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April Machinery Orders

April orders decline by -3.1% m/m. Non-manufacturing orders appear to be taking a breather.

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Summary

- According to statistics for machinery orders in April, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders declined for the first time in three months by -3.1% m/m, defying market consensus at +0.5%. Manufacturing orders grew for the third consecutive month at +2.5% m/m, but non-manufacturing (excluding ships and electric power) suffered a decline for the second consecutive month at -5.0%, pulling down overall results along with it.

- The Cabinet Office forecast for the Apr-Jun 2017 period sees private sector demand (excluding ships and electrical power) down for the second consecutive quarter by -5.9% q/q. Looking at orders by source of demand we see declines for both manufacturing (-1.1%) and non-manufacturing (excluding ships and electric power) at -9.6%. Looking at April results, we see that manufacturing registered growth, while non-manufacturing orders declined less than originally expected. Non-manufacturing orders appear to be taking a breather, and this is the one worrisome point.

- Machinery orders, the leading indicator for capex, are expected to experience ups and downs in the future. If operating rates in the manufacturing industry continue their growth trend due to the increase in exports encouraged by recovery in the world economy, this should also encourage more aggressive corporate capex. 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. However, there is always a possibility that a reactionary decline could occur in the future with orders having continued on such a high level until now. We expect computers, conveying, elevating, and materials handling machinery, and industrial robots to do well in the future due to investments in labor saving equipment.

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

	2016								2017			
	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr
Machinery orders (private sector)*	-2.2	7.1	5.6	-5.9	0.3	3.4	-2.8	2.1	-3.2	1.5	1.4	-3.1
Market consensus (Bloomberg)												0.5
DIR estimate												-1.5
Manufacturing orders	0.0	6.5	0.9	-3.1	-3.3	0.4	8.1	0.8	-10.8	6.0	0.6	2.5
Non-manufacturing orders*	1.0	1.8	6.5	-3.1	0.7	2.7	-5.6	2.1	0.7	1.8	-3.9	-5.0
Overseas orders	-16.3	9.7	-9.0	-0.7	2.8	7.1	16.3	-12.1	3.2	-1.1	-2.8	17.4

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

April orders: manufacturing wins growth, non-manufacturing declines

According to statistics for machinery orders in April, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders declined for the first time in three months by -3.1% m/m, defying market consensus at +0.5%. Manufacturing orders grew for the third consecutive month at +2.5% m/m, but non-manufacturing (excluding ships and electric power) suffered a decline for the second consecutive month at -5.0%, pulling down overall results along with it.

The Cabinet Office forecast for the Apr-Jun 2017 period sees private sector demand (excluding ships and electrical power) down for the second consecutive quarter by -5.9% q/q. Looking at orders by source of demand we see declines for both manufacturing (-1.1%) and non-manufacturing (excluding ships and electric power) at -9.6%. Looking at April results, we see that manufacturing registered growth, while non-manufacturing orders declined less than originally expected. Non-manufacturing orders appear to be taking a breather, and this is the one worrisome point.

Manufacturing orders grow for third consecutive month

Looking at orders by source of demand in April, the manufacturing industries grew for the third consecutive month at +2.5% m/m. Our evaluation is that on average, manufacturing orders are marking time.

