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December 2017 Industrial Production

Production maintains favorability, but iPhone production cut may bring -1.9% decline in production for electronic parts and devices

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Summary

- The December 2017 indices of industrial production recorded growth for the third consecutive month at +2.7% m/m, while shipments grew for the second consecutive month at +2.7% and inventory declined by -0.4%. The METI production forecast survey sees January 2018 performance down by -4.3% m/m, and February up by +5.7%.
- Industrial production is maintaining favorable performance due to expanding exports accompanying recovery of the global economy. However, it is important to note that the reason December production exceeded market consensus (+1.5%) by such a large percentage was because of a temporary production increase for transport equipment.
- The electronic parts and devices industry announced ambitious plans for the future with January 2018 production seen up by +4.8% m/m, and February also up by +13.5%. However, this forecast most likely has not taken into consideration the planned iPhone production cut. Considering global production volume of smart phones and the share of that market held by Japanese electronic parts and devices for the Jan-Mar period of 2017, the electronic parts and devices industry could experience a production decline of around -1.9%.
- Production is expected to experience moderate growth in March 2018 and beyond. As for capital goods, exports are expected to expand centering on industrial robots due to the recovery in the global economy. However, caution is required regarding overseas demand due to possible downside risk. If US interest rates undergo a rapid rise in association with the Fed's exit strategy, this could bring downward pressure on the US economy, while at the same time encouraging capital outflows from the emerging nations.

Industrial Production (m/m %; SA basis)

Chart 1

	2017									
	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Industrial Production	-1.9	4.0	-3.6	2.2	-0.8	2.0	-1.0	0.5	0.5	2.7
Market consensus (Bloomberg)										1.5
DIR estimate										2.0
Shipments	-0.8	2.7	-2.9	2.5	-0.7	1.8	-2.5	-0.4	2.3	2.7
Inventories	1.5	1.5	0.0	-2.0	-1.1	-0.6	0.0	3.2	-0.8	-0.4
Inventory ratio	0.2	2.9	-1.9	-1.9	2.6	-4.1	1.6	3.5	-2.7	-0.5

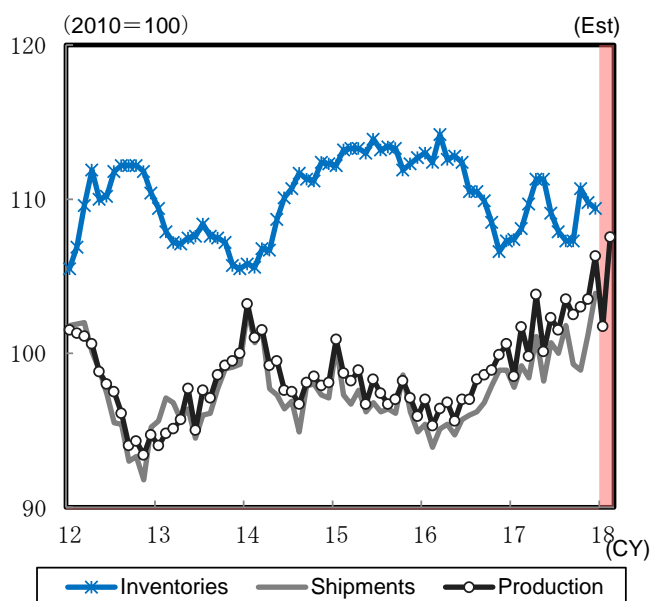
Source: Ministry of Economy, Trade, and Industry; Bloomberg; compiled by DIR.

