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September Machinery Orders

Signs of reactionary decline in comparison to previous month, but manufacturing industry maintains growth trend

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Summary

- According to statistics for machinery orders in September, 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 -8.1% m/m. Manufacturing suffered a decline of -5.1%, while non-manufacturing also fell by -11.1%. While the manufacturing industry suffered a reactionary decline in response to the previous month's major growth (+16.1% m/m in August), it is maintaining its moderate growth trend upheld since the beginning of 2017. Meanwhile, non-manufacturing, which had been showing signs of a comeback until recently, suffered a major decline in September, and is expected to continue marking time.

- The Cabinet Office forecast for the Oct-Dec 2017 period (excluding ships and electrical power) sees a decline of -3.5% q/q.

- With the September results, machinery orders (excluding ships and electrical power) have registered a decline of -3.1% for the first half of FY2017 in comparison with the previous half-year period. General-purpose & production machinery led results, while manufacturing grew by +5.7%, while non-manufacturing declined by -9.2% due to the slump in construction orders.

- Machinery orders, the leading indicator for capex, are expected to experience ups and downs in the future. Investment in maintenance & repair looks promising in the manufacturing industry, but willingness to invest in capacity increase is not strong. In order for capex spending to become full-fledged, operating rates must grow more. The non-manufacturing industry is 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.

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

	2016 Oct	Nov	Dec	2017 Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
Machinery orders (private sector)*	3.4	-2.8	2.1	-3.2	1.5	1.4	-3.1	-3.6	-1.9	8.0	3.4	-8.1
Market consensus (Bloomberg)												-2.0
DIR estimate												0.5
Manufacturing orders	0.4	8.1	0.8	-10.8	6.0	0.6	2.5	1.0	-5.4	2.9	16.1	-5.1
Non-manufacturing orders*	2.7	-5.6	2.1	0.7	1.8	-3.9	-5.0	-5.1	0.8	4.8	3.1	-11.1
Overseas orders	7.1	16.3	-12.1	3.2	-1.1	-2.8	17.4	-5.2	-3.1	9.1	11.5	-9.8

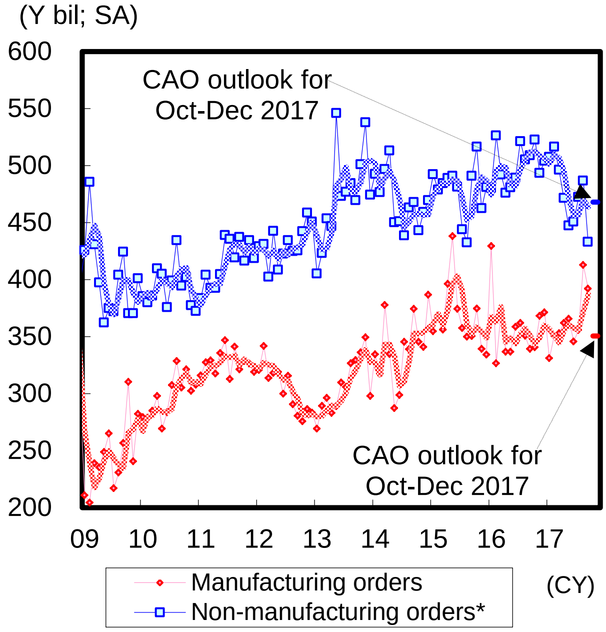
Source: Cabinet Office, Bloomberg; compiled by DIR.
*excl. those for ships and from electric utilities.
Note: Figures on market consensus from Bloomberg

September orders: manufacturing continues growth trend

According to statistics for machinery orders in September, 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 -8.1% m/m. Manufacturing suffered a decline of -5.1%, while non-manufacturing also fell by -11.1%. With these results machinery orders (excluding ships and electrical power) have registered a decline of -3.1% for the first half of FY2017 in comparison with the previous half-year period. Meanwhile, the Cabinet Office forecast for the Oct-Dec 2017 period (excluding ships and electrical power) sees a decline of -3.5% q/q.

