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October Machinery Orders

Manufacturing industry shows strong growth trend

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Summary

- According to statistics for machinery orders in October, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders grew by +5.0% m/m. Manufacturing registered growth of +7.4%, while non-manufacturing also grew by +1.1%.

- The Cabinet Office forecast for the Oct-Dec 2017 period sees manufacturing with a decline of -9.4% q/q, but October results are a plus, showing the industry with a strong growth trend. On the other hand, the non-manufacturing industry, which maintained a high level of performance during the previous fiscal year, is in a gradual declining trend when all is averaged out, despite the growth recorded in October.

- 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 with expanding exports backed by the recovery in the global economy, 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, but caution is advised regarding the weakening growth trend in housing starts and public investment.

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

	2016		2017									
	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct
Machinery orders (private sector)*	-2.8	2.1	-3.2	1.5	1.4	-3.1	-3.6	-1.9	8.0	3.4	-8.1	5.0
Market consensus (Bloomberg)												2.9
DIR estimate												1.5
Manufacturing orders	8.1	0.8	-10.8	6.0	0.6	2.5	1.0	-5.4	2.9	16.1	-5.1	7.4
Non-manufacturing orders*	-5.6	2.1	0.7	1.8	-3.9	-5.0	-5.1	0.8	4.8	3.1	-11.1	1.1
Overseas orders	16.3	-12.1	3.2	-1.1	-2.8	17.4	-5.2	-3.1	9.1	11.5	-9.8	4.9

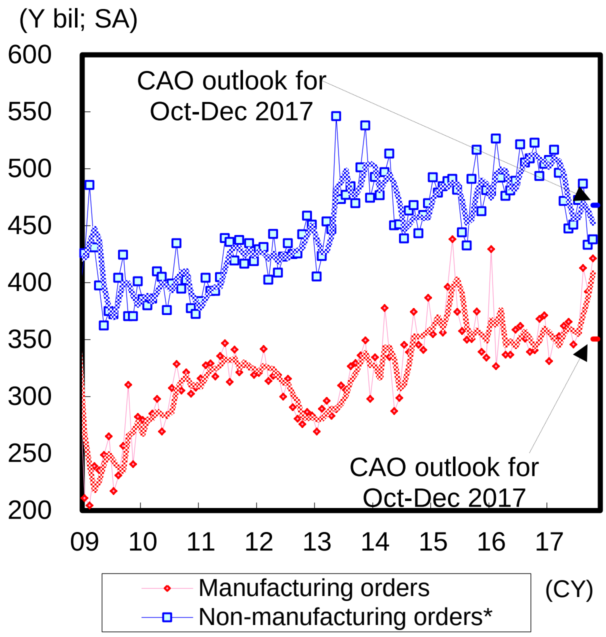
Source: Cabinet Office, Bloomberg; compiled by DIR.
*excl. those for ships and from electric utilities.
Note: Figures on market consensus from Bloomberg

October orders: Growth achieved for the first time in two months

According to statistics for machinery orders in October, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders grew by +5.0% m/m. Manufacturing registered growth of +7.4%, while non-manufacturing also grew by +1.1%.

The Cabinet Office forecast for the Oct-Dec 2017 period sees manufacturing with a decline of -9.4% q/q, but October results are a plus, showing the industry with a strong growth trend. On the other hand, the non-manufacturing industry, which maintained a high level of performance during the previous fiscal year, is in a gradual declining trend when all is averaged out, despite the growth recorded in October.

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 exhibit strong growth trend

Looking at performance by source of demand in October, we see that the manufacturing industry achieved growth for the first time in two months at +7.4% m/m. The Cabinet Office forecast for the Oct-Dec 2017 period sees manufacturing with a decline of -9.4% q/q, but October results are a plus, showing the industry with a strong growth trend.

