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August Industrial Production

Growth in production of capital goods and passenger vehicles leads overall performance

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Summary

- The August indices of industrial production recorded growth of +2.1% m/m, while at the same time exceeding market consensus at +1.8%. The August shipping index was also up by +1.8%, while the inventory index fell by -0.6%. Meanwhile, the inventory ratio declined by -4.3%. The METI production forecast survey sees September performance down by -1.9% m/m, and October up by +3.5%.
- In addition to the August indices of industrial production achieving positive performance, inventory declined and the growth trend in production was maintained due to favorable domestic demand and positive performance for exports. According to the METI production forecast survey, a decline in production is expected in September, but October is seen making a comeback with a return to production growth. Hence there is no need for pessimism in regard to the September outlook.
- Production is expected to experience moderate growth in November 2017 and beyond. Capex spending in the area of maintenance & repair remains promising throughout FY2017, but caution is required as it is unknown whether the growth trend in operating rate can be maintained. Meanwhile, 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

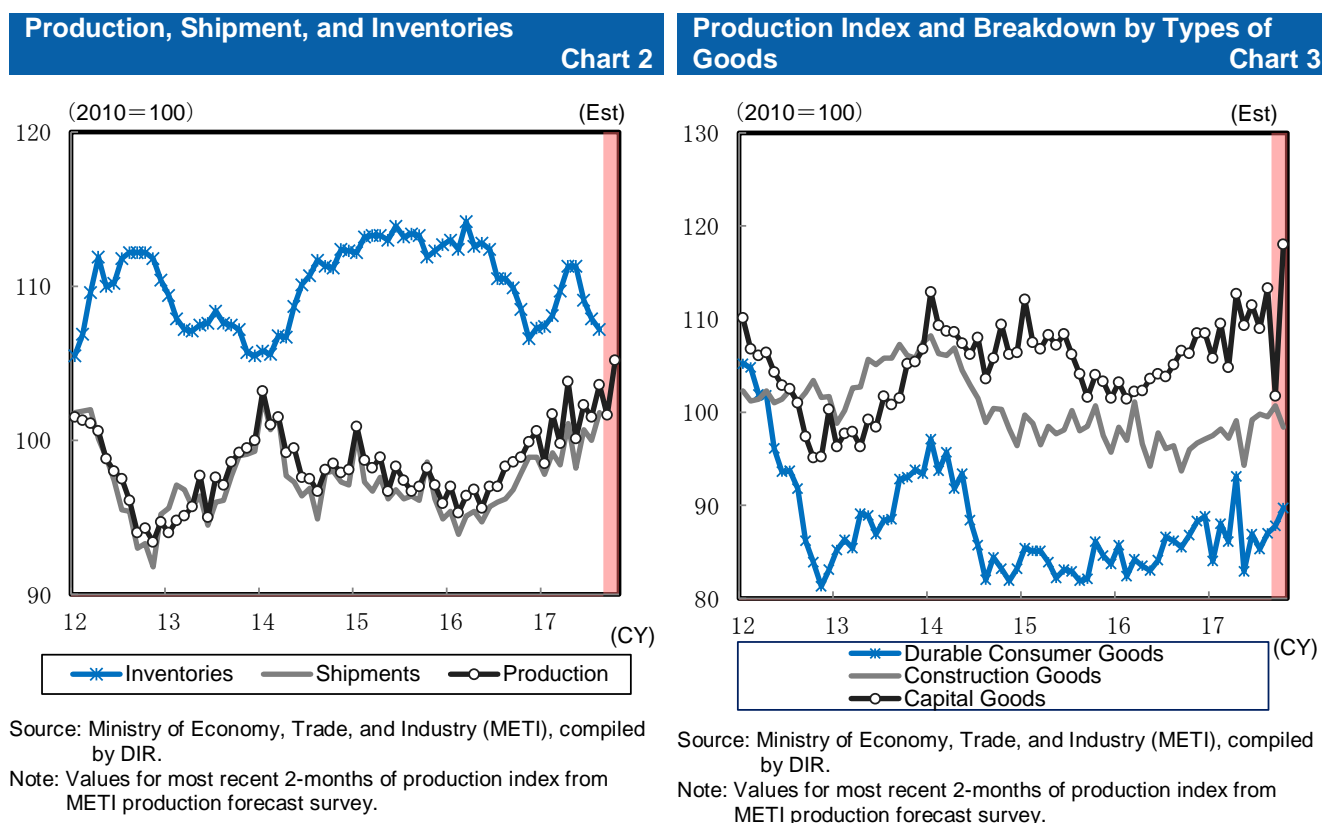
	2016		2017							
	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
Industrial Production	1.0	0.7	-2.1	3.2	-1.9	4.0	-3.6	2.2	-0.8	2.1
Market consensus (Bloomberg)										1.8
DIR estimate										1.6
Shipments	1.0	0.0	-1.1	1.4	-0.8	2.7	-2.9	2.5	-0.7	1.8
Inventories	-1.8	0.7	0.1	0.7	1.5	1.5	0.0	-2.0	-1.1	-0.6
Inventory ratio	-3.7	0.8	2.5	-0.3	0.2	2.9	-1.9	-1.9	2.6	-4.3

