

30 June 2017 (No. of pages: 4)

Japanese report: 30 Jun 2017

May Industrial Production

Production to maintain growth trend despite decline of -3.3% m/m

Economic Research Dept.
Kazuma Maeda
Shunsuke Kobayashi

Summary

- The May indices of industrial production recorded a decline of -3.3% m/m, while at the same time falling below market consensus at -3.0%. Almost all industries suffered declines, though most of these are considered to have been due to a reactionary decline in response to the previous month's major gains in production. The May shipping index also declined for the first time in two months at -2.8%, while the inventory index grew, though only slightly, for the sixth consecutive month at +0.1%, and inventory ratio declined for the first time in three months at -1.9%.
- The METI production forecast survey sees June performance up by +2.8% m/m, but then down again in July at -0.1%. While May results suffered a reactionary decline in response to April's major gains, production is considered to be maintaining its growth trend on average. Assuming the June projection of +2.8% can be upheld, the Apr-Jun period will reach +2.4% q/q. Even if June results mark time, q/q growth should come in at +1.5%. 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 expansion of exports centering on the EU, while personal consumption is expected to hit bottom.
- Production is expected to experience moderate growth in August 2017 and beyond. Capital goods are expected to see an increase in production due to favorable orders, but a reactionary decline could also occur due to the high level of performance recorded up till now. 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, automobile exports to the US appear to be taking a breather as well as IC exports to China, while exports to the EU are maintaining favorable performance with that region entering a growth phase. This is expected to help push up overall production.

Industrial Production (m/m %; SA basis)

Chart 1

	2016					2017					May
	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr		
Industrial Production	1.3	0.3	0.3	1.0	0.7	-2.1	3.2	-1.9	4.0	-3.3	
Market consensus (Bloomberg)										-3.0	
DIR estimate										-3.2	
Shipments	0.2	0.6	1.1	1.0	0.0	-1.1	1.4	-0.8	2.7	-2.8	
Inventories	0.0	-0.5	-1.3	-1.8	0.7	0.1	0.7	1.5	1.5	0.1	
Inventory ratio	-2.5	0.3	-1.1	-3.7	0.8	2.5	-0.3	0.2	2.9	-1.9	

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

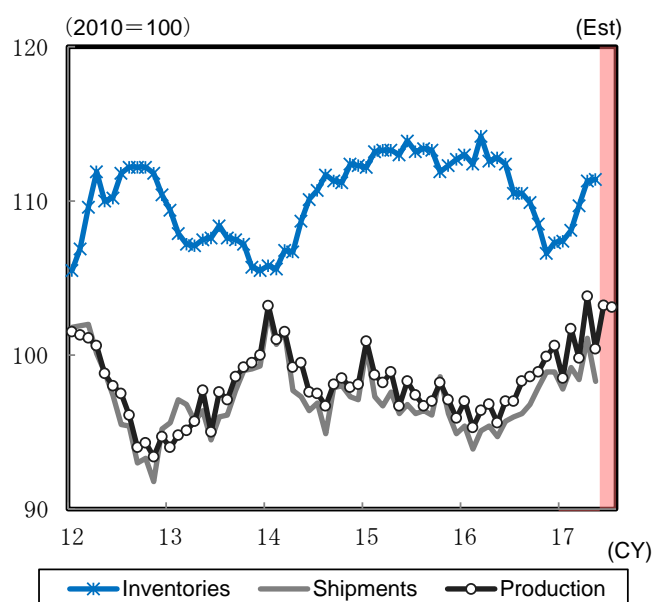
Production records decline of -3.3% m/m due to reactionary decline in response to positive April results

The May indices of industrial production recorded a decline of -3.3% m/m, while at the same time falling below market consensus at -3.0%. The May shipping index also declined for the first time in two months at -2.8%, while the inventory index grew, though only slightly, for the sixth consecutive month at +0.1%, and inventory ratio declined for the first time in three months at -1.9%. The METI production forecast survey sees June performance up by +2.8% m/m, but then down again in July at -0.1%.

