17 January 2018 (No. of pages: 6)

Japanese report: 17 Jan 2018

November Machinery Orders

Non-manufacturing leads overall performance, manufacturing also maintains high level

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Summary

- According to statistics for machinery orders in November, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders grew by +5.7% m/m, registering growth for the second consecutive month contrary to market consensus (-1.4%). Manufacturing suffered a minor decline of -0.2%, while non-manufacturing grew by +9.8%, leading overall performance.

- Although manufacturing orders fell in November, a high level was still maintained due to expanding exports associated with recovery in the global economy. Non-manufacturing grew in November, but on average is actually in a declining trend.

- 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, but caution is advised regarding the weakening growth trend in housing starts and public investment.

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

	2016	2017										
	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Machinery orders (private sector)*	2.1	-3.2	1.5	1.4	-3.1	-3.6	-1.9	8.0	3.4	-8.1	5.0	5.7
Market consensus (Bloomberg)												-1.4
DIR estimate												-1.0
Manufacturing orders	0.8	-10.8	6.0	0.6	2.5	1.0	-5.4	2.9	16.1	-5.1	7.4	-0.2
Non-manufacturing orders*	2.1	0.7	1.8	-3.9	-5.0	-5.1	0.8	4.8	3.1	-11.1	1.1	9.8
Overseas orders	-12.1	3.2	-1.1	-2.8	17.4	-5.2	-3.1	9.1	11.5	-9.8	4.9	4.9

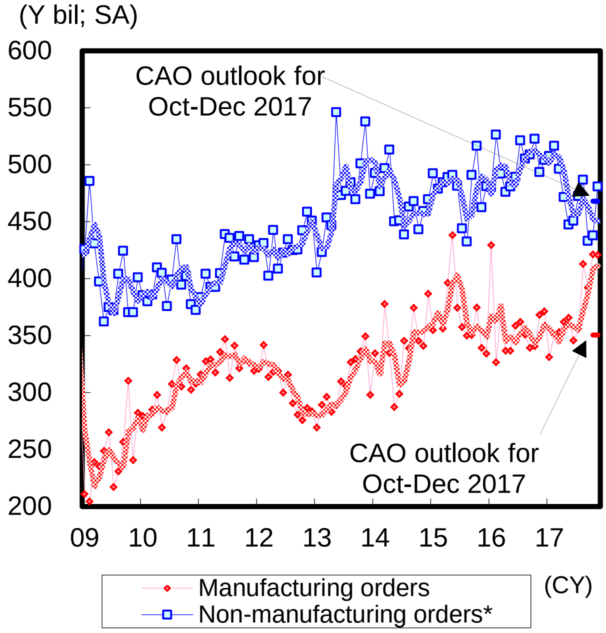
Source: Cabinet Office, Bloomberg; compiled by DIR.
*excl. those for ships and from electric utilities.
Note: Figures on market consensus from Bloomberg

November orders: Second consecutive month of growth

According to statistics for machinery orders in November, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders grew by +5.7% m/m, registering growth for the second consecutive month contrary to market consensus (-1.4%). Manufacturing suffered a minor decline of -0.2%, while non-manufacturing grew by +9.8%, leading overall performance.

Although manufacturing orders fell in November, a high level was still maintained due to expanding exports associated with recovery in the global economy. Non-manufacturing grew in November, but on average is actually in a declining trend.

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: High level maintained despite decline

Looking at performance by source of demand in November, we see that the manufacturing industry declined for the first time in two months by -0.2% m/m. Although manufacturing orders fell in November, a high level was still maintained due to expanding exports associated with recovery in the global economy.

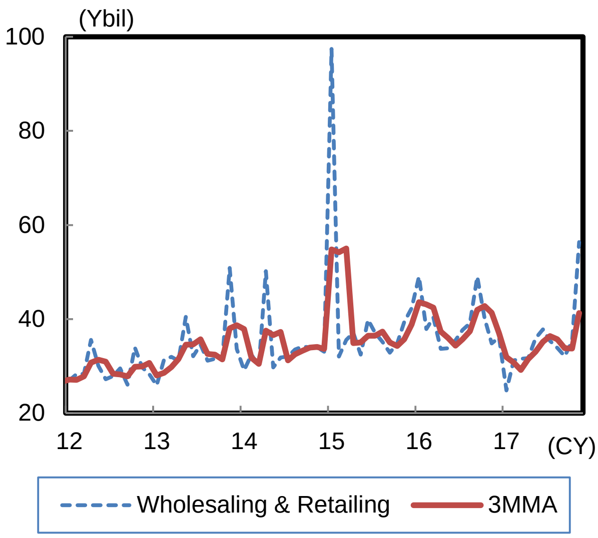
Non-ferrous metals grew by +309.3% m/m due to large scale orders, as well as other transport equipment at +45.2%, while chemicals experienced a reactionary decline in response to last month’s results, falling by -43.3%. On the other hand, general-purpose & production machinery, which has been in a growth trend recently, registered its second consecutive month of growth.

