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August Industrial Production

Doldrums to persist; full-fledged recovery unlikely before 2013

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Summary

- Production persistently weak:** August industrial production declined 1.3% m/m, the second consecutive monthly slide, and short of the market consensus (down 0.5%). Production declined for the fifth consecutive month on a three-month moving average basis, showing underlying weakness. The METI survey projects overall production to decline 2.9% in September and remain flat (0.0%) in October. If the September figure turns out as expected, production would decline 3.6% q/q in Jul-Sep, leading to the second consecutive quarterly slide.
- Downward pressure from electronic components/devices, info/communications equipment:** Production declined in August for 11 industries out of 16 for which data is available on a preliminary estimate basis. Major factors pulling down overall production were declines in production of the electronic components/devices and info/communications equipment industries. The former declined 5.2% m/m for the second consecutive month, although an advance of 6.1% had been projected in the METI survey released last month, resulting in a greater-than-expected decline in overall production.
- Full-fledged recovery unlikely before 2013:** We expect industrial production to remain weak for the time being as (1) production of the transportation equipment industry is likely to remain at a low level in reaction to a boost from eco-car subsidies, which had driven overall production, and (2) shipments for export will likely continue to stagnate amid the slowdown in overseas economies. Production would firm up if exports gain momentum accompanying a recovery in overseas economies, but the EU economy, which has dragged down Japan's exports, is unlikely to see a proper recovery before 2013. Thus, production is unlikely to see a full-fledged turnaround before 2013.

Industrial Production (m/m %; SA basis)
Chart 1

	2012							Aug
	Jan	Feb	Mar	Apr	May	Jun	Jul	
Industrial Production	0.9	-1.6	1.3	-0.2	-3.4	0.4	-1.0	-1.3
Market consensus (Bloomberg)								-0.5
DIR estimate								-0.5
Shipments	-1.1	0.3	0.5	0.6	-1.3	-0.9	-3.1	0.4
Inventories	2.1	-0.5	4.3	2.0	-0.7	-1.2	2.9	-1.6
Inventory ratio	0.7	-2.7	4.4	6.9	-3.7	4.2	3.7	-2.9

Source: Ministry of Economy, Trade, and Industry (METI); Bloomberg; compiled by DIR. Note: SA by METI.

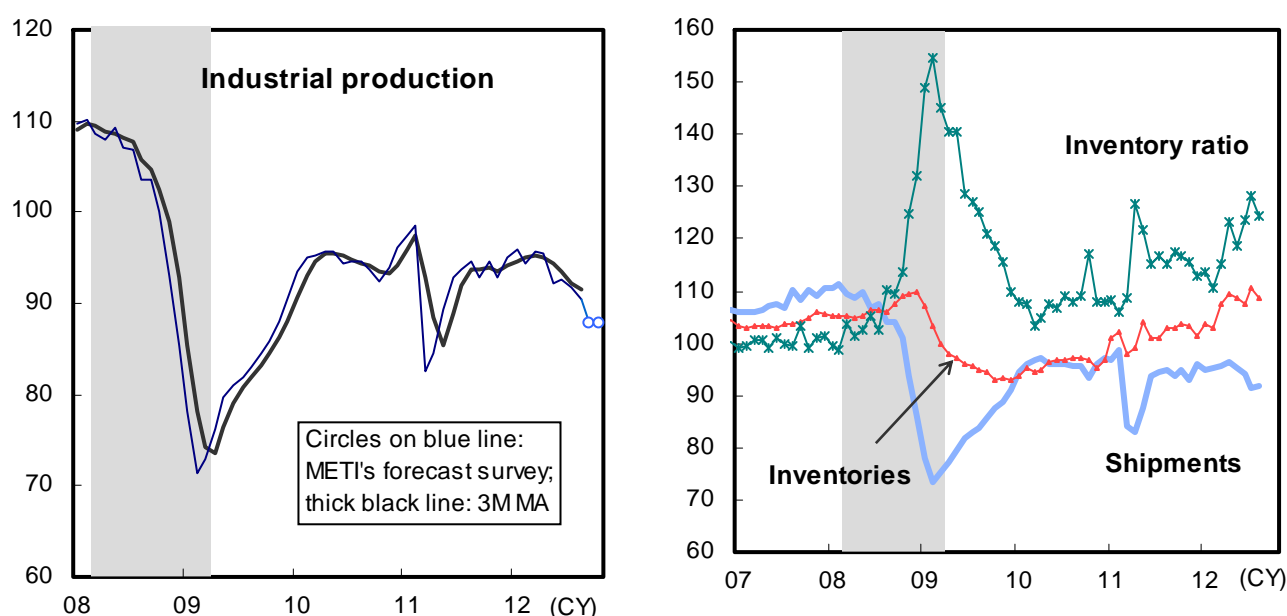
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Economic Research

