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# February Industrial Production

Jan-Mar period expected to end in decline; production in temporary lull

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## Summary

- The February 2018 indices of industrial production grew by +4.1% m/m in a rebound from the previous month's performance (-6.8% in January). Growth in the transport equipment industry (which suffered a major decline in January) helped to pull up overall performance. The METI production forecast survey sees March performance up by +0.9%, while April is seen at +5.2%. Meanwhile, the estimated value for March is +0.5% (corrected for production plan bias).
- In order for the Jan-Mar period to achieve growth, March performance would have to record more than +6.7% m/m in growth, which is a hurdle all too high. Therefore the Jan-Mar period is expected to be in a temporary lull, while April is seen achieving +5.2% in m/m growth. Our outlook has not essentially changed, and we see production continuing favorable performance due to the expanding global economy.
- Production is expected to experience moderate growth in May 2018 and beyond. As for capital goods, the growth trend seen up till now may weaken, but favorable performance is expected to be maintained due to the expanding global economy. As for domestic capex, favorable corporate business performance and investment in maintenance and repair is expected to provide a boost to overall performance in 2018. However, caution is required regarding overseas demand due to possible downside risk. As for the US, its protectionist policies and measures various countries are taking to deal with it may cause trade friction, leading to stagnation of global trade. Meanwhile, if US interest rates undergo a rapid rise in association with the Fed's exit strategy, this could bring downward pressure on the US economy, while at the same time encouraging capital outflows from the emerging nations.

Industrial Production (m/m %; SA basis)

Chart 1

	2017									2018	
	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	
Industrial Production	-3.6	2.2	-0.8	2.0	-1.0	0.5	0.5	2.9	-6.8	<b>4.1</b>	
Market consensus (Bloomberg)										5.0	
DIR estimate										5.3	
Shipments	-2.9	2.5	-0.7	1.8	-2.5	-0.4	2.3	2.9	-5.7	<b>2.2</b>	
Inventories	0.0	-2.0	-1.1	-0.6	0.0	3.2	-0.8	-0.3	-0.5	<b>0.9</b>	
Inventory ratio	-1.9	-1.9	2.6	-4.1	1.6	3.5	-2.7	-0.5	3.3	<b>-0.1</b>	

