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January 2018 Machinery Orders

Major growth following December 2017 reactionary decline

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Summary

- According to statistics for machinery orders in January, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders grew by +8.2% m/m in a rebound from last month's decline. Manufacturing was up by +9.9%, while non-manufacturing (excluding ships and electric power) gained by +4.4%.

- Manufacturing orders for the Jan-Mar period are expected to be down by -7.0% q/q, but January performance greatly exceeds the outlook, and there is a good chance that favorable performance can be maintained. Energy-saving and labor-saving investment has brought favorable orders to industrial machinery and machine tools, as well as computers and telecommunications equipment, including items attracting IT investment. Meanwhile, non-manufacturing orders continue to mark time.

- 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 approximately 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 Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	2018 Jan
Machinery orders (private sector)*	1.1	0.4	-2.1	-1.9	-1.8	4.5	3.2	-5.5	2.7	5.5	-9.3	8.2
Market consensus (Bloomberg)												5.2
DIR estimate												2.0
Manufacturing orders	3.7	-0.7	2.1	1.7	-4.1	1.8	11.8	-3.2	5.1	0.0	-8.5	9.9
Non-manufacturing orders*	1.4	-4.8	-2.7	-3.4	-1.5	4.2	-0.2	-5.1	-0.7	6.0	-5.3	4.4
Overseas orders	0.8	-2.4	11.8	-2.0	-2.7	7.6	9.4	-6.9	3.7	2.3	-8.2	11.6

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

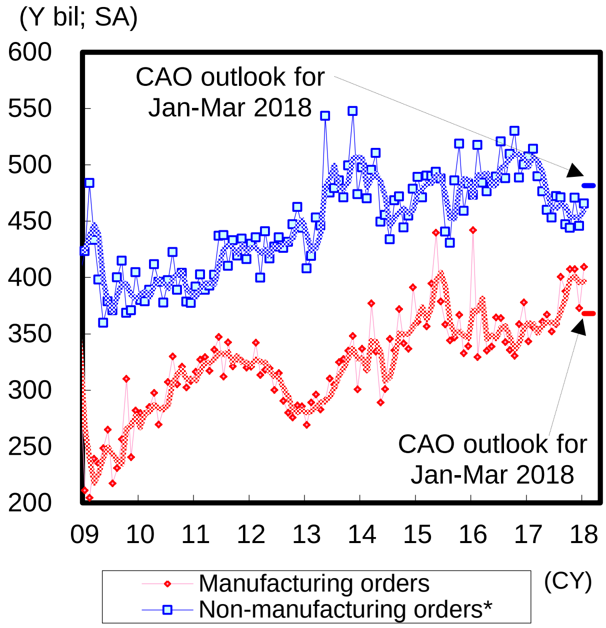
Both manufacturing and non-manufacturing win growth

According to statistics for machinery orders in January, the leading indicator for domestic capex and private sector demand (excluding ships and electrical power), orders grew by +8.2% m/m in a rebound from last month's decline. Manufacturing was up by +9.9%, while non-manufacturing (excluding ships and electric power) gained by +4.4%.

Manufacturing orders for the Jan-Mar period are expected to be down by -7.0% q/q, but January performance greatly exceeds the outlook, and there is a good chance that favorable performance can be maintained. Meanwhile, non-manufacturing orders continue to mark time.

Seasonally adjusted figures on the January survey have been revised.

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: Growth won by electrical machinery and other equipment

Looking at performance source of demand in January, we see that in the manufacturing industry grew for the first time in two months at +9.9% m/m. Manufacturing orders for the Jan-Mar period are expected to be down by -7.0% q/q, but January performance greatly exceeds the outlook, and there is a good chance that favorable performance can be maintained.

Looking at performance by industry, electrical machinery (+23.4% m/m) and chemical & chemical products (+37.9%) registered positive growth. Approximately 70% of electrical machinery order volume is accounted for by IT investment and electronics and telecommunications equipment, including semiconductor manufacturing equipment. Capex has been active in the area of semiconductor manufacturing equipment due to brisk demand for semiconductors. Durables maintained favorable performance due to replacement demand, and order volume for electrical machinery was especially notable, growing by +9.8% (annualized up to January performance). Meanwhile, chemical & chemical products achieved growth after having suffered setbacks from reactionary decline during the previous months (-38.5% m/m in November 2017 and -13.5% in December).

