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December 2017 Machinery Orders

Lull in manufacturing orders causes concern – possible slowdown due to capex cycle

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Summary

- According to statistics for machinery orders in December, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders declined by -11.9% m/m, while at the same time falling significantly below market consensus (-2.0%). Manufacturing suffered a decline of -13.3%, while non-manufacturing also fell by -7.3%. Meanwhile, the Cabinet Office forecast for the Jan-Mar 2018 period sees growth of +0.6% q/q.

- Manufacturing orders suffered a major decline in December, and are expected to continue the downtrend with the outlook for the Jan-Mar 2018 period at -5.7% q/q. It appears that manufacturing orders are experiencing a lull in the growth phase which had been seen up to this point. In contrast, non-manufacturing orders, which had been in a declining trend until now, are seen moving to the positive side with an outlook of +7.4% for the Jan-Mar period.

- Machinery orders, the leading indicator for capex, are expected to exhibit moderate growth in the future, and then slow down by around 2019 at the latest. In manufacturing, expanding exports are expected to act as a tailwind in generating replacement demand for machinery and facilities, but considering the ten year cycle which tends to drive capex, there is a good possibility that a slowdown will occur by around 2019 at the latest. On the other hand, in the non-manufacturing industries, investment in transportation and logistics infrastructure to handle growth in the number of foreigners visiting Japan appears promising, along with IT investment to handle the tight labor market. It should be noted, however, that due to the shortage of manpower, goods and services of this type face strict supply constraints, and this is cause for concern.

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

	2017 Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Machinery orders (private sector)*	-3.2	1.5	1.4	-3.1	-3.6	-1.9	8.0	3.4	-8.1	5.0	5.7	-11.9
Market consensus (Bloomberg)												-2.0
DIR estimate												-3.3
Manufacturing orders	-10.8	6.0	0.6	2.5	1.0	-5.4	2.9	16.1	-5.1	7.4	-0.2	-13.3
Non-manufacturing orders*	0.7	1.8	-3.9	-5.0	-5.1	0.8	4.8	3.1	-11.1	1.1	9.8	-7.3
Overseas orders	3.2	-1.1	-2.8	17.4	-5.2	-3.1	9.1	11.5	-9.8	4.9	4.9	-13.2

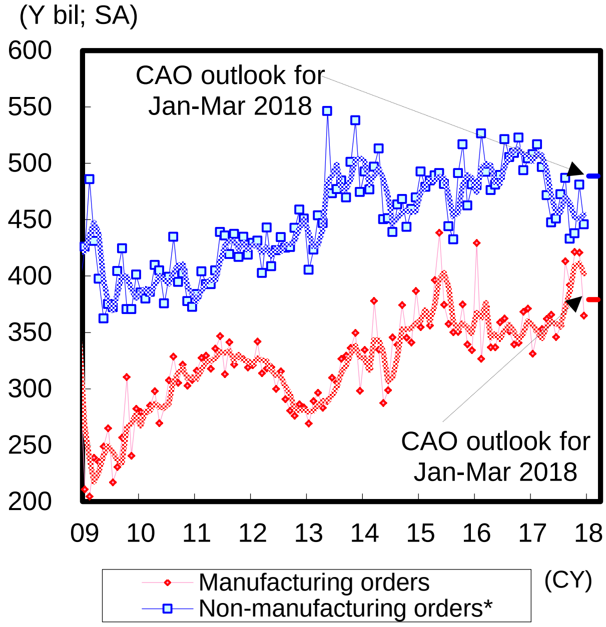
Source: Cabinet Office, Bloomberg; compiled by DIR.
*excl. those for ships and from electric utilities.
Note: Figures on market consensus from Bloomberg

December orders: Manufacturing experiences lull

According to statistics for machinery orders in December, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders declined by -11.9% m/m, while at the same time falling significantly below market consensus (-2.0%). Manufacturing suffered a decline of -13.3%, while non-manufacturing also fell by -7.3%. Meanwhile, the Cabinet Office forecast for the Jan-Mar 2018 period sees growth of +0.6% q/q.

Manufacturing orders suffered a major decline in December, and are expected to continue the downtrend with the outlook for the Jan-Mar 2018 period at -5.7% q/q. It appears that manufacturing orders are experiencing a lull the growth phase which had been seen up to this point. In contrast, non-manufacturing orders, which had been in a declining trend until now, are seen moving to the positive side with an outlook of +7.4% for the Jan-Mar period.

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.

