

30 September 2015 (No. of pages: 4)

Japanese report: 30 Sep 2015

# August Industrial Production

GDP growth rate will likely fall for second consecutive quarter in Jul-Sep period

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## Summary

- The August 2015 indices of industrial production was down by -0.5% m/m, suffering a decline for the second consecutive month and falling well below market consensus (+1.0%). The shipment index was also down for the second consecutive month at -0.5% m/m, while the inventory ratio index grew for the first time in three months at +6.1%. This month's results confirm that Japan's economy is in a temporary lull. The adjustment phase in overseas demand centering on the US and China has a much deeper bottom than had been expected. Hence production and inventory adjustment is expected to drag on for a while.
- These results, coupled with METI's production forecast survey for September, point to the likelihood of a decline in the GDP growth rate during the Jul-Sep period (GDP figures to be announced on November 16). The important question here is what kind of a policy response the government comes up with. Expectations are growing in regard to concrete policy measures (The New Three Arrows), as well as additional monetary easing by the BOJ.

## Industrial Production (m/m %; SA basis)

Chart 1

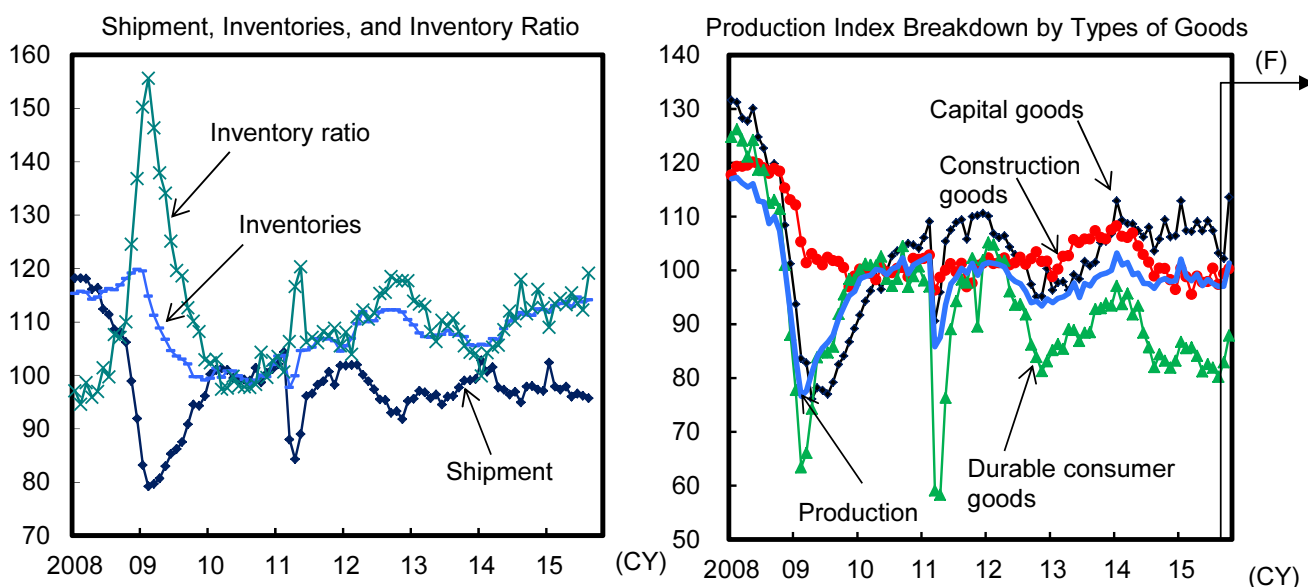
	2014		2015							
	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
Industrial Production	-0.6	0.2	4.1	-3.1	-0.8	1.2	-2.1	1.1	-0.8	<b>-0.5</b>
Market consensus (Bloomberg)										1.0
DIR estimate										1.0
Shipments	-0.7	-0.2	5.5	-4.4	-0.6	0.6	-1.9	0.6	-0.4	<b>-0.5</b>
Inventories	1.1	-0.1	-0.4	1.1	0.4	0.4	-0.8	1.5	-0.8	<b>0.4</b>
Inventory ratio	3.1	-2.9	-3.3	4.0	0.9	-1.0	1.9	-1.6	-1.1	<b>6.1</b>

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

## August 2015 production index declines for second consecutive month

The August 2015 indices of industrial production was down by -0.5% m/m, suffering a decline for the second consecutive month and falling well below market consensus (+1.0%). The shipment index was also down for the second consecutive month at -0.5% m/m, while the inventory ratio index grew for the first time in three months at +6.1%. This month's results confirm that Japan's economy is in a temporary lull. The adjustment phase in overseas demand centering on the US and China has a much deeper bottom than had been expected. Hence production and inventory adjustment is expected to drag on for a while.