While May results suffered a reactionary decline in response to April's major gains, production is considered to be maintaining its growth trend on average. Assuming the June projection of +2.8% can be upheld, the Apr-Jun period will reach +2.4% q/q. Even if June results mark time, q/q growth should come in at +1.5%. 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 expansion of exports centering on the EU, while personal consumption is expected to hit bottom.

Production, Shipment, and Inventories

Chart 2

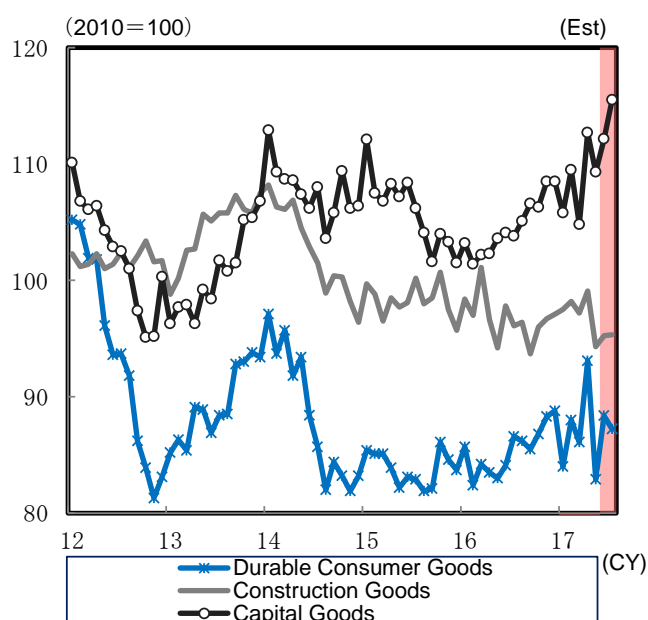


Source: Ministry of Economy, Trade, and Industry (METI), compiled by DIR.

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

Production Index and Breakdown by Types of Goods

Chart 3



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.

Fourteen out of fifteen industries suffered declines

As for production index performance by industry in May, fourteen out of the total of fifteen industries recorded declines in production. Of these, contribution to overall decline was especially notable for transport equipment (-11.7% m/m), general-purpose, production and business oriented machinery (-2.6%), and fabricated metals (-6.3%). As for transport equipment, the spring national holiday caused production line shutdowns to be longer than in most years, and there was a reactionary decline in response to April's major production increases (+10.8% in comparison to March). General-purpose, production and business oriented machinery, which had been in a growth trend since the beginning of last year (+8.7% in comparison to March), is also thought to have experienced a reactionary decline in response to the previous month's performance. On the other hand, one industry stood out in recording an increase in production. This was petroleum & coal products (+2.3%).

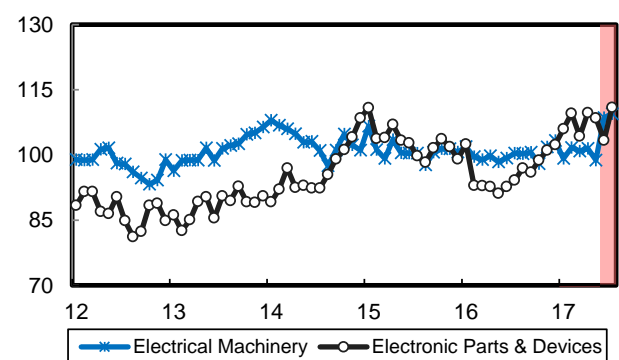
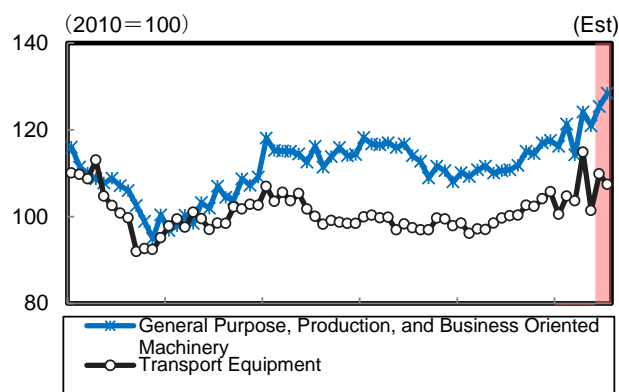
Looking at performance by types of goods, we see that capital goods declined by -3.0% m/m, while construction goods were down by -4.8%, and durable consumer goods declined by -11.0%. All goods suffered production declines. Capital goods experienced a reactionary decline in May in comparison to April performance, but are maintaining their overall growth trend thanks to favorable orders. Meanwhile, construction goods appeared to be taking a breather from their overall growth trend. Durable consumer goods have been in a growth trend since the beginning of last year, but recently they have been experiencing ups and downs.