Manufacturing: Major declines in some industries bring down overall results

Looking at performance source of demand in December, we see that the manufacturing industry declined for the second consecutive month by -13.3% m/m. In addition to the major decline in orders for manufacturing in December, the outlook for the 2018 Jan-Mar period also sees a decline of -5.7% in comparison with the previous period. It appears that manufacturing orders are experiencing a lull in the growth phase which had been seen up to this point.

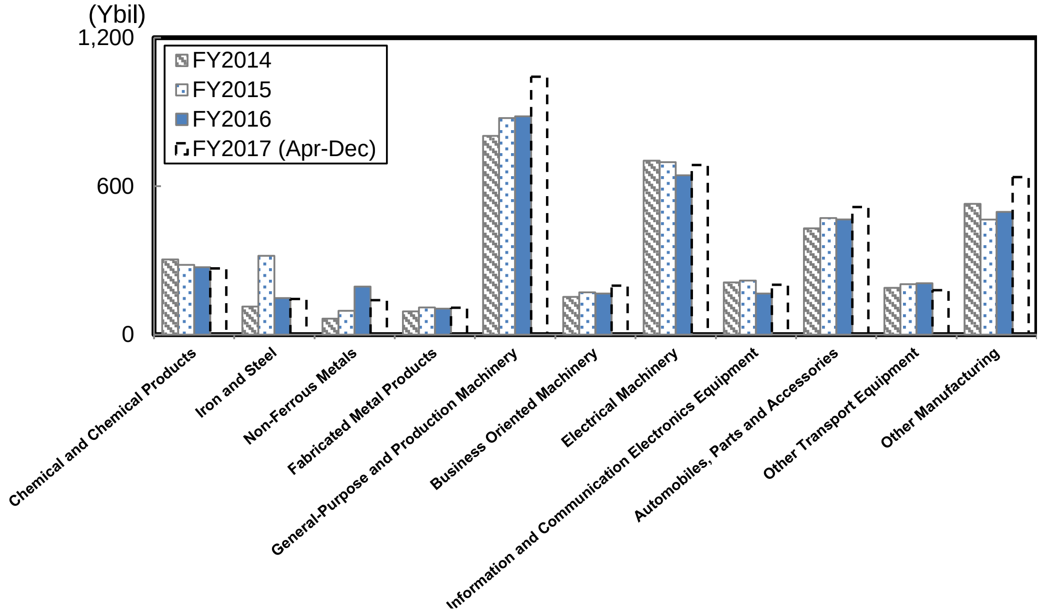
Non-ferrous metals declined by -83.7% in comparison to its November results, which grew by +309.3% due to large scale orders. Other manufacturing also suffered a major decline at -32.7%. It should be noted, however, that out of a total of 17 industries, only 5 industries suffered declines. Overall results came under serious downward pressure from major declines in a small number of industries.

Non-manufacturing: Wholesale & retail trade suffer reactionary decline

Non-manufacturing (excluding ships and electrical power) declined for the first time in three months at -7.3% m/m. non-manufacturing is in a declining trend, but is expected to return to growth at +7.4% in comparison with the previous quarter in the Jan-Mar period.

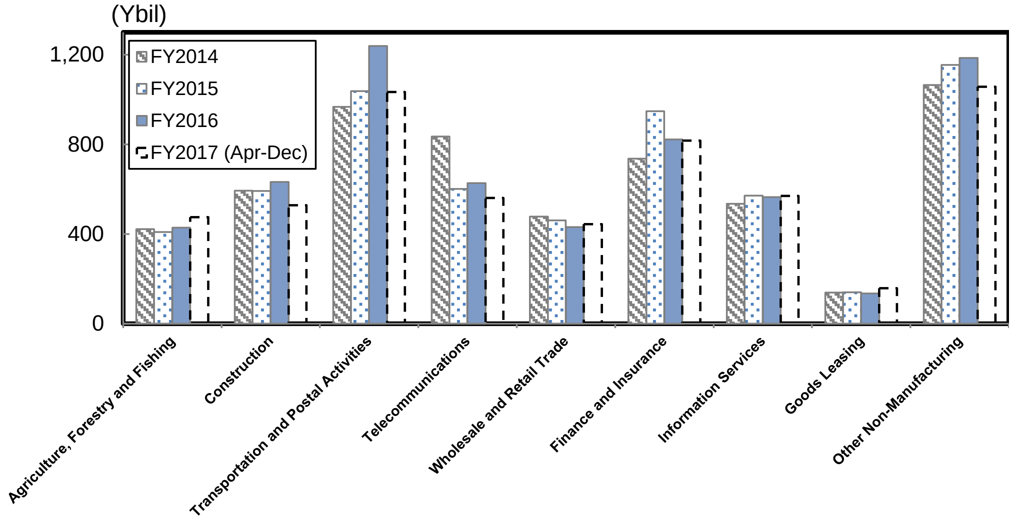
Wholesale & retail trade suffered a decline (-38.5% m/m), as well as telecommunications (-21.1%). As for Wholesale & retail trade, a reactionary decline was experienced in response to the previous month's major growth (+59.6% in November). Meanwhile, telecommunications is experiencing the continuation of a gradual decline which began last year. Capital investment in next generation high-speed communication (5G) is expected to be carried out gradually in the future, and it is possible that the intensification of competition between major communications carriers and mobile virtual network operators (MVNO) has brought downward pressure on said capital investment.

