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# BOJ June 2014 Tankan Survey

**Business sentiment suffers from reactionary decline after tax hike; capex forecast revised upwards**

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## Summary

- In the BOJ June Tankan survey of corporate sentiment, business sentiment worsened overall. Major corporations in the manufacturing industry fell below market expectations, bringing a somewhat negative tone to this report. However, this was due mainly to the reactionary decline which occurred after the increase in consumption tax, so it comes as no surprise.
- The business conditions DI for large manufacturers fell to +12%pt in comparison to the previous report (+17%pt), and fell below market consensus (+15%pt). Performance by industry was as follows: in the materials industry, lumber & wood products took an especially big hit due to the effects of the reactionary decline after the increase in consumption tax, while ceramics, stone & clay showed a major deterioration in business sentiment as well due to the decline in housing investment. In the processing industry, domestic sales of automobiles have been in a decline as a result of the reactionary decline subsequent to raising the consumption tax, and this contributed to the deterioration of business sentiment in the industry overall. Meanwhile, general purpose machinery and production machinery, which tend to have a high business conditions DI, also deteriorated somewhat.
- The business conditions DI for large non-manufacturing corporations was +19%pt, showing worsened conditions in comparison to the previous survey (+24%pt). Results were right in line with market consensus (+19%pt). Looking by industry, we see that retail sales suffered a major decline due to the reactionary decline after the increase in consumption tax, pulling down the overall industry along with it. However, in the household sector, the accommodations, eating and drinking services industry experienced a fairly minor deterioration in business sentiment, with personal services marking time with the services and consumer related industries maintaining a steady undertone. In other industries, the decline in housing investment saw construction and real estate worsen, while electric/gas utilities saw their business condition DI deteriorate as well, due to rising fuel prices.
- Sales projections of large manufacturers for FY2014 see an improvement of +1.8% y/y with recurring profits seen down by -4.6% y/y. However, when we take a look at earnings projections on a half-term basis, we see that the 1<sup>st</sup> half is expected to be down by -9.3% y/y, while the 2<sup>nd</sup> half is seen achieving a turnaround at +0.2%.
- The FY 2014 capex projection (incl. investment in properties but excl. that in software; all industries, large companies) was revised upwards from the previous survey to +7.4% y/y (+5.8%), exceeding market consensus (+6.0%).

## Business conditions DI of major manufacturers worsens for first time in six quarters

In the BOJ June Tankan survey of corporate sentiment, business sentiment worsened overall. Major corporations in the manufacturing industry fell below market expectations, bringing a somewhat negative tone to this report. However, this was due mainly to the reactionary decline which occurred after the increase in consumption tax, so it comes as no surprise.

The business conditions DI for large manufacturers fell to +12%pt in comparison to the previous report (+17%pt), and fell below market consensus (+15%pt). Performance by industry was as follows: in the materials industry, lumber & wood products took an especially big hit due to the effects of the reactionary decline after the increase in consumption tax, while ceramics, stone & clay showed a major deterioration in business sentiment as well due to the decline in housing investment. On the other hand, petroleum and coal products improved since the last survey, with the price of crude oil considered to be the major factor in pushing up earnings. In the processing industry, domestic sales of automobiles have been in a decline as a result of the reactionary decline subsequent to raising the consumption tax, and this contributed to the deterioration of business sentiment in the industry overall. Meanwhile, general purpose machinery and production machinery, which tend to have a high business conditions DI, also deteriorated somewhat.

Looking at supply and demand conditions for products of large manufacturers, we see domestic supply and demand conditions worsening due to reactionary decline subsequent to raising the consumption tax. On the other hand, overseas supply and demand conditions improved for the processing industries and the materials industries, bringing a positive point to the overall survey. Meanwhile, looking at price conditions, purchase price DI for the materials industries as well as sales price DI were both down, indicating terms of trade remained flat. In contrast, the processing industries also saw a falling purchase price DI, but saw their sales price DI rise due to improvements in terms of trade.

