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BOJ December 2014 Tankan Survey

Business sentiment marking time; forecast cautious

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Summary

- In the BOJ December Tankan survey of corporate sentiment, the current trend in business sentiment was marking time, reconfirming business conditions since the last report. Corporations of all sizes reported forecasts worsening, and all reported being cautious as regards the future business environment.

- The business conditions DI for large manufacturers (+12%pt) worsened in comparison to the previous report (+13%pt), and fell slightly below market consensus (+13%pt). The cheap yen and high stock prices have persisted since the end of October when the BOJ announced its decision to expand both qualitative and quantitative monetary easing measures. It had been hoped that this would push up the business conditions DI for large corporations (especially in processing), but the effect was fairly limited. In the processing industries, the business conditions DI of production machinery continues to be firm with the help of firm capital investment related demand overseas as well as the weak yen.

- Business conditions DI for large non-manufacturing industries improved by +16%pt in comparison to the previous survey (+13%pt) and exceeded market consensus (+13%pt). In performance by industry, we see an improvement in business conditions for the real estate and construction industries due to the comeback in housing starts which had experienced a low after the increase in consumption tax. Meanwhile, accommodations, eating & drinking services improved for the first time in three quarters supported by the increase in foreign tourists and business travel to Japan.

- Sales projections of large corporations for FY2014 see an improvement of +2.0% y/y (+1.8% on the previous survey), a small upward revision from the last survey. Revenues are expected to increase for the fifth year in a row. Major corporations in all industries see FY2014 recurring profits up by +1.6% y/y (-3.0% on the last survey), the third consecutive year of earnings growth. The originally expected decline in recurring profit was primarily because of the reaction to last year’s major gains. For this reason a minor decline in earnings was expected. But in the end, the corporate earnings environment had a much stronger undertone than was expected.

- The FY 2014 capex projection (incl. investment in properties but excl. that in software; all industries, large companies) is +8.9% y/y, and exceeds market consensus (+8.1%). According to GDP statistics, real capex investment has decline for two consecutive quarters, but according to the results of the BOJ Tankan, corporations continue to have a positive view of capex investment.

Outlook for business conditions DI worsens for both large and small enterprises

In the BOJ December Tankan survey of corporate sentiment, the current trend in business sentiment was marking time, reconfirming business conditions since the last report. Corporations of all sizes reported forecasts worsening, and all reported being cautious as regards the future business environment. Small enterprises find themselves in an especially difficult earnings environment with benefits won from improvements in domestic demand limited, and input cost increasing due to the weak yen.

The business conditions DI for large manufacturers (+12%pt) worsened in comparison to the previous report (+13%pt), and fell slightly below market consensus (+13%pt). The cheap yen and high stock prices have persisted since the end of October when the BOJ announced its decision to expand both qualitative and quantitative monetary easing measures. It had been hoped that this would push up the business conditions DI for large corporations (especially in processing), but the effect was fairly limited. Performance by industry was as follows: in the materials industry, the major influencing factor continues to be the rising the cost of raw materials due to the weak yen. The paper & pulp industry worsened for the second consecutive quarter, joined by iron & steel, also worsening somewhat for the second consecutive quarter with public investment slowing and demand for steel shipments for automobile production stagnant. There is a sense that the iron & steel industry has peaked out. Petroleum and coal products also worsened considerably despite the outlook in the September survey that it would improve. This was due to the downtrend in the international commodities markets (especially oil), which has led to expanding inventory appraisal losses. On the other hand, the business conditions DI of nonferrous metals improved somewhat, due to the progressively weakening yen, as well as the decline in input costs as a result of the falling price of resources. Meanwhile, ceramics, stone & clay marked time due to the comeback in housing starts which had suffered for due to the increase in the consumption tax. In the processing industries, the business conditions DI of production machinery continues to be firm with the help of firm capital investment related demand overseas as well as the weak yen. Automobiles worsened for the first time in two quarters due to a decline in domestic sales (on a y/y basis) as well as sluggish export volume and the effects of large scale recalls. Meanwhile, electrical machinery where hopes were high for the effect of the weak yen marked time due to the lagging recovery in domestic demand, showing a slowdown in its former growth trend.