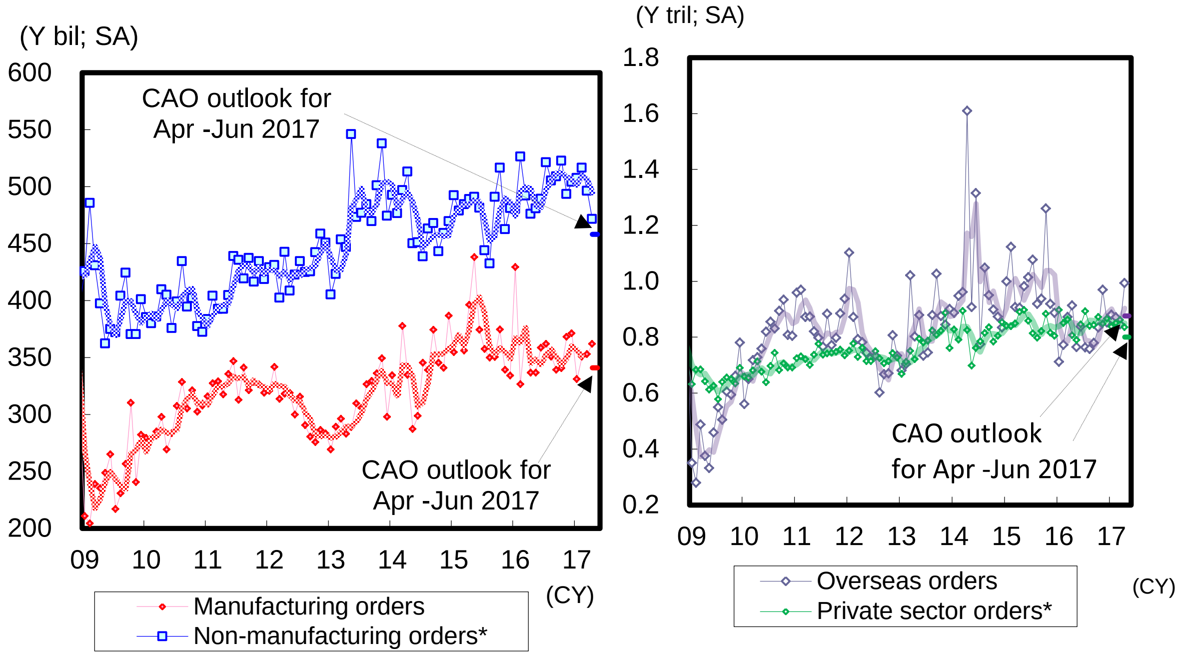
As for performance by industry, growth was seen in electrical machinery (+25.0% m/m), general-purpose and production machinery (+8.8%), and other manufacturing (+15.7%). As for electrical machinery, growth was achieved for the first time in three months, but recent performance reveals something to be lacking (-27.1% m/m in March, and -27.7% m/m in February). Meanwhile, general-purpose and production machinery registered growth for the third consecutive month, and appears to be continuing the growth trend it has maintained since the beginning of 2016. In the short-term there is a good possibility that a reactionary decline could occur, but since this industry also includes production machinery, it is actually expected to lead overall growth in manufacturing during the FY2017 period if the manufacturing industry continues growth in operating rate. On the other hand, some industries suffered declines in comparison with the previous month, including non-ferrous metals (-91.8%), chemicals and chemical products (-6.4%), and foods and beverages (-9.2%). The major decline recorded by non-ferrous metals is thought to represent a reactionary decline in response to growth due to large-scale orders received in March (+862.5% m/m in March).

Non-manufacturing orders decline for second consecutive month

Non-manufacturing orders (excluding ships and electric power) suffered a decline for the second consecutive month at -5.0% m/m. The non-manufacturing industry is considered to be taking a breather for the moment after the high level of orders maintained in recent months.

Looking at performance by industry, month-to-month declines were seen in finance & insurance (-38.5%), construction (-31.8%), and other non-manufacturing (-18.5%). Finance & insurance appeared to be taking a breather after the growth trend of recent months. Meanwhile, construction was thought to be manifesting a reactionary decline after the previous month’s growth (+66.3%). On the other hand, some industries experienced month-to-month growth, including agriculture, forestry & fishing (+31.8%), transportation & postal activities (+10.7%), and telecommunications (+8.2%). Transportation & postal activities achieved growth for the first time in two months.

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

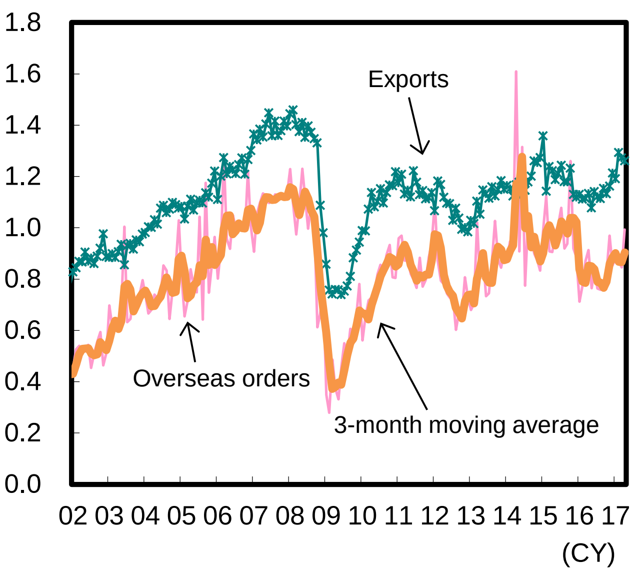


Source: Cabinet Office (CAO); compiled by DIR.
*excl. those for ships and from electric utilities.
Note: Thick lines 3M/MA basis.

