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October Machinery Orders

Orders suffer first decline in five months, but on average, upward movement continues

Economic Intelligence Team
Shotaro Kugo

Summary

- According to statistics for machinery orders in October 2014, the leading indicator for domestic capex, private sector demand (excluding shipbuilding and electrical power), were down by -6.4% m/m, as well as falling below market consensus (-1.7%). This was the first decline orders have suffered in five months, but in terms of direction, our conclusion is that orders are headed toward a comeback and that these numbers are not so weak as to suggest an adjustment.

- Looking at results by source of demand, the manufacturing industries suffered a decline for the first time in two months at -5.5% m/m. However, averaged out, results show that manufacturing is moving toward a comeback. Non-manufacturing orders (excluding shipbuilding and electric power) declined for the first time in three months at -7.5% m/m. On the other hand, many industries achieved growth in m/m terms, giving one the sense that despite the headlines, performance was not nearly as weak as one might think.

- Overseas demand suffered a decline of -4.6% m/m. This appears to be in reaction to the major growth experienced during the Apr-Jun quarter, revealing a sharp downtrend.

- According to the CAO outlook for the Oct-Dec 2014 period, private sector demand (excluding shipbuilding and electrical power) is expected to suffer a decline of -0.3% q/q, its first decline in two quarters. In order to achieve these results, average growth of +3.0% m/m must be recorded in November and December. In order for the Oct-Dec 2014 period to report overall growth, the months of November and December will have to record growth of +3.3% m/m. With orders already in a growth trend up to now, these numbers should not be difficult to achieve.

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

	2013		2014									
	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct
Machinery orders (private sector)*	6.5	-12.1	8.1	-4.6	19.1	-9.1	-19.5	8.8	3.5	4.7	2.9	-6.4
Market consensus (Bloomberg)												-1.7
DIR estimate												-3.4
Manufacturing orders	0.5	-7.8	4.9	-4.6	23.7	-9.4	-18.6	6.7	20.3	-10.8	12.0	-5.5
Non-manufacturing orders*	6.4	-11.5	6.1	-5.1	8.5	0.9	-17.8	4.0	-4.3	10.7	1.7	-7.5
Overseas orders	-5.6	3.2	3.7	2.3	3.2	71.3	-45.9	62.8	-42.6	29.1	-9.4	-4.6

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

October Machinery Orders Decline for First Time in Five Months, But on Average, Upward Movement Continues

According to statistics for machinery orders in October 2014, the leading indicator for domestic capex, private sector demand (excluding shipbuilding and electric power), were down by -6.4% m/m, as well as falling below market consensus (-1.7%). This was the first decline orders have suffered in five months, but in terms of direction, our conclusion is that orders are headed toward a comeback and that these numbers are not so weak as to suggest an adjustment.

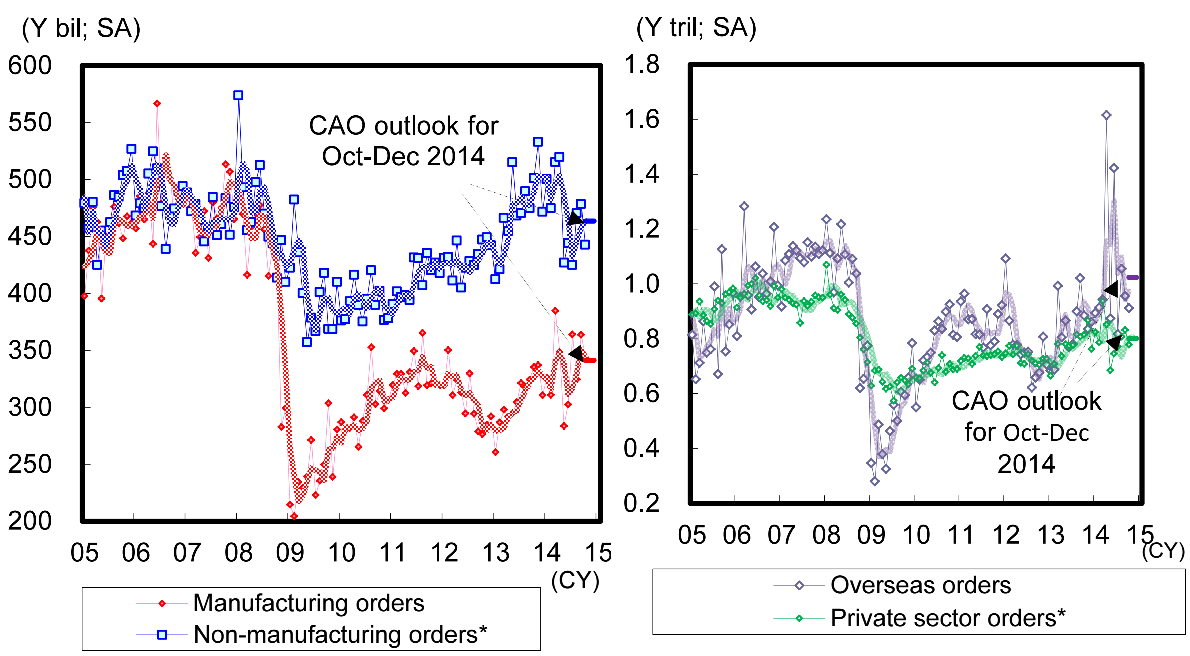
Manufacturing Industry Results Were a Mixed Bag