**Shipments, Inventories, Inventory Ratio, and Shipment Index Breakdown (2010 = 100; SA basis) Chart 2**



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

## Adjustment in overseas demand deeper than expected

As for production index performance by industry in August, ten out of the total of fifteen industries recorded production declines. Tough times continue for downstream industries closer to production of final goods, with declines especially noticeable in general-purpose, production and business oriented machinery (-3.2% m/m), electrical machinery (-3.2%), and transport equipment (-0.7%). General-purpose, production and business oriented machinery, which had been continuing a trend of strong performance in the Apr-Jun period, saw the trend toward holding back a certain amount of machinery in storage after production in association with the off-road law fall away. This factor plus the soft performance of exports to the US and China are thought to be behind these results. On the other hand, those close to upstream in the materials industry, including plastic products (+2.3% m/m), petroleum & coal products (+3.7%), and chemicals (less pharmaceuticals) (+0.3%), continued to recover. However, fabricated metals saw a -3.0% decline in production, most likely related to economic conditions in China.

Looking at August production index performance by types of goods, declines were seen in all areas with the exception of non-durable consumer goods (+2.1% m/m). Declines in capital goods (-3.9%) and durable consumer goods (-2.1%) were thought to be due to the downturn in exports to China and the US, but weak domestic demand indicated by machinery orders statistics is also worrisome. As for the decline in production of construction goods (-3.0%), most likely this indicates that the digestion coefficient for construction orders for the first half of the fiscal year is continuing its reactionary decline after having remained at a high level on hopes of an announcement of a supplementary budget related to public works projects in the second half of the fiscal year.

## Weak performance expected to continue in September

August production appears to have been weak due to turmoil in the world's financial markets as well as the explosion in Tianjin, China. The announcement of regulatory measures prior to the military parade in Beijing also had a negative effect. As for September, the effects of the accident and regulatory measures are expected to drop off, but the effects of declining stock markets around the world and the foreign exchange intervention which should lead to a higher renminbi (purchasing of renminbi means monetary restraint) just before President Xi Jinping's state visit to the US means that demand in China is likely to remain sluggish.

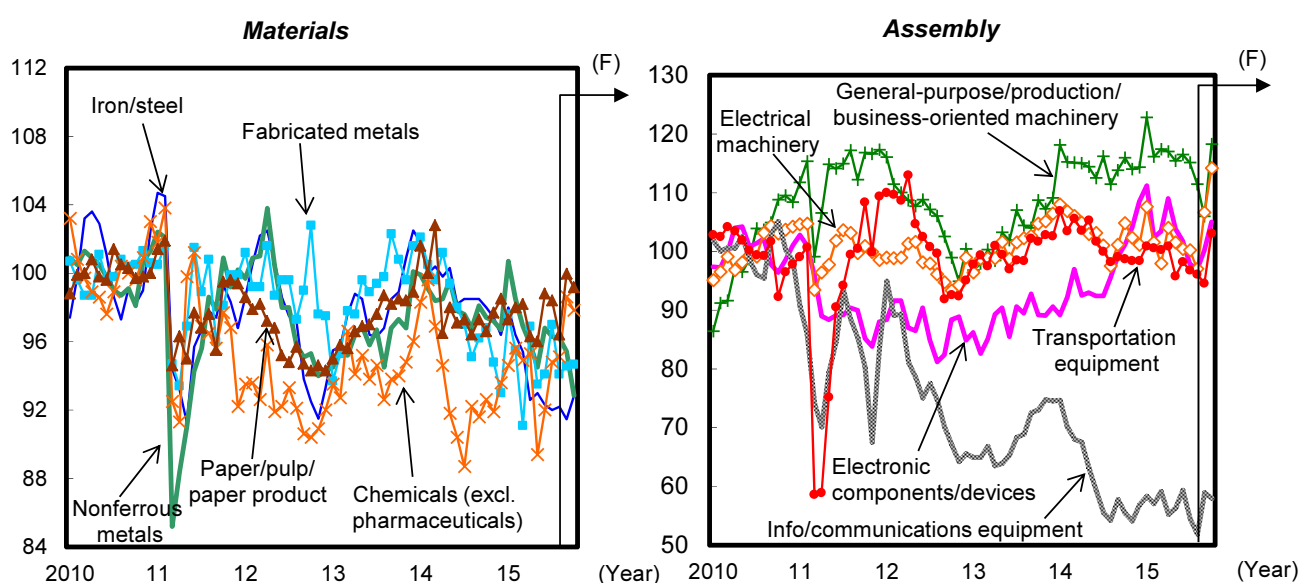
Meanwhile, the production forecast survey for September expects a continuation of sluggish performance at +0.1%. As for performance by industry, the slump is expected to continue for general-purpose, production and business oriented machinery (-4.9% m/m) and iron & steel (-0.8%). On the other hand, favorable performance is seen for information and communication electronics equipment (+13.5% m/m) due to special demand related to the iPhone, as well as electrical machinery (+9.9%) and electronic parts and devices (+3.4% m/m)

The October forecast survey is expected to achieve a major increase of +4.4% m/m. This is due to expectations that many of the negative factors discussed earlier will have run their course by then. Especially confident production plans are indicated in general-purpose, production and business oriented machinery (+11.6% m/m) and transport equipment (+9.0%). Meanwhile, electrical machinery (+7.1%) and electronic parts and devices (+4.8%) are expected to maintain favorable performance.