Business conditions DI for large non-manufacturing industries improved by +16%pt in comparison to the previous survey (+13%pt) and exceeded market consensus (+13%pt). In performance by industry, we see an improvement in business conditions for the real estate and construction industries due to the comeback in housing starts which had experienced a low after the increase in consumption tax. As the paperwork to resume operations at nuclear power plants progressed, electric & gas utilities saw a major improvement in its business conditions DI thanks to the fall in imported energy prices. However, the cost of generating thermal power as a substitute has already brought downward pressure on earnings for some time now, so ultimately negative numbers were recorded for the fifteenth consecutive quarter. Meanwhile, accommodations, eating & drinking services improved for the first time in three quarters supported by the increase in foreign tourists and business travel to Japan. The forecast for retailing showed a major improvement on the September survey leading to hopes for a recovery from the reactionary decline experienced after the increase in the consumption tax. However, the industry was hit by a completely unexpected worsening of business conditions for the third consecutive quarter. Retailing is in the habit of producing rather optimistic forecasts for the future as was seen on the previous survey. On top of that, recovery in household consumption has been lagging, leading to the current result which falls considerably below last survey’s outlook. Services for individuals, which relies heavily on the household related area, saw its numbers worsen for the second consecutive quarter due to the lagging recovery in household consumption.

Looking at the future outlook for business conditions DI, large manufacturers are expected to see +9%pt (a drop in 3%pt in comparison to the current survey), while +15%pt is seen for major non-manufacturers (a decline 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, one matter of concern is that the auto and electrical machinery industries are expected to worsen again despite the weakening yen. Meanwhile, the non-manufacturing industries expect reactionary decline to ease up, bringing expectations for major improvements in retailing. However, it should be kept in mind that retailing has a tendency to exaggerate future performance. Hence this can be taken with a certain grain of salt. Construction, which improved on the current survey, is expected to worsen.

As for the business conditions DI of small enterprises, there were both bright and dark spots, though results differed in the manufacturing and non-manufacturing industries. The business conditions DI of small manufacturers overall was +1%pt, the first time in three quarters small business has seen improvements. Looking at results by industry, a broad range of areas saw improvements, with chemicals, general-purpose machinery, and business oriented machinery improving considerably. However, small non-manufacturers worsened for the third consecutive quarter recording -1%pt. their DI level fell into negative numbers for the first time in five quarters. The negative tone stood out most in construction and real estate where the shortage in manpower is especially acute, and retailing, where the lagging recovery in household consumption stands out. As for the future, both small manufacturers and small non-manufacturers are expecting further worsening. It should be noted that the extent of the deterioration is larger than that of major corporations. Business conditions are especially tough for small enterprises with their dependence on a recovery in domestic demand and their increasing input costs due to the weakening yen. It should also be pointed out that small companies also have difficulty in sufficiently realizing price pass-through. Future economic policy must keep in mind the need for something that will provide more support for small business.

Processing industry wins gradual improvement in supply-demand conditions for products overseas

Taking a look at large corporations' supply-demand conditions DI for domestic products and services, we see that the manufacturing industry is flat in comparison with the previous survey. The domestic supply and demand situation is seen as marking time. As for supply and demand for products overseas, the processing industries have improved somewhat since the last survey, most likely a sign that exports are beginning to make a comeback in comparison to performance up to now. It should be noted that projections for the future see continued small improvements in supply-demand conditions for products overseas. Meanwhile, price conditions DI have been expected to win major growth since August due to the progressively weak yen, but in reality, the change was fairly minimal. Large manufacturers are finding that the extent of growth in their input price conditions DI exceeds that of their output price conditions DI. This suggests that corporations have been unable to achieve price pass-through to cover the amount of growth in their input costs.

FY2014 sales & revenue projections see growth in recurring profits for large corporations

Sales projections of large corporations for FY2014 see an improvement of +2.0% y/y (+1.8% on the previous survey), a small upward revision from the last survey. Revenues are expected to increase for the fifth year in a row. On an industry by industry basis, manufacturing sees +1.1% y/y (a slight downward revision from the previous survey which had +1.2%), while non-manufacturing projects +2.5% (an upward revision from the previous survey which had +2.2%). Of the projected sales for manufacturing industries, domestic business is expected to be up by +1.1% y/y, a downward revision in comparison with the previous survey due to the lagging recovery in domestic demand. Exports are seen up +1.2%, an upward revision thanks to the weak yen and the gradual comeback in export business.

