continued shortage of manpower. 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, while exports to the EU and Asia are maintaining favorable performance, and are expected to help push up overall production.

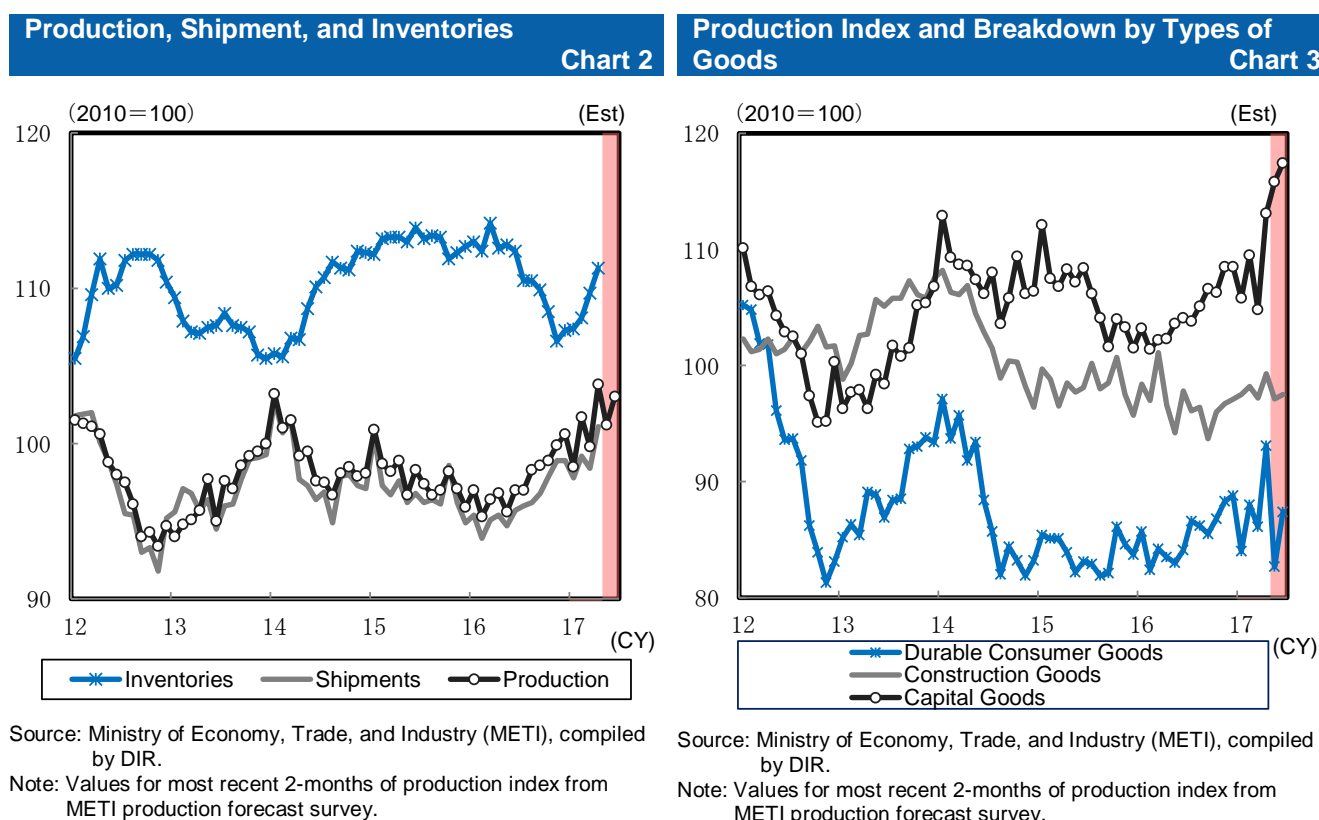
Industrial Production (m/m %; SA basis)											Chart 1
	2016						2017				
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	
Industrial Production	0.0	1.3	0.3	0.3	1.0	0.7	-2.1	3.2	-1.9	4.0	
Market consensus (Bloomberg)										4.2	
DIR estimate										4.5	
Shipments	0.3	0.2	0.6	1.1	1.0	0.0	-1.1	1.4	-0.8	2.7	
Inventories	-1.7	0.0	-0.5	-1.3	-1.8	0.7	0.1	0.7	1.5	1.5	
Inventory ratio	0.6	-2.5	0.3	-1.1	-3.7	0.8	2.5	-0.3	0.2	2.9	

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

Production records major growth at +4.0%

The April indices of industrial production recorded major growth at +4.0% m/m, while at the same time falling below market consensus at +4.2%. Meanwhile, the April shipping index grew for the first time in two months at +2.7%, with the inventory index growing for the fifth consecutive month at +1.5%, and inventory ratio growing for the second consecutive month at +2.9%. The METI production forecast survey sees May performance down by -2.5% m/m, but then back up again in June at +1.8%.