Non-manufacturing leads overall performance

Non-manufacturing (excluding ships and electrical power) grew for the second consecutive month at +9.8% m/m. while non-manufacturing grew in November, it is actually in a declining trend when all is averaged out.

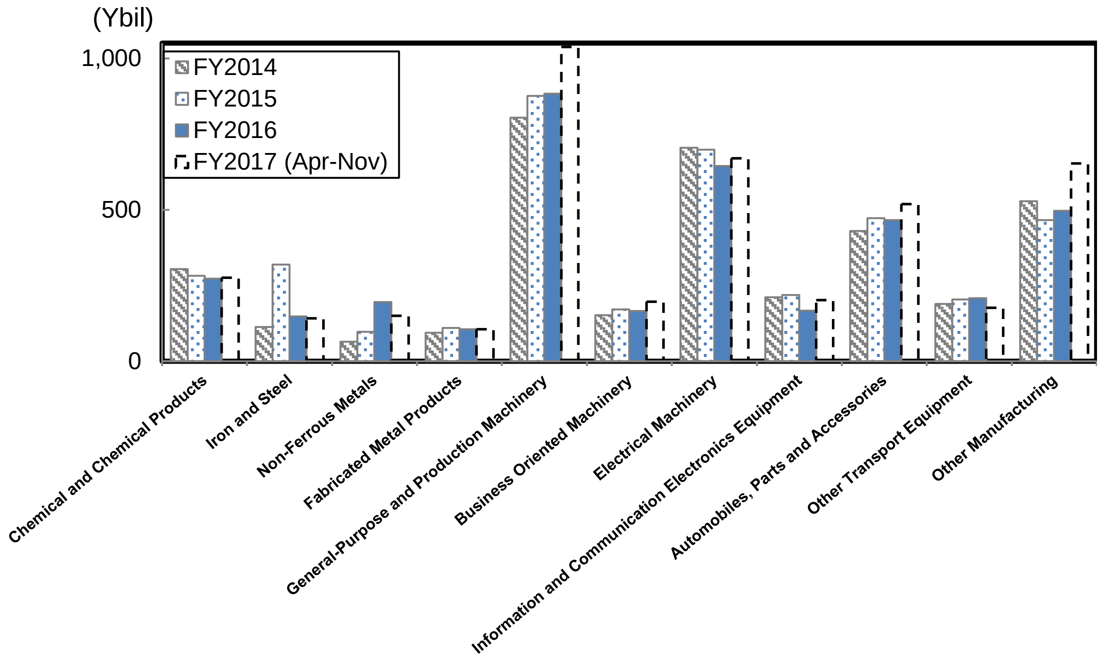
Wholesale & retail trade registered growth (+59.6% m/m), as well as construction (+24.9%). The majority of wholesale & retail trade orders were for computers reflecting active IT investment. The recovery for orders in FY2017 is thought to be supported especially by investment in labor saving devices associated with the shortage of manpower. Meanwhile, construction, which won growth in November, has seen orders maintaining a low level since last summer with construction demand related to the 2020 Tokyo Olympics and Paralympics expected to approach its peak in 2018.

Order Amounts for Wholesaling & Retailing (Left) and Construction (Right) **Chart 3**