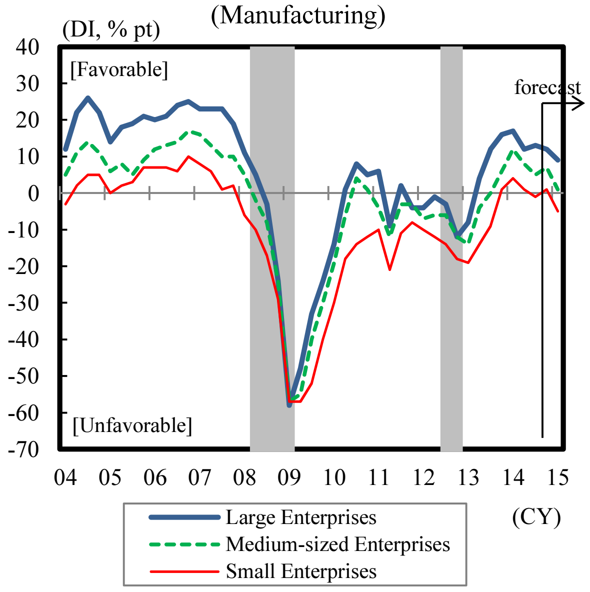
Large corporations in all industries see FY2014 recurring profits up by +1.6% y/y (-3.0% on the last survey), the third consecutive year of earnings growth. When we take a look at recurring profit projections on a half-term basis, we see that the 1st half (-3.1% y/y) was revised downwards from the last survey (+1.4%), while the 2nd half at +6.2% y/y was revised upwards considerably from the last survey's -7.2%. The originally expected decline in recurring profit was primarily because of the reaction to last year's major gains. For this reason a minor decline in earnings was expected. But in the end, the corporate earnings environment had a much stronger undertone than was expected.

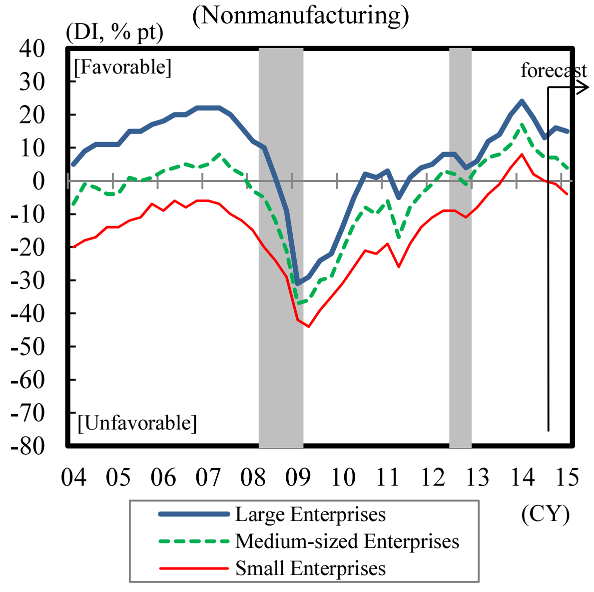
The assumed exchange rate in FY2014 for major manufacturers is 103.36 yen to the dollar. This rate has not taken into consideration the progressively weakening yen after August this year, and hence shows the yen as being considerably stronger than it actually is at this time. The weak yen is expected 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 all-industry 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 lead to more upward revisions of corporate earnings in the future, especially in the manufacturing industry.

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) is +8.9% y/y, and exceeds market consensus (+8.1%). According to GDP statistics, real capex investment has decline for two consecutive quarters, but according to the results of the BOJ Tankan, corporations continue to have a positive view of capex investment. On an industry by industry basis, large manufacturers revised projections down to +11.4% y/y, while non-manufacturing revised projections upwards to +7.6%. Comparing with past tendencies, the manufacturing industry is moving along as expected, while the non-manufacturing industry has come up with a much larger upward revision than expected. It seems that propensity to invest in capex is fairly strong in the non-manufacturing industry. 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 capacity DI for major manufacturers was 4%pt, down -1pt from the previous survey, meaning that the excess in production capacity has decreased, and is a positive development. 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 capacity DI should also provide support for future growth in capex.

Business Conditions DI — Chart 1





(DI, % pt)