While the manufacturing industry suffered a reactionary decline in response to the previous month's major growth (+16.1% m/m in August), it is maintaining its moderate growth trend upheld since the beginning of 2017. However, the fact that the Cabinet Office forecasts the Oct-Dec period at -9.4% q/q is cause for concern. Meanwhile, non-manufacturing, which had been showing signs of a comeback until recently, suffered a major decline in September, and is expected to continue marking time.

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.

Manufacturing orders: reactionary decline suffered in response to previous month's results

Looking at performance by source of demand in September, we see that the manufacturing industry declined for the first time in three months by -5.1% m/m. This is considered to be a reactionary decline in response to the previous month's major growth (+16.1% m/m in August), but the industry is maintaining its moderate growth trend upheld since the beginning of 2017.

As for performance by industry, declines in general-purpose & production machinery (-11.6% m/m) and foods & beverages (-51.4%) brought down overall results. Both of these industries are seen as having suffered from reactionary declines in response to the previous month's results (general-purpose & production machinery registered +23.1% m/m in August, while foods & beverages were up by +72.8%).

Non-manufacturing orders suffer decline for the first time in four months

Non-manufacturing, which had been showing signs of a comeback until recently, suffered a major decline in September, falling for the first time in four months by -11.1%, and is expected to continue marking time.

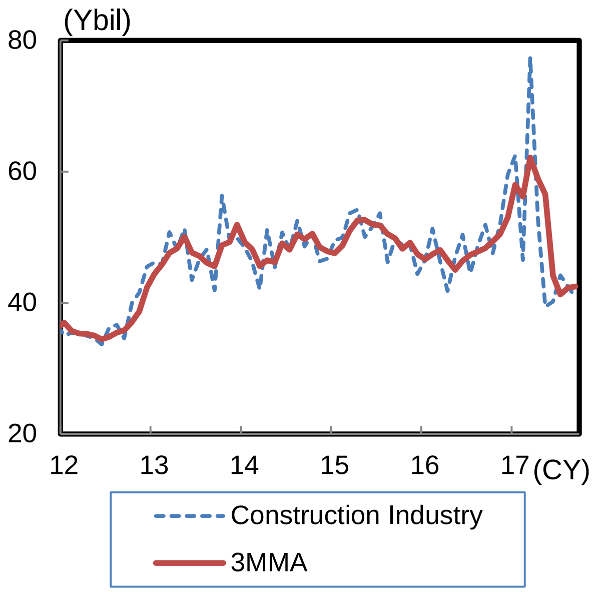
Looking at performance by industry, weakness was notable in other non-manufacturing (-33.5% m/m), and finance & insurance (-20.9%). As was seen in manufacturing, these industries are presumed to have suffered from a reactionary decline in comparison to the previous month's results (other non-manufacturing was up by +57.7% in August, while finance & insurance was up by +24.2%).

Performance in first half of FY2017: non-manufacturing performance brings downward pressure on overall results

With the September results, machinery orders (excluding ships and electrical power) have registered a decline of -3.1% for the first half of FY2017 in comparison with the previous half-year period. General-purpose & production machinery led results, while manufacturing grew by +5.7%, while non-manufacturing declined by -9.2% due to the slump in construction orders.