April production results were especially strong, starting FY2017 off on an optimistic note. May is expected to suffer a reactionary decline at -2.5% due to the previous month's positive performance, while June is expected to hit +1.8%. Assuming this projection can be upheld, the Apr-Jun period will reach +2.7% q/q. Even if June marks time the final quarterly results will come in at +2.1%. Growth was sluggish during the Jan-Mar period at +0.2% (+1.8% during the Oct-Dec period), but production is expected to get a lift in the future due to the recovery in the global economy, which should encourage exports to expand, while personal consumption is expected to hit bottom. Meanwhile, investments in labor-saving and rationalization to deal with the continued shortage of manpower is also expected to bring upward pressure on production.



Eleven out of fifteen industries record growth

As for production index performance by industry in April, eleven out of the total of fifteen industries recorded growth in production. Of these, contribution to growth was especially notable for transport equipment (+10.8% m/m), general-purpose, production and business oriented machinery (+9.2%), and electronic parts & devices (+5.2%). As for transport equipment, performance was weak during the Jan-Mar period at -1.1% q/q, but production recorded major growth in April. However, exports of automobiles to the US appear to be about to peak out, hence caution is recommended here. As for general-purpose, production and business oriented machinery, favorable orders for construction machinery from China helped push up overall results. On the other hand, four industries recorded

declines in production, including information and communication electronics equipment (-1.3% m/m), pulp, paper & paper products (-1.0%), and petroleum & coal products (-1.1%).

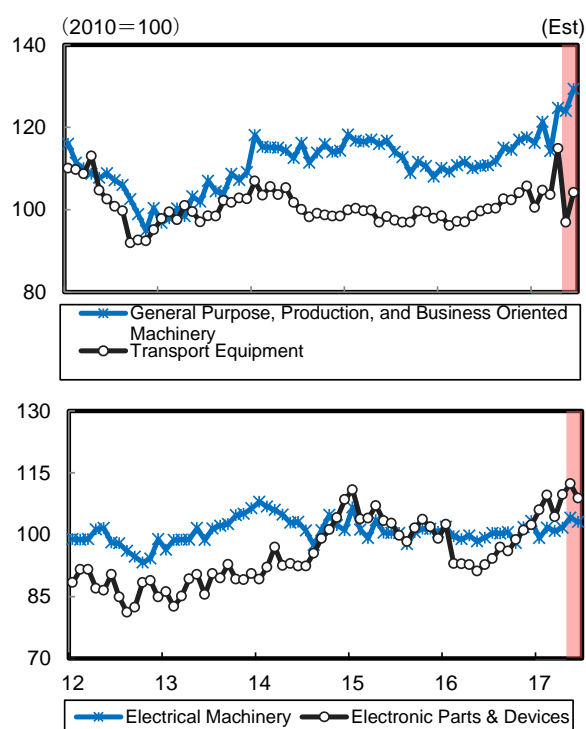
Looking at performance by types of goods, we see that capital goods grew by +7.9% m/m, while construction goods were up by +2.2%, and durable consumer goods grew by +8.1%. All goods saw production increases. Capital goods are now experiencing a growth trend in production due to favorable orders. Meanwhile, construction goods continue gradually expand. Durable consumer goods have also been in a growth trend since the beginning of last year, but there is some cause of concern regarding weak expectations for May and June.

May expected to suffer a decline, but production in June expected to grow

The METI production forecast survey sees May performance down by -2.5% m/m, but then back up again in June at +1.8%. METI’s estimated forecast value for the May Indices of Industrial Production indicates a decline of -3.5%. A reactionary decline is expected to occur in May in response to the especially strong production figures recorded in April, but production levels are expected to continue to be on the high side.

Looking at the production forecast survey by industry, we see that production plans are weak for transport equipment, which helped to push up overall performance in April (-15.6% m/m in May and +7.5% in June). Assuming METI’s projection can be upheld, the Apr-Jun period is expected to reach +2.3% q/q. Meanwhile, general-purpose, production and business oriented machinery is expected to experience a decline in production in May, but then is expected to be back up in June (-0.6% in May and +4.3% in June). On the other hand, production plans for information and communication electronics equipment are showing less strength than desired in the near future (-0.4% in May and -0.2% in June).