The business conditions DI for large non-manufacturing corporations was +19%pt, showing worsened conditions in comparison to the previous survey (+24%pt). Results were right in line with market consensus (+19%pt). Looking by industry, we see that retail sales suffered a major decline due to the reactionary decline after the increase in consumption tax, pulling down the overall industry along with it. However, in the household sector, the accommodations, eating and drinking services industry experienced a fairly minor deterioration in business sentiment, with personal services marking time with the services and consumer related industries maintaining a steady undertone. In other industries, the decline in housing investment saw construction and real estate worsen, while electric/gas utilities saw their business condition DI deteriorate as well, due to rising fuel prices. On the other hand, communications, which suffered a major decline on the previous survey, showed improvement this time around.

Future outlook for business conditions DI of major manufacturers is +15%pt (an improvement of +3pt from the current survey), and +19%pt for major non-manufacturers (flat in comparison to the current survey). While most manufacturing industries see improvements, lumber & wood products expects further deterioration to follow the current survey's poor showing. Petroleum and coal products, which showed improvement this time around, is expected to worsen in the future. These two industries will bring down overall performance for manufacturing industries in the near future. One matter of concern is the auto industry which posted especially dismal performance on the current survey due to reactionary decline after the raising of the consumption tax. Though the industry expects to improve, it will only be slight. Meanwhile, the non-manufacturing industries expect reactionary decline to ease up, bringing expectations for improvements in the retail sales industry. On the other hand, personal services and the accommodations, eating and drinking services industry expect business conditions DI

to worsen. Construction and real estate are also expected to continue doing poorly due to the overall deterioration in areas affected by housing investment.

As for the business conditions DI of small businesses, the situation is expected to deteriorate in the near-term. This is especially so for the non-manufacturing industries, which are doing even more poorly than large corporations in reaction to the worsening of business conditions for retail sales and construction. The non-manufacturing industries overall expect business conditions to worsen in the future, and are generally in more serious condition than are the major corporations. In the area of manufacturing, lumber & wood products and automobiles will be suffering to a much lesser degree than the large corporations, hence the overall degree to which business conditions are deteriorating is limited in comparison.

## **FY2014 Sales seen up while earnings expected be down**

Sales projections of large manufacturers for FY2014 see an improvement of +1.8% y/y. On an industry by industry basis, manufacturing sees +1.4% y/y, while non-manufacturing projects +2.1%. Of the projected sales for manufacturing industries, domestic business is expected to be up by +1.4% y/y with exports seen up +1.4%. Both domestic sales and exports are expected to continue gradual growth.

Major corporations in all industries see FY2014 recurring profits down by -4.6% y/y. This represents an upward revision of +3.1% from the outlook reported on the last survey, but since FY2013 results were revised upwards by +5.6%, the rate of change in recurring profits for FY2014 was revised downwards from the previous survey. (Previous: -2.3% y/y, current: -4.6%.) However, when we take a look at earnings projections on a half-term basis, we see that the 1<sup>st</sup> half is expected to be down by -9.3% y/y, while the 2<sup>nd</sup> half is seen achieving a turnaround at +0.2%. In the manufacturing industries, the materials industry is expected to win earnings growth in the 2<sup>nd</sup> half at +11.6% y/y, thereby pushing up figures for all industries. The processing industries and the non-manufacturing industries are expected to see the extent of their earnings declines contract somewhat in the 2<sup>nd</sup> half, but declines overall will not be avoided in either the 1<sup>st</sup> or 2<sup>nd</sup> half.

The assumed exchange rate in FY2014 for major manufacturers is 100.18 yen to the dollar. The yen is expected to appreciate just slightly in the near term, but the rate of deviation between the assumed rate and the actual market rate is expected to shrink, so the extent to which foreign exchange earnings are promised should be limited.

