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BOJ September 2014 Tankan Survey

Recovery in business sentiment falls behind; forecast cautious

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Summary

- In the BOJ September Tankan survey of corporate sentiment, the current trend in business sentiment was especially important as a means of confirming the status of economic recovery since the downtrend which ensued after the raising of the consumption tax. Major corporations in the manufacturing industry saw modest improvement in business sentiment, but even that lacked vitality, and the situation in the non-manufacturing industries worsened considerably. Results hence seem to have reconfirmed the growing sense that economic recovery has slowed down. Recovery in consumption is sluggish, and with production also slowing down, the results of the current report are not all that surprising, but at the same time, need not be taken in a purely negative light. Still, it is significant that both major corporations and small enterprises were cautious about the future. Hence we recommend further monitoring of the situation.
- The business conditions DI for large manufacturers (+13%pt) improved in comparison to the previous report (+12%pt), and exceeded market consensus (+10%pt). In the processing industries, automobiles improved for the first time in two months after having gone through a period of fears associated with declines in domestic sales as a result of the reactionary decline subsequent to raising the consumption tax, as well as the slowdown in exports. However, when considering the extent of the deterioration in the previous survey results, the improvement was limited. Hence continued monitoring of the situation is recommended. Meanwhile, general purpose machinery and production machinery, are maintaining their high business conditions DI with the help of firm capital investment related demand both in Japan and overseas.
- The business conditions DI for large non-manufacturing corporations was +13%pt, showing worsened conditions in comparison to the previous survey (+19%pt). Results fell below market consensus (+17%pt). Looking at performance by industry, we see that recovery from the reactionary decline after the increase in consumption tax has been sluggish, while retail sales worsened for the second consecutive period, due partly to unseasonable weather. In the household sector, the accommodations, eating and drinking services industry was weak, as well as personal services. This suggests the necessity of exercising caution in relation to household consumption in the future.
- Sales projections of large corporations (all industries) for FY2014 are flat in comparison to the last survey at +1.8% y/y, while projections for recurring profits were revised upwards to -3.0% y/y. Although recurring profits are expected to be down, this is thought to be due mostly to the reaction to last year's considerable growth. Considering the fact that outlooks for recurring profits were revised upwards in both the first and second halves, these figures can be interpreted as a sign of a steady undertone.
- The FY 2014 capex projection (incl. investment in properties but excl. that in software; all industries, large companies) was up by +8.6%y/y, and exceeded market consensus (+7.0%). A positive attitude toward capex spending has been confirmed in the manufacturing industries, which had been slow to improve until now.

Business conditions DI of major manufacturers improves slightly; non-manufacturing worsens considerably

In the BOJ September Tankan survey of corporate sentiment, the current trend in business sentiment was especially important as a means of confirming the status of economic recovery since the downtrend which ensued after the raising of the consumption tax. Major corporations in the manufacturing industry saw modest improvement in business sentiment, but even that lacked vitality, and the situation in the non-manufacturing industries worsened considerably. Results hence seem to have reconfirmed the growing sense that economic recovery has slowed down. Recovery in consumption is sluggish, and with production also slowing down, the results of the current report are not all that surprising, but at the same time, need not be taken in a purely negative light. Still, it is significant that both major corporations and small enterprises were cautious about the future. Hence we recommend further monitoring of the situation.