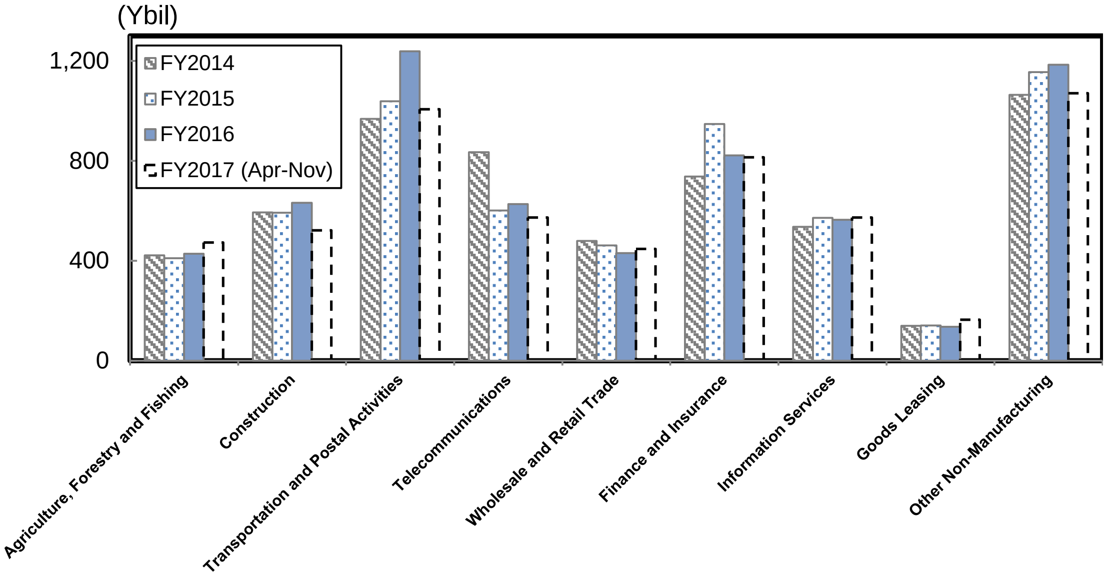
Source: Cabinet Office (CAO); compiled by DIR.
Note: Seasonally adjusted figures.

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



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

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



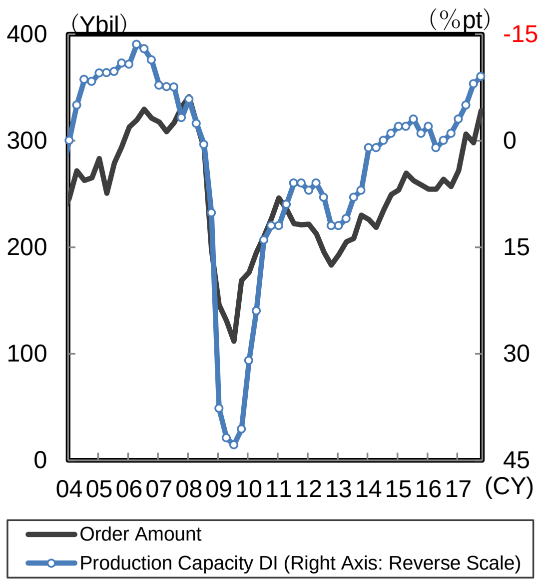
Source: Cabinet Office (CAO); compiled by DIR.
Note: Figures for FY2017 Apr-Nov are converted to fiscal year.

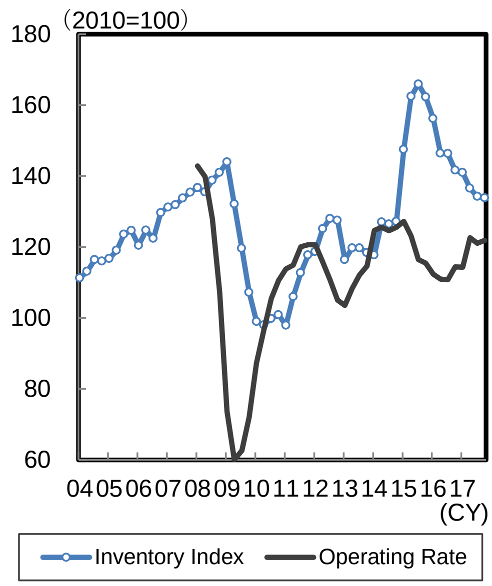
No sign of slowdown seen in general-purpose & production, and business oriented machinery

General-purpose & production, and business oriented machinery have been reporting favorable orders recently due to brisk demand for semiconductor manufacturing machinery and industrial robots. This industry's contribution rate to industrial production is also high, hence it is important to look at the trend in orders for this industry in forecasting future trends.

Production capacity DI according to the BOJ Tankan (excess-shortage) is on the decline, and corporations in this industry are experiencing a sense of shortage regarding capex. Considering the fact that operating rates are marking time though high levels of production are being maintained, the possibility that orders might experience a slowdown in the short-term is unlikely.