## **Capex projections revised upwards**

The FY 2014 capex projection (incl. investment in properties but excl. that in software; all industries, large companies) was revised upwards from the previous survey to +7.4% y/y (+5.8%), exceeding market consensus (+6.0%). On an industry by industry basis, large manufacturers recorded +12.7% y/y, while non-manufacturing was at +4.9%. The manufacturing industries had been lagging in improvement in this area and now it is confirmed that they have become more aggressive in capex. Production/management capex DI has grown by +1 pt (a slight deterioration), and a sense that capex is insufficient is likely to develop in the future (in other words, the sense that there is excess capex will ease up). Meanwhile, production/management capex DI for companies of all sizes in all industries was +1pt, up +1pt from the previous survey (a worsening of the situation). The number of employees DI (all sizes all industries) was up by +2pt in comparison with the last survey at -10%pt (a worsening of conditions), indicating that the gap between supply and demand according to the BOJ Tankan has worsened slightly.

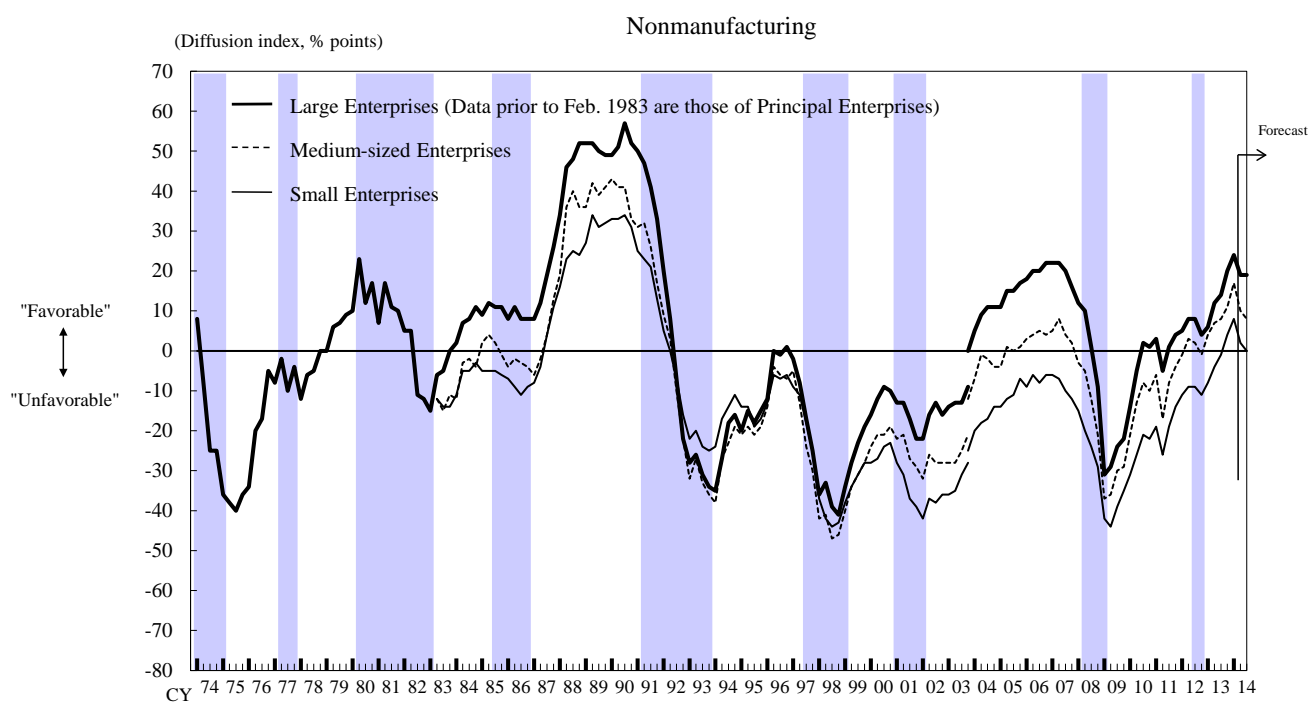
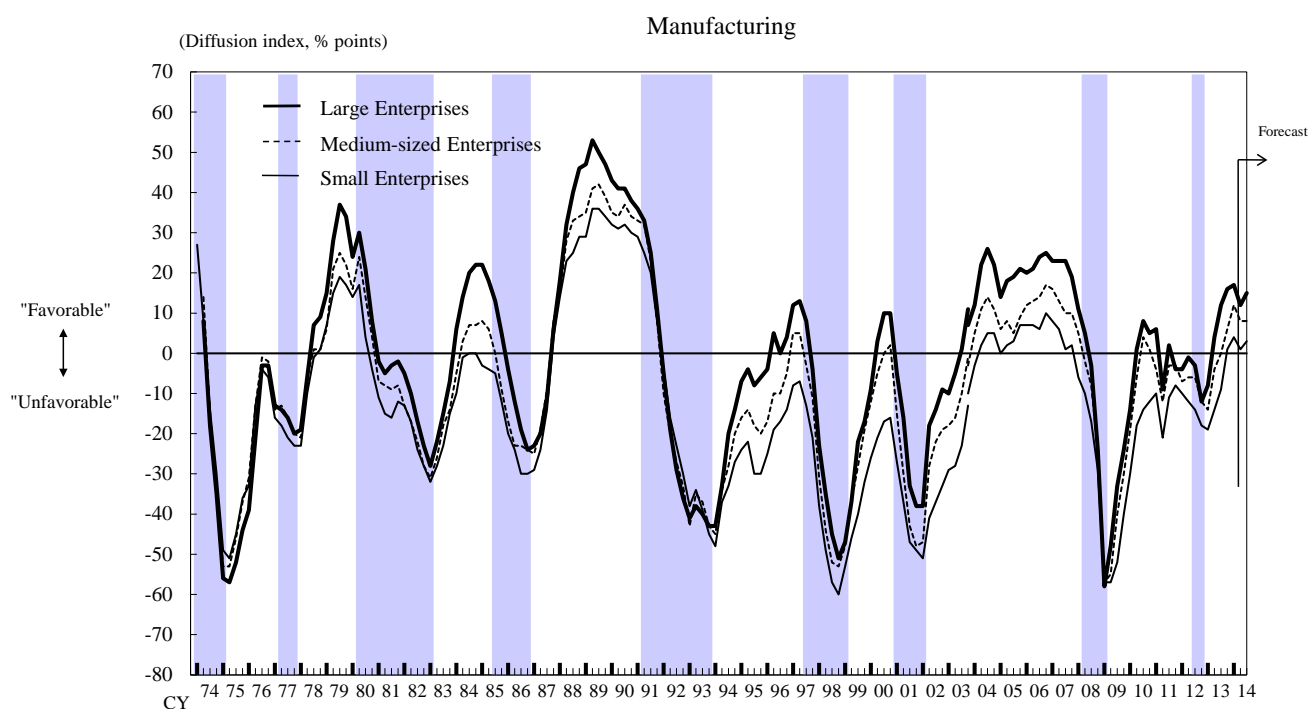
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## Japanese economy back on growth track by Jul-Sep 2014 period