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

Production and shipments grow, while inventory declines

The August indices of industrial production recorded growth of +2.1% m/m, while at the same time exceeding market consensus at +1.8%. The August shipping index was also up by +1.8%, while the inventory index fell by -0.6%. Meanwhile, the inventory ratio declined by -4.3%. The METI production forecast survey sees September performance down by -1.9% m/m, and October up by +3.5%.

In addition to the August indices of industrial production achieving positive performance, inventory declined and the growth trend in production was maintained due to favorable domestic demand and positive performance for exports. According to the METI production forecast survey, a decline in production is expected in September, but October is seen making a comeback with a return to production growth. Hence there is no need for pessimism in regard to the September outlook. General-purpose, production, and business oriented machinery and transport equipment contributed considerably to overall growth in production. Inventory in these industries is in a declining trend, and it is expected to continue its role in leading overall performance.



Eleven out of fifteen industries register growth

As for production index performance by industry in August, eleven out of the total of fifteen industries recorded growth in production. Of these, contribution to growth was especially notable for general-purpose, production and business oriented machinery (+3.7% m/m), and transport equipment (+2.4%). As for general-purpose, production and business oriented machinery, overall performance was improved by production growth in semiconductor manufacturing equipment, which continues in a growth trend for exports. On the other hand, industries reporting declines in production totaled four industries, including chemicals (excluding drugs) at -0.7%.

Production growth expected in October followed by decline in September

The METI production forecast survey sees September performance down by -1.9% m/m, with October performance up by +3.5%. Meanwhile, METI's estimated forecast value for the September Indices of Industrial Production indicates a decline of -1.4% (mode value). Looking at the production forecast survey by industry, we see that production plans for transport equipment (+0.6% m/m in September and +0.7% in October) are expected to maintain their growth trend backed by favorable domestic sales. However, the rate of growth is expected to be moderate. Meanwhile, electrical machinery also displays self-confidence in its production plans (+0.1% in September and +11.6% in October) with support from favorable domestic demand. However, 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.