Production maintains favorability

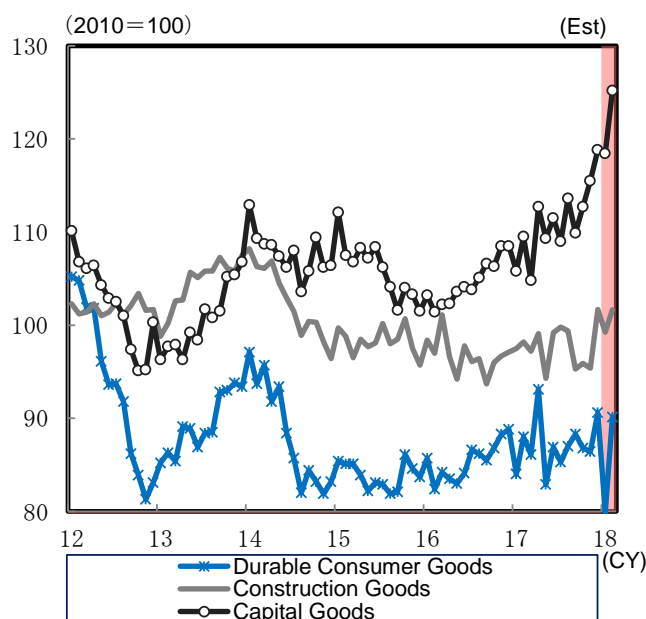
The December 2017 indices of industrial production recorded growth for the third consecutive month at +2.7% m/m, while shipments grew for the second consecutive month at +2.7% and inventory declined by -0.4%. The METI production forecast survey sees January 2018 performance down by -4.3% m/m, and February up by +5.7%.

Industrial production is maintaining favorable performance due to expanding exports accompanying recovery of the global economy. However, it is important to note that the reason December production exceeded market consensus (+1.5%) by such a large percentage was because of a temporary production increase for transport equipment.

Production, Shipment, and Inventories Chart 2 **Production Index and Breakdown by Types of Goods** Chart 3



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.



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Twelve out of fifteen industries register growth

As for production index performance by industry in December, contribution to growth was especially notable for transport equipment and general-purpose, production and business oriented machinery. Passenger vehicles and shovel type excavators especially contributed to growth.

As for transport equipment, a major positive contribution was made to overall December production. However, it is important to note that both domestic and overseas new car sales are expected to slow down in the future, hence a major decline in production is seen in January 2018. The METI forecast survey sees January 2018 production for this industry down by -17.7% m/m, and February up by +9.8%.

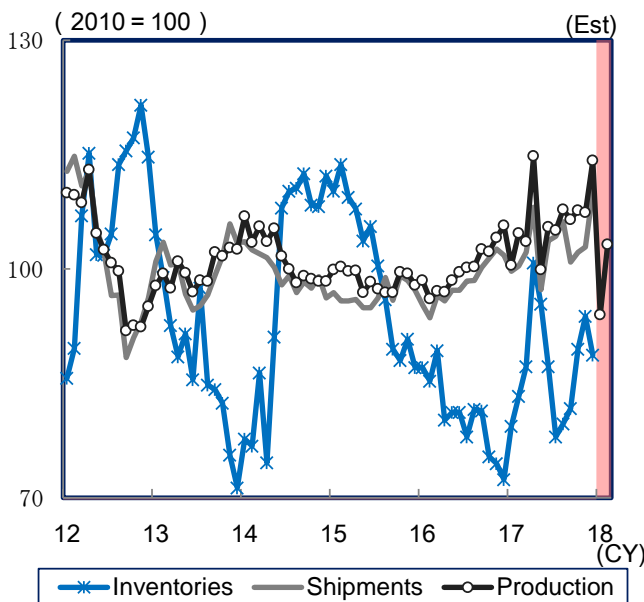
On the other hand, three industries reported declines in production, including information and communication electronics equipment, and petroleum and coal products.

General-purpose, production and business oriented machinery expected to maintain favorable performance