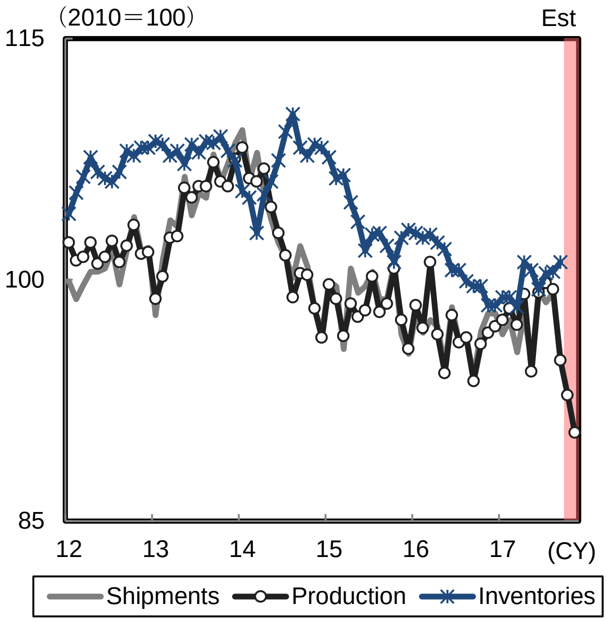
The construction industry registered -24.8% for the first half of FY2017 in comparison with the previous half-year period, with orders suffering a major decline. Looking at the statistics for industrial production we see that not only construction materials such as bridges and steel frame, but construction related goods such as excavators and cranes are also exhibiting weak performance. Behind this is thought to be the recent slowdown in housing construction and public works projects.

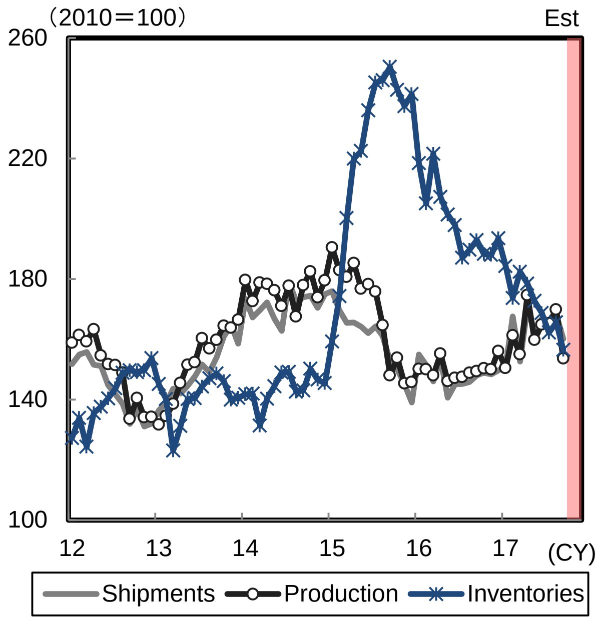
Order Amounts for Construction Industry **Chart 3**



Source: Cabinet Office (CAO); compiled by DIR.

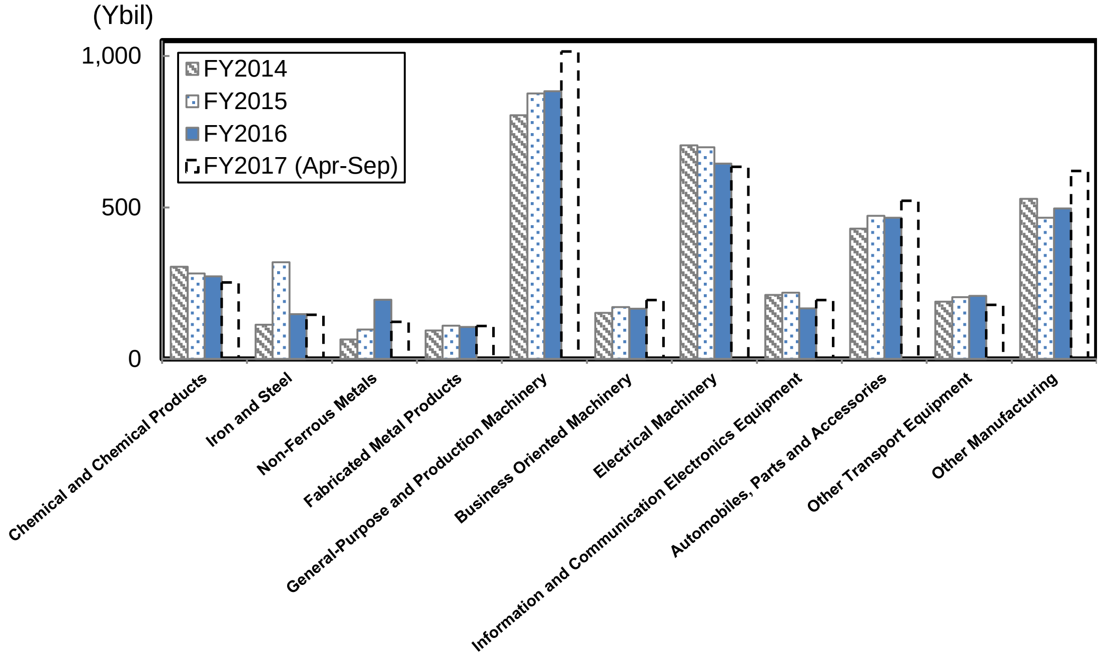
Production, Shipments, and Inventory for Construction Materials (Left), and Engineering & Construction Machinery (Right) Chart 4