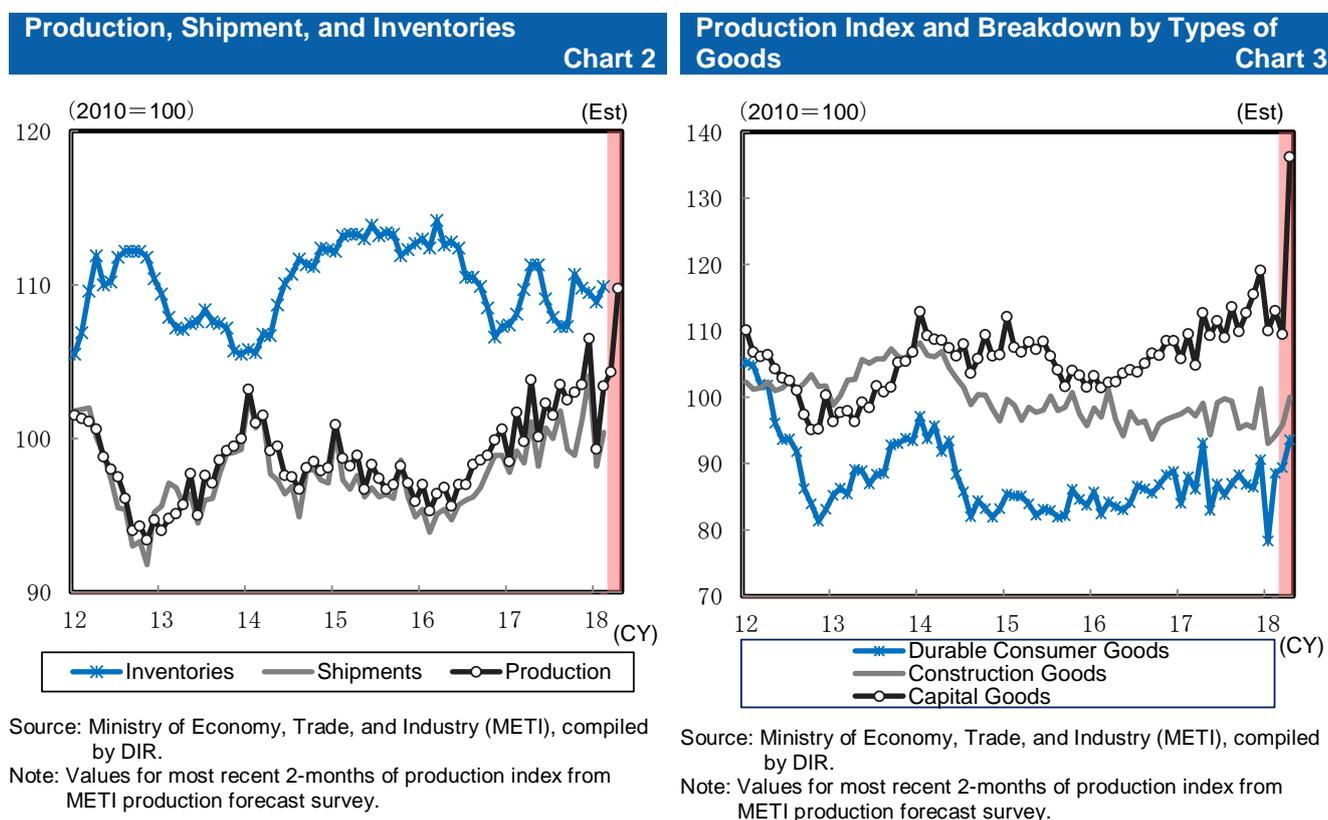
Source: Ministry of Economy, Trade, and Industry; Bloomberg; compiled by DIR.

## Jan-Mar period expected to end in q/q decline

The February 2018 indices of industrial production grew by +4.1% m/m in a rebound from the previous month's performance (-6.8% in January). Growth in the transport equipment industry (which suffered a major decline in January) helped to pull up overall performance. The METI production forecast survey sees March performance up by +0.9%, while April is seen at +5.2%. Meanwhile, the estimated value for March is +0.5% (corrected for production plan bias).

In order for the Jan-Mar period to achieve growth, March performance would have to record more than +6.7% m/m in growth, which is a hurdle all too high. Therefore the Jan-Mar period is expected to be in a temporary lull, while April is seen achieving +5.2% in m/m growth. Our outlook has not essentially changed, and we see production continuing favorable performance due to the expanding global economy.

The annual revision of the indices of industrial production is carried out in April of each year during which time a readjustment of the seasonal adjustment is performed. Recent performance of industrial production has shown intense fluctuation on a single month basis, but this may be removed through averaging on the final April report using revised data.



## Overall performance expected to get a lift from general-purpose, production and business oriented machinery

As for production index performance by industry in February, contribution to overall growth was especially notable for transport equipment (+10.3% m/m) and general-purpose, production and business oriented machinery (+3.6%). Meanwhile, the indices of industrial production shows eleven out of fifteen industries recording growth.

As for transport equipment, recent performance has shown intense fluctuation on a single month basis, but on average, the industry has been marking time. Exports to the US centering on SUVs is favorable,