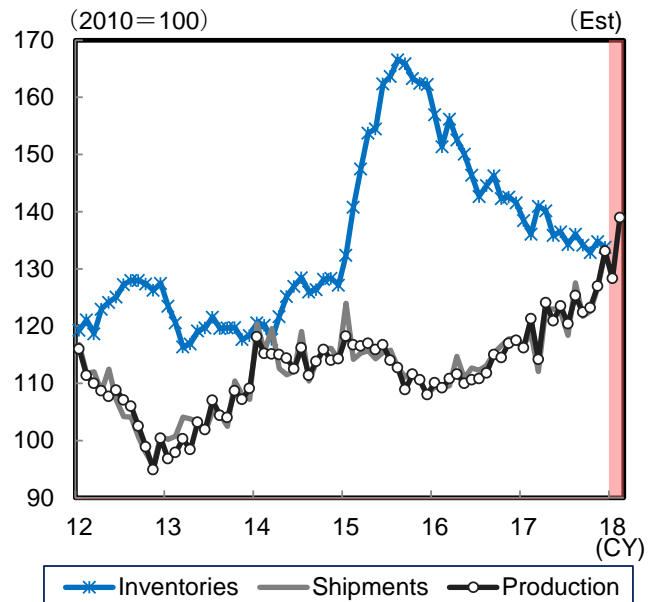
The METI production forecast survey sees January 2018 performance down by -4.3% m/m, and February up by +5.7%. Meanwhile, METI’s estimated forecast value for the January Indices of Industrial Production indicates a decline of -4.3% (mode value).

Looking at the production forecast survey by industry, we see that production plans for general-purpose, production and business oriented machinery show January 2018 performance down by -3.6% and February up by +8.3%. Though January 2018 is expected to see a decline in production, favorable performance is expected to be maintained. 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.

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



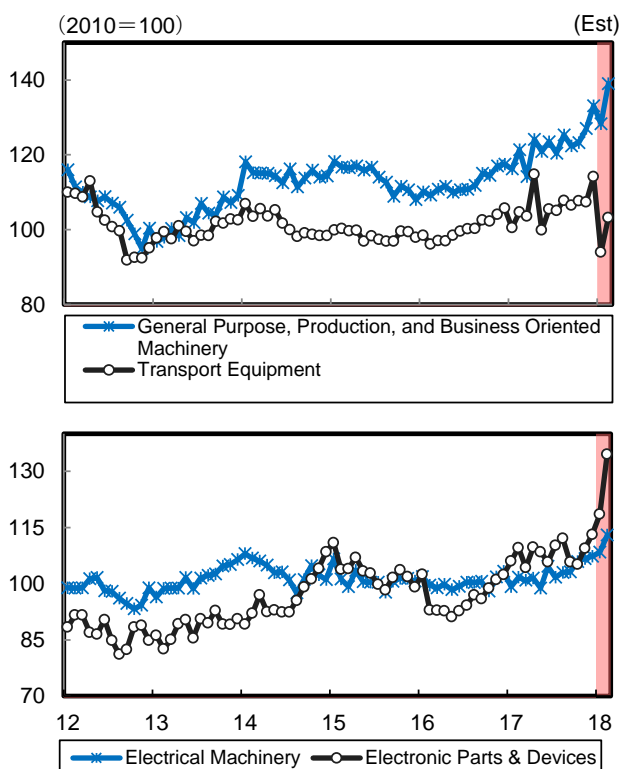
Source: Ministry of Economy, Trade, and Industry, compiled by DIR.
 Note: Values for most recent 2-months of production index from METI production forecast survey.



Source: Ministry of Economy, Trade, and Industry, compiled by DIR.
 Note: Values for most recent 2-months of production index from METI production forecast survey.

Production Indices (Assembly)

