Daiwa
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**28 December 2015 (No. of pages: 4)**

Japanese report: 28 Dec 2015

# November Industrial Production

## Recovery from temporary lull begins

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**Summary**

- The November 2015 indices of industrial production was down by -1.0% m/m, its first decline in three months, while falling slightly below market consensus (0.5%). The shipment index was down considerably by -2.5% m/m; negative results were recorded for all headliners. Inventories were up slightly by +0.5%, with inventory ratio up for the first time in three months at +2.9% m/m. However, the METI forecast sees an increase in production in the future, suggesting that Japan's economy will leave behind the recent temporary lull and begin heading toward recovery.

- Production is expected to return to a growth trend in the future. First, in the area of domestic demand, recovery is expected for consumption, reflecting the improvement in real income for both working households and pensioners. Meanwhile, corporations have not lost their willingness to invest in domestic capex, and this should provide underlying support for demand in the area of capital goods. Overseas demand is also expected to return to a recovery trend, despite a mixture of both strong and weak points. In the US, economic growth continues with a strong undertone especially in the household sector. Exports to the US are expected to move into a growth phase centering on durable goods. In the Eurozone, the trend toward recovery is expected to continue, supported by cheap crude oil and the ECB's quantitative easing. As for the Asian economy, China's ratio of cash reserves to deposits has been lowered along with its interest rates, and there are signs that the real economy has hit bottom. It is very possible that further declines in demand can be avoided, centering on consumer goods.

**Industrial Production** (m/m %; SA basis) **Chart 1**

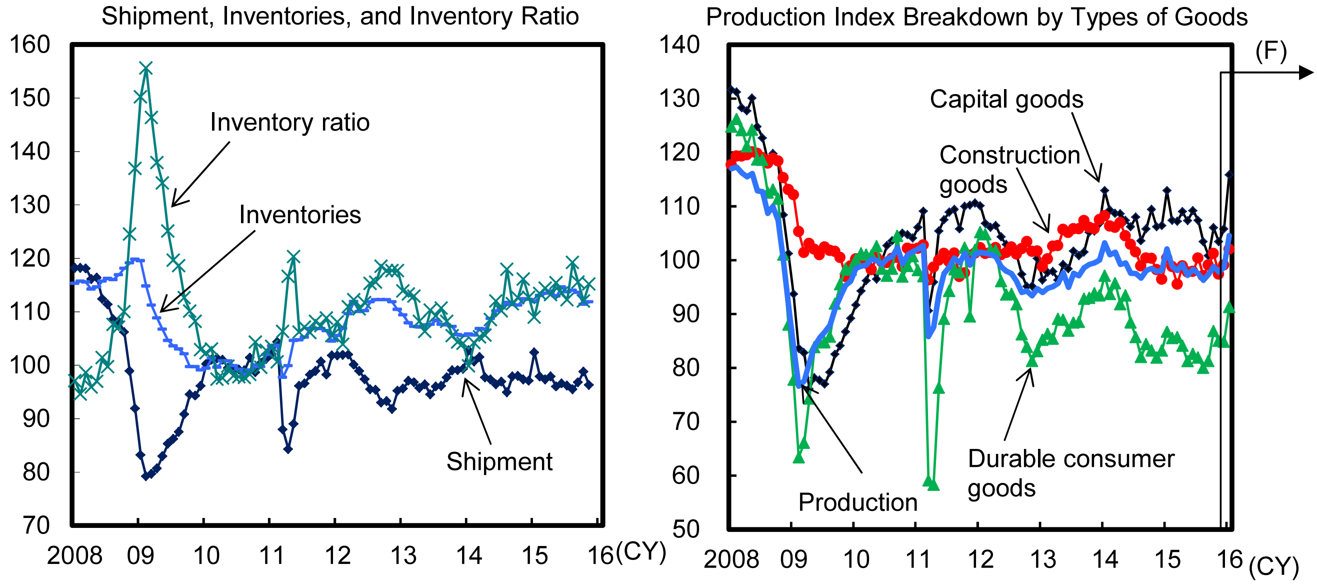
| | 2015 Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov |
|---|---|---|---|---|---|---|---|---|---|---|
| Industrial Production | -3.1 | -0.8 | 1.2 | -2.1 | 1.1 | -0.8 | -1.2 | 1.1 | 1.4 | **-1.0** |
| Market consensus (Bloomberg) | | | | | | | | | | -0.5 |
| DIR estimate | | | | | | | | | | -1.0 |
| Shipments | -4.4 | -0.6 | 0.6 | -1.9 | 0.6 | -0.4 | -0.7 | 1.4 | 2.1 | **-2.5** |
| Inventories | 1.1 | 0.4 | 0.4 | -0.8 | 1.5 | -0.8 | 0.3 | -0.4 | -1.9 | **0.4** |
| Inventory ratio | 4.0 | 0.9 | -1.0 | 1.9 | -1.6 | -1.1 | 6.2 | -3.1 | -3.0 | **2.9** |