Looking at results by source of demand, the manufacturing industries suffered a decline for the first time in two months at -5.5% m/m. However, averaged out, results show that manufacturing is moving toward a comeback. Results by industry were as follows: electrical machinery (-21.2% m/m) and petroleum and coal products (-74.7%) experienced reactionary declines due to especially high growth during the previous month and this contributed to bringing down overall results. However, the decline in petroleum and coal products was only enough to say the industry is marking time, while electrical machinery can still be seen as being in a moderate growth trend and hence this result need not be taken too seriously. Meanwhile, many other of the manufacturing industries boasted growth in comparison to the previous month, so it was a mixed bag. Pulp, paper, and paper products was down by -68.8% m/m, while automobiles, parts and accessories fell by -8.3%. On the other hand, chemicals were up by +17.3% m/m, while information and communication electronics equipment jumped by +28.5%, with iron and steel up +39.4% and general machinery up by +4.5%.

Non-manufacturing Industry Performance Not Bad Despite Headlines

Non-manufacturing orders (excluding shipbuilding and electric power) declined for the first time in three months at -7.5% m/m. Results by industry showed especially large negative contributions from telecommunications (-35.9% m/m), real estate (-44.8%), and goods leasing (-16.0%). On the other hand, many industries achieved growth in m/m terms, giving one the sense that despite the headlines, performance was not nearly as weak as one might think. Industries boasting growth included the following: transportation and postal activities (+46.7%), finance and insurance (+21.1%), and agriculture, forestry and fishing (+24.8%).

Orders by Demand Source (seasonally adjusted figures) **Chart 2**

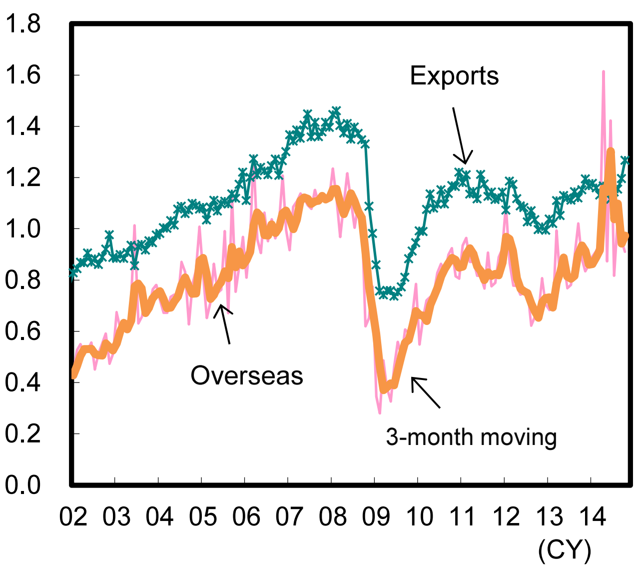


Source: Cabinet Office (CAO); compiled by DIR.
*excl. those for shipbuilding and from electric utilities.
Note: Thick lines 3M/MA basis.

