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June Industrial Production

Growth trend in production confirmed

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Summary

- The June indices of industrial production recorded growth of +1.6% m/m, for the most part in tune with market consensus at +1.5%. The June shipping index also grew for the first time in two months at +2.3%, while the inventory index fell for the first time in seven months at -2.2% along with the inventory ratio, which declined for the second consecutive month at -2.1%. The METI production forecast survey sees July performance up by +0.8% m/m, and August also up by +3.6%.

- Both production and shipments registered growth, while inventory declined, putting the amendment ratio of the July forecast on the plus side, with August also expecting production growth. Considering these developments the overall assessment is a good one. The June result now puts the Apr-Jun period at +1.9% q/q. Growth was sluggish during the Jan-Mar period at +0.2% (+1.8% during the Oct-Dec period), but the pace of production appears to be accelerating due to a comeback for personal consumption and capex.

- Production is expected to experience moderate growth in September 2017 and beyond. Capital goods are expected to see an increase in production due to favorable orders, but caution is required regarding the future, as it is unknown whether the growth trend in operating rate can be maintained. 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.

Industrial Production (m/m %; SA basis) **Chart 1**

	2016				2017					
	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Industrial Production	0.3	0.3	1.0	0.7	-2.1	3.2	-1.9	4.0	-3.6	**1.6**
Market consensus (Bloomberg)										1.5
DIR estimate										1.5
Shipments	0.6	1.1	1.0	0.0	-1.1	1.4	-0.8	2.7	-2.9	**2.3**
Inventories	-0.5	-1.3	-1.8	0.7	0.1	0.7	1.5	1.5	0.0	**-2.2**
Inventory ratio	0.3	-1.1	-3.7	0.8	2.5	-0.3	0.2	2.9	-1.9	**-2.1**

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

Production and shipments record growth, while inventory declines

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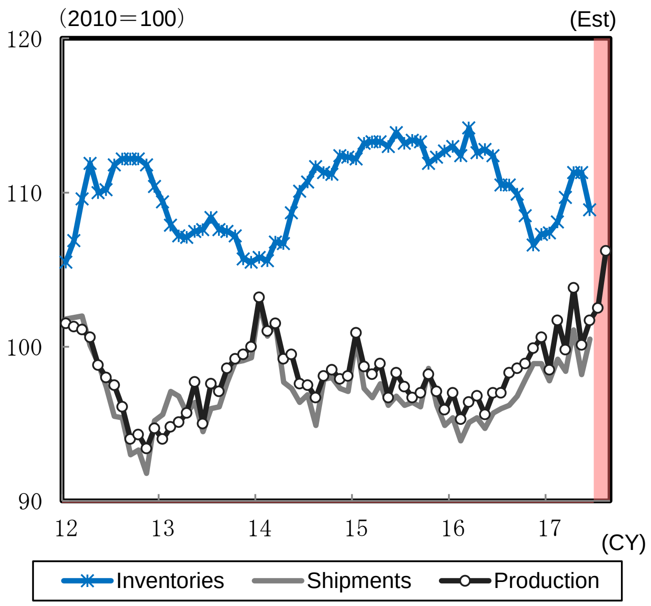
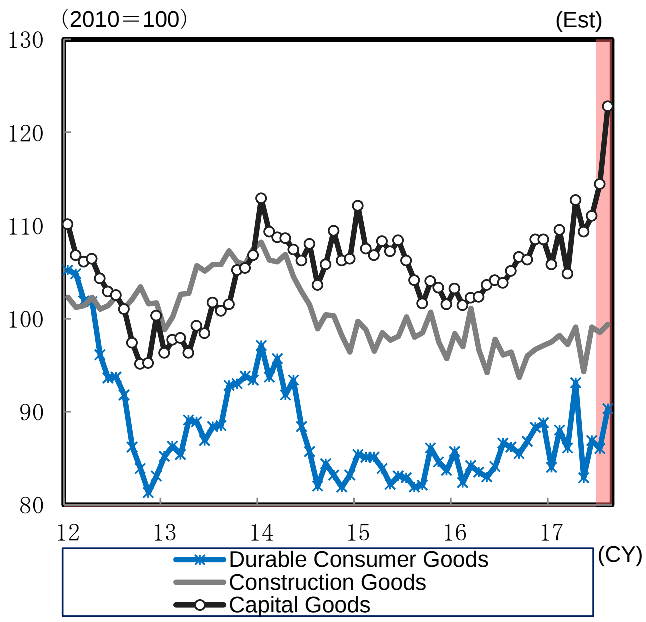
Production, Shipment, and Inventories **Chart 2**



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.