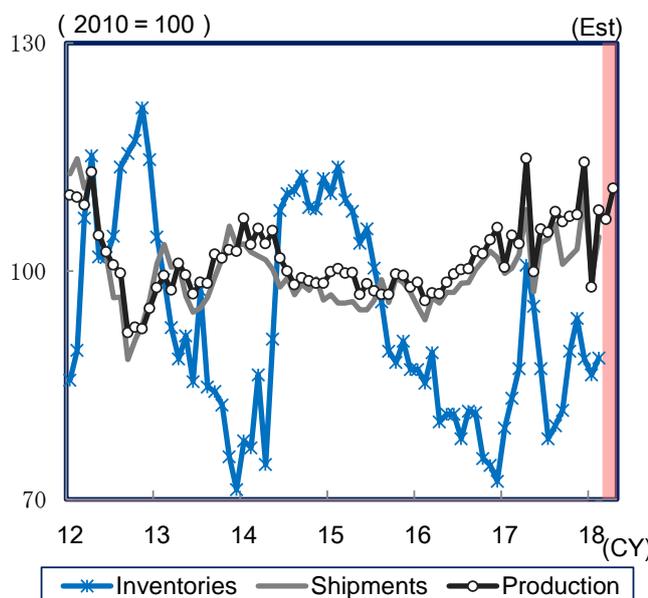
but domestic new car sales in FY2018 are expected to decline by -0.3% y/y according to the Japan Automobile Manufacturers Association. The METI forecast survey sees March production down by -1.1% m/m, while April is to achieve growth of +3.8%. At the same time it is important to remain cautious as regards downside risk.

Electronic parts and devices gained +4.8% m/m, but the realization rate for February was -8.2%. The realization rate has continued in the negative range more recently as well due to the effects of production cuts for the new model iPhone (the annual average for the realization rate in 2017 was -3.2%, while on a monthly basis it was -8.9% in December 2017 and -9.2% in January 2018). However, the revision rate for the March survey is +0.6%. The major downturn in performance is expected to weaken in the future.

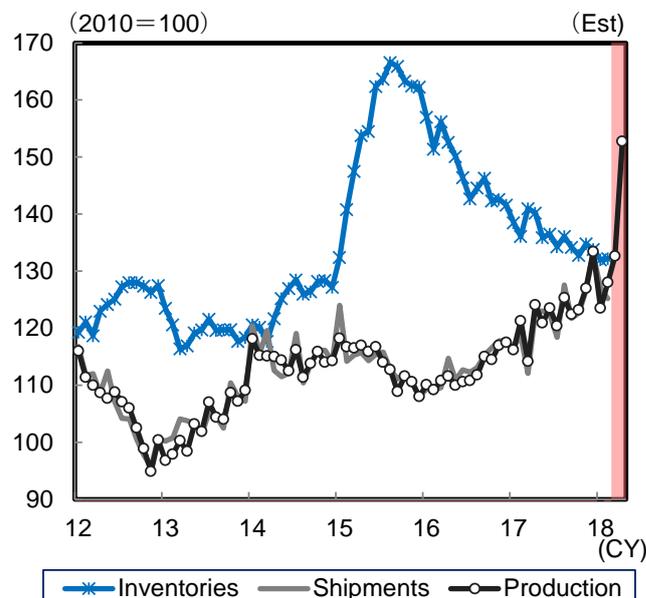
According to the METI production forecast survey, production plans for general purpose, production, and business oriented machinery is expected to continue strong performance (+3.6% m/m in March and +15.2% in April). According to the Japan Machine Tool Builders' Association, orders for machine tools in 2018 are expected to win y/y growth for the second consecutive year and there are no signs of slowing down. However, the realization rate for this outlook was -19.4% in 2016 and +21.9% in 2017. The major fluctuations of this outlook suggest that we should take results with a certain grain of salt. Meanwhile, it has also been indicated that procurement of parts and materials is becoming increasingly difficult due to the large number of orders; hence there may be a lag between time of order and production.

In other news, April production plans for information & communication electronics equipment are notable (-7.9% m/m in March and +21.3% in April). However, actual figures for production in this industry tend to undergo major downward revisions in comparison to initially announced plans. Therefore, these figures should be taken with a certain grain of salt.