Production Persistently Weak

August industrial production declined 1.3% m/m, the second consecutive monthly slide, and short of the market consensus (down 0.5%). Production declined for the fifth consecutive month on a three-month moving average basis, showing underlying weakness. Industrial shipments saw the first advance in four months (up 0.4%), while inventories saw the first slide in two months (down 1.6%), leading to the first decline (improvement) in two months (down 2.9%). The METI survey projects overall production to decline 2.9% in September and remain flat (0.0%) in October. If the September figure turns out as expected, production would decline 3.6% q/q in Jul-Sep, leading to the second consecutive quarterly slide. Given the ongoing weakness in exports, real GDP is very likely to see negative growth in Jul-Sep.

Production, Shipments, and Inventories (2005 = 100; SA basis) Chart 2



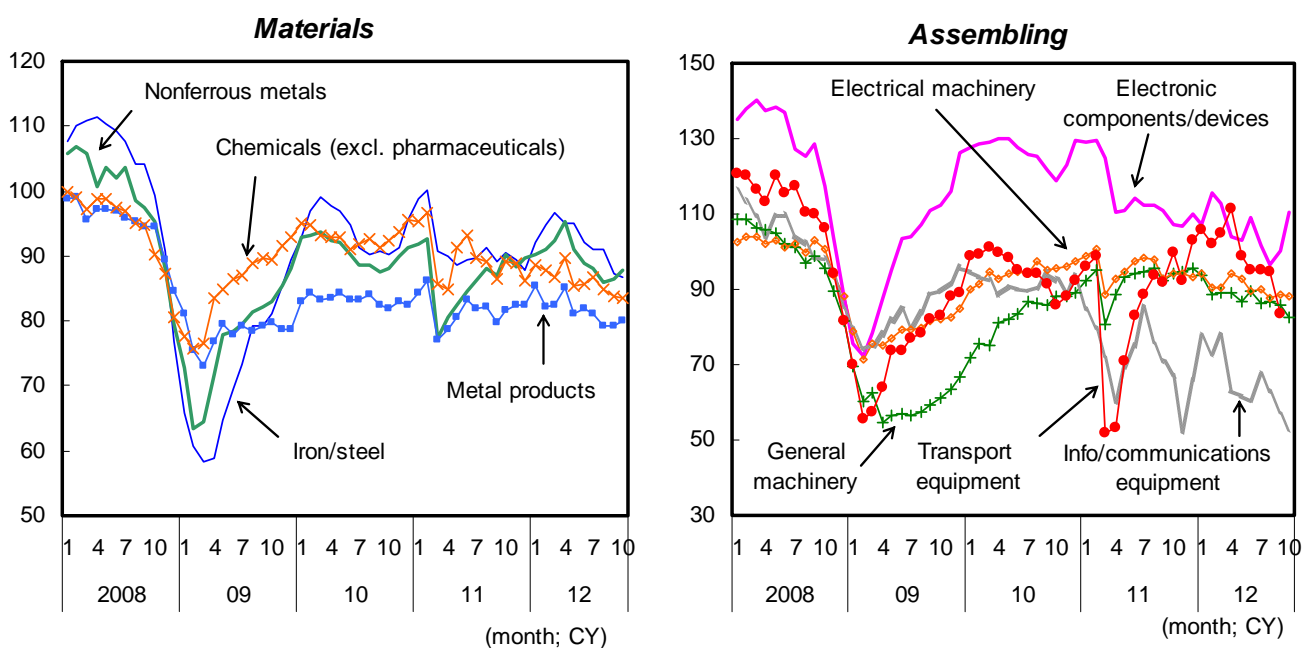
Source: Ministry of Economy, Trade, and Industry (METI); Ministry of Finance; Cabinet Office; compiled by DIR.
 Notes: 1) Shaded areas denote economic downturns.
 2) SA by source.

Downward Pressure Arising from Electronic Components/devices, Info/communications Equipment

Production declined in August for 11 industries out of 16 for which data is available on a preliminary estimate basis.