The business conditions DI for large manufacturers (+13%pt) improved in comparison to the previous report (+12%pt), and exceeded market consensus (+10%pt). Performance by industry was as follows: in the materials industry, the deterioration of business sentiment was especially noticeable in the iron & steel industry with demand for steel stock for automobile production stagnant, and the paper & pulp industry where there are fears that raw materials costs will rise in association with the weak yen. Petroleum and coal products also worsened considerably due to the downtrend in the international commodities markets which have been influenced by the slowdown in China's economy. On the other hand, ceramics, stone & clay saw an improvement, though this is most likely merely a reaction to the major deterioration seen in the last survey. The decline in housing investment associated with the increase in the consumption tax continues to be a heavy burden for that industry. In the processing industries, automobiles improved for the first time in two months after having gone through a period of fears associated with declines in domestic sales as a result of the reactionary decline subsequent to raising the consumption tax, as well as the slowdown in exports. However, when considering the extent of the deterioration in the previous survey results, the improvement was limited. Hence continued monitoring of the situation is recommended. Meanwhile, general purpose machinery and production machinery, are maintaining their high business conditions DI with the help of firm capital investment related demand both in Japan and overseas. The progressive weakening of the yen since mid-August is thought to have been a plus for these industries. On the other hand, the weak yen also leads to rising raw materials costs, and this has brought negative results to the food & beverages industry for three consecutive periods. Business sentiment in real estate worsened for the second consecutive period due to the decline in housing sales associated with the increase in the consumption tax, as well as the manpower shortage. Meanwhile, the business conditions DI for electric & gas utilities saw modest growth due to progress in procedures to bring nuclear power plants back on line. However, the business environment remains difficult for this industry with earnings shrinking due to the cost of alternative thermal power, and hence keeping business sentiment bearish. In other non-manufacturing industries, a considerable worsening of business sentiment in the goods rental & leasing industry and the communications industry was especially noteworthy, as these industries had maintained a high business conditions DI until now.

Looking at the future outlook for business conditions DI, major manufacturers are expected to see +13%pt (flat in comparison to the current survey), while +14%pt is seen for major non-manufacturers (an improvement of +1%pt in comparison to the current survey). Overall, corporations are taking a cautious view regarding the future, apparently expecting the economy to continue treading water for some time. In the manufacturing industries, the auto industry, which showed an improvement this time around, is expected to worsen again, while general purpose machinery, which previously had a strong undertone, is expected to weaken. Meanwhile, the non-manufacturing industries expect reactionary decline to ease up, bringing expectations for improvements in the retail sales industry. However, it should be kept in mind that the major retail sales corporations have a tendency to exaggerate future

performance. Real estate, which did poorly this time around due to the decline in housing investment, is expected to continue the same trend.

As for the business conditions DI of small enterprises, the situation has deteriorated for two consecutive periods in both the manufacturing and non-manufacturing industries. The business conditions DI of small manufacturers was -1%pt, the first time in four periods to come up with negative figures. Looking at results by industry, chemicals and nonferrous metals performed poorly, bringing down the manufacturing industries overall. Performance was much worse than it was for large manufacturers. On the other hand, in the non-manufacturing industries, real estate, personal services, and the accommodations, eating and drinking services industries had a smaller rate of deterioration than was seen amongst the large corporations. Overall, the extent of deterioration was limited compared to the large corporations. The non-manufacturing industries see further deterioration in the future, reporting more cautious outlooks than the large corporations.

Looking at the supply and demand conditions DI for manufactured goods, we see that domestic demand for the non-manufacturing industries has deteriorated for two consecutive periods due to the effects of the reactionary decline subsequent to raising the consumption tax and unseasonable weather. The manufacturing industry improved by +1pt in comparison to the previous survey, but improvement was modest. Results show that demand was in no way excessive. As for overseas supply and demand, the processing and materials industries were flat in comparison to the previous survey, reflecting the stagnant performance of exports up to now. On the other hand, the fact that the supply and demand situation did improve somewhat for both industries is a positive point and brings some optimism for the future. Meanwhile, price conditions DI are also weakening. With the yen progressively weakening since mid-August, both purchase price and sales price conditions DI are expected to increase in the future.

FY2014 sales & revenue projections see upward revision of recurring profit in both first and second half

Sales projections of large manufacturers for FY2014 see an improvement of +1.8% y/y, flat in comparison with the previous survey. Revenues have increased for five years in a row. On an industry by industry basis, manufacturing sees +1.2% y/y (a downward revision from the previous survey which had +1.4%), while non-manufacturing projects +2.2% (an upward revision from the previous survey which had +2.1%). Of the projected sales for manufacturing industries, domestic business is expected to be up by +1.3% y/y (correction factor -0.1%) with exports seen up +1.0% (correction factor -0.4%). The downward revision in the area of exports reflects the stagnant conditions for exports.