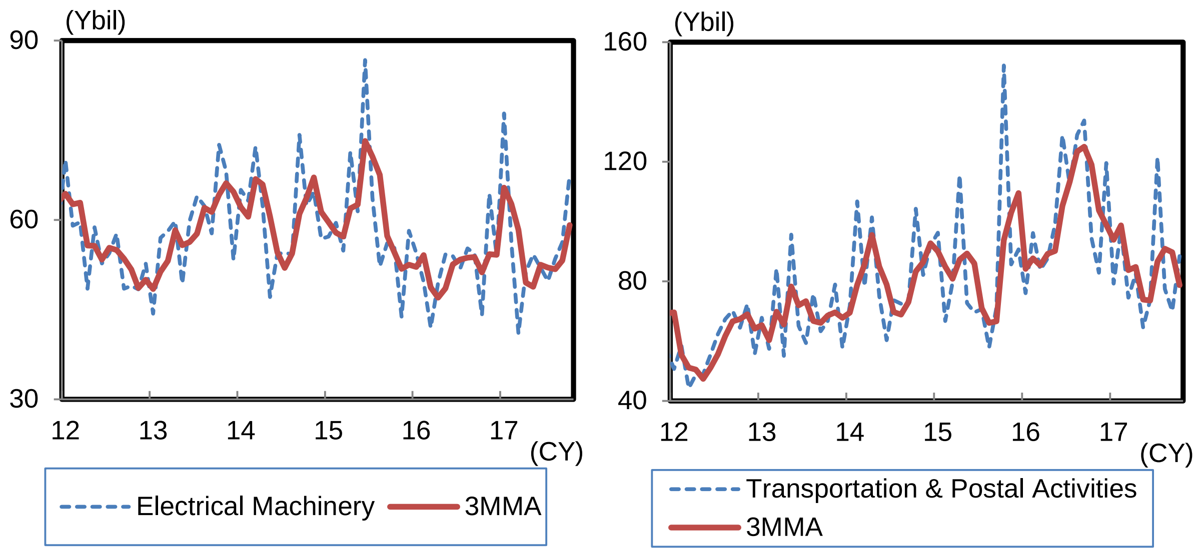
As for performance by industry, growth was registered in a broad range of fields, including the materials industries, such as chemicals (+82.1% m/m) and petroleum & coal products (+88.9%), and assembly, such as electrical machinery (+20.2%), and information & communication electronics equipment (+53.9%). Electrical machinery and information & communication electronics equipment have received the benefits of expanding exports backed by the recovery in the global economy, and the comeback in domestic demand, and have been maintaining a moderate growth trend since the beginning of FY2017.

Non-manufacturing shows a weakening tone

Non-manufacturing (excluding ships and electrical power) recorded growth for the first time in two months at +1.1% m/m. The non-manufacturing industry maintained a high level of performance during the previous fiscal year, but is now in a gradual declining trend on average, despite growth in October.

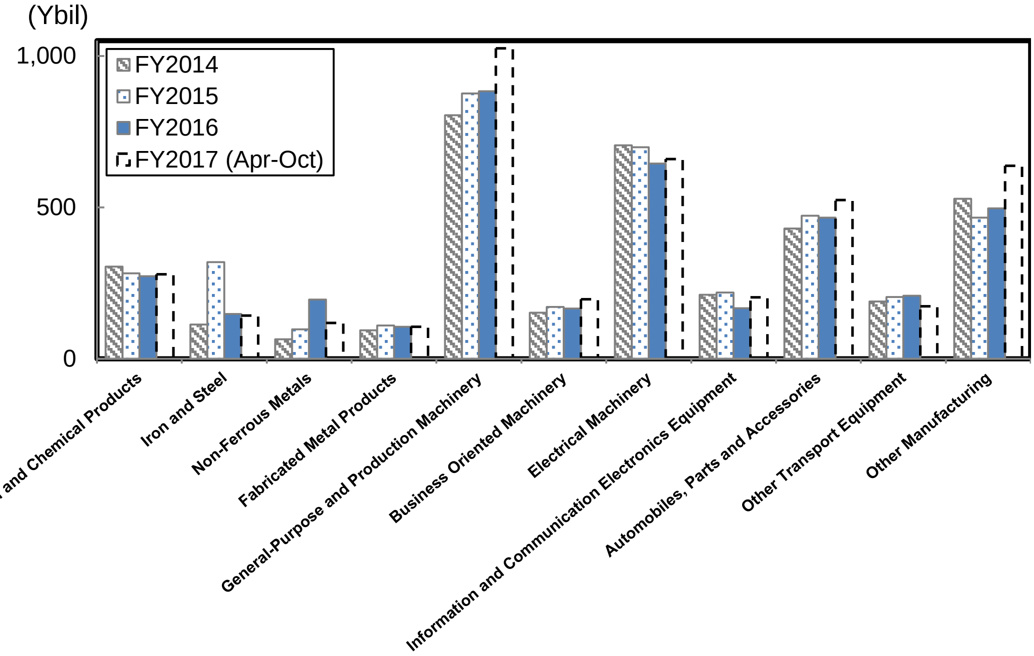
Looking at performance by industry, overall performance received a boost from transportation and postal activities (+26.2% m/m), and wholesale & retail trade (+10.0%). As for transportation and postal activities, large size orders for railway cars were coming in continually during the previous fiscal year, but at this point, the industry is marking time.