Order Amounts by Industry (Manufacturing) (FY2014 – FY2017 Apr-Dec) Chart 3



Source: Cabinet Office (CAO); compiled by DIR.
Note: Figures for FY2017 Apr-Dec are converted to fiscal year.

Order Amounts by Industry (Non-Manufacturing) (FY2014 – FY2017 Apr-Dec) Chart 4

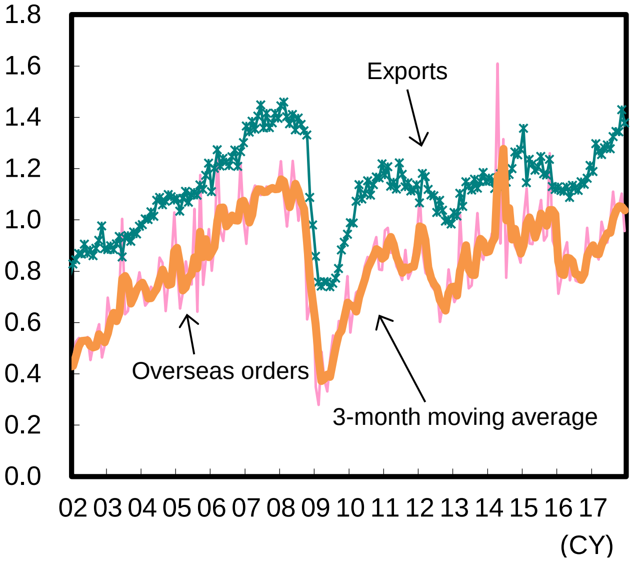


Source: Cabinet Office (CAO); compiled by DIR.
Note: Figures for FY2017 Apr-Dec are converted to fiscal year.

Overseas orders decline for the first time in three months

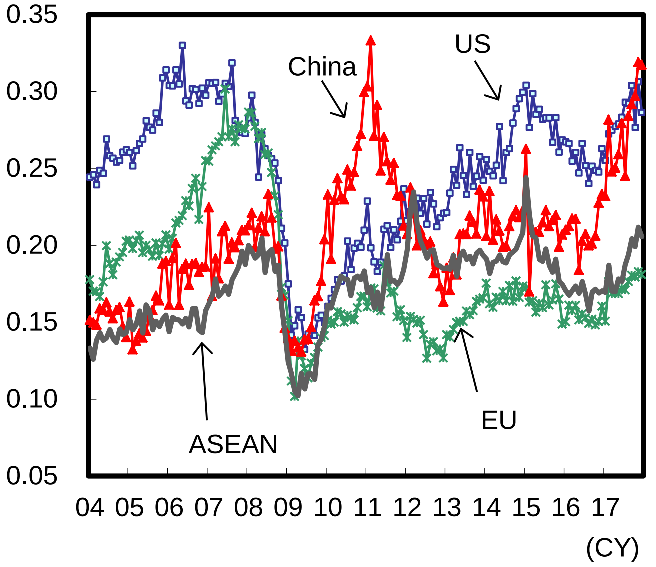
Overseas orders declined for the first time in three months at -13.2% m/m. According to the Cabinet Office, orders for all goods, including electronic & communication equipment and ships declined, thereby bringing overall decline of -13.2%. Looking at export value of general machinery by region, we see that in addition to major growth in export value to China, export value to the US also maintained favorable performance.

