

## **Japan: Machinery Orders Indicate the Outlook for Business Investment Remains Grim**

- **Core private-sector machinery orders dropped by 4.1% m/m in October. The fall is partly a correction following a strong gain in the previous month. Yet, the trend is globally not encouraging.**
- **The rising trend in orders observed in Q2 has been short-lived. Orders declined by 1.7% q/q in Q3, and a further drop is likely in Q4.**
- **Corporate profits have started to improve, though it is not translating into new expenditure. Corporate appetite for investment is bound to remain weak ; there is hardly any engine to support growth now.**

### **Machinery orders dropped in October, worse than market expectations**

Core private-sector machinery orders slumped by 4.1% m/m in October. This is somewhat worse than consensus expectations (-3.5%). Orders rose by 1.9% on a y/y basis. The monthly fall appears partly as a reaction to a strong improvement in September (+12.7%).

Orders from manufacturers - which were the primary beneficiaries of booming exports - increased by a sharp 10.5% m/m, while orders from non-manufacturers – which are more dependent on domestic demand – slumped by 10.0% m/m. The electrical machinery industry and automakers were the main beneficiaries of firm exports.

Despite the negative outcome, the official assessment remained unchanged: “machinery orders are showing signs of bottoming out”, and “corporate capital investment may shows signs of bottoming out toward the end of the current fiscal year”. The government maintained its assessment unchanged, as machinery orders are prone to large monthly fluctuations.

### **More weakness ahead**

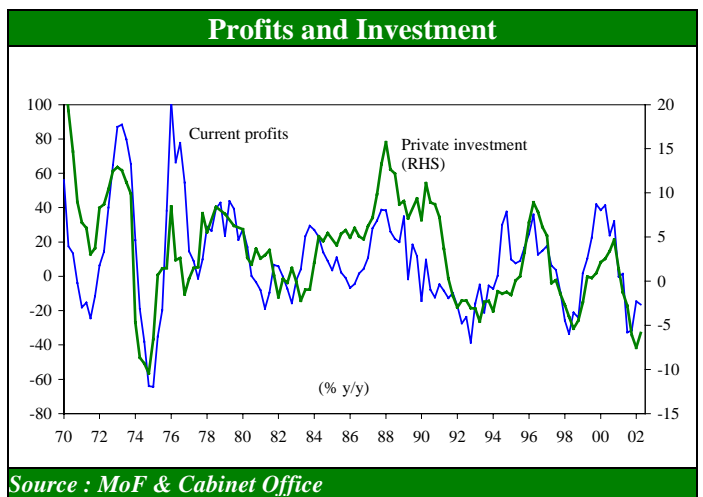
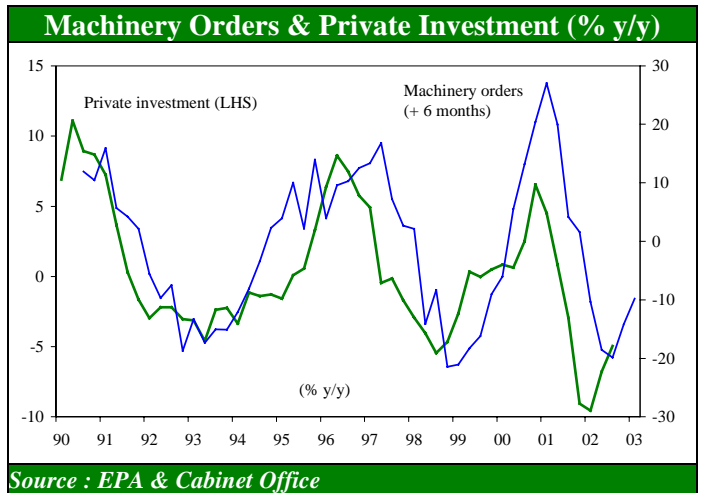
Machinery orders declined by 7.4% q/q in Q1, and grew by 7.1% in Q2, before falling again in Q3, by 1.7%. The government forecasts machinery orders will drop by 6.5% q/q in Q4. This target takes into account growing uncertainty over the global economic outlook, which is raising risks that firms may turn more cautious over capital spending.

Indeed, the MoF quarterly survey released last week pointed that Japanese companies cut their capital expenditure by 2% in Q3 from Q2. On a y/y basis, capital spending slumped by a sharp 13.9%, following a 15.5% y/y drop in Q2, due to the slump in demand and deflationary conditions.

### **The outlook for private investment is dim**

Machinery orders are widely considered as a leading indicator of private capital investment with a six-to-nine-months lead. The current downturn suggests a drop in capital expenditure in the coming months. Even though earnings picked up in Q3 (the MoF quarterly survey pointed that combined pretax profits jumped by

20.5% y/y), it has not led to an upturn in capital investment, as companies are more inclined to repay debt than finance new investment. In the past, capital spending always recovered on the back of rising profits. This time, the relationship is broken. Besides, the export boom has been short-lived, suggesting that exporters will grow more cautious. This will likely be reflected in the BoJ's Tankan survey – due out on 13 December – which is expected to show a business sentiment unchanged. Therefore, capital investment is heading for a further contraction in Q4, which will likely contribute to drive GDP in negative territory.



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