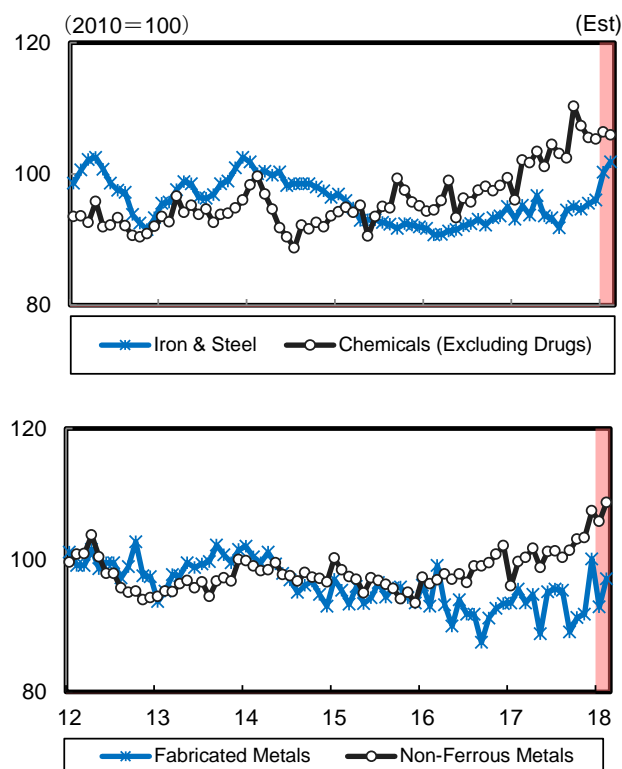
Chart 5



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.

Production Indices (Materials)

Chart 6



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.

New model iPhone production cut may bring -1.9% decline in production for electronic parts and devices

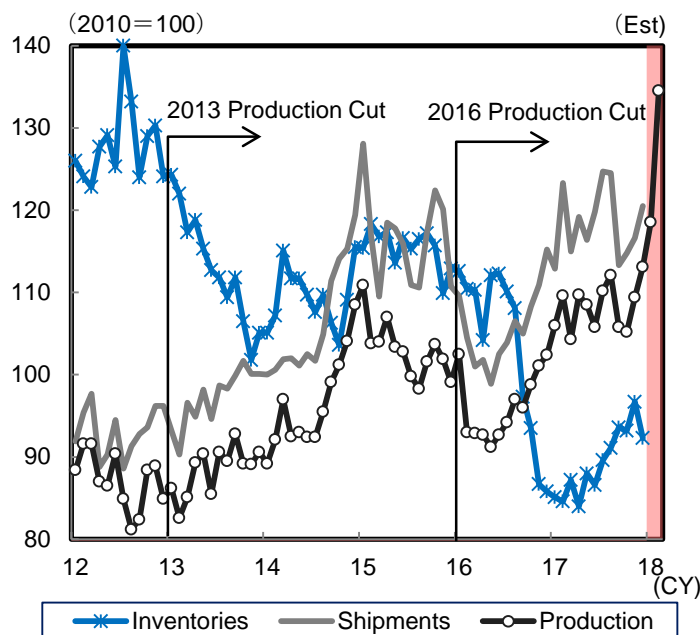
Meanwhile, the METI forecast survey for electronic parts and devices records ambitious plans with January 2018 production seen up by +4.8% m/m, and February also up by +13.5%. However, this forecast most likely has not taken into consideration the January 29 news that new model iPhone production plans for the Jan-Mar period of 2018 are to be changed from the original 40 million units to about half that at 20 million units. (Note that the deadline for submitting data for the January survey was January 10.) Considering global production volume of smart phones for the Jan-Mar period of 2017 (estimated by TrendForce research to have been 320 million units), a production decline of around 20 million units comes to about 6.2% of overall production. Meanwhile, a 30.5% share of Japanese electronic parts and devices were devoted to use in communication devices including smartphones during the Jan-Mar period of 2017 (according to the JEITA). This means that there is a good possibility that the electronic parts and devices industry could experience downward pressure on its production of an estimated -1.9%.

There have been past instances of new model iPhone production plans being revised downwards as well. In 2013 there was a public announcement that orders for LCD panels for the iPhone would be cut back by half (about 32.5 million units) in the Jan-Mar period of 2013. The production index for electronic parts and devices declined by -3.2% between the Oct-Dec period of 2012 when it was at around 87.4 and the Jan-Mar period of 2013 when it reached 84.6. Meanwhile, in 2016 a production cut of 30% was announced in the financial papers, leading to a -5.3% decline in the production index for electronic parts and devices between the Oct-Dec period of 2015 when it was at around 101.6 and the Jan-Mar period of 2016 when it reached 96.1.

The above estimate must of course be taken with a certain grain of salt, since the situation would also have been influenced by questions, such as to what extent did other manufacturers increase their share of the market, and were Japanese parts installed in smartphones made by other manufacturers. However, if there is a connection between this development and the global decline in smartphone sales, then there should also be some risk of downward pressure on the currently favorable production performance of electronic parts and devices, and general-purpose, production and business oriented machinery.