Overseas orders grow for first time in three months

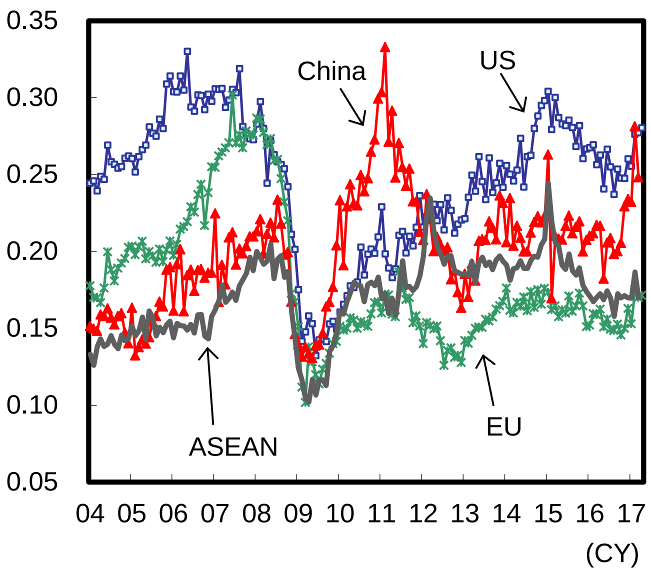
Overseas orders grew for the first time in three months at +17.4% m/m. According to the Cabinet Office, orders for electrical motors and aircraft declined, while orders for industrial machinery and electronics & telecommunications equipment grew.

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.

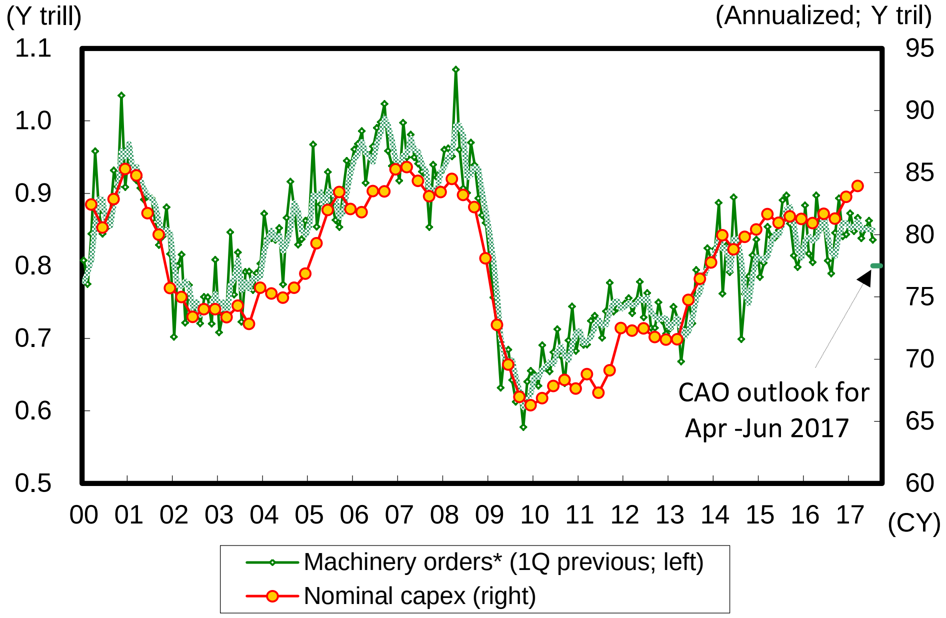
Machinery orders to experience ups and downs in future

Machinery orders, the leading indicator for capex, are expected to experience ups and downs in the future. Operating rates in the manufacturing industry have been in a growth trend since the second half of last year due to the increase in exports encouraged by recovery in the world economy. However, it is difficult to see this reaching a high enough level to encourage more aggressive investment in increasing capacity. We will continue to monitor operating rates closely as a means of predicting the industry's future. 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. In addition, recurring profit levels are high, and investments in rationalization and labor saving are seen in response to the tight labor market. This should work on the positive side for machinery orders. However, there is always a possibility that a reactionary decline could occur in the future with orders having continued on such a high level until now.

We expect three types of machinery to do well in the future due to investments in labor saving equipment. We suggest keeping an eye on the following. In the area of IT investment computers will be a focus, including general use computers and computer programs. Computers account for approximately one fourth of overall private sector demand. Potential demand is thought to be huge, with an accumulation of order backlog of nearly 3 tril yen and a balance which has doubled over a period of ten years. Large-scale systems development projects take place over the long-term, and this type of project could mean a structural change in terms of demand. In cases where there is a shortage of IT engineers, orders often cannot be processed quickly, and this could become a barrier to further growth in orders received. Next on our list are conveying, elevating, and materials handling machinery, such as conveyor belts, and transport machinery including cargo handling equipment. We suggest keeping an eye on this area in the future where investment in distribution centers is going. A serious labor shortage in the areas of transport and postal services is expected to contribute to growth for the overall industry. The third area of focus as regards investment in labor saving is industrial robots. Although robots now account for only a small portion of overall investment, they could become the representative type of labor saving investment in the future if orders from the non-manufacturing industries grow significantly.

The future of overseas demand according to our main scenario sees a continuation of gradual expansion backed by the recovery of the world economy. On the other hand, there are growing doubts regarding the Trump administration's policies and the possibility of world economic slowdown if protectionist trade policies go into effect. Meanwhile, geopolitical risk is on the rise with the tense situation in North Korea. We therefore urge caution on these points.

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.