Looking at the forecast survey by types of goods, factors discussed earlier in this report are expected to influence production in September as well, meaning another drop in production for capital goods (with the exception of transport equipment) at -1.0% m/m. At the same time, durable consumer goods centering on household electric appliances are expected to experience a recovery in production output at +3.4%. Meanwhile, production increases are expected for all goods in October. Production increases are expected to be especially large for capital goods (with the exception of transport equipment) at +11.2% m/m and durable consumer goods at +6.0%.

Production by Industry (2010 = 100; SA basis)

Chart 3



Source: Ministry of Economy, Trade, and Industry (METI); compiled by DIR.  
F: METI's forecast survey.

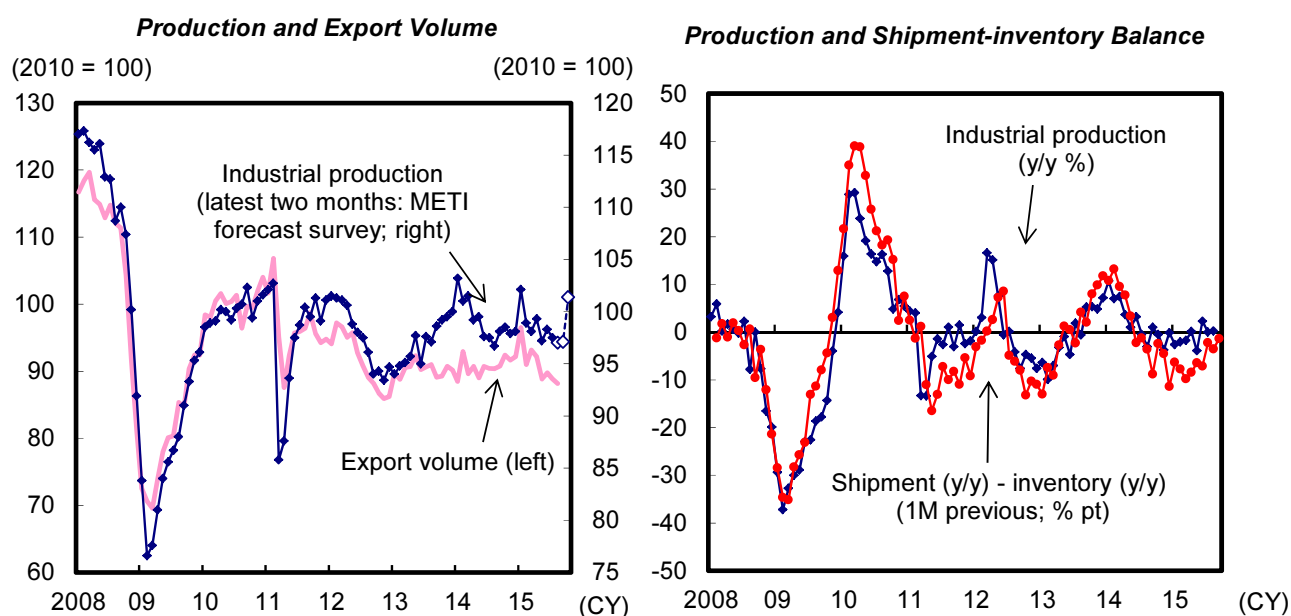
## GDP growth rate will likely fall for second consecutive quarter in Jul-Sep period

As for the future of industrial production, the growth trend is expected to return once the temporary adjustment has run its course. Overseas demand is expected to gradually recover. The adjustment phase has been continuing for capital goods in the US with a strong dollar and cheap crude oil, but demand for consumer goods remains favorable. In the Eurozone, the trend toward recovery is strengthening, supported by the weak Euro, cheap crude oil, and monetary policy. Meanwhile, emerging markets centering on China are beginning to show signs of bottoming out with news that US interest rates will be moving up and the effects of domestic monetary policy. Possibilities are good that the economy will hit bottom after October and then head toward recovery. As for domestic demand, recovery is expected due to gradual improvement in consumption, reflecting the continued increase in domestic capex and improvement in real income for both working households and pensioners.

This month's results, coupled with METI's production forecast survey for September, point to the likelihood of a decline in the GDP growth rate during the Jul-Sep period (GDP figures to be announced on November 16). The important question here is what kind of a policy response the government comes up with. Expectations are growing in regard to concrete policy measures (The New Three Arrows), as well as additional monetary easing by the BOJ. This latter expectation is bolstered by comments made by Haruhiko Kuroda, Governor of the Bank of Japan at a news conference held after the September Monetary Policy Meeting, in which he indicated that "the growth rate of real GDP in the July-September quarter is expected to return to a clearly positive one."

Production, Export Volume, and Shipment-inventory Balance

Chart 4



Source: Ministry of Economy, Trade, and Industry (METI); Cabinet Office; compiled by DIR.