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May Machinery Orders

Signs of a slowdown in non-manufacturing orders

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Summary

- According to statistics for machinery orders in May, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders declined for the second consecutive month at -3.6% m/m, while at the same time falling below market consensus at +1.6%. Manufacturing orders grew for the fourth consecutive month at +1.0% m/m, but non-manufacturing (excluding ships and electric power) suffered a decline for the third consecutive month at -5.1%, pulling down overall results along with it. In response to these results, the Cabinet Office changed its official economic assessment from “there are signs of some recovery but the economy remains at a standstill” to “the economy remains at a standstill.”

- The Cabinet Office forecast for the Apr-Jun 2017 period sees private sector demand (excluding ships and electrical power) down for the second consecutive quarter by -5.9% q/q. Performance for orders in April and May was down by -3.5% in comparison to the Jan-Mar period, hence it is likely that actual performance for the Apr-Jun period will suffer a slight decline. While performance for manufacturing orders during the months of April and May averaged +5.5% in comparison to the Jan-Mar period, there are signs of a slowdown in non-manufacturing orders at -9.4%.

- Machinery orders, the leading indicator for capex, are expected to experience ups and downs in the future. Operating rates in the manufacturing industry have been in a growth trend since the second half of last year, but caution is required regarding exports to the US and Asia, whose economies have been exhibiting a weakening of their former growth trends. 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. However, one worrisome factor is that a reactionary decline has begun to appear after orders having continued on such a high level until now. We expect computers, conveying, elevating, and materials handling machinery, and industrial robots to do well in the future due to investments in labor saving equipment.

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

	2016							2017				
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May
Machinery orders (private sector)*	7.1	5.6	-5.9	0.3	3.4	-2.8	2.1	-3.2	1.5	1.4	-3.1	-3.6
Market consensus (Bloomberg)												1.6
DIR estimate												1.0
Manufacturing orders	6.5	0.9	-3.1	-3.3	0.4	8.1	0.8	-10.8	6.0	0.6	2.5	1.0
Non-manufacturing orders*	1.8	6.5	-3.1	0.7	2.7	-5.6	2.1	0.7	1.8	-3.9	-5.0	-5.1
Overseas orders	9.7	-9.0	-0.7	2.8	7.1	16.3	-12.1	3.2	-1.1	-2.8	17.4	-5.2

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

May orders: manufacturing wins growth, non-manufacturing declines

According to statistics for machinery orders in May, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders declined for the second consecutive month at -3.6% m/m, while at the same time falling below market consensus at +1.6%. Manufacturing orders grew for the fourth consecutive month at +1.0% m/m, but non-manufacturing (excluding ships and electric power) suffered a decline for the third consecutive month at -5.1%, pulling down overall results along with it. In response to these results, the Cabinet Office changed its official economic assessment from “there are signs of some recovery but the economy remains at a standstill” to “the economy remains at a standstill.”

The Cabinet Office forecast for the Apr-Jun 2017 period sees private sector demand (excluding ships and electrical power) down for the second consecutive quarter by -5.9% q/q. Performance for orders in April and May was down by -3.5% in comparison to the Jan-Mar period, hence it is likely that actual performance for the Apr-Jun period will suffer a slight decline. Looking at orders by source of demand we see manufacturing, now at +5.5% in comparison to the Jan-Mar period, coming in on the positive side as long as June performance is at -16.0% m/m or better (the Cabinet Office forecast sees -1.1% q/q). On the other hand, there are signs of a slowdown in non-manufacturing orders (excluding ships and electric power). Performance is expected to change little in comparison to the previous forecast of -9.6%, with -9.4% seen in comparison to the Jan-Mar period based on the Apr-May average. Transportation & postal activities, as well as construction and real estate are seen as being especially weak.

Manufacturing orders grow for fourth consecutive month

Looking at orders by source of demand in May, the manufacturing industries grew for the fourth consecutive month at +1.0% m/m. Manufacturing orders are continuing moderate growth due to increased operating rate associated with the expansion in exports.