	Large Enterprises						Small Enterprises					
	Sept. 2014 Survey		Dec. 2014 Survey				Sept. 2014 Survey		Dec. 2014 Survey			
	Actual result	Forecast	Actual result	Changes	Forecast	Changes	Actual result	Forecast	Actual result	Changes	Forecast	Changes
Manufacturing	13	13	12	-1	9	-3	-1	0	1	2	-5	-6
Textiles	5	3	0	-5	-2	-2	-22	-23	-23	-1	-32	-9
Lumber & Wood products	0	13	-9	-9	0	9	-17	-20	-20	-3	-26	-6
Pulp & Paper	-4	-7	-7	-3	-13	-6	-22	-14	-20	2	-15	5
Chemicals	7	6	5	-2	2	-3	-4	1	5	9	-2	-7
Petroleum & Coal products	0	6	-27	-27	-20	7	-16	-9	-9	7	-15	-6
Ceramics, Stone & Clay	15	23	15	0	13	-2	16	11	22	6	5	-17
Iron & Steel	16	16	14	-2	10	-4	14	16	13	-1	2	-11
Nonferrous metals	27	27	28	1	31	3	1	8	4	3	4	0
Food & Beverages	6	7	10	4	3	-7	-9	-3	-5	4	-6	-1
Processed metals	14	18	2	-12	0	-2	6	5	12	6	2	-10
General-purpose machinery	26	21	19	-7	19	0	-2	-1	8	10	-5	-13
Production machinery	19	21	27	8	28	1	17	7	11	-6	7	-4
Business oriented machinery	8	24	15	7	20	5	1	6	13	12	-1	-14
Electrical machinery	17	14	17	0	12	-5	3	4	4	1	-5	-9
Shipbuilding & Heavy machinery, etc.	3	7	14	11	10	-4	12	9	14	2	13	-1
Motor vehicles	20	15	14	-6	9	-5	23	11	24	1	11	-13
Basic materials	9	11	6	-3	4	-2	-5	-3	-2	3	-10	-8
Processing	14	15	15	1	12	-3	1	1	4	3	-2	-6
Nonmanufacturing	13	14	16	3	15	-1	0	-1	-1	-1	-4	-3
Construction	36	28	40	4	34	-6	17	8	14	-3	4	-10
Real estate	22	16	25	3	25	0	0	-4	-3	-3	-5	-2
Goods rental & Leasing	30	27	30	0	30	0	18	20	16	-2	9	-7
Wholesaling	4	7	7	3	5	-2	-4	-3	-6	-2	-7	-1
Retailing	-1	11	-5	-4	8	13	-24	-15	-26	-2	-22	4
Transport & Postal activities	9	7	13	4	7	-6	-5	-8	-5	0	-8	-3
Communications	14	5	20	6	25	5	3	14	20	17	20	0
Information services	17	20	24	7	23	-1	7	11	5	-2	6	1
Electric & Gas utilities	-10	0	-5	5	-5	0	5	5	8	3	13	5
Services for businesses	25	26	30	5	30	0	6	2	4	-2	0	-4
Services for individuals	14	12	10	-4	11	1	-5	-6	-5	0	-6	-1
Accommodations, Eating & Drinking services	8	10	12	4	8	-4	-10	-9	-6	4	-11	-5
All industries	13	14	14	1	12	-2	0	-1	0	0	-4	-4

Note: 1. DI = “Favorable” minus “Unfavorable”; % pt.
2. Shaded areas denote economic down turns.
3. Changes in forecast = "Forecast of the current survey" minus "Actual result of the current survey"

Source: Bank of Japan.

Sales and Current Profits Projections — Chart 2

Sales (Year-to-year % change)

		FY2013	FY2014 (Forecast)	Revision rate
Large Enterprises	Manufacturing	7.1	1.1	-0.1
	Domestic Sales	5.1	1.1	-0.2
	Exports	12.3	1.2	0.2
	Nonmanufacturing	5.4	2.5	0.3
	All industries	6.0	2.0	0.2
Medium-sized Enterprises	Manufacturing	3.8	1.9	0.5
	Nonmanufacturing	3.2	0.7	0.1
	All industries	3.4	1.0	0.2
Small Enterprises	Manufacturing	4.9	2.1	0.7
	Nonmanufacturing	6.3	-0.2	0.8
	All industries	6.0	0.3	0.8
All Enterprises	Manufacturing	6.2	1.4	0.1
	Nonmanufacturing	5.2	1.4	0.4
	All industries	5.5	1.4	0.3

Current Profits (Year-to-year % change)

		FY2013	FY2014 (Forecast)	Revision rate
Large Enterprises	Manufacturing	48.7	0.4	2.6
	Basic materials	34.4	2.5	0.3
	Processing	55.7	-0.5	3.6
	Nonmanufacturing	24.6	2.7	6.7
	All industries	35.0	1.6	4.7
Medium-sized Enterprises	Manufacturing	25.4	-3.3	5.1
	Nonmanufacturing	9.0	-5.8	1.2
	All industries	14.2	-4.9	2.5
Small Enterprises	Manufacturing	15.3	4.2	3.2
	Nonmanufacturing	21.3	-6.4	1.1
	All industries	19.7	-3.7	1.7
All Enterprises	Manufacturing	40.9	0.3	3.0
	Nonmanufacturing	20.8	-0.8	4.5
	All industries	28.4	-0.3	3.8

Note: Revision rates are calculated as the percentage change of the figures between the current and the previous survey.
Source: Bank of Japan.

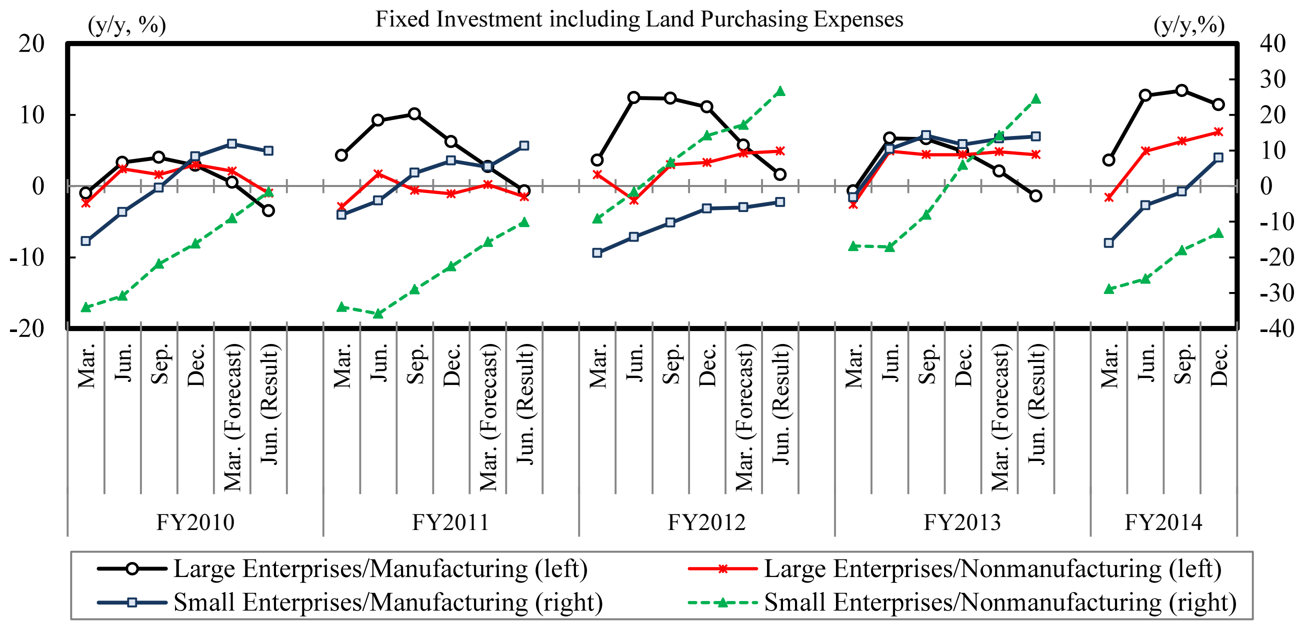
Developments of Fixed Investment including Land Purchasing Expenses (excl. software investment) — Chart 3

Fixed Investment including Land Purchasing Expenses (Year-to-year % change)

		FY2013	FY2014 (Forecast)	Revision rate
Large Enterprises	Manufacturing	-1.4	11.4	-1.8
	Nonmanufacturing	4.4	7.6	1.3
	All industries	2.5	8.9	0.2
Medium-sized Enterprises	Manufacturing	-3.6	19.6	0.3
	Nonmanufacturing	8.0	-2.6	-0.1
	All industries	3.6	5.2	0.1
Small Enterprises	Manufacturing	13.9	7.9	9.6
	Nonmanufacturing	24.5	-13.2	5.8
	All industries	21.0	-6.7	7.1
All Enterprises	Manufacturing	0.5	12.2	0.3
	Nonmanufacturing	8.2	2.2	1.7
	All industries	5.6	5.5	1.2

Software Investment (Year-to-year % change)

		FY2013	FY2014 (Forecast)	Revision rate
Large Enterprises	Manufacturing	4.9	7.3	-0.9
	Nonmanufacturing	19.1	-1.3	-2.4
	All industries	14.4	1.3	-1.9
Medium-sized Enterprises	Manufacturing	2.6	18.9	-10.0
	Nonmanufacturing	7.3	7.7	3.0
	All industries	6.4	9.7	0.1
Small Enterprises	Manufacturing	42.2	5.4	-3.2
	Nonmanufacturing	8.1	31.7	2.8
	All industries	17.5	22.9	1.0
All Enterprises	Manufacturing	6.8	8.1	-2.0
	Nonmanufacturing	16.5	2.1	-1.2
	All industries	13.5	3.9	-1.4



Note: 1. Revision rates are calculated as the percentage change of the figures between the current and the previous survey.
2. The graph indicates the revision pattern of fixed investment. Namely, the first survey for each fiscal year (March survey) is on the left, and the last survey (June survey of the following year; actual result) is on the right.
Source: Bank of Japan.