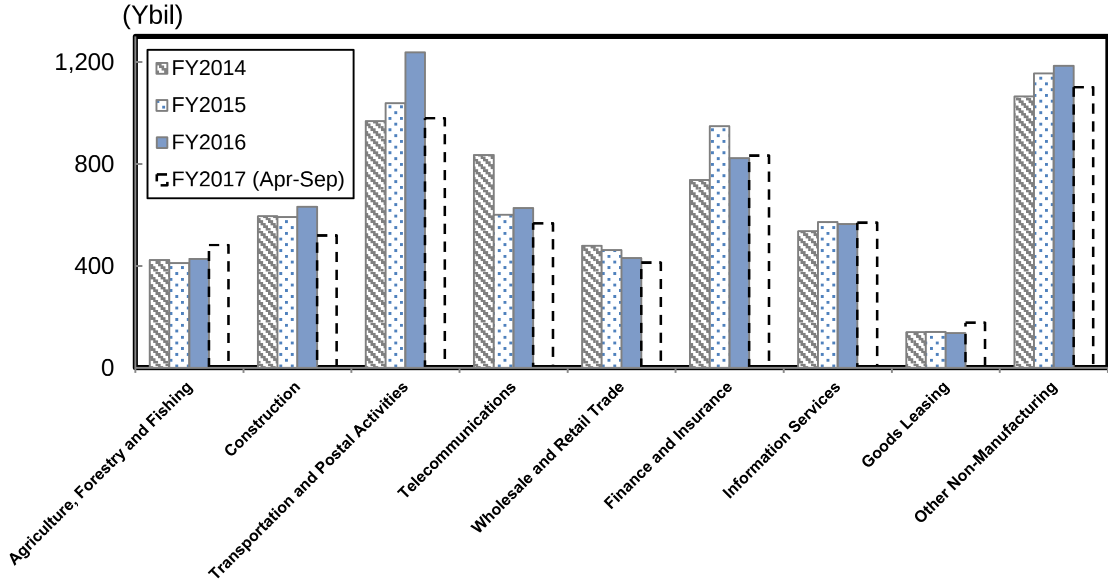
Source: Ministry of Economy, Trade and Industry; compiled by DIR.
Note: Values for most recent two months of the production index are from the METI Production Forecast Survey.

Order Amounts by Industry (Manufacturing) (FY2014 – FY2017 Apr-Sep) Chart 5



Source: Cabinet Office (CAO); compiled by DIR.
Note: Figures for FY2017 Apr-Sep are converted to fiscal year.