Order Amounts for Electrical Machinery (Left) and Transportation & Postal Activities (Right) Chart 3



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

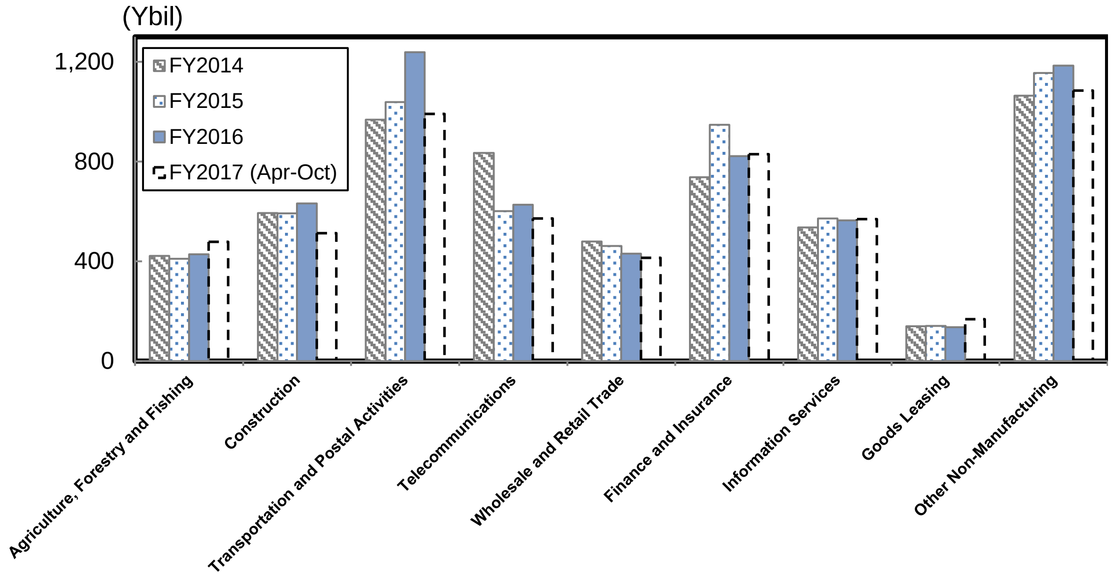
Order Amounts by Industry (Manufacturing) (FY2014 – FY2017 Apr-Oct) Chart 4



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

Note: Figures for FY2017 Apr-Oct are converted to fiscal year.

Order Amounts by Industry (Non-Manufacturing) (FY2014 – FY2017 Apr-Oct) **Chart 5**

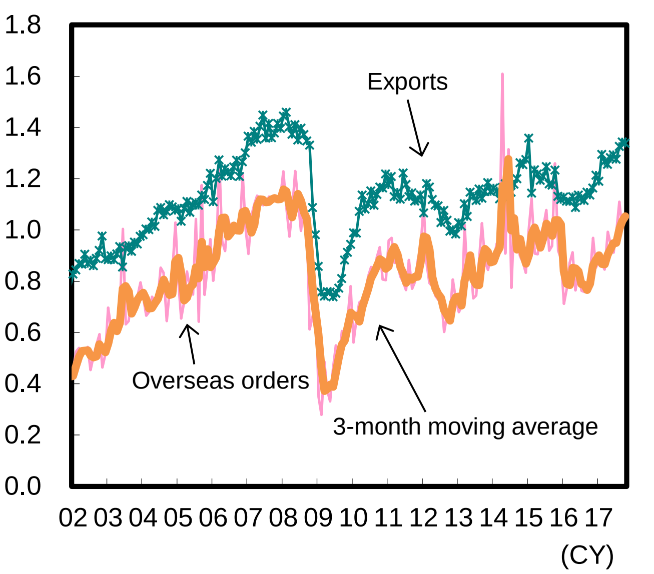


Source: Cabinet Office (CAO); compiled by DIR.
Note: Figures for FY2017 Apr-Oct are converted to fiscal year.