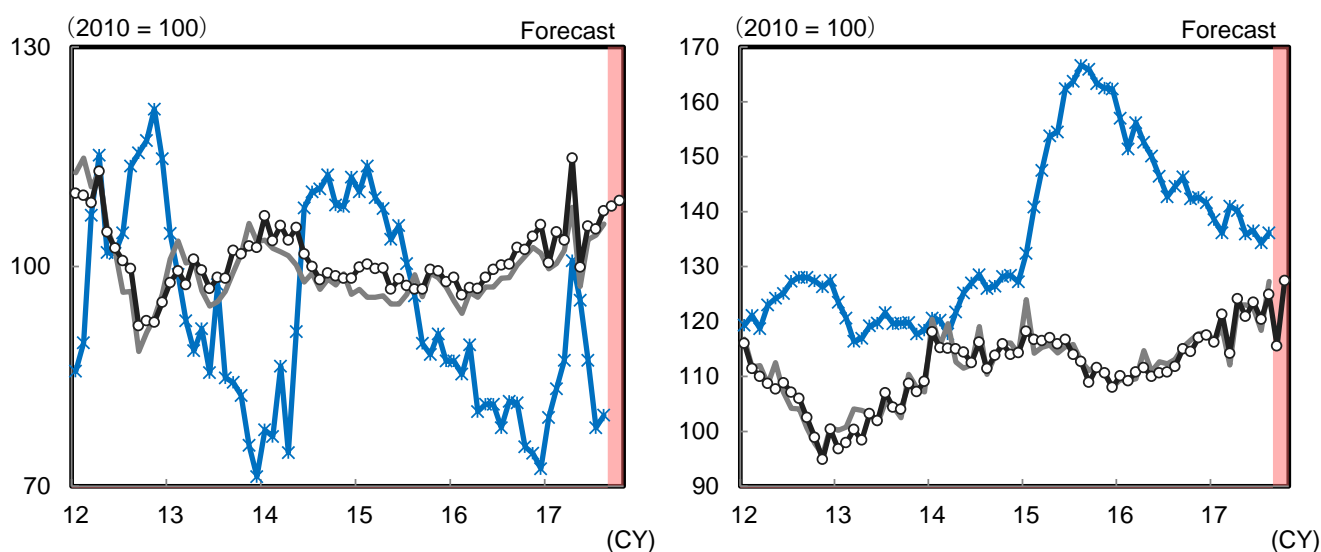
Exports of semiconductor manufacturing equipment favorable, along with domestic sales of new model cars

The recent growth trend in production has been led by general-purpose, production and business oriented machinery, and transport equipment. Inventories for both of these industries are in a declining trend, so they are expected to continue pushing up overall results in the future.

As for general-purpose, production and business oriented machinery, growth in exports of semiconductor production equipment is especially notable. Behind this development is the increase in business activities related to autonomous cars, and progress in making use of AI, and IoT (the internet of things). Activity in these new fields is causing an increase in global demand for semiconductors.

Meanwhile, in the transport equipment industry, domestic new car sales are favorable due to the effects of introducing new car models. According to the Japan Automobile Manufacturers Association forecast, total demand in FY2017 is expected to be 5 million units for 4-wheelers (99.2% of the previous year), 3,258,000 units for registered vehicles (98.2%), and 1,742,000 units for light weight 4-wheelers (101.3%). However, this forecast had already been exceeded by the month of August when actual results already showed registered vehicles at 104.9% of the previous year and light weight 4-wheelers at 116.3%. Introduction of more new models is expected to continue with the upcoming Tokyo Motor Show in October, and this industry is expected to continue with favorable business in the future.

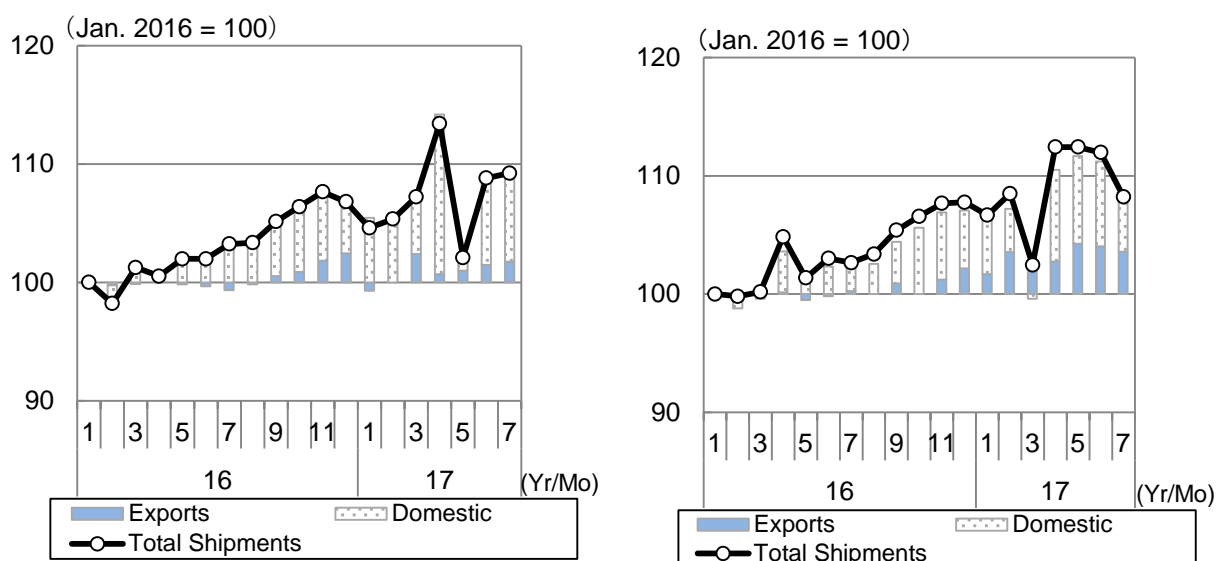
Production, Shipments, and Inventory (Left: Transport Equipment, Right: General-Purpose, Production and Business Oriented Machinery) Chart 4