Order Amounts by Industry (Non-Manufacturing) (FY2014 – FY2017 Apr-Sep) Chart 6

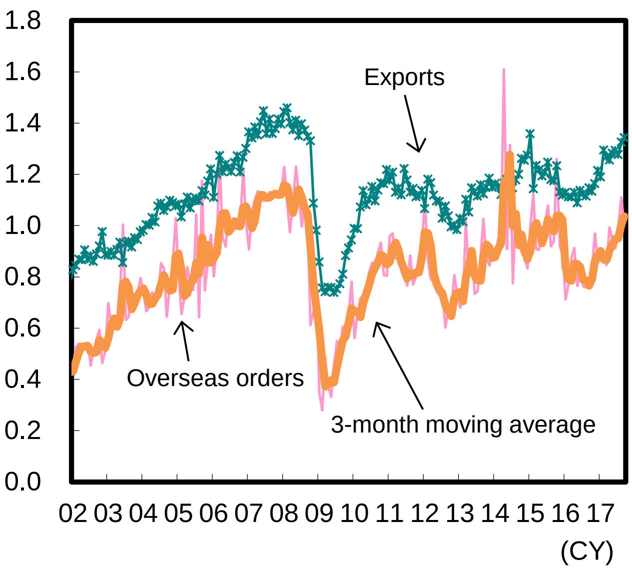


Source: Cabinet Office (CAO); compiled by DIR.
Note: Figures for FY2017 Apr-Sep are converted to fiscal year. Information Services includes newspapers and publishing.

Overseas orders suffer decline for first time in three months

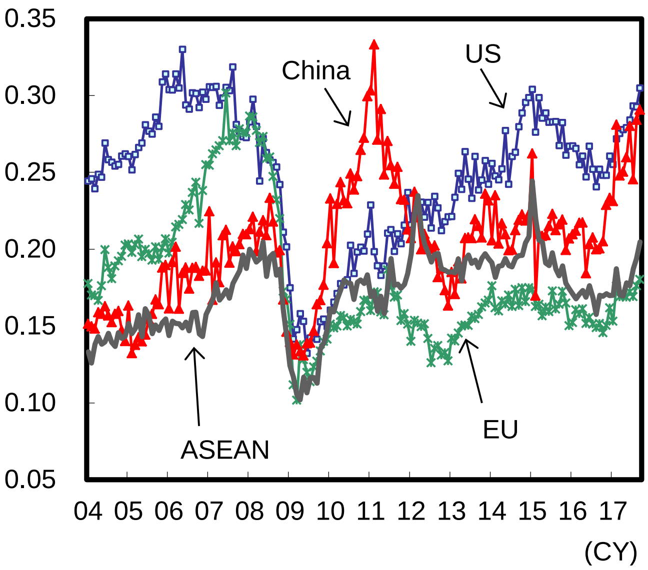
Overseas orders declined for the first time in three months by -9.8% m/m. According to the Cabinet Office, orders for aircraft and railway cars grew, while orders for heavy electric machinery and motors declined growth. Looking at export value of general machinery by region, we see that in addition to major growth in export amount to China, export amount to the US also maintained favorable performance.

General Machinery: Overseas Orders and Exports (Y tril; SA) **Chart 7**



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 8**



Source: Ministry of Finance; compiled by DIR.
Note: SA by DIR.

Forecast for Oct-Dec 2017 period: manufacturing expected to decline, while non-manufacturing seen gaining a tad

The Cabinet Office forecast for the Oct-Dec 2017 period (excluding ships and electrical power) sees a decline of -3.5% q/q. Looking at performance by industry, manufacturing is expected to suffer a decline for the first time in three quarters at -9.4%, while non-manufacturing (excluding ships and electrical power) is seen growing a tad at +0.9%.

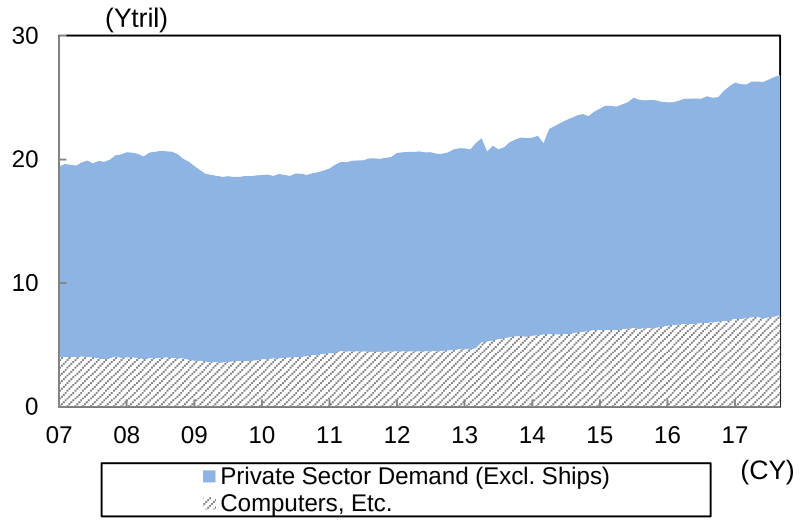
Machinery orders to experience ups and downs in future