Twelve out of fifteen industries register growth

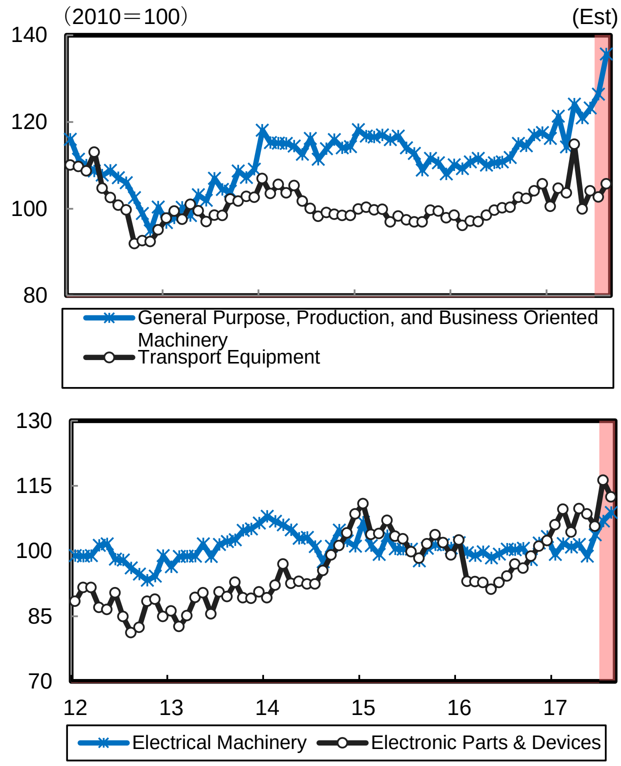
As for production index performance by industry in June, twelve out of the total of fifteen industries recorded growth in production. Of these, contribution to overall growth was especially notable for transport equipment (+4.2% m/m), and chemicals (excluding drugs) (+3.4%). As for transport equipment, while the spring national holiday caused major fluctuation in production, on the whole, a moderate growth trend has been confirmed. Domestic sales recorded their eighth consecutive month of y/y growth in June due to the introduction of new model vehicles. Meanwhile, chemicals have been achieving favorable exports centering on Asia. On the other hand, three industries recorded declines in production. These included electronic parts and devices (-2.6%), and other manufacturing (-0.8%).

Looking at performance by types of goods, we see that capital goods grew by +1.6% m/m, while construction goods also grew by +5.1%, and durable consumer goods grew by +4.8%. Capital goods have done well thanks to four consecutive months of growth in the machinery orders statistics through the month of May. Meanwhile, exports of semiconductor and other manufacturing equipment to the US and Asia have also been favorable.

General-purpose, production and business oriented machinery maintains growth trend

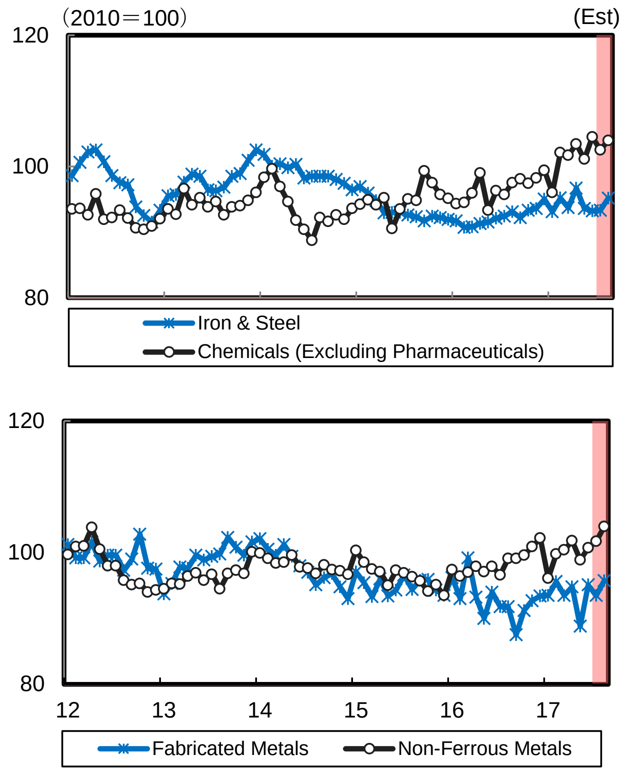
The METI production forecast survey sees July performance up by +0.8% m/m, with August performance also up at +3.6%. The production forecast for July was revised upwards from the forecast of -0.1% reported on the June survey. Meanwhile, METI's estimated forecast value for the July Indices of Industrial Production indicates a decline of -0.3% (mode). Looking at the production forecast survey by industry, we see that production plans for transport equipment, which helped to push up overall performance in June, are expected to see a decline in production in July, but are seen maintaining underlying strength overall due to favorable domestic sales (-1.4% m/m in July and +3.0% in August). Inventory, which had been accumulating up till recently, also declined for the second consecutive month. Meanwhile, general-purpose, production and business oriented machinery continues to show optimistic production plans (+2.6% in July and +7.3% in August). This industry tends to experience downturns in production after initial plans have been announced, hence figures should be taken with a certain grain of salt. However, inventory levels have continued to decline, so hopes are that this industry will lead overall performance 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