Major factors pulling down overall production were declines in production of the electronic components/devices and info/communications equipment industries. The former declined 5.2% m/m for the second consecutive month, although an advance of 6.1% had been projected in the METI survey released last month, resulting in a greater-than-expected decline in overall production. Taking a closer look at electronic components/devices, active liquid crystal devices and MOS-IC memory chips have both seen increases in shipments but declines in production. This, combined with persistently high inventories, suggests production cuts are taking place to adjust inventory levels. Production of the info/communications equipment industry declined 6.4%, the first slide in two months. Given inventory accumulation, centering on LCD TVs, production cuts have also been carried out for inventory adjustments in the industry. Meanwhile, production of the transportation equipment industry, where benefits from eco-car subsidies played out, declined 0.4%, the fourth monthly slide in a row. In this regard, the METI survey projects the slide to widen substantially to a drop of 11.6% in September, pulling down overall industrial production. While the survey projects a gain for October, the margin of gain is minor at 0.6%, indicating production will remain sluggish for the industry.

Production by Industry (2005 = 100; SA basis) Chart 3



Source: Ministry of Economy, Trade, and Industry (METI); compiled by DIR.

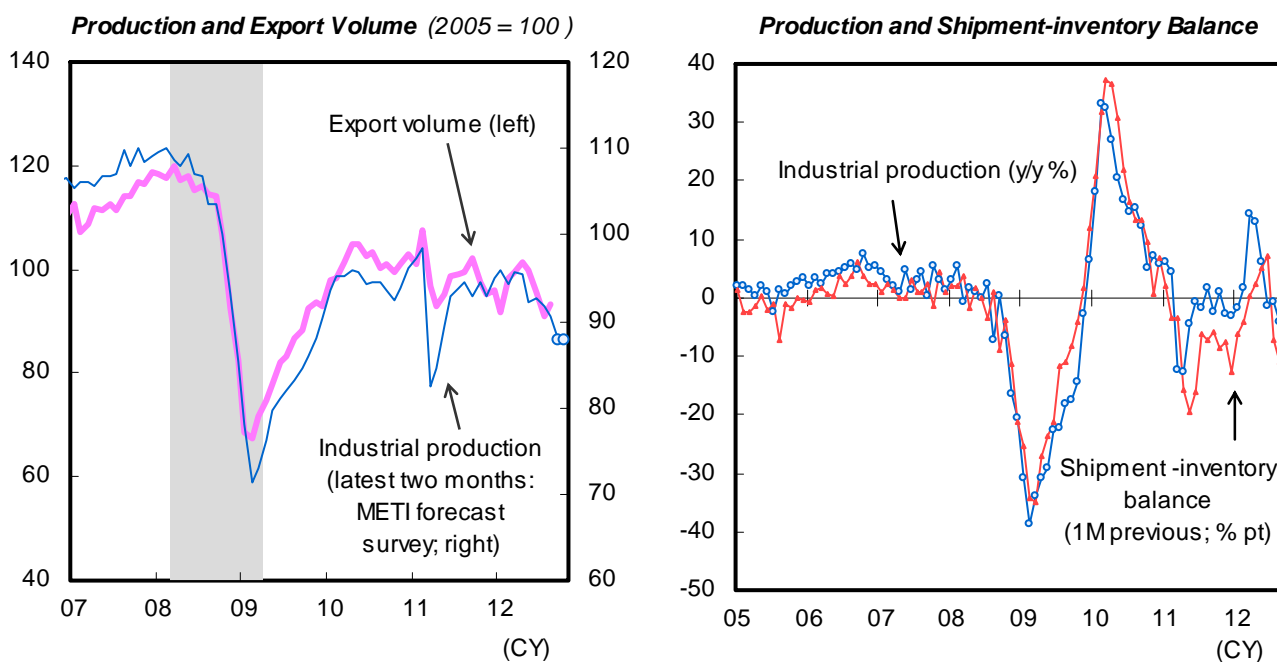
Notes: 1) Seasonally adjusted by METI.

2) Latest two months based on METI's forecast survey.

Full-fledged Recovery Unlikely Before 2013

We expect industrial production to remain weak for the time being, because (1) production of the transportation equipment industry is likely to remain at a low level in reaction to the boost from eco-car subsidies, which had driven overall production, and (2) shipments for export will likely continue to stagnate amid the slowdown in overseas economies. Production would firm up if exports gain momentum accompanying a recovery in overseas economies, but the EU economy, which has dragged down Japan's exports, is unlikely to see a proper recovery before 2013. Thus, production is unlikely to see a full-fledged turnaround before 2013.

Shipment-inventory Balance and Outlook for Industrial Production **Chart 4**



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