Machinery orders, the leading indicator for capex, are expected to experience ups and downs in the future. With supply & demand for labor remaining tight, investment in rationalization and labor saving are seen, but order backlog for computers including those associated with IT investment are accumulating. There are concerns that this could lead to an increase in the cost of IT investment and postponement of orders.

Looking at performance by industry, investment in maintenance & repair looks promising in the manufacturing industry, but willingness to invest in capacity increase is not strong. In order for capex spending to become full-fledged, operating rates must grow more. On the other hand, the non-manufacturing industry is 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, and this is expected to lead capex spending overall.

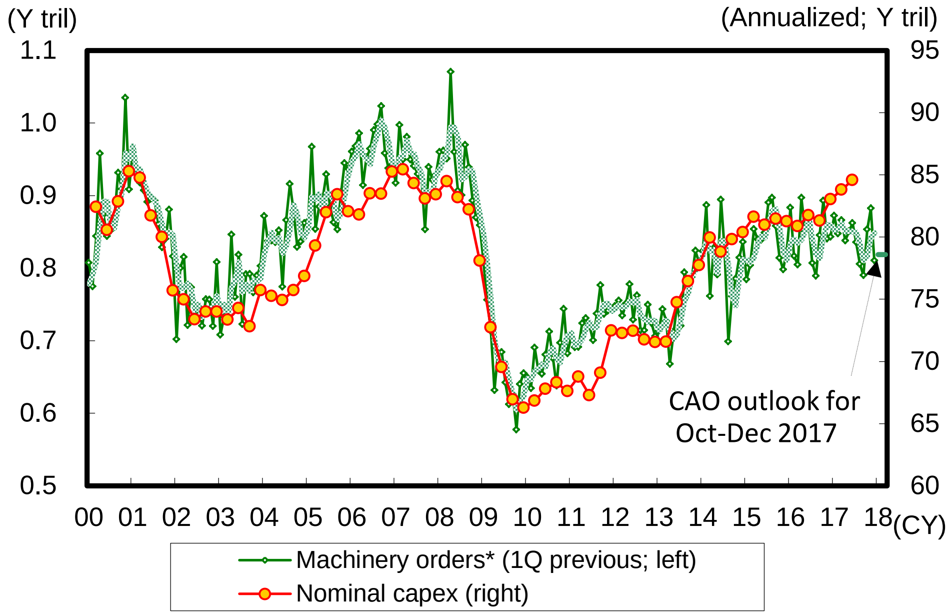
Meanwhile, the future of overseas demand according to our main economic scenario is expected to continue gradual expansion, with the overseas economy maintaining underlying strength. However, caution is required as regards downside risk in association with the Fed's exit strategy which could cause a slowdown in the US economy and turmoil in the emerging markets, as well as the risk that China's economy could slow down after the October 2017 meeting of the National Congress of the Communist Party of China.

Changes in Order Backlog (Seasonally Adjusted) **Chart 9**



Source: Cabinet Office; compiled by DIR.
Notes: 1) Seasonal adjustment of data on computers etc. by DIR.
2) The category Computers includes general use computers and programs, as well as semiconductor manufacturing equipment.

Domestic Demand and Nominal Capex (seasonally adjusted figures) Chart 10



Source: Cabinet Office (CAO); compiled by DIR.

Note: Excluding those for ships and from electric utilities; thick lines 3M/MA basis.