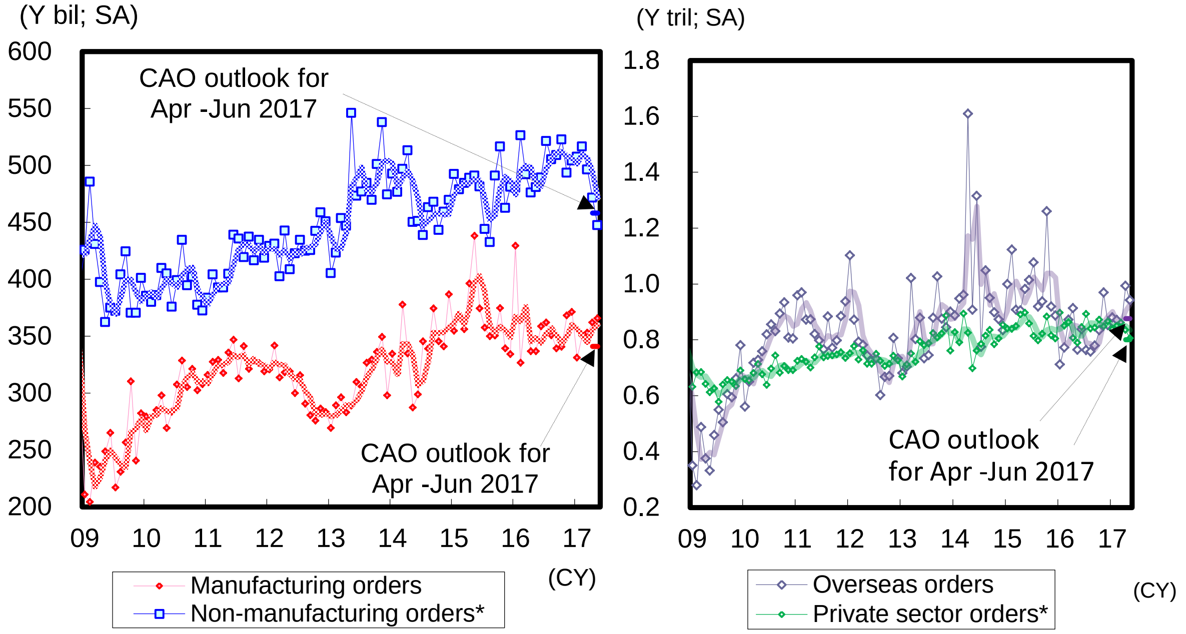
As for performance by industry, growth was seen in other manufacturing (+12.5% m/m), electrical machinery (+5.8%), and information and communications electronics equipment (+17.9%). As for other manufacturing, electrical machinery and information and communications electronics equipment, growth was achieved for the second consecutive month. Electrical machinery is especially worthy of note as it appears to be taking a breather from its recent downward trend. On the other hand, some industries suffered declines in comparison with the previous month, including general-purpose & production machinery (-8.2%), textiles mill products (-64.8%), and automobiles, parts & accessories (-7.4%). Textiles mill products appear to have suffered a reactionary decline in comparison to April performance (+93.5% in comparison to March results), which benefited from large-scale orders.

Non-manufacturing orders decline for third consecutive month

Non-manufacturing orders (excluding ships and electric power) suffered a decline for the third consecutive month at -5.1% m/m. There are signs of a slowdown in non-manufacturing orders, which had been maintaining a high level of performance up to now. Transportation & postal activities, as well as construction and real estate are seen as being especially weak.

Looking at performance by industry, month-to-month declines were seen in transportation & postal activities (-21.7%), telecommunications (-29.5%), and construction (-25.3%). As for transportation & postal activities, the industry was given a major lift during the first half of FY2016 with orders for railway cars, but since then orders have continued to decline. Construction chalked up y/y growth of +6.8% in FY2016, but recently orders have appeared weak, with two consecutive months of declines experienced in the most recent months of April and May. On the other hand, some industries experienced month-to-month growth, including finance and insurance (+59.2%), wholesale and retail trade (+13.4%), and information services (+2.6%). As for finance and insurance, it appears that a rebound occurred after April's dismal performance of -38.5% in comparison to March performance.

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

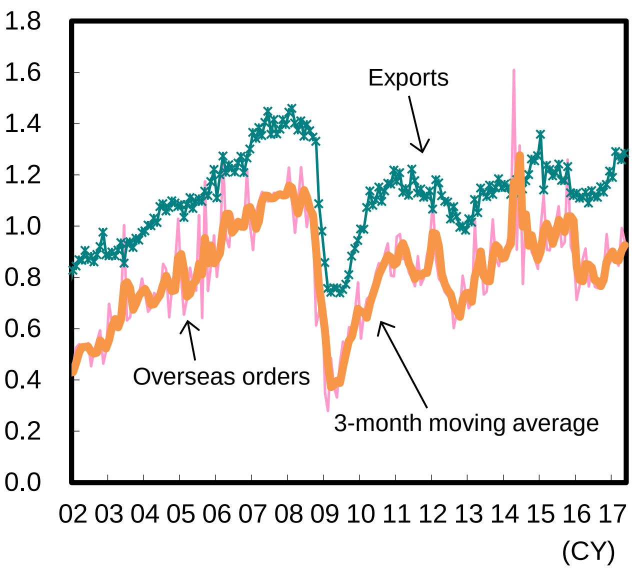


Source: Cabinet Office (CAO); compiled by DIR.
*excl. those for ships and from electric utilities.
Note: Thick lines 3M/MA basis.