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

## Shipment index declines and inventory ratio increases

The November 2015 indices of industrial production was down by -1.0% m/m, its first decline in three months, while falling slightly below market consensus (0.5%). The shipment index was down considerably by -2.5% m/m; negative results were recorded for all headliners. Inventories were up slightly by +0.5%, with inventory ratio up for the first time in three months at +2.9% m/m. However, the METI forecast sees an increase in production in the future, suggesting that Japan's economy will leave behind the recent temporary lull and begin heading toward recovery.

**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.

## Capital goods and materials sectors continue unfavorably, while production of final goods declines

As for production index performance by industry in November, ten out of the total of fifteen industries recorded production declines. Both the capital goods and materials sectors recorded declines across the board, with general-purpose, production and business oriented machinery down by -2.5%, chemicals (less pharmaceuticals) down by -2.7%, fabricated metals down by -2.9%, petroleum and coal products down by -4.9%, and ceramics, stone & clay products -1.3%. Meanwhile, transport equipment, which is thought to be starting production headed toward rollout of new products, was also down by -0.6%, as well as related industry, electrical machinery, which was down by -0.4%. Electronic parts & devices also showed temporary weakness at -1.1%.

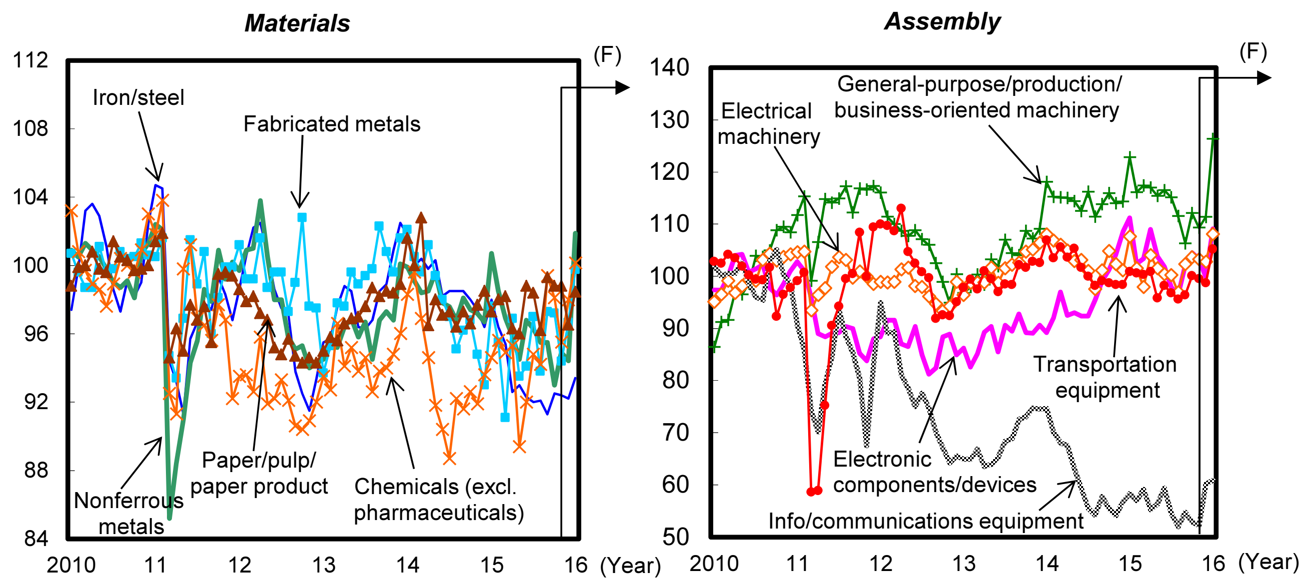
Looking at November production index performance by types of goods, we see that declines were considerable in the area of investment goods. Capital goods experienced a production increase last month, but in comparison, suffered a decline this month at -2.5% m/m, and continues in a soft tone. Construction goods, which had been maintaining favorable performance until now, was down by -3.8%. Consumer goods were down by -1.5%. Durable consumer goods were especially weak, with a decline of -2.1%.

