1 October 2015 (No. of pages: 7)

Japanese report: 01 Oct 2015

BOJ September 2015 Tankan Survey

Business sentiment worsens amongst major manufacturers, risk of downward swing in future rises

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Summary

- In the BOJ September Tankan survey of corporate sentiment, the current trend in business sentiment has worsened, especially amongst large corporations in manufacturing. Corporations have clearly become more cautious regarding the future. Fears of worldwide economic slowdown are behind this development, centering especially on China, as well as worries regarding stagnant exports and production, as well as sluggish personal consumption in addition to yen appreciation and falling stock prices.

- The business conditions DI for large manufacturers (+12%pt in comparison with last survey's +15%pt) worsened, while at the same time falling below market consensus (+13%pt). The business conditions DI for manufacturers worsened for the first time in three quarters. Especially notable was the worsening of business conditions DI for the export-driven processing industries due to the economic slowdown in China and the low price of natural resources.

- Business conditions DI for large non-manufacturing industries improved (+25%pt) in comparison to the previous survey (+23%pt) and exceeded market consensus considerably at +20%pt. This represents the fourth consecutive quarter of improvement for business sentiment in the non-manufacturing industry. While domestic consumption has recently been marking time overall, inbound tourist consumption has been favorable, and this is thought to have contributed to favorable performance.

- Sales projections of large corporations (all industries) for FY2015 grew +0.4% y/y, with recurring profits expected to be up by +4.7% y/y, reflecting the rebound from declines experienced after the increase in the consumption tax and showing a modest improvement in earnings. Recurring profits are expected to increase due to improved margins associated with price hikes and the low price of natural resources.

- The FY 2015 capex projection for all corporations in all industries (incl. investment in properties but excl. that in software; all industries, large companies) is +6.4% y/y, an upward revision from the previous report (+3.4%). Capital expenditure plans on the September survey reflect a certain quirk in statistics whereby upward revisions tend to occur, especially for small enterprises. Upward revisions of capex projections on the current survey are considerably larger than the average year, especially for the non-manufacturing industries.

- Market expectations are on the rise in regard to concrete policy measures such as a supplementary budget, as well as additional monetary easing by the BOJ in view of the current BOJ Tankan results and the index of industrial production announced yesterday. Our main economic scenario assumes additional monetary easing by the beginning of next year. However, there is a possibility that the market may be surprised with monetary easing measures as early as this month (October).

Business sentiment worsens amongst major manufacturers on fears of worldwide economic slowdown

In the BOJ September Tankan survey of corporate sentiment, the current trend in business sentiment has worsened, especially amongst large corporations in manufacturing. Corporations have clearly become more cautious regarding the future. Fears of worldwide economic slowdown are behind this development, centering especially on China, as well as worries regarding stagnant exports and production, as well as sluggish personal consumption in addition to yen appreciation and falling stock prices. As for business sentiment amongst large non-manufacturers, results were firm due to favorable inbound tourist consumption. However, almost all industries expect business to worsen in the future. Our current assessment of the Japanese economy is that it has entered a temporary lull, and the BOJ September Tankan seems to bear us out, indicating that the domestic economy is indeed reflecting conditions of a temporary lull. On the other hand, corporations centering on the non-manufacturing industries still show a willingness to invest in capex and are forward looking in this sense, with plans for corporate capex investment in FY2015 being revised upwards more than the average year.

The business conditions DI for large manufacturers (+12%pt in comparison with last survey's +15%pt) worsened, while at the same time falling below market consensus (+13%pt). The business conditions DI for manufacturers worsened for the first time in three quarters. Especially notable was the worsening of business conditions DI for the export-driven processing industries due to the economic slowdown in China and the low price of natural resources.

The materials industries saw improvements, though small, for the first time in two quarters. Margins improved due to low prices for natural resources and energy, but while this was a plus for business conditions DI, exports and production were stagnant due to the economic slowdown in the emerging nations centering on China. In the end this appeared to push things more onto the negative side.