**Production, Shipments, and Inventory (Left: Transport Equipment, Right: General-Purpose, Production and Business Oriented Machinery) Chart 4**



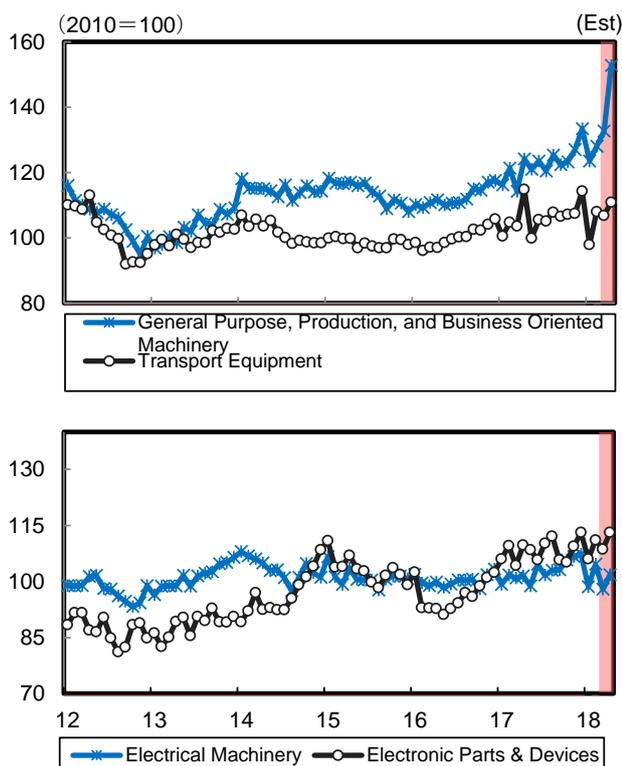
Source: Ministry of Economy, Trade, and Industry, compiled by DIR.  
 Note: Values for most recent 2-months of production index from METI production forecast survey.



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## Production Indices (Assembly)

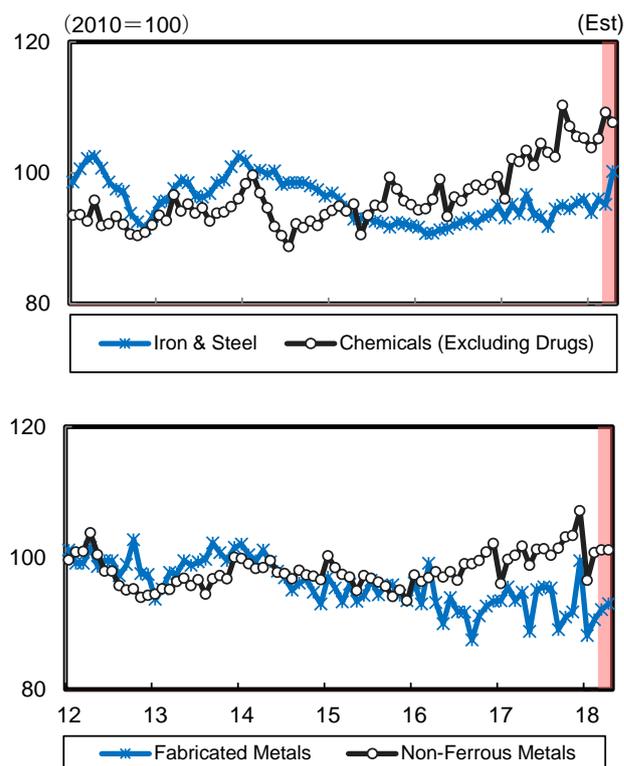
Chart 5



Source: Ministry of Economy, Trade and Industry; compiled by DIR.  
 Note: Figures for most recent two months of the production index are from the METI production forecast survey.