General-Purpose, Production & Business Oriented Machinery Trends Chart 6



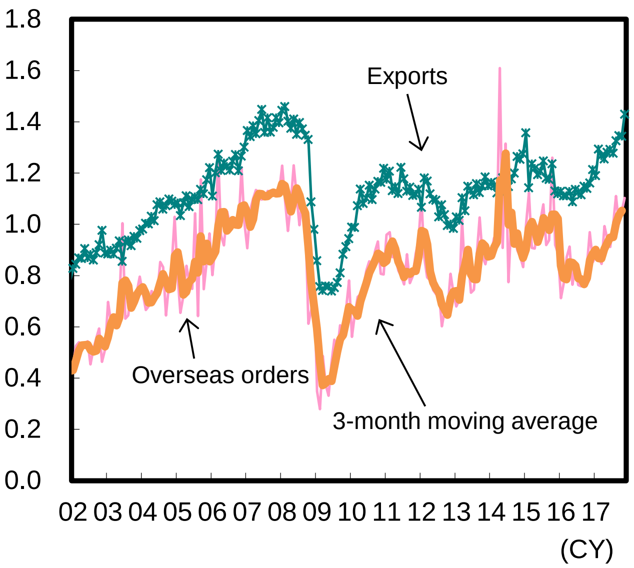


Source: Cabinet Office, BOJ, METI; compiled by DIR.
Note: Order amounts before March 2011 are a total of general machinery and precision machinery. Production capacity DI before December 2009 and inventory before December 2007 are calculated using general machinery and precision machinery.

Overseas orders win second consecutive month of growth

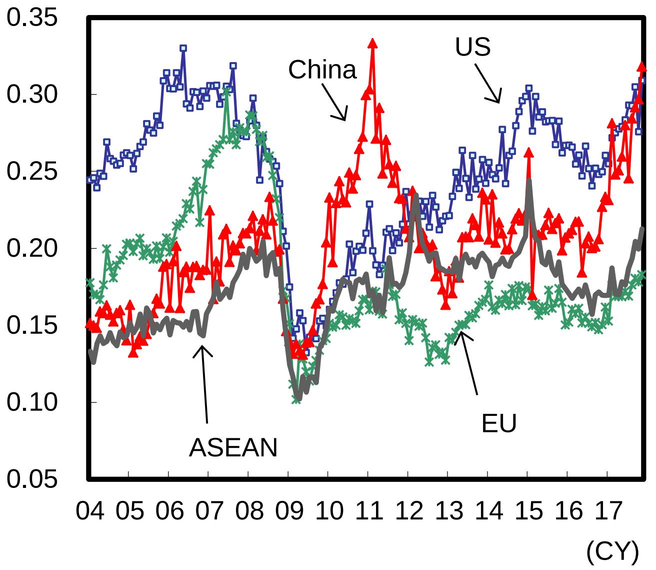
Overseas orders grew for the second consecutive month at +4.9% m/m. According to the Cabinet Office, orders for aircraft and industrial machinery declined, while orders for motors and electronic & communication equipment grew. Looking at export value of general machinery by region, we see that in addition 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 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.

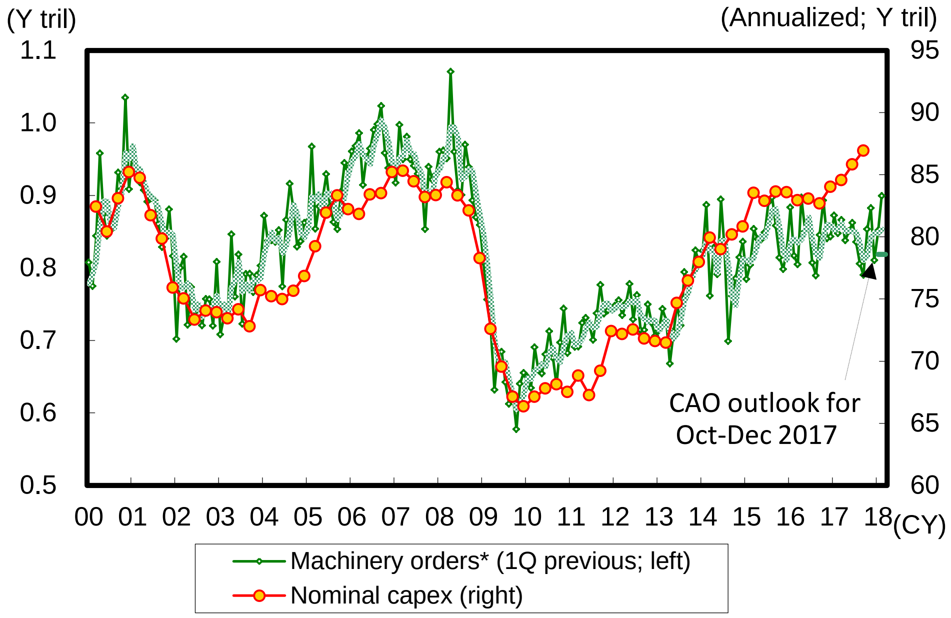
Machinery orders to experience ups and downs in future

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, 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.

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.