Electronic Parts and Devices Production, Shipments, and Inventory

Chart 7



Source: METI; compiled by DIR.

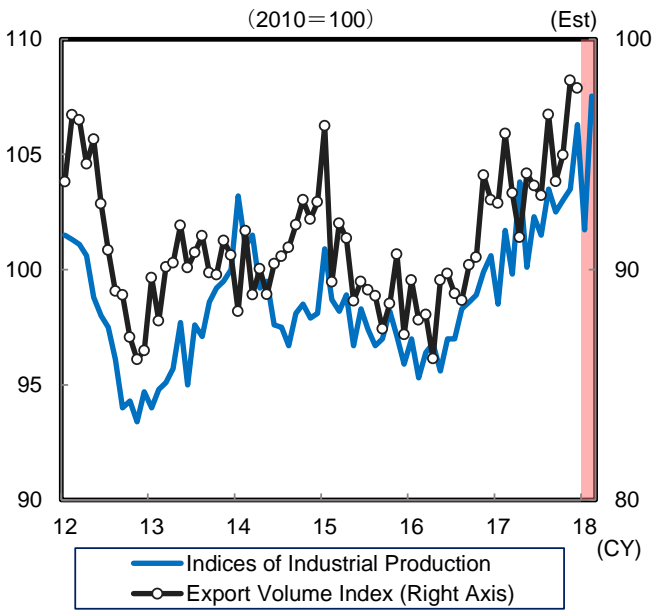
Note: Values from most recent two months taken from METI production forecast survey.

Moderate growth seen in future

Production is expected to experience moderate growth in March 2018 and beyond. As for capital goods, exports are expected to expand centering on industrial robots due to the recovery in the global economy. As for the domestic situation, capex is promising in the current fiscal year focusing on maintenance and repair related investment, but caution is urged regarding the fact that operating rates continue to mark time.

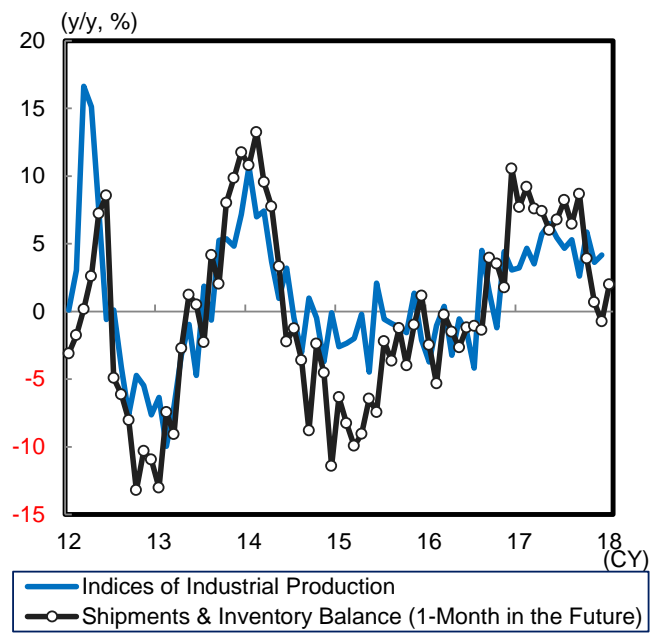
However, caution is required regarding overseas demand due to possible downside risk. If US interest rates undergo a rapid rise in association with the Fed's exit strategy, this could bring downward pressure on the US economy, while at the same time encouraging capital outflows from the emerging nations. Meanwhile, the ECB has begun further reducing its asset purchases in January 2018, hence we advise caution regarding the possibility that this could bring downward pressure on the EU economy. While our main scenario sees a continuation of moderate growth for the global economy, if uncertainty regarding the future grows, it could lead to a slowdown in exports and risks bringing downward pressure on the Japanese economy.

Industrial Production & Export Volume
Chart 8



Source: Ministry of Economy, Trade, and Industry, compiled by DIR.
Note: Values for most recent 2-months of production index from METI production forecast survey.

Shipments, Inventory Balance & Production
Chart 9



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