The BOJ Tankan has confirmed that business sentiment has worsened and this is reflected in the outlook for the Japanese economy for the period of Apr-Jun 2014, which is likely to see declines in personal consumption and housing investment for the first time in 7 quarters. The Tankan takes an especially wary view of the future for the non-manufacturing industries, but DIR is of the opinion that the Japanese economy will get back on track by the Jul-Sep period.

The reactionary decline occurring after the last minute demand prior to the increase in consumption tax, and which is the major factor behind the decline in business sentiment in this report, is seen as having hit bottom in April, and is expected to begin easing up, supported by increases in base wages by major corporations feeling pressured to raise wages due to the stringent supply and demand situation for labor. Therefore possibilities are good that personal consumption will enter a growth trend in q/q terms by the Jul-Sep quarter. At the same time, the Tankan takes a wary view of automobiles as well, and it is indeed possible that autos, along with other consumer durables, may experience a prolonged reactionary decline, hence we recommend keeping a close eye on developments in the near future. Even so, there is still a good possibility that personal consumption will return to a growth trend on a y/y basis during the Jul-Sep period.

Improvement in the corporate sector is expected to lead the economic expansion in the future. According to the Tankan, while supply and demand of domestic products worsens, overseas supply and demand improves. This is a major factor providing support for business sentiment. Meanwhile, exports are expected to grow as overseas economies, led by the U.S., continue to expand, and as Japan improves its global competitiveness thanks to the weak yen. Increasing exports will lead to production growth and improved earnings, and this is expected to trigger more capex.



Source: Bank of Japan. DI = "Favorable" minus "Unfavorable"; % pt.  
 Note: Shaded areas denote economic downturns.

(Diffusion index of "Favorable" minus "Unfavorable," % points)

	Large Enterprises						Small Enterprises					
	March 2014 Survey		June 2014 Survey				March 2014 Survey		June 2014 Survey			
	Actual result	Forecast	Actual result	Forecast		Actual result	Forecast	Actual result	Forecast		Actual result	Forecast
				Changes	Changes				Changes	Changes		
Manufacturing	17	8	12	-5	15	3	4	-6	1	-3	3	2
Textiles	8	0	3	-5	5	2	-19	-27	-18	1	-21	-3
Lumber & Wood products	74	5	18	-56	4	-14	32	-19	-6	-38	-5	1
Pulp & Paper	0	-4	3	3	-6	-9	-12	-14	-15	-3	-9	6
Chemicals	10	5	7	-3	9	2	1	-4	4	3	4	0
Petroleum & Coal products	-6	0	14	20	0	-14	10	-11	-11	-21	-9	2
Ceramics, Stone & Clay	29	21	12	-17	25	13	22	12	18	-4	12	-6
Iron & Steel	19	12	21	2	31	10	19	9	11	-8	20	9
Nonferrous metals	22	8	6	-16	16	10	7	-3	2	-5	5	-3
Food & Beverages	9	7	8	-1	6	-2	-5	-6	-7	-2	-3	4
Processed metals	16	15	16	0	18	2	10	6	7	-3	14	7
General-purpose machinery	27	33	23	-4	29	6	-4	0	1	5	11	10
Production machinery	25	18	19	-6	28	9	17	3	15	-2	16	-1
Business oriented machinery	12	9	15	3	17	2	12	1	13	1	8	-5
Electrical machinery	12	8	16	4	21	5	0	-13	-3	-3	4	7
Shipbuilding & Heavy machinery, etc.	-3	3	0	3	7	7	8	4	19	11	10	-9
Motor vehicles	36	-2	13	-23	14	1	25	0	15	-10	9	-6
Basic materials	17	7	10	-7	12	2	7	-7	-1	-8	1	2
Processing	17	9	15	-2	17	2	4	-5	2	-2	4	2
Nonmanufacturing	24	13	19	-5	19	0	8	-4	2	-6	0	-2
Construction	37	26	33	-4	28	-5	21	1	14	-7	7	-7
Real estate	36	29	32	-4	27	-5	6	-3	1	-5	-1	-2
Goods rental & Leasing	55	42	52	-3	39	-13	25	16	16	-9	25	9
Wholesaling	16	8	11	-5	14	3	7	-5	2	-5	0	-2
Retailing	24	-5	1	-23	10	9	11	-25	-25	-36	-16	9
Transport & Postal activities	15	9	13	-2	14	1	-2	-6	-2	0	-3	-1
Communications	21	17	36	15	23	-13	8	14	12	4	15	3
Information services	28	23	23	-5	26	3	13	-10	8	-5	9	-1
Electric & Gas utilities	-3	-13	-13	-10	-8	5	-2	0	5	7	7	2
Services for businesses	34	32	38	4	33	-5	11	2	9	-2	4	-5
Services for individuals	20	16	20	0	12	-8	-10	-12	-4	6	-5	-1
Accommodations, Eating & Drinking services	19	2	14	-5	12	-2	-13	-15	-10	3	-8	2
All industries	21	11	16	-5	17	1	7	-5	2	-5	2	0

Source: Bank of Japan. DI = "Favorable" minus "Unfavorable"; % pt.

● Change from previous survey; % pt. \*\* Difference from actual figure in the current survey; % pt.