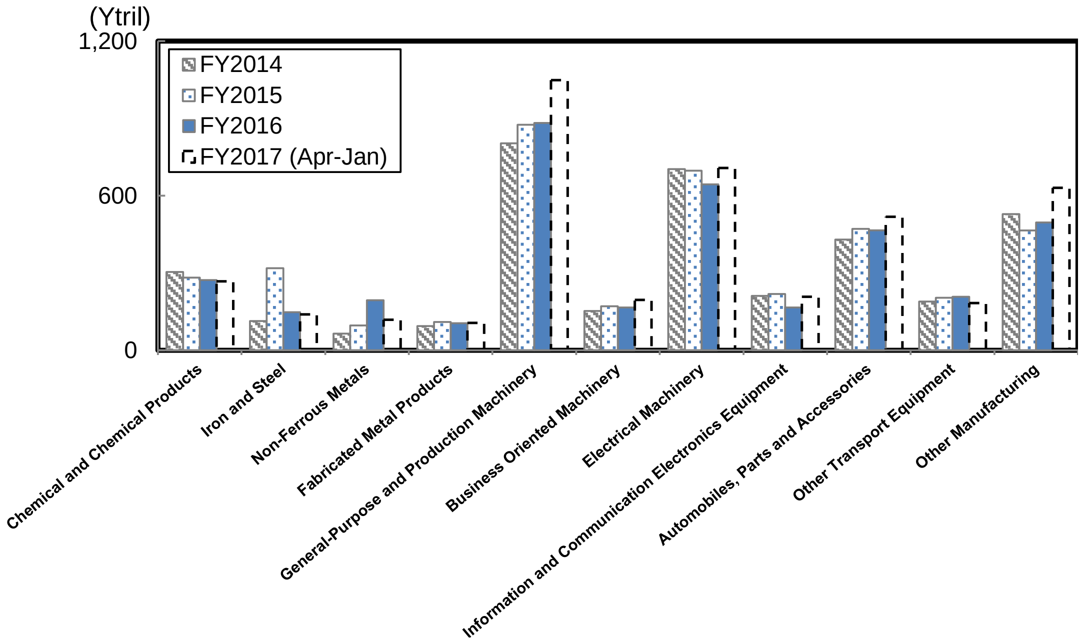
Looking at performance by type of machinery, with the shortage of manpower as background, energy-saving and labor-saving investment has brought favorable orders to industrial machinery and machine tools. Electronics and telecommunications equipment, which has been gaining substantial orders recently, includes semiconductor manufacturing equipment and system programs for factory automation.

Non-manufacturing: Railway cars and other equipment help push up overall performance

Non-manufacturing (excluding ships and electrical power) won growth for the first time in two months at +4.4% m/m. Meanwhile, non-manufacturing orders continue to mark time.

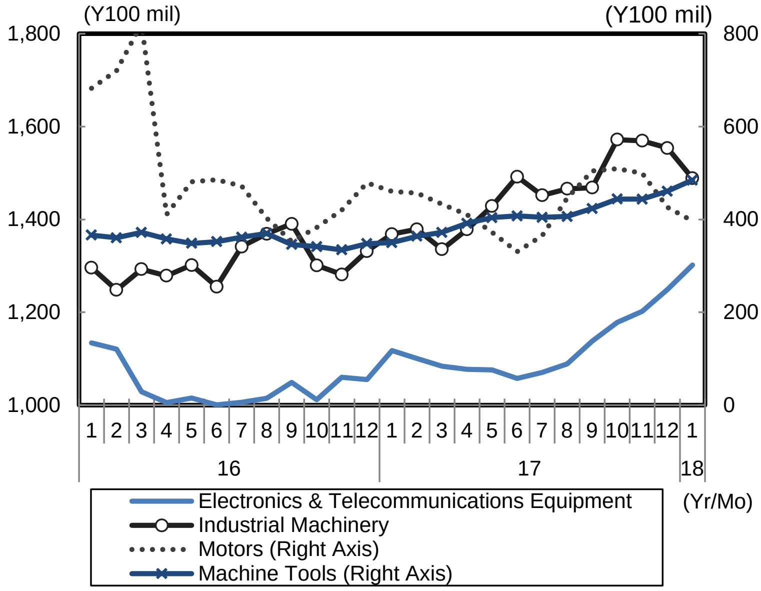
Looking at performance by industry, growth was achieved in other non-manufacturing (+17.6% m/m) and transportation & postal activities (+11.2%). Transportation & postal activities helped to push up overall performance along with railway cars.