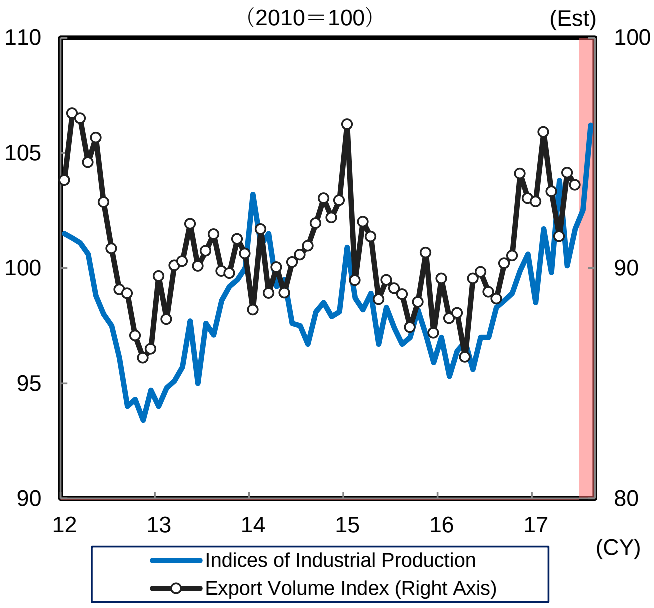
Source: Ministry of Economy, Trade, and Industry (METI), compiled by DIR.
Note: Values for most recent 2-months of production index from METI production forecast survey.

Moderate production growth seen in future

Production is expected to experience moderate growth in September 2017 and beyond. Capital goods are expected to see an increase in production due to favorable orders, but caution is required regarding the future, as it is unknown whether the growth trend in operating rate can be maintained. As for construction goods, infrastructure demand associated with the 2020 Tokyo Olympics and Paralympics is expected to remain constant, placing this area in a growth trend. 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, and the negative influence of preconsumption over demand due to last minute demand experienced prior to the increase in consumption tax has gradually fallen away.

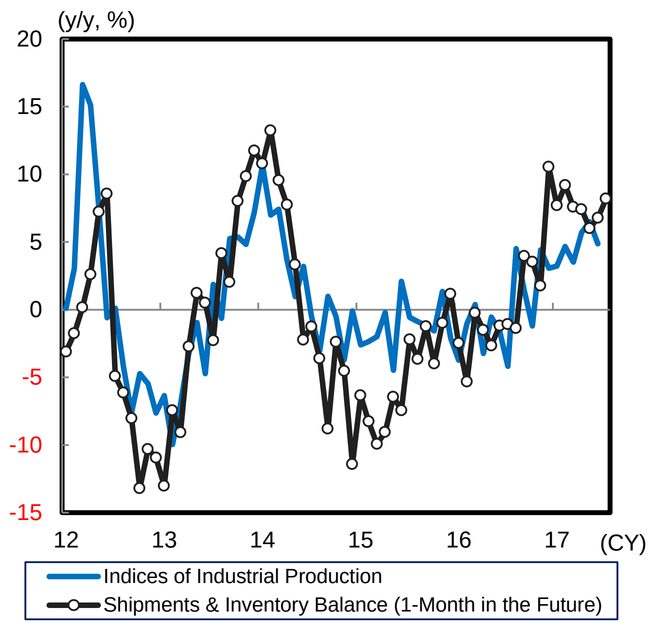
However, caution is required regarding overseas demand due to possible downside risk. As for the US, the Fed implemented an interest rate increase in June 2017, and may raise rates again this year, as well as implement asset reduction. Rising US interest rates could bring downward pressure on the US 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 National Congress of the Communist Party, 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.