## Tankan Sales and Recurring Profit Projections (y/y %)

Chart 2

		(Year-to-year % change)			
		FY2013		FY2014 (Forecast)	
			Revision rate		Revision rate
Large Enterprises	Manufacturing	7.1	1.6	1.4	1.7
	Domestic Sales	5.1	2.0	1.4	2.2
	Exports	12.3	0.6	1.4	0.6
	Nonmanufacturing	5.4	2.0	2.1	3.1
	All industries	6.0	1.8	1.8	2.5
Medium-sized Enterprises	Manufacturing	3.8	0.7	1.1	1.0
	Nonmanufacturing	3.2	0.8	0.8	0.4
	All industries	3.4	0.8	0.9	0.6
Small Enterprises	Manufacturing	4.9	1.0	1.0	1.1
	Nonmanufacturing	6.3	2.1	-1.8	1.3
	All industries	6.0	1.9	-1.2	1.2
All Enterprises	Manufacturing	6.2	1.3	1.3	1.5
	Nonmanufacturing	5.2	1.8	0.7	2.0
	All industries	5.5	1.6	0.9	1.8

(Note) Revision rates are calculated as the percentage change of the figures between the current and the previous survey.

		(Year-to-year % change)							
		1H FY2013		2H FY2013		1H FY2014 (Forecast)		2H FY2014 (Forecast)	
			Revision rate		Revision rate		Revision rate		Revision rate
Large Enterprises	Manufacturing	4.0	10.0	2.2	2.1	1.4	0.7	2.0	
	Domestic Sales	1.2	8.9	2.7	2.6	2.2	0.2	2.2	
	Exports	11.6	13.0	0.9	0.7	-0.5	2.0	1.6	
	Nonmanufacturing	3.4	7.2	3.6	3.2	2.3	1.2	3.8	
	All industries	3.7	8.3	3.1	2.7	1.9	1.0	3.1	
Medium-sized Enterprises	Manufacturing	-0.4	8.0	1.6	2.4	0.9	-0.1	1.2	
	Nonmanufacturing	0.5	5.7	1.7	2.4	0.0	-0.6	0.8	
	All industries	0.3	6.3	1.7	2.4	0.2	-0.5	0.9	
Small Enterprises	Manufacturing	1.0	8.7	1.9	3.6	1.6	-1.3	0.6	
	Nonmanufacturing	4.1	8.3	3.7	0.4	1.2	-3.7	1.3	
	All industries	3.4	8.4	3.3	1.1	1.3	-3.2	1.2	
All Enterprises	Manufacturing	2.8	9.5	2.1	2.4	1.4	0.2	1.7	
	Nonmanufacturing	3.0	7.2	3.2	2.2	1.5	-0.6	2.5	
	All industries	2.9	7.9	2.9	2.3	1.4	-0.4	2.2	

		(Year-to-year % change)			
		FY2013		FY2014 (Forecast)	
			Revision rate		Revision rate
Large Enterprises	Manufacturing	48.7	3.8	-3.0	2.1
	Basic materials	34.4	4.0	1.8	9.3
	Processing	55.7	3.7	-5.1	-0.8
	Nonmanufacturing	24.6	7.3	-6.1	4.0
	All industries	35.0	5.6	-4.6	3.1
Medium-sized Enterprises	Manufacturing	25.4	6.6	-8.5	4.9
	Nonmanufacturing	9.0	7.5	-9.1	-0.2
	All industries	14.2	7.2	-8.9	1.5
Small Enterprises	Manufacturing	15.3	4.8	0.2	2.3
	Nonmanufacturing	21.3	8.8	-6.7	2.7
	All industries	19.7	7.8	-4.9	2.6
All Enterprises	Manufacturing	40.9	4.2	-3.4	2.5
	Nonmanufacturing	20.8	7.7	-6.8	2.9
	All industries	28.4	6.2	-5.4	2.7