General-purpose, production and business oriented machinery to maintain growth trend

The METI production forecast survey sees June performance up by +2.8% m/m, but then down again in July at -0.1%. METI's estimated forecast value for the June Indices of Industrial Production indicates growth of +1.7%. Looking at the production forecast survey by industry, we see that production plans are positive for transport equipment, which helped to push down overall performance in May (+8.3% m/m in June and -2.2% in July). Meanwhile, general-purpose, production and business oriented machinery is expected to show strength in June also (+3.7% in June and +2.4% in July), with electrical machinery following suit (+9.9% in June and +0.8% in July). On the other hand, production plans are expected to be on the weak side for the materials industries, including iron & steel (-2.7% in June and +1.3% in July), and chemicals (+1.4% in June and -5.6% in July).

Looking at the inventory index, we see that it has been recording growth for six consecutive months since December 2016. May inventory experienced an especially large decline in the area of transport equipment, which helped to push up overall results thanks to favorable sales of new model automobiles. Meanwhile, general-purpose, production and business oriented machinery, which has been maintaining a high level of production, is experiencing a decline in inventory, and because of concerns that production may be unable to keep up with orders, will likely see further production increases in the future, and this is expected to help encourage overall production growth in the future.

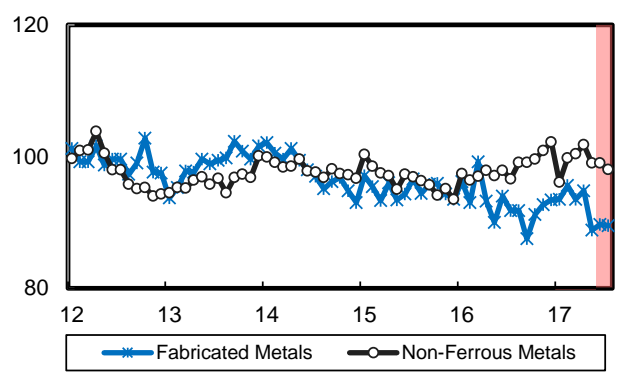
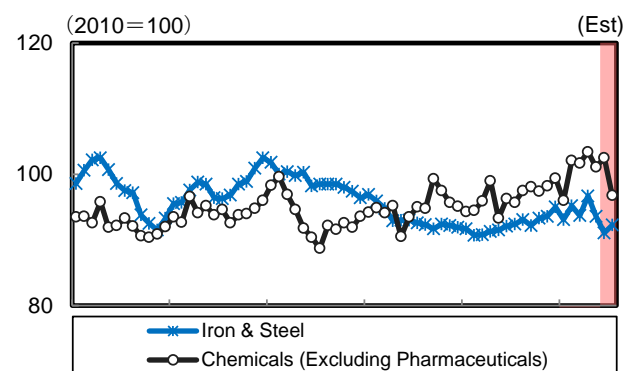
Production Indices (Assembly) Chart 4



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.