## Growth in production seen in future

The forecast survey for December and January 2016 expects industrial production to return to a growth trend, with growth for each of these months at +0.9% m/m and +6.0% respectively. In performance by industry, the durable goods and capital goods sectors are expected to pull off a return to growth in production, with general-purpose, production and business oriented machinery performing positively (+1.9% m/m in December and +13.4% in January 2016), as well as electronic parts and devices (-3.3% in December and +9.2% in January), electrical machinery (-0.4% in December and +5.1% in January), information communication & electronics equipment (+15.2% in December and +1.2% in January), and transport equipment (-0.8% in December and +6.6% in January). Meanwhile, the materials sector is expected to bottom out with non-ferrous metals recording -0.5% m/m in December and +7.9% in January, fabricated metals up by +2.4% in December and +3.2% in January, and chemicals achieving growth at +2.6% in December and +2.2% in January.

Looking at the forecast survey by types of goods, capital goods and consumer goods are expected to see a strengthening of production in the future, with capital goods (less transport equipment) at +2.3% m/m in December and +9.5% in January, with durable consumer goods down by -0.2% in December and up by +9.5% in January, and non-durable consumer goods up by +3.2% in December and +12.0% in January. Construction goods are also expected to recover to a moderate growth trend in production with +1.7% in December and +3.0% in January.

**Production by Industry (2010 = 100; SA basis)** **Chart 3**



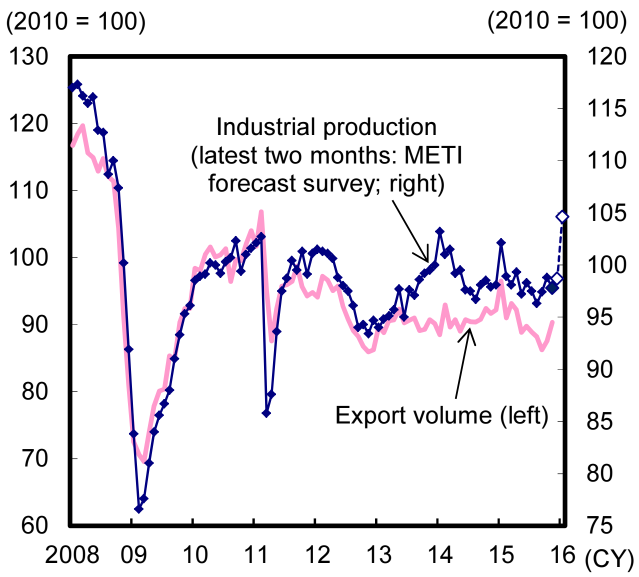

Source: Ministry of Economy, Trade, and Industry (METI); compiled by DIR.
F: METI's forecast survey.

## Production to move toward recovery from temporary lull

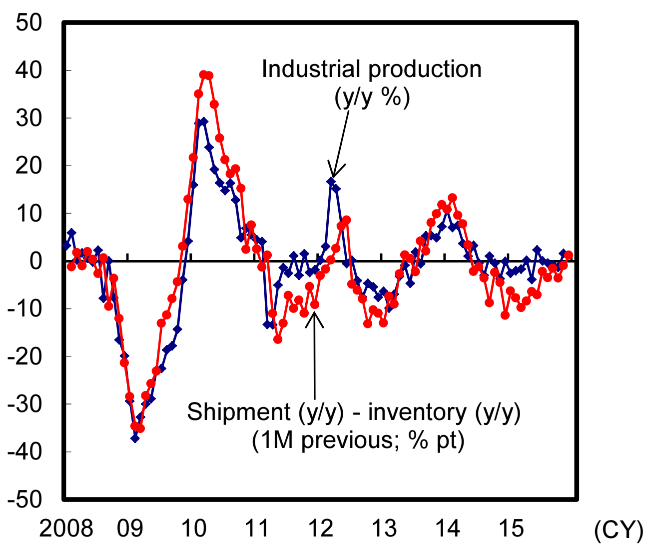
As can be seen in METI's production forecast survey, production is expected to return to a growth trend in the future. First, in the area of domestic demand, recovery is expected for consumption, reflecting the improvement in real income for both working households and pensioners. Meanwhile, corporations have not lost their willingness to invest in domestic capex, and this should provide underlying support for demand in the area of capital goods. Overseas demand is also expected to return to a recovery trend, despite a mixture of both strong and weak points. In the US, economic growth continues with a strong undertone especially in the household sector. Exports to the US are expected to move into a growth phase centering on durable goods. In the Eurozone, the trend toward recovery is expected to continue, supported by cheap crude oil and the ECB's quantitative easing. As for the Asian economy, China's ratio of cash reserves to deposits has been lowered along with its interest rates, and there are signs that the real economy has hit bottom. It is very possible that further declines in demand can be avoided, centering on consumer goods.

**Production, Export Volume, and Shipment-inventory Balance** **Chart 4**

***Production and Export Volume***




***Production and Shipment-inventory Balance***




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