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



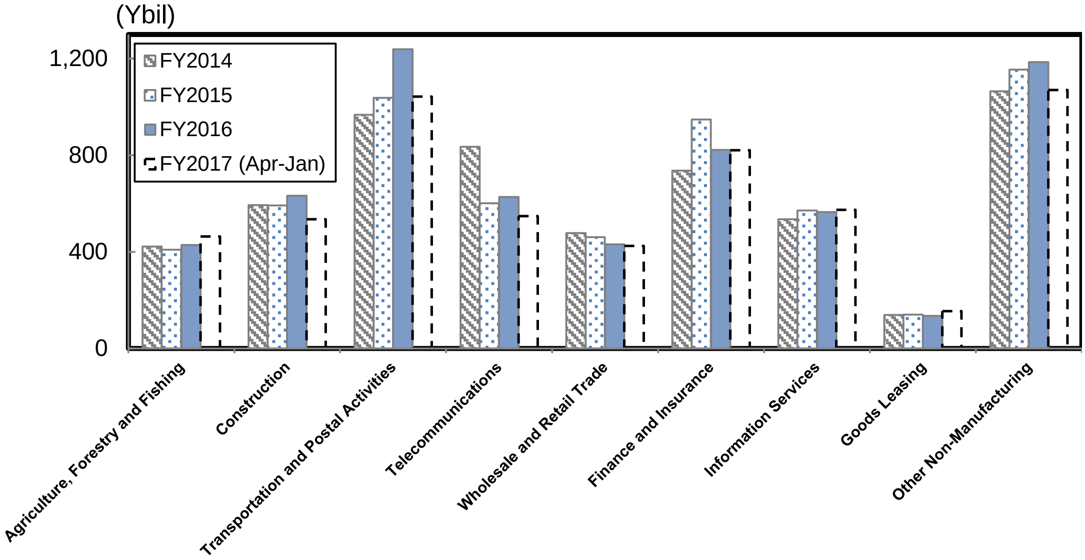
Source: Cabinet Office (CAO); compiled by DIR.
Note: Figures for FY2017 Apr-Jan are converted to fiscal year.

Order Volume for Major Equipment in Manufacturing Chart 4



Source: Cabinet Office (CAO); compiled by DIR.
Note: Seasonally adjusted values, 3-month moving average. Seasonal adjustment by DIR.

Order Amounts by Industry (Non-Manufacturing) (FY2014 – FY2017 Apr-Jan) Chart 5

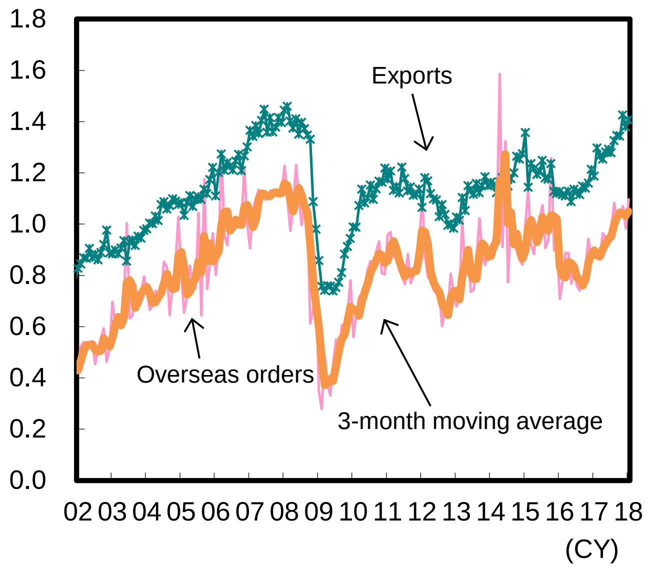


Source: Cabinet Office (CAO); compiled by DIR.
Note: Figures for FY2017 Apr-Jan are converted to fiscal year.