		(Year-to-year % change)							
		1H FY2013		2H FY2013		1H FY2014 (Forecast)		2H FY2014 (Forecast)	
			Revision rate		Revision rate		Revision rate		Revision rate
Large Enterprises	Manufacturing	83.9	23.7	4.7	-8.3	-0.4	2.5	4.6	
	Basic materials	67.7	11.1	1.0	-7.5	7.6	11.6	10.9	
	Processing	91.7	29.9	6.4	-8.6	-3.4	-1.4	1.9	
	Nonmanufacturing	26.1	23.0	14.2	-10.3	-3.1	-1.8	11.6	
	All industries	48.6	23.3	9.5	-9.3	-1.8	0.2	8.1	
Medium-sized Enterprises	Manufacturing	28.5	22.9	13.0	-13.1	1.8	-4.5	7.4	
	Nonmanufacturing	9.0	9.1	13.1	-14.0	-3.4	-5.3	2.2	
	All industries	15.3	13.3	13.1	-13.7	-1.5	-5.0	3.8	
Small Enterprises	Manufacturing	8.3	21.6	8.8	2.5	1.6	-1.7	2.9	
	Nonmanufacturing	16.0	25.2	15.9	-0.8	1.8	-10.7	3.3	
	All industries	13.8	24.3	14.1	0.1	1.8	-8.5	3.2	
All Enterprises	Manufacturing	64.3	23.3	6.3	-7.8	0.1	1.0	4.8	
	Nonmanufacturing	21.0	20.6	14.4	-9.1	-2.1	-4.7	7.7	
	All industries	36.5	21.7	11.0	-8.5	-1.2	-2.4	6.5	

Source: Bank of Japan.

Revision rate: % change from previous survey.

## Tankan Capex Projections (incl. property investment; excl. software investment; y/y %)

Chart 3

		(Year-to-year % change)			
		FY2013		FY2014 (Forecast)	
			Revision rate		Revision rate
Large Enterprises	Manufacturing	-1.4	-3.4	12.7	5.1
	Nonmanufacturing	4.4	-0.4	4.9	6.1
	All industries	2.5	-1.4	7.4	5.8
Medium-sized Enterprises	Manufacturing	-3.6	-2.0	15.9	4.5
	Nonmanufacturing	8.0	3.1	-5.2	3.3
	All industries	3.6	1.3	2.2	3.8
Small Enterprises	Manufacturing	13.9	0.6	-5.4	13.3
	Nonmanufacturing	24.5	9.0	-26.0	13.4
	All industries	21.0	6.2	-19.7	13.4
All Enterprises	Manufacturing	0.5	-2.5	10.1	6.1
	Nonmanufacturing	8.2	1.7	-2.4	6.6
	All industries	5.6	0.3	1.7	6.5

Source: Bank of Japan.

		(Year-to-year % change)							
		1H FY2013		2H FY2013		1H FY2014 (Forecast)		2H FY2014 (Forecast)	
			Revision rate		Revision rate		Revision rate		Revision rate
Large Enterprises	Manufacturing	-8.4	5.2	-6.5	22.7	5.3	4.6	5.0	
	Nonmanufacturing	6.1	3.1	-1.3	13.6	8.0	-1.9	4.5	
	All industries	0.8	3.8	-3.1	16.6	7.0	0.2	4.6	
Medium-sized Enterprises	Manufacturing	-10.2	2.5	-2.8	33.8	3.9	1.4	5.2	
	Nonmanufacturing	10.1	6.2	5.8	-0.4	4.7	-9.5	2.0	
	All industries	2.2	4.9	2.5	11.2	4.3	-5.6	3.2	
Small Enterprises	Manufacturing	20.9	8.2	0.8	13.5	17.0	-22.7	8.6	
	Nonmanufacturing	30.2	19.9	18.2	-16.6	14.6	-34.2	12.1	
	All industries	27.1	16.1	12.3	-7.1	15.5	-30.7	10.9	
All Enterprises	Manufacturing	-4.6	5.2	-4.8	22.9	6.8	-0.4	5.5	
	Nonmanufacturing	10.7	6.3	2.7	5.5	8.4	-8.8	5.0	
	All industries	5.2	5.9	0.2	11.3	7.8	-6.1	5.2	

Revision rate: % change from previous survey.