Daiwa
Daiwa Institute of Research

12 April 2017 (No. of pages: 4)

Japanese report: 12 Apr 2017

February Machinery Orders

February orders grow +1.5% m/m. Degree of certainty low for achievement of Jan-Mar period outlook

Economic Research Dept.
Kazuma Maeda
Shunsuke Kobayashi

Summary

- According to statistics for machinery orders in February, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders grew for the first time in two months by +1.5% m/m, while at the same time falling below market consensus at +3.6%. Manufacturing grew by +6.0% m/m in a rebound from the previous month’s major decline, while non-manufacturing (excluding ships and electric power) grew also for the third consecutive month.

- The Cabinet Office forecast for the Jan-Mar 2017 period sees private sector demand (excluding ships and electrical power) up by +1.5% q/q. However, in order to fulfill this forecast, private sector demand (excluding ships and electrical power) will have to pull in +10.0% in orders received in March in comparison with February performance. Hence the degree of certainty with which this outlook can be achieved is not a high one.

- Looking at orders by source of demand in February, the manufacturing industries grew for the first time in two months by +6.0% m/m in a rebound from the previous month’s major decline (-10.8% in comparison to December 2016). Our evaluation is that on average, manufacturing is marking time. Non-manufacturing orders (excluding ships and electric power) grew for the third consecutive month at +1.8% m/m. Non-manufacturing orders have experienced ups and downs up to now, but on the whole, the trend in non-manufacturing orders maintains underlying strength.

- Machinery orders, the leading indicator for capex, are expected to gradually expand in the future. Operating rates in the manufacturing industry have been in a growth trend since the second half of last year due to the increase in exports encouraged by recovery in the world economy. Meanwhile, the non-manufacturing industries are expected to carry out investments in transport and distribution infrastructure with the continuing growth in foreign visitors to Japan, as well as expectations regarding the 2020 Tokyo Olympics and Paralympics.

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

	2016 Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	2017 Jan	Feb
Machinery orders (private sector)*	1.4	-6.4	-2.2	7.1	5.6	-5.9	0.3	3.4	-2.8	2.1	-3.2	1.5
Market consensus (Bloomberg)												3.6
DIR estimate												2.0
Manufacturing orders	14.2	-9.7	0.0	6.5	0.9	-3.1	-3.3	0.4	8.1	0.8	-10.8	6.0
Non-manufacturing orders*	-6.5	-3.3	1.0	1.8	6.5	-3.1	0.7	2.7	-5.6	2.1	0.7	1.8
Overseas orders	12.9	4.7	-16.3	9.7	-9.0	-0.7	2.8	7.1	16.3	-12.1	3.2	-1.1

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

February orders: both manufacturing and non-manufacturing achieve growth

According to statistics for machinery orders in February, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders grew for the first time in two months by +1.5% m/m, while at the same time falling below market consensus at +3.6%. Manufacturing grew by +6.0% m/m in a rebound from the previous month's major decline, while non-manufacturing grew also for the third consecutive month.

The Cabinet Office forecast for the Jan-Mar 2017 period sees private sector demand (excluding ships and electrical power) up by +1.5% q/q. However, in order to fulfill this forecast, private sector demand (excluding ships and electrical power) will have to pull in +10.0% in orders received in March in comparison with February performance. Hence the degree of certainty with which this outlook can be achieved is not a high one. This is due to the likelihood of manufacturing orders falling into a decline during the quarter, despite having been predicted to grow by +9.7% q/q during the Jan-Mar period. On the other hand, non-manufacturing, which had been expected to decline by -3.3% q/q, has maintained positive growth in January and February.

Manufacturing orders grow for first time in two months after previous month's major decline

Looking at orders by source of demand in February, the manufacturing industries grew for the first time in two months by +6.0% m/m in a rebound from the previous month's major decline (-10.8% in comparison to December 2016). Our evaluation is that on average, manufacturing is marking time.