Major corporations in all industries see FY2014 recurring profits down by -3.0% y/y, the first time in three years to report a decline in earnings. At the same time, this represents an upward revision from -4.6% on the last survey, meaning the extent of the decline has shrunk. When we take a look at earnings projections on a half-term basis, we see that both have upward revisions, with the 1st half down -7.2% y/y (correction rate +2.4%), and the 2nd half at +1.4% (correction rate +1.2%). The expected declines in earnings are primarily the result of the reaction to last year's major gains. Considering the fact that results were revised upwards for both the first and second halves, this can be interpreted as a sign of a steady undertone.

The assumed exchange rate in FY2014 for major manufacturers is 100.73 yen to the dollar. This rate has not taken into consideration the progressively weakening yen after mid-August this year, and hence shows the yen as being considerably stronger than it actually is at this time. The weak yen is expected to have a negative effect on the business results of corporations in the non-manufacturing industries, while it should have a more positive effect for the manufacturing industry. In overall macro terms, the effect should be positive. It is possible that if the yen continues to be weak in comparison to

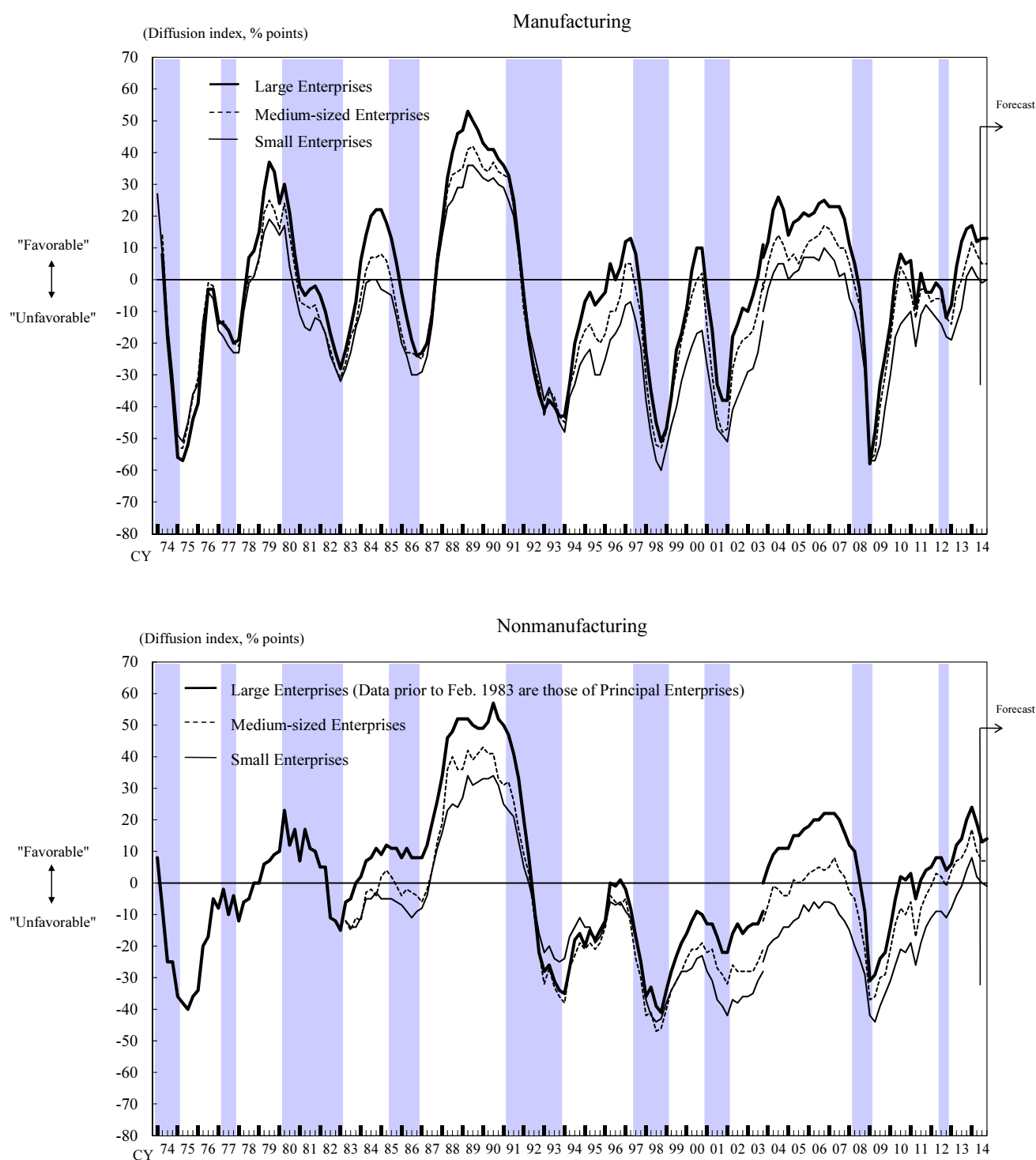
the assumed exchange rates of corporations, it could ultimately help to increase corporate earnings due to foreign exchange rate profit.