Overseas Orders Show Sharp Downtrend, but Should Soon Hit Bottom

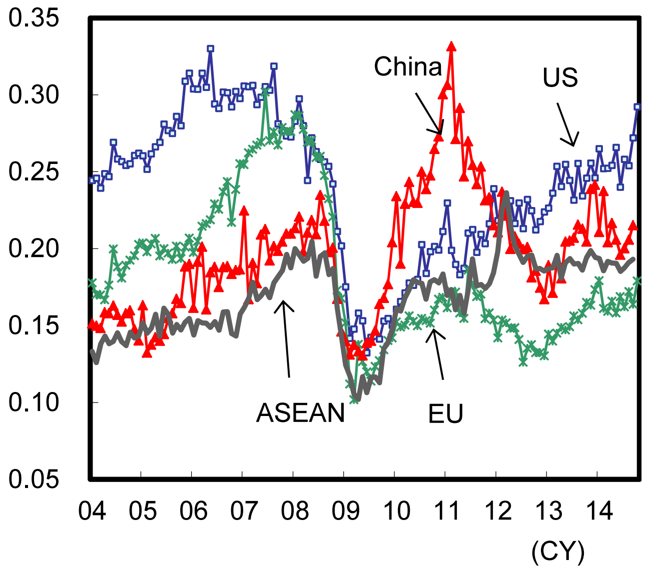
Overseas demand suffered a decline of -4.6% m/m. This appears to be in reaction to the major growth experienced during the Apr-Jun quarter, revealing a sharp downtrend. Care should be taken regarding an increasingly unclear future, due mostly to the slowdown in the EU and Chinese economies. However, orders are expected to hit bottom soon according to the CAO outlook for the Oct-Dec 2014 period

General Machinery: Overseas Orders and Exports Chart 3
(Y tril; SA)



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 Chart 4
(Y tril; SA)



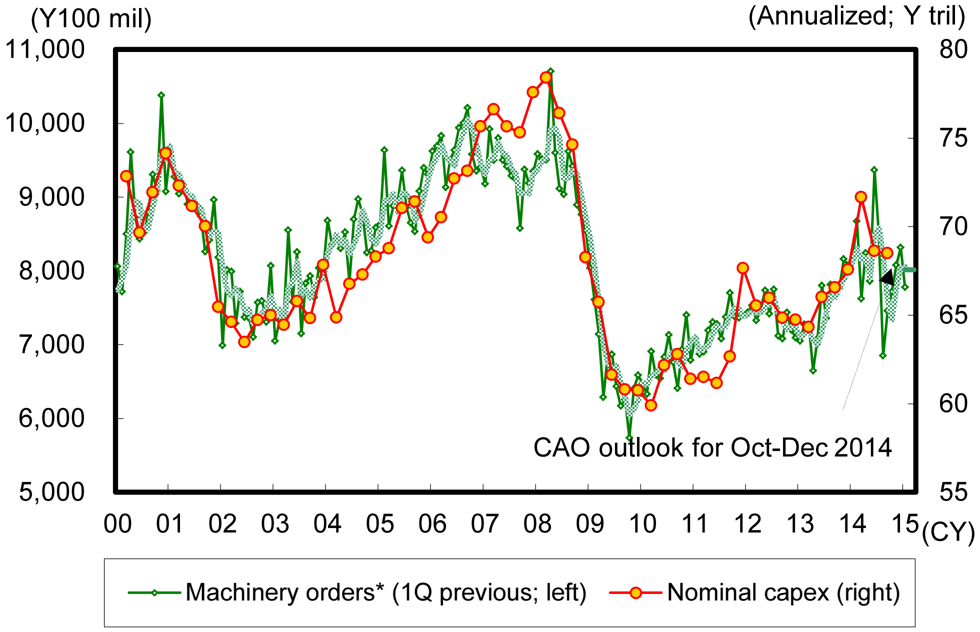
Source: Ministry of Finance; compiled by DIR.
Note: SA by DIR.

Possibilities Good that Capex Will Enter a Growth Phase Later in the Fiscal Year

According to the CAO outlook for the Oct-Dec 2014 period, private sector demand (excluding shipbuilding and electrical power) is expected to suffer a decline of -0.3% q/q, its first decline in two quarters. In order to achieve these results, average growth of +3.0% m/m must be recorded in November and December. In order for the Oct-Dec 2014 period to report overall growth, the months of November and December will have to record growth of +3.3% m/m. With orders already in a growth trend up to now, these numbers should not be difficult to achieve.

According to GDP statistics, Jul-Sep period capex fell in comparison with the previous quarter. Hopes had been pinned on capex to lead the economy back to growth after the April increase in consumption tax, but it was ultimately weaker than expected, and this weakness is considered to be one of the factors behind stagnant domestic demand. However, the coincident index for capex, shipments of capital goods, has been steadily moving toward a comeback, and when averaged out, machinery orders (a leading indicator) are also seen as moving into an upswing. In addition, the BOJ Tankan survey on planned capital spending shows a positive attitude towards capex. Hence we believe that capex spending is likely to recover and move into a growth phase later in the current fiscal year.

Domestic Demand and Nominal Capex — Chart 5



Source: Cabinet Office (CAO); compiled by DIR.
Note: Excluding those for shipbuilding and from electric utilities; thick lines 3M/MA basis.