## Production Indices (Materials)

Chart 6



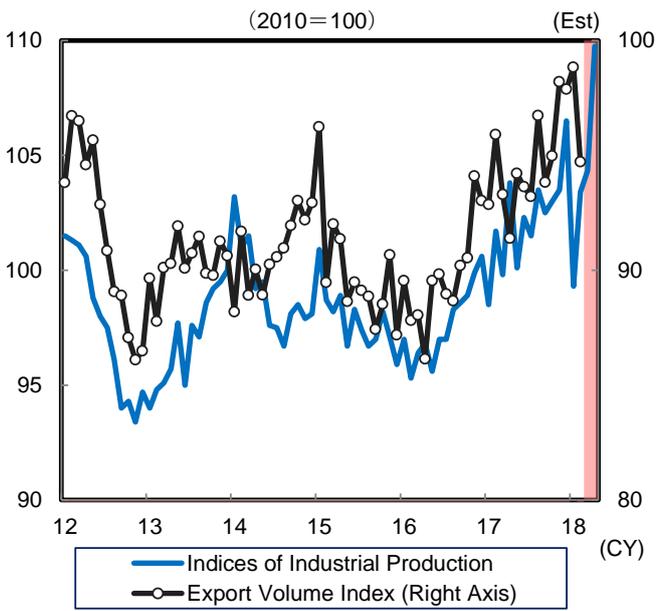
Source: Ministry of Economy, Trade and Industry; compiled by DIR.  
 Note: Figures for most recent two months of the production index are from the METI production forecast survey.

## Moderate growth in production seen in future

Production is expected to experience moderate growth in May 2018 and beyond. As for capital goods, the growth trend seen up till now may weaken, but favorable performance is expected to be maintained due to the expanding global economy. As for domestic capex, favorable corporate business performance and investment in maintenance and repair is expected to provide a boost to overall performance in 2018.

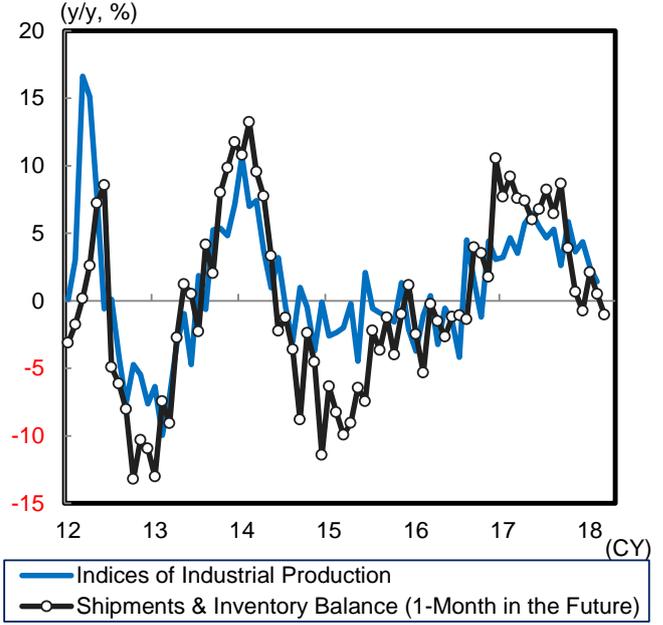
However, caution is required regarding overseas demand due to possible downside risk. As for the US, its protectionist policies and measures various countries are taking to deal with it may cause trade friction, leading to stagnation of global trade. Meanwhile, the Fed raised interest rates three times in 2017, and could raise interest any number of times in 2018. If US interest rates undergo a rapid rise in association with the Fed's exit strategy, this could bring downward pressure on the US economy, while at the same time encouraging capital outflows from the emerging nations. Meanwhile, the ECB has begun further reducing its asset purchases since January 2018. Hence we advise caution regarding the possibility that this could bring downward pressure on the EU economy. While our main scenario sees a continuation of moderate growth for the global economy, if uncertainty regarding the future grows, it could lead to a slowdown in exports and risks bringing downward pressure on the Japanese economy.

**Industrial Production & Export Volume** Chart 7



Source: Ministry of Economy, Trade, and Industry, compiled by DIR.  
 Note: Values for most recent 2-months of production index from METI production forecast survey.

**Shipments, Inventory Balance & Production** Chart 8



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