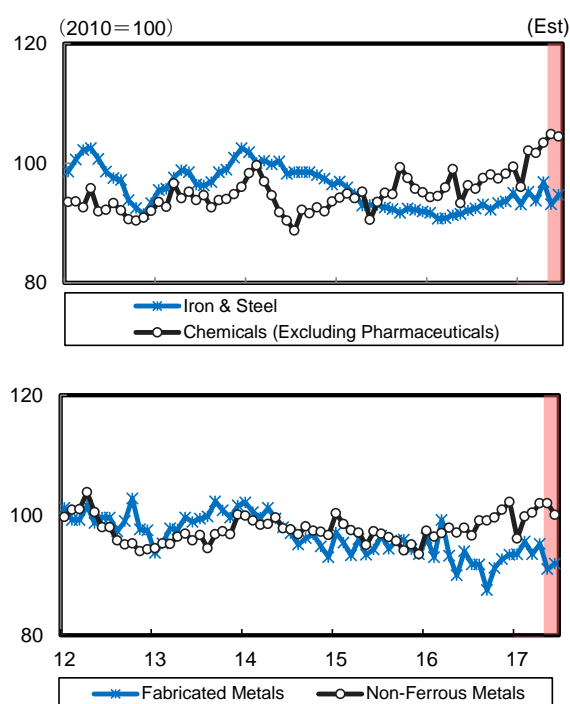
Production Indices (Assembly) Chart 4



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



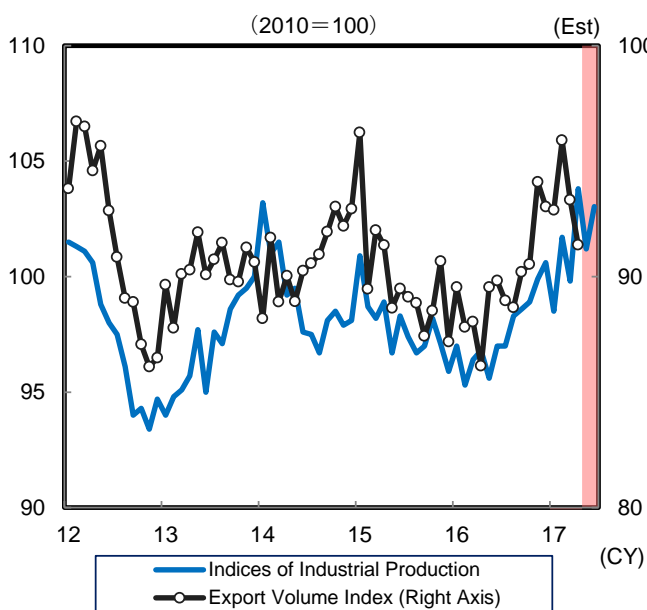
Source: Ministry of Economy, Trade, and Industry (METI), compiled by DIR.

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

Moderate production growth seen in future

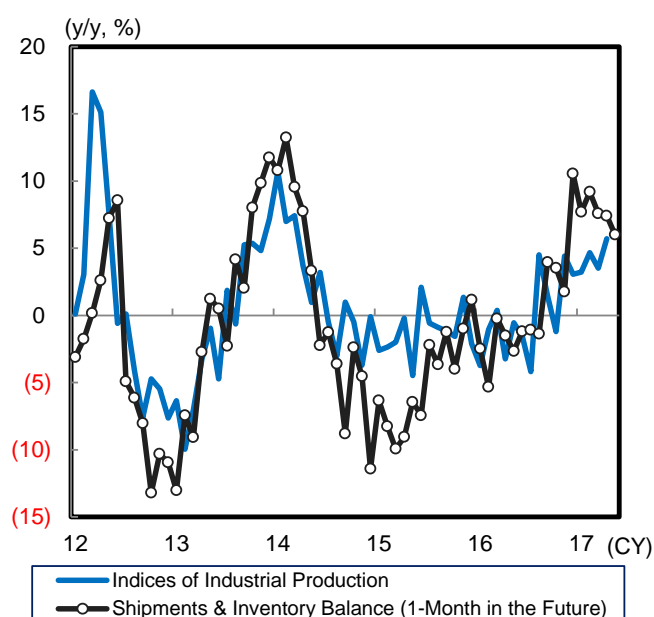
Production is expected to experience moderate growth in July 2017 and beyond. Capital goods are expected to gain an upward push overall due to investments in labor-saving and rationalization to deal with the continued shortage of manpower. Construction goods are expected to maintain favorable performance 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, there is no need to be pessimistic regarding exports to the US, as April personal consumption appears to be heading toward a comeback. Meanwhile, exports to the EU and Asia are expected to maintain favorable performance. 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, which could bring an increase in uncertainty regarding the future in the global economy. Meanwhile, geopolitical risk has increased due to the tense situation with North Korea, and could lead to a stronger sense of uncertainty, hence requiring caution.

Industrial Production & Export Volume Chart 6 **Shipments, Inventory Balance & Production** Chart 7



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.



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