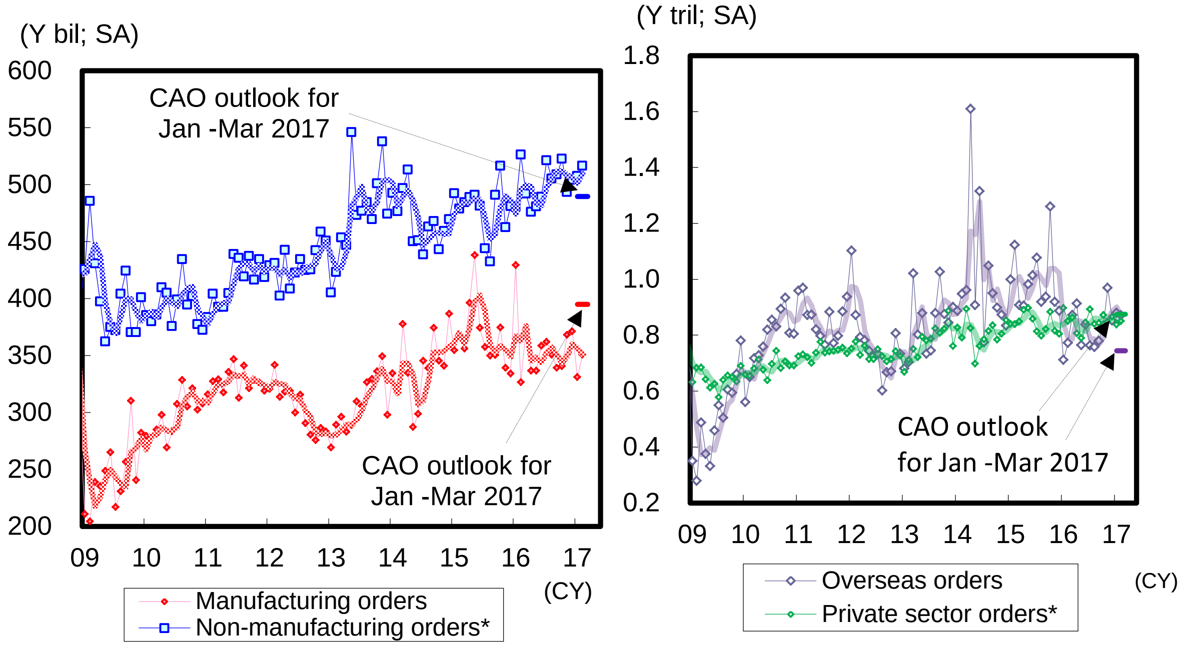
As for performance by industry, growth was seen in pulp, paper & paper products (+533.9% m/m), foods and beverages (+76.6%), and general-purpose and production machinery (+6.8%). As for pulp, paper & paper products, performance was most likely due to large-scale orders. On the other hand, declines in comparison with the previous month were seen in electrical machinery (-27.7%), automobiles, parts and accessories (-15.3%), and business oriented machinery (-26.5%). Electrical machinery suffered a reactionary decline after the previous month's gains, but on the whole, it is continuing the growth trend it has exhibited since the beginning of FY2016.

Non-manufacturing orders favorable, recording growth for third consecutive month

Non-manufacturing orders (excluding ships and electric power) grew for the third consecutive month at +1.8% m/m. Non-manufacturing orders have experienced ups and downs up to now, but on the whole, the trend in non-manufacturing orders maintains underlying strength.

Looking at performance by industry, month-to-month growth was seen in other non-manufacturing (+69.0%), transportation and postal activities (+22.9%), and finance & insurance (+11.8%). Other non-manufacturing was especially influential in bringing additional levity to overall results. As for finance and insurance, a declining trend continued for much of 2016 ever since the beginning of the year, but as of this point the industry is in its second consecutive month of growth. Until now, the industry was suffering a reactionary decline in response to large-scale IT investments carried out in 2015. It is possible that this latest development may signal that these negative influences have finally run their course. On the other hand, some industries experienced declines. These were telecommunications (-31.4%), construction (-25.5%), and real estate (-41.5%). Both construction and real estate suffered declines for the first time in four months, taking a short breather from the growth trend both are experiencing.

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

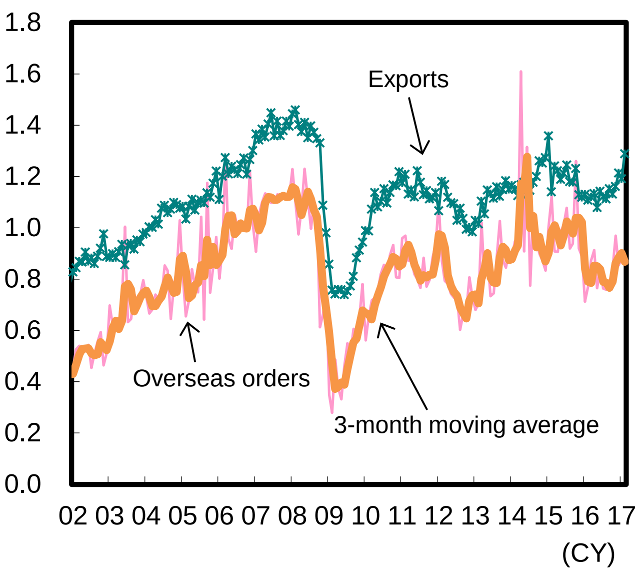


Source: Cabinet Office (CAO); compiled by DIR.
*excl. those for ships and from electric utilities.
Note: Thick lines 3M/MA basis.