Corporations remain positive in their capex projections

The FY 2014 capex projection (incl. investment in properties but excl. that in software; all industries, large companies) was revised upwards from the previous year to +8.6% y/y, exceeding market consensus (+7.0%). On an industry by industry basis, large manufacturers recorded +13.4% y/y, while non-manufacturing was at +6.3%. The manufacturing industries had been lagging in improvement in this area and now it is confirmed that they have become more aggressive in capex. There had been fears that the worsening of business sentiment might have a negative effect on capex projections, but as of this point, no such effect has been seen. Meanwhile, production/management capex DI for major manufacturers was 5%pt, down -2pt from the previous survey, meaning that the excess in production/management capex has decreased. Meanwhile, major non-manufacturers were flat in comparison to the previous survey at -2%pt, continuing negative levels of capex (deficiency). These levels of production/management capex DI should also provide support for future growth in capex.

BOJ Business Conditions DI

Chart 1



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

Note: Shaded areas denote economic down turns.

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

	Large Enterprises						Small Enterprises					
	June 2014 Survey		Sept. 2014 Survey				June 2014 Survey		Sept. 2014 Survey			
	Actual result	Forecast	Actual result	Changes	Forecast	Changes	Actual result	Forecast	Actual result	Changes	Forecast	Changes
Manufacturing	12	15	13	1	13	0	1	3	-1	-2	0	1
Textiles	3	5	5	2	3	-2	-18	-21	-22	-4	-23	-1
Lumber & Wood products	18	4	0	-18	13	13	-6	-5	-17	-11	-20	-3
Pulp & Paper	3	-6	-4	-7	-7	-3	-15	-9	-22	-7	-14	8
Chemicals	7	9	7	0	6	-1	4	4	-4	-8	1	5
Petroleum & Coal products	14	0	0	-14	6	6	-11	-9	-16	-5	-9	7
Ceramics, Stone & Clay	12	25	15	3	23	8	18	12	16	-2	11	-5
Iron & Steel	21	31	16	-5	16	0	11	20	14	3	16	2
Nonferrous metals	6	16	27	21	27	0	2	5	1	-1	8	7
Food & Beverages	8	6	6	-2	7	1	-7	-3	-9	-2	-3	6
Processed metals	16	18	14	-2	18	4	7	14	6	-1	5	-1
General-purpose machinery	23	29	26	3	21	-5	1	11	-2	-3	-1	1
Production machinery	19	28	19	0	21	2	15	16	17	2	7	-10
Business oriented machinery	15	17	8	-7	24	16	13	8	1	-12	6	5
Electrical machinery	16	21	17	1	14	-3	-3	4	3	6	4	1
Shipbuilding & Heavy machinery, etc.	0	7	3	3	7	4	19	10	12	-7	9	-3
Motor vehicles	13	14	20	7	15	-5	15	9	23	8	11	-12
Basic materials	10	12	9	-1	11	2	-1	1	-5	-4	-3	2
Processing	15	17	14	-1	15	1	2	4	1	-1	1	0
Nonmanufacturing	19	19	13	-6	14	1	2	0	0	-2	-1	-1
Construction	33	28	36	3	28	-8	14	7	17	3	8	-9
Real estate	32	27	22	-10	16	-6	1	-1	0	-1	-4	-4
Goods rental & Leasing	52	39	30	-22	27	-3	16	25	18	2	20	2
Wholesaling	11	14	4	-7	7	3	2	0	-4	-6	-3	1
Retailing	1	10	-1	-2	11	12	-25	-16	-24	1	-15	9
Transport & Postal activities	13	14	9	-4	7	-2	-2	-3	-5	-3	-8	-3
Communications	36	23	14	-22	5	-9	12	15	3	-9	14	11
Information services	23	26	17	-6	20	3	8	9	7	-1	11	4
Electric & Gas utilities	-13	-8	-10	3	0	10	5	7	5	0	5	0
Services for businesses	38	33	25	-13	26	1	9	4	6	-3	2	-4
Services for individuals	20	12	14	-6	12	-2	-4	-5	-5	-1	-6	-1
Accommodations, Eating & Drinking services	14	12	8	-6	10	2	-10	-8	-10	0	-9	1
All industries	16	17	13	-3	14	1	2	2	0	-2	-1	-1