Overseas orders grow for first time in two months

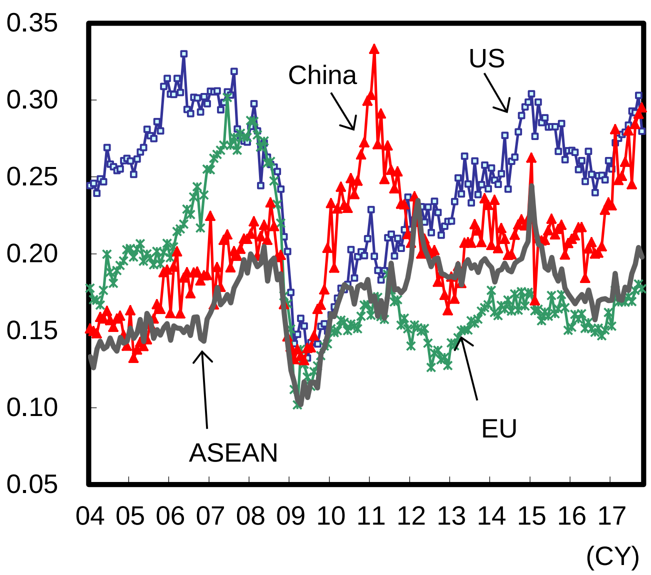
Overseas orders grew for the first time in two months by +4.9% m/m. According to the Cabinet Office, orders for aircraft and motors declined, while orders for electronic & communication equipment, and industrial machinery grew. Looking at export value of general machinery by region, we see that in addition to major growth in export value to China, export value to the US also maintained favorable performance.

General Machinery: Overseas Orders and Exports (Y tril; SA) **Chart 6**



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 7**



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

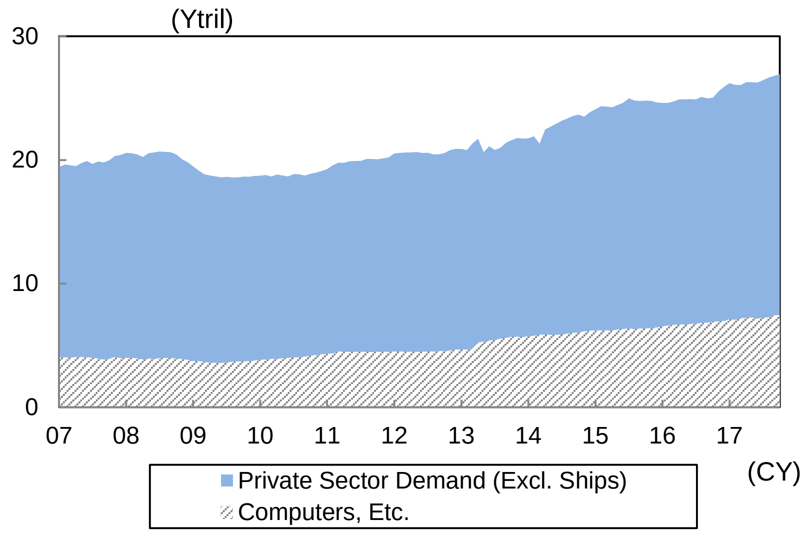
Machinery orders to experience ups and downs in future

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 with expanding exports backed by the recovery in the global economy, 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, but caution is advised regarding the weakening growth trend in housing starts and public investment.

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.

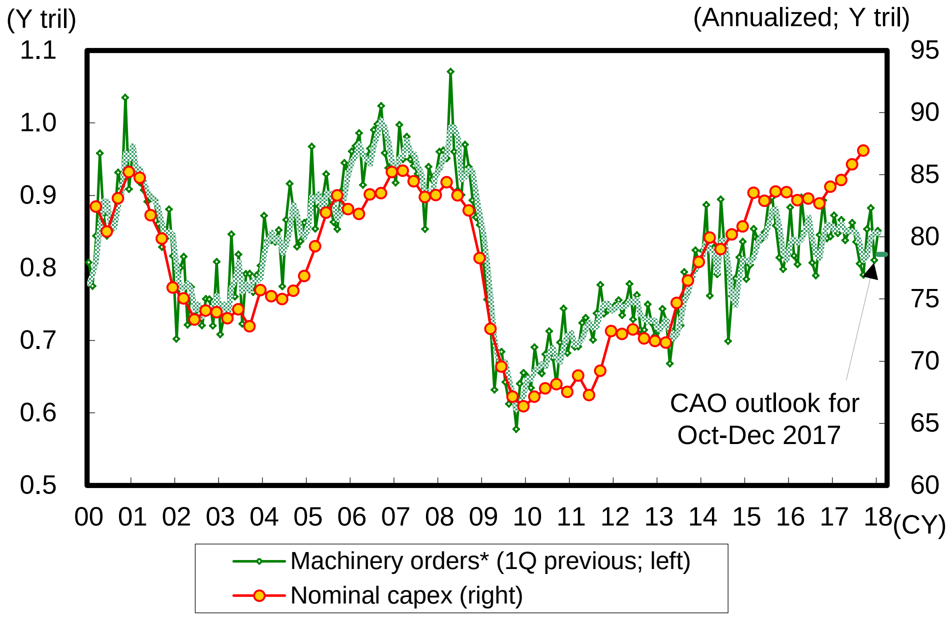
Changes in Order Backlog (Seasonally Adjusted) **Chart 8**



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 9



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

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