General Machinery: Overseas Orders and Exports (Y tril; SA) **Chart 5**



Source: Cabinet Office, Ministry of Finance; compiled by DIR.
Notes: 1) Overseas orders 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 6**



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

Machinery orders expected to see moderate growth in future, then slow down around 2019

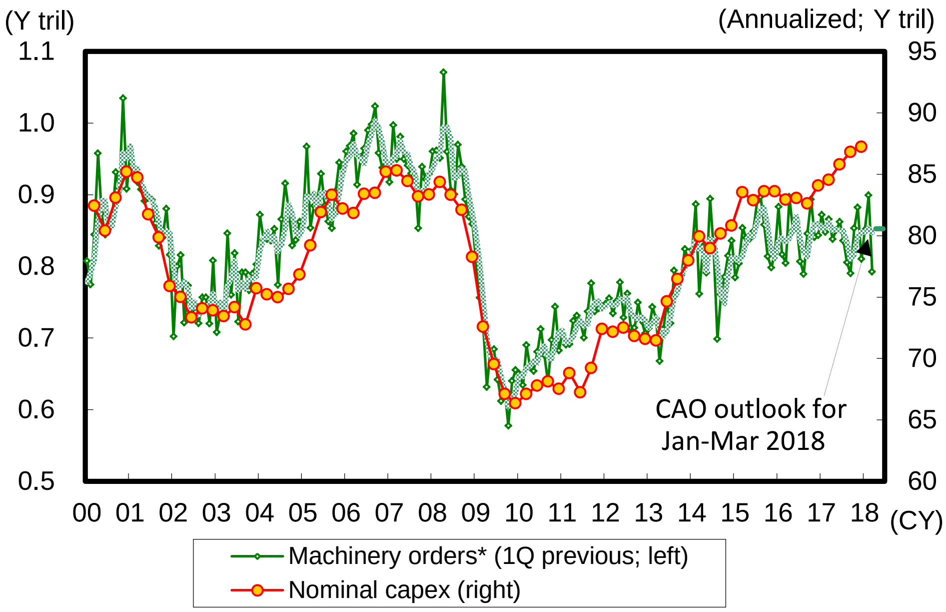
Machinery orders, the leading indicator for capex, are expected to exhibit moderate growth in the future, and then slow down by around 2019 at the latest.

In manufacturing, expanding exports are expected to act as a tailwind in generating replacement demand for machinery and facilities. The service life of machinery and facilities is eight to ten years. Hence manufacturing orders tend to follow a ten-year cycle. The cyclical factor, as well as favorable corporate earnings, is expected to continue to push up orders for some time to come. However, we also have to take into consideration the capital stock cycle, which is now in a mature phase, as well as other factors such as the expected increase in the consumption tax in October 2019. These factors are likely to bring a slowdown by around 2019 at the latest. Meanwhile, if yen appreciation progresses, there will be pressure on corporate earnings, which could put a damper on the propensity to invest in capex.

On the other hand, in the non-manufacturing industries, investment in transportation and logistics infrastructure to handle growth in the number of foreigners visiting Japan appears promising, along with IT investment to handle the tight labor market. It should be noted, however, that due to the shortage of manpower, goods and services of this type face strict supply constraints, and this is cause for concern. Construction and information services are experiencing an intense labor shortage, and this may cause an increase in costs including investment in the opening of new outlets and IT. Orders for computers and other items included under IT investment are in fact accumulating, and this fact requires caution.

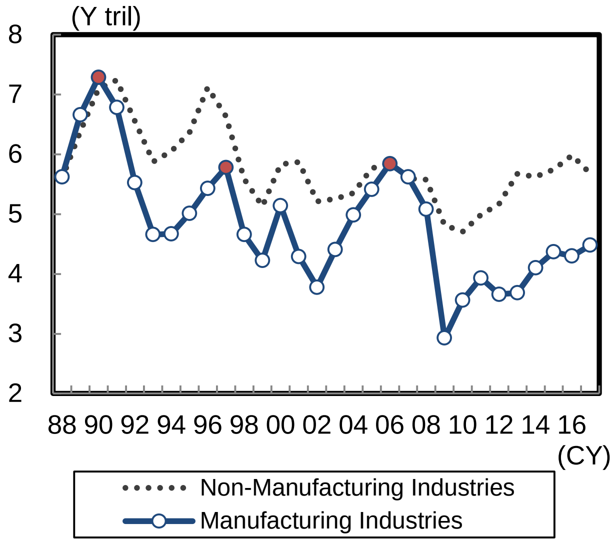
As for the future of overseas demand, the overseas economy continues steady growth. Hence our main scenario calls for an expected continuation of the moderate expansion. However, the Fed's exit strategy could cause a slowdown in the US economy, as well as triggering turmoil in the emerging markets. Meanwhile, there is also risk that China's economy could face a slowdown after the October 2017 meeting of the National Congress of the Communist Party of China.

Domestic Demand and Nominal Capex (seasonally adjusted figures) **Chart 7**



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

Changes in Order Volume **Chart 8**



Source: Cabinet Office (CAO); compiled by DIR.