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

Note: Figures for most recent two months of the production index are from the METI production forecast survey.

Industrial Production Shipments and Contribution by Source of Demand (Left: Transport Equipment, Right: General-Purpose, Production and Business Oriented Machinery) Chart 5



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

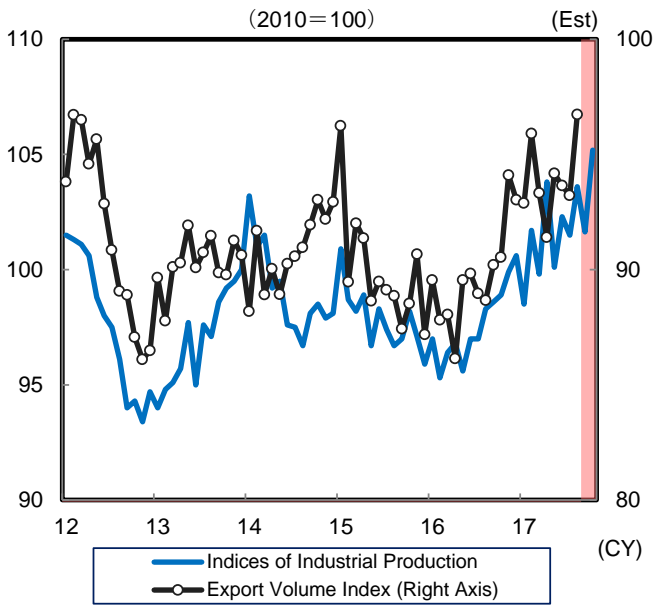
Note: Shipping index and contribution by source of demand with January 2016 as reference date.

Moderate growth in production seen in future

Production is expected to experience moderate growth in November 2017 and beyond. As for capital goods, capex spending in the area of maintenance & repair remains promising throughout FY2017, but caution is required 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. Meanwhile, 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.

However, caution is required regarding overseas demand due to possible downside risk. As for the US, the Fed is expected to begin asset reduction in October, and is also seen raising interest rates for the third time within the year. 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. Meanwhile, China's economy may very likely have recently begun a gradual decline. 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.

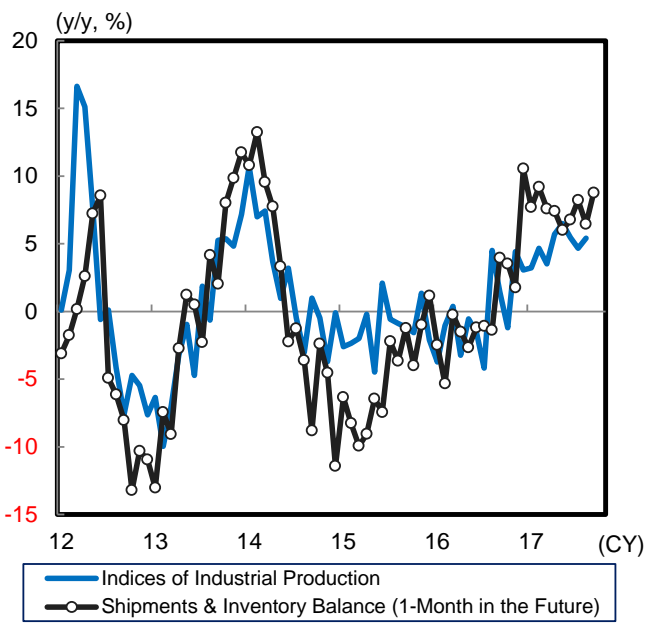
Industrial Production & Export Volume
Chart 6



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.

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- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

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