Overseas orders win growth for the first time in two months

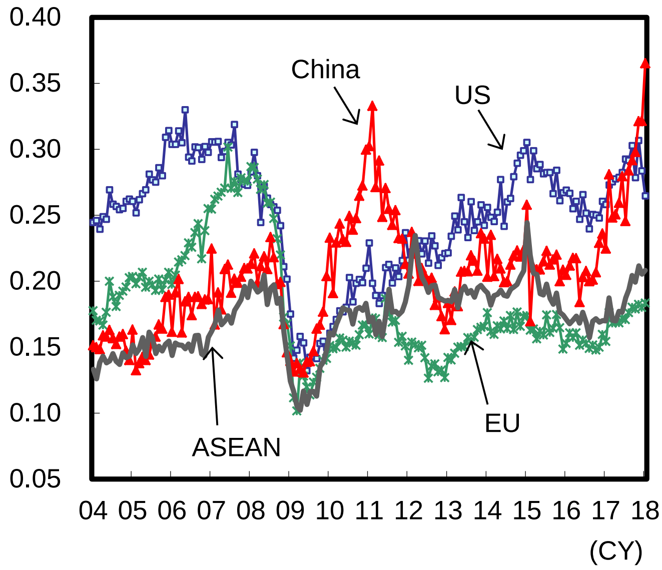
Overseas orders grew for the first time in two months at +11.6% m/m. According to the Cabinet Office, orders for motors and industrial machinery declined, while those for electronic & communication equipment as well as railway cars grew. Looking at export value of general machinery by region, we see that export value to China continued to record major growth.

General Machinery: Overseas Orders and Exports
(Y tril; SA) **Chart 6**



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 7**



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

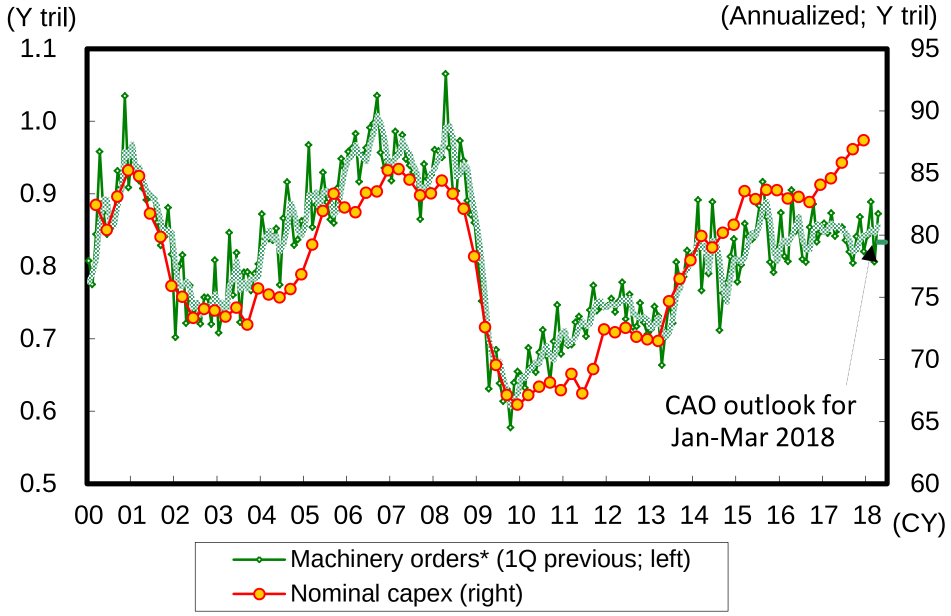
Machinery orders, the leading indicator for capex, are expected to exhibit moderate growth in the future, and then slow down by around 2019 at the latest.

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 an approximately 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.

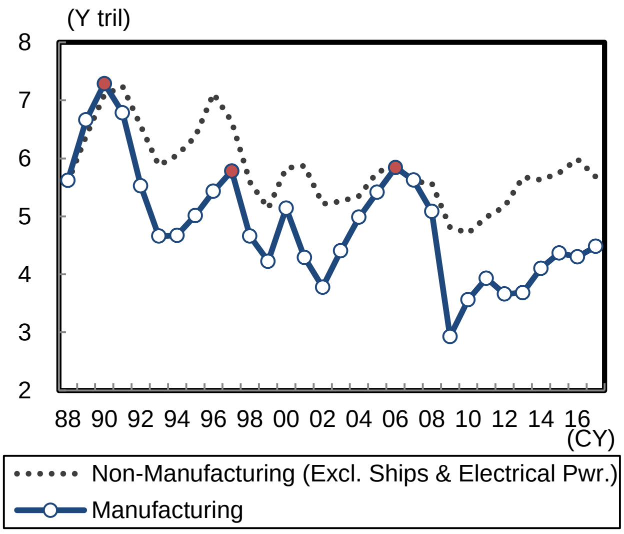
As for the future of overseas demand, the overseas economy continues steady growth. Hence our main scenario calls for an expected continuation of the moderate expansion. However, the Fed’s exit strategy could cause a slowdown in the US economy, as well as triggering turmoil in the emerging markets. Meanwhile, 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 8



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 9



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