

31 August 2017 (No. of pages: 4)

Japanese report: 31 Aug 2017

July Industrial Production

Production maintaining at high level

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Summary

- The July indices of industrial production recorded a decline of -0.8% m/m, while at the same time falling below market consensus at -0.3%. The July shipping index was also down for the first time in two months at -0.7%, while the inventory index fell for the second consecutive month at -1.2%. The inventory ratio grew for the first time in three months at +2.4%. The METI production forecast survey sees August performance up by +6.0% m/m, and September down by -3.1%.
- While the July indices of industrial production fell below market consensus, the extent of decline was small, and production is actually maintaining a high level of performance. Favorable domestic demand and two consecutive months of inventory decline appear to have led to plans for production increases in August.
- Production is expected to experience moderate growth in October 2017 and beyond. Capital goods will remain promising throughout the rest of the fiscal year due to capex spending in the area of maintenance & repair, 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 new model cars centering on light weight vehicles gaining from the effect of introducing new models, and major appliances reaching the culmination of their replacement cycle.

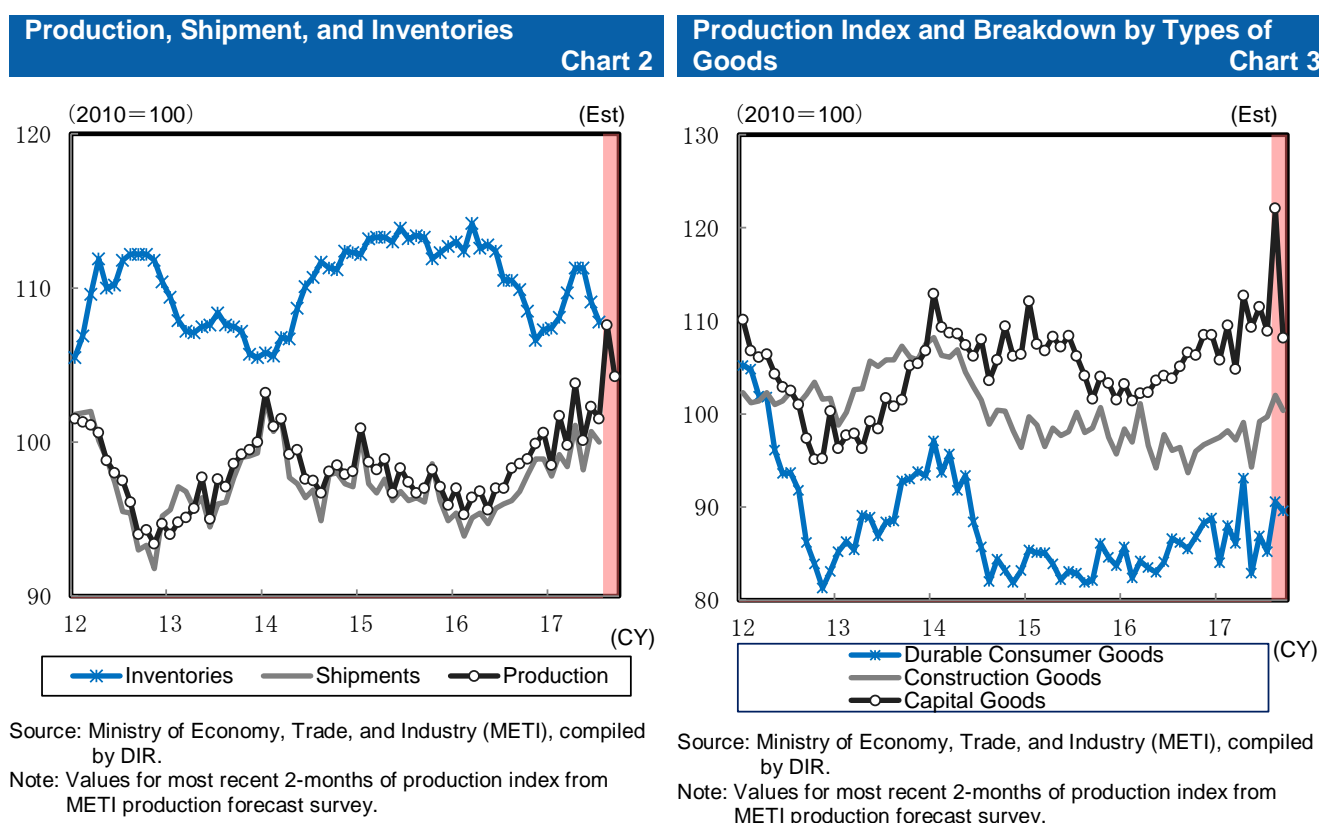
Industrial Production (m/m %; SA basis)										Chart 1
	2016			2017						
	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul
Industrial Production	0.3	1.0	0.7	-2.1	3.2	-1.9	4.0	-3.6	2.2	-0.8
Market consensus (Bloomberg)										-0.3
DIR estimate										-0.1
Shipments	1.1	1.0	0.0	-1.1	1.4	-0.8	2.7	-2.9	2.5	-0.7
Inventories	-1.3	-1.8	0.7	0.1	0.7	1.5	1.5	0.0	-2.0	-1.2
Inventory ratio	-1.1	-3.7	0.8	2.5	-0.3	0.2	2.9	-1.9	-1.9	2.4