Overseas orders decline for first time in two months

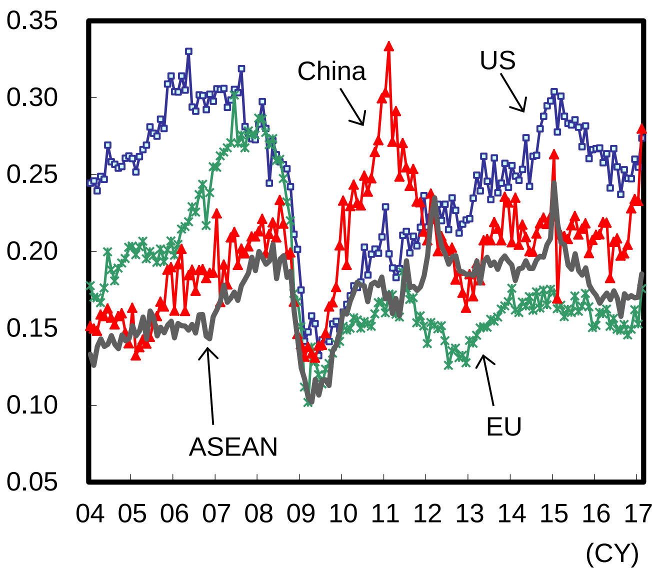
Overseas orders declined for the first time in two months at -1.1% m/m. According to the Cabinet Office, orders for industrial machinery and aircraft grew, while orders for engines and turbines, as well as electronics & telecommunications equipment declined.

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



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 4**



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

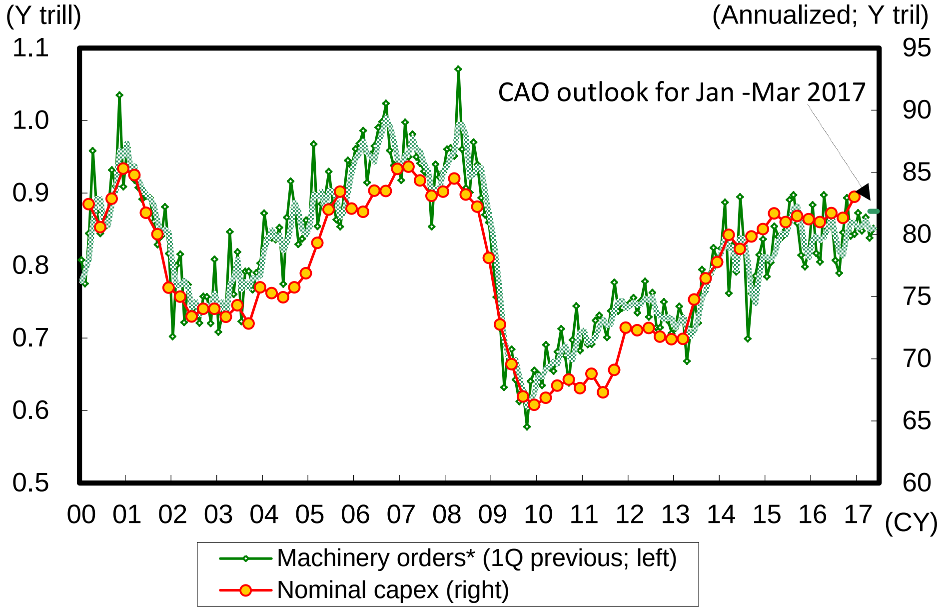
Machinery orders expected to gradually expand in the future

Machinery orders, the leading indicator for capex, are expected to gradually expand in the future. According to the BOJ March 2017 Tankan survey of corporate sentiment published earlier this month, production capacity DI for large enterprises (all industries) is marking time (0%pt), while middle sized and small enterprises were at -2%pt, down in comparison to the previous survey (0%pt). While large enterprises show no signs of overcapacity, signs of undercapacity can be seen amongst middle sized and small enterprises. This fact will likely be a boost for machinery orders.

Operating rates in the manufacturing industry have been in a growth trend since the second half of last year due to the increase in exports encouraged by recovery in the world economy. Meanwhile, the non-manufacturing industries are expected to carry out investments in transport and distribution infrastructure with the continuing growth in foreign visitors to Japan, as well as expectations regarding the 2020 Tokyo Olympics and Paralympics. Other positive factors include the high level of recurring profits and investments in rationalization and labor-saving devices due to the fact that supply and demand for labor remains tight.

The future of overseas demand according to our main scenario sees a continuation of gradual expansion backed by the recovery of the world economy. On the other hand, geopolitical risk is on the rise with the US bombing of Syria and the tense situation with North Korea. We urge caution as it is possible that yen appreciation could accelerate due to these factors, bringing downward pressure on export value.

Domestic Demand and Nominal Capex (seasonally adjusted figures) **Chart 5**



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