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	-	1.2	-0.1
	Domestic Sales	5.1	-	1.3	-0.1
	Exports	12.3	-	1.0	-0.4
	Nonmanufacturing	5.4	-	2.2	0.1
	All industries	6.0	-	1.8	0.0
Medium-sized Enterprises	Manufacturing	3.8	-	1.4	0.3
	Nonmanufacturing	3.2	-	0.6	-0.2
	All industries	3.4	-	0.8	-0.1
Small Enterprises	Manufacturing	4.9	-	1.4	0.4
	Nonmanufacturing	6.3	-	-1.0	0.8
	All industries	6.0	-	-0.5	0.7
All Enterprises	Manufacturing	6.2	-	1.3	0.0
	Nonmanufacturing	5.2	-	0.9	0.2
	All industries	5.5	-	1.0	0.2

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

		(Year-to-year % change)			
		FY2013		FY2014 (Forecast)	
			Revision rate		Revision rate
1H FY2013	2H FY2013				
1H FY2014	2H FY2014				

		(Year-to-year % change)			
		FY2013		FY2014 (Forecast)	
			Revision rate		Revision rate
Large Enterprises	Manufacturing	48.7	-	-2.1	0.9
	Basic materials	34.4	-	2.2	0.4
	Processing	55.7	-	-4.0	1.1
	Nonmanufacturing	24.6	-	-3.7	2.6
	All industries	35.0	-	-3.0	1.8
Medium-sized Enterprises	Manufacturing	25.4	-	-8.0	0.6
	Nonmanufacturing	9.0	-	-6.9	2.5
	All industries	14.2	-	-7.3	1.8
Small Enterprises	Manufacturing	15.3	-	1.0	0.8
	Nonmanufacturing	21.3	-	-7.4	-0.8
	All industries	19.7	-	-5.3	-0.3
All Enterprises	Manufacturing	40.9	-	-2.6	0.9
	Nonmanufacturing	20.8	-	-5.1	1.8
	All industries	28.4	-	-4.0	1.4

		(Year-to-year % change)			
		FY2013		FY2014 (Forecast)	
			Revision rate		Revision rate
1H FY2013	2H FY2013				
1H FY2014	2H FY2014				

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	-	13.4	0.6
	Nonmanufacturing	4.4	-	6.3	1.3
	All industries	2.5	-	8.6	1.1
Medium-sized Enterprises	Manufacturing	-3.6	-	19.2	2.8
	Nonmanufacturing	8.0	-	-2.5	2.9
	All industries	3.6	-	5.1	2.9
Small Enterprises	Manufacturing	13.9	-	-1.6	4.1
	Nonmanufacturing	24.5	-	-18.0	10.9
	All industries	21.0	-	-12.9	8.4
All Enterprises	Manufacturing	0.5	-	11.8	1.5
	Nonmanufacturing	8.2	-	0.5	2.9
	All industries	5.6	-	4.2	2.4

* Excludes Software Investment.

		(Year-to-year % change)			
		FY2013		FY2014 (Forecast)	
			Revision rate		Revision rate
1H FY2013	2H FY2013				
1H FY2014	2H FY2014				

Source: Bank of Japan.

Revision rate: % change from previous survey.