Overseas orders decline for first time in two months

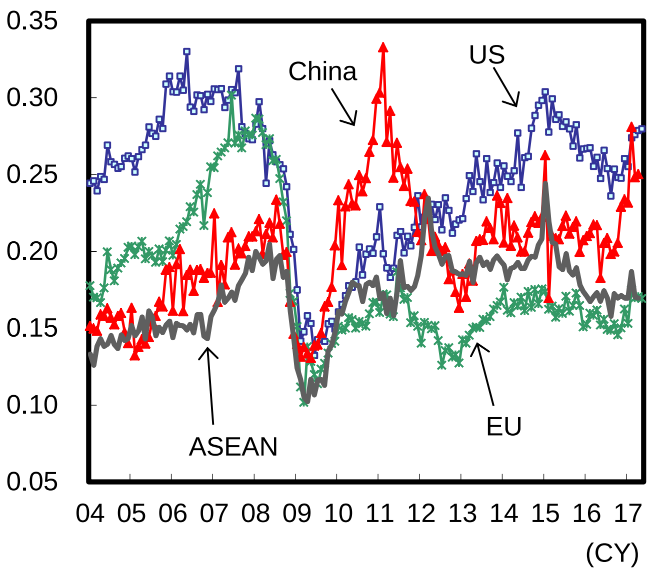
Overseas orders declined for the first time in two months at -5.2% m/m. According to the Cabinet Office, orders for electrical motors and heavy electric machinery grew, while orders for industrial machinery and ships declined.

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.

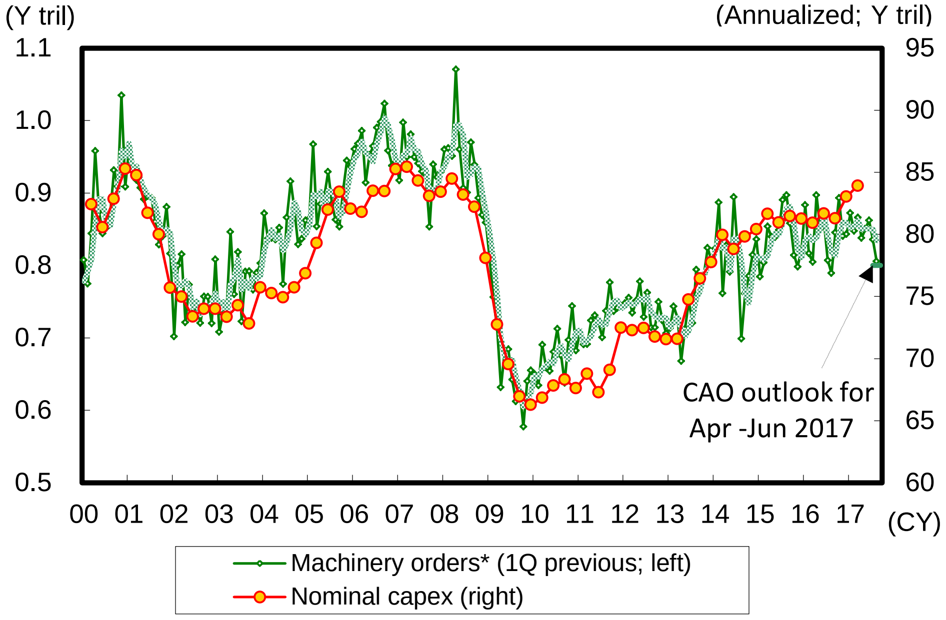
Machinery orders to experience ups and downs in future

Machinery orders, the leading indicator for capex, are expected to experience ups and downs in the future. Operating rates in the manufacturing industry have been in a growth trend since the second half of last year, but caution is required regarding exports to the US and Asia, whose economies have been exhibiting a weakening of their former growth trends. 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. In addition, recurring profit levels are high, and investments in rationalization and labor saving are seen in response to the tight labor market. This should work on the positive side for machinery orders. However, there is always a possibility that a reactionary decline could occur in the future with orders having continued on such a high level until now.

We expect three types of machinery to do well in the future due to investments in labor saving equipment. We suggest keeping an eye on the following. In the area of IT investment computers will be a focus, including general use computers and computer programs. Computers account for approximately one fourth of overall private sector demand. Potential demand is thought to be huge, with an accumulation of order backlog of nearly 3 tril yen and a balance which has doubled over a period of ten years. Large-scale systems development projects take place over the long-term, and this type of project could mean a structural change in terms of demand. In cases where there is a shortage of IT engineers, orders often cannot be processed quickly, and this could become a barrier to further growth in orders received. Next on our list are conveying, elevating, and materials handling machinery, such as conveyor belts, and transport machinery including cargo handling equipment. We suggest keeping an eye on this area in the future where investment in distribution centers is going. A serious labor shortage in the areas of transport and postal services is expected to contribute to growth for the overall industry. The third area of focus as regards investment in labor saving is industrial robots. Although robots now account for only a small portion of overall investment, they could become the representative type of labor saving investment in the future if orders from the non-manufacturing industries grow significantly.

The future of overseas demand according to our main scenario sees a continuation of gradual expansion backed by the continued underlying strength of growth in overseas economies. On the other hand, caution is required regarding possible downside risk. The Fed’s interest rate hikes and asset reduction could bring an economic downturn in the US, while at the same time causing market turmoil in the emerging nations. Meanwhile, caution is also advised in regard to downside risk in China’s economy after the Fall 2017 Communist Party Convention.

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.