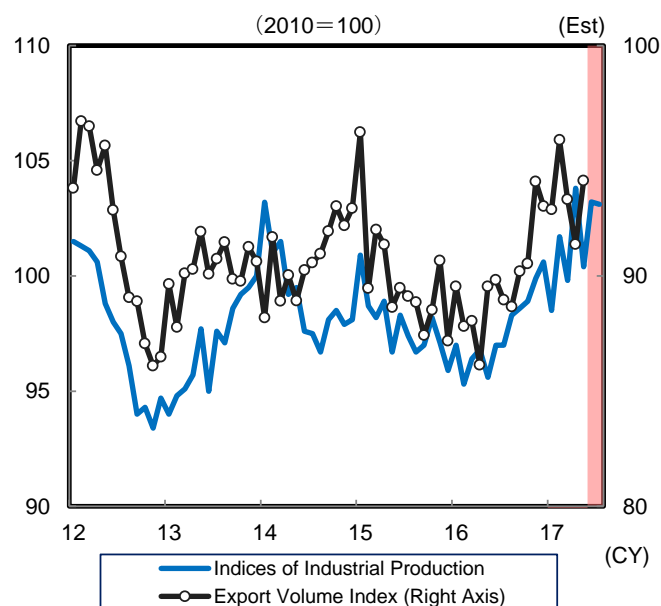
Note: Values for most recent 2-months of production index from METI production forecast survey.

Moderate production growth seen in future

Production is expected to experience moderate growth in August 2017 and beyond. Capital goods are expected to see an increase in production due to favorable orders, but a reactionary decline could also occur due to the high level of performance recorded up till now. As for construction goods, infrastructure demand associated with the 2020 Tokyo Olympics and Paralympics is expected to remain constant, but recently performance appears to be taking a breather in comparison to the growth trend experienced until now. 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, automobile exports to the US appear to be taking a breather as well as IC exports to China, while exports to the EU are maintaining favorable performance with that region entering a growth phase.

However, caution is required regarding overseas demand due to possible downside risk. As for the US, the Fed implemented an interest rate increase in June 2017, and may raise rates again this year, as well as implement asset reduction. Rising US interest rates could bring downward pressure on the US economy, while at the same time encouraging capital outflows from the emerging nations. On the other hand, while there is little chance of a major slowdown in China's economy before the Fall 2017 Communist Party Convention, beyond that there is risk of downward pressure on the economy due to reactionary decline in demand, which has been kept artificially high through government policy measures.

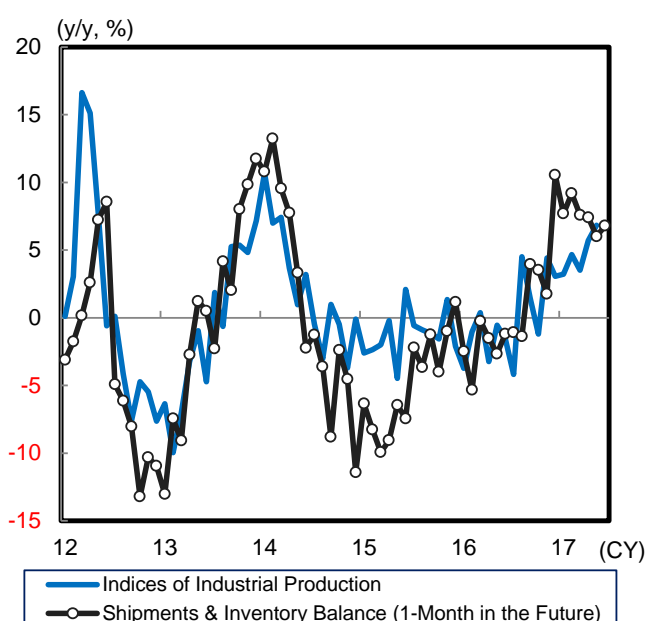
Industrial Production & Export Volume Chart 6



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.