As for performance of individual industries, petroleum and coal products worsened considerably due to the low price of crude oil. The outlook for this industry saw major improvement in business conditions DI as of the previous Tankan survey, which took place in June, due to a comeback in the price of crude oil after spring this year, but contrary to the outlook, the price of crude oil declined sharply, and as a result, performance fell considerably below the June outlook. Other industries also worsened, including ceramics, stone & clay, iron& steel, and nonferrous metals. As for ceramics, stone & clay, the reactionary decline was notable after the major improvement seen on the previous Tankan report due to improved profit margins made possible by price hikes and the low cost of natural resources. Meanwhile, corporate performance in the iron & steel industry was hit by the negative influence of a worsening market for steel products in China caused by excessive supply on the part of Chinese steel manufacturers, occurring on top of weakening infrastructure investment in China including construction projects. Nonferrous metals were also influenced negatively by the worsening market conditions. On the other hand, lumber & wood products managed a major improvement, due at least in part to the rebound from major slump on the previous Tankan report.

The processing industries saw a worsening of business sentiment for the first time in four quarters. Negative factors included stagnant exports and production, as well as yen appreciation. In addition, the sense that personal consumption is taking a breather after its recent recovery also weighed down on corporate business sentiment. As for performance of individual industries, worsening was especially noticeable in electrical machinery, shipbuilding & heavy machinery, general-purpose machinery, production machinery, and business oriented machinery due to the slowdown in overseas economies. On the other hand, automobiles experienced their first improvement in two quarters due to the rebound from the decline experienced on the previous Tankan report. However, recent sales of new vehicles have continued to be weak, hence the improvement was a modest one at +3pt.

Business conditions DI for large non-manufacturing industries improved (+25%pt) in comparison to the previous survey (+23%pt) and exceeded market consensus considerably at +20%pt. This represents the fourth consecutive quarter of improvement for business sentiment in the non-manufacturing industry. While domestic consumption has recently been marking time overall, inbound tourist consumption has been favorable, and this is thought to have contributed to favorable performance.

Looking at performance by industry, business conditions DI was at an especially high level in retailing, accommodations, eating & drinking services, and personal services. Since the pace of improvement was brisk in the past for these industries a reactionary decline had been expected, but results were unexpectedly strong. One of the reasons for this has been that while domestic consumption has recently been marking time overall, inbound tourist consumption has been favorable. Real estate was expected to worsen as of the previous report, but instead showed improvement. This was likely due to the gradual comeback in housing starts and the declining trend in the office vacancy rate. Meanwhile, electric & gas utilities saw profit margins improve thanks to the fall in energy prices, thereby contributing considerably to positive results. However, since the business environment remains difficult overall, results remained flat.

Large corporations in both manufacturing and non-manufacturing industries see worsening in future

Looking at the future outlook for business conditions DI, both the manufacturing and non-manufacturing industries see conditions worsening, with large manufacturers expecting +10%pt (down by -2pt in comparison to the current survey), and +19%pt seen for major non-manufacturers (a decline of -6pt). Corporations appear to have become more cautious regarding the future due to fears of worldwide economic slowdown centering on China, and turmoil in the global financial markets. In the manufacturing industries, there are fears that the future will be worsening for the export oriented industries, such as general machinery, electrical machinery, shipbuilding & heavy machinery, and automobiles. Meanwhile, it should be noted that the non-manufacturing industries also expect a worsening in the future for all industries with the exception of information services.

As for the business conditions DI of small enterprises in the manufacturing industry, performance was flat in comparison to the previous report at 0%pt. Looking at results by industry, worsening business sentiment was especially outstanding for iron & steel, automobiles, and electrical machinery. Meanwhile, small non-manufacturers saw a worsening of -1pt, a modest drop. As for performance by industry, personal services and wholesale were down, while improvements were seen in retailing and accommodations, eating & drinking services.

Overseas supply and demand worsens slightly in manufacturing industry

Taking a look at large corporations' supply-demand conditions DI for domestic products and services, we see that the manufacturing industry has improved somewhat, while the non-manufacturing industry marked time. As for large corporations' supply-demand conditions DI for overseas products and services, there was a modest drop in comparison to the previous