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

Production, shipments and inventory all suffer declines

The July indices of industrial production recorded a decline of -0.8% m/m, while at the same time falling below market consensus at -0.3%. The July shipping index was also down for the first time in two months at -0.7%, while the inventory index fell for the second consecutive month at -1.2%. The inventory ratio grew for the first time in three months at +2.4%. The METI production forecast survey sees August performance up by +6.0% m/m, and September down by -3.1%.

While the July indices of industrial production fell below market consensus, the extent of decline was small, and production is actually maintaining a high level of performance. Favorable domestic demand and two consecutive months of inventory decline appear to have led to plans for production increases in August.



Eleven out of fifteen industries register declines

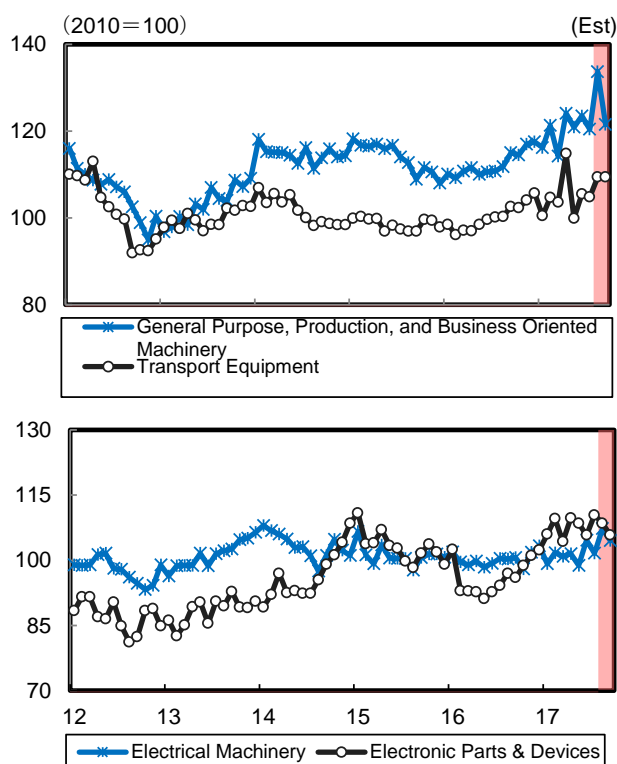
As for production index performance by industry in July, eleven out of the total of fifteen industries recorded declines in production. Of these, contribution to the decline was especially pronounced for general-purpose, production and business oriented machinery (-2.5% m/m), and electrical machinery (-2.9%). As for general-purpose, production and business oriented machinery, manufacturing equipment for semiconductors and flat panel displays, which had been performing at a high level up to this point, appeared to be taking a breather, thus contributing to the overall decline. On the other hand, industries reporting growth in production totaled four industries, including electronic parts and devices (+4.3%), and ceramics, stone & clay products (+0.8%).

Looking at performance by types of goods, we see that capital goods fell by -2.3% m/m, while construction goods grew by +0.5%, and durable consumer goods fell by -2.0%.

Production growth expected in August followed by decline in September

The METI production forecast survey sees August performance up by +6.0% m/m, with September performance down by -3.1%. Meanwhile, METI’s estimated forecast value for the August Indices of Industrial Production indicates growth of +1.4% (mode value). Looking at the production forecast survey by industry, we see that production plans for general-purpose, production and business oriented machinery (+11.0% m/m in August and -9.1% in September) as well as information and communication electronics equipment (+10.8% in August and -12.0% in September) show strength in August but then fall back into decline in September. At the same time, it should be noted that these industries tend to experience downturns in production after initial plans have been announced; hence figures should be taken with a certain grain of salt. Transport equipment is expected to maintain its growth trend in production backed by favorable domestic sales (+4.4% in August and 0.0% in September). Meanwhile, electronic parts and devices, which recorded growth in July, are expecting production to decline (-1.7% in August and -2.5% in September).

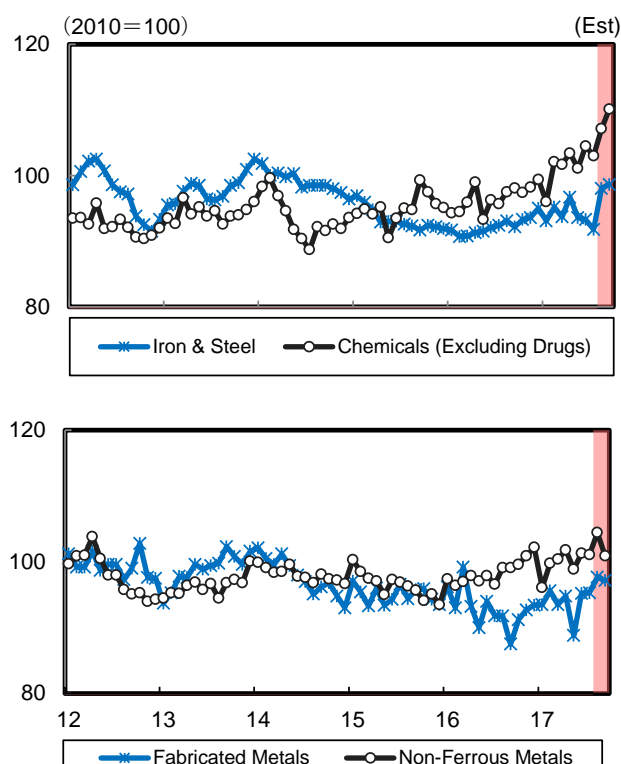
Production Indices (Assembly) Chart 4



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.

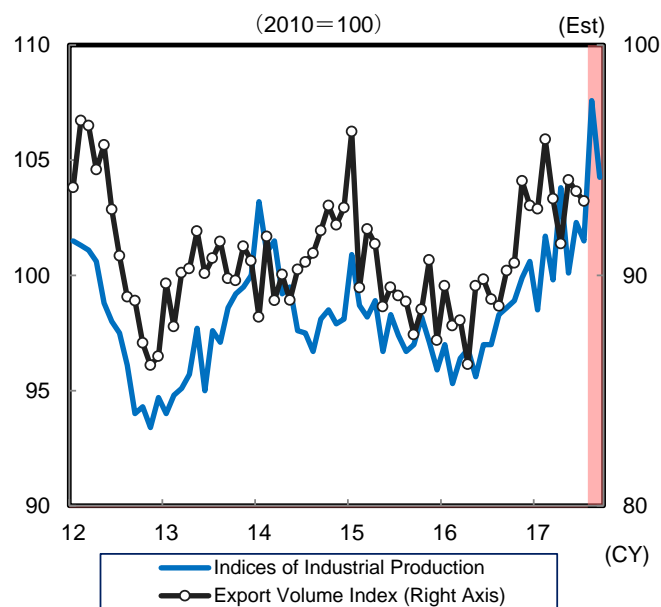
Note: Values for most recent 2-months of production index from METI production forecast survey.

Moderate production growth seen in future

Production is expected to experience moderate growth in October 2017 and beyond. Capital goods will remain promising throughout the rest of the fiscal year due to capex spending in the area of maintenance & repair, 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, the growth trend continues due to infrastructure demand associated with the 2020 Tokyo Olympics and Paralympics. Durable consumer goods are expected to maintain a steady undertone, with new model cars centering on light weight vehicles gaining from the effect of introducing new models, and major appliances reaching the culmination of their replacement cycle. Caution is advised regarding automobiles, as the extent of growth in domestic new model car sales is shrinking, with new model car sales in the US on the decline as well.

Meanwhile, 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. If US interest rates undergo a rapid rise, this 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. There is also geopolitical risk with tensions rising regarding the North Korea situation. Further caution is required regarding the possibility that corporations may cool to the idea of carrying out capex spending due to yen appreciation associated with the North Korea situation.

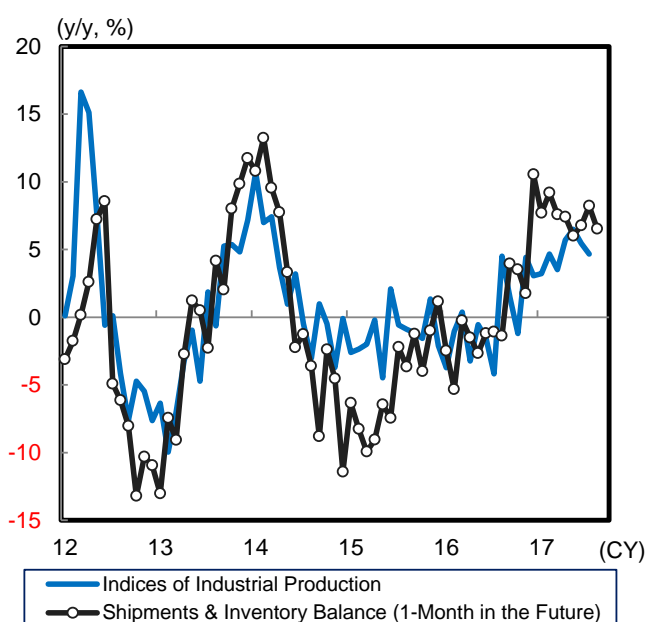
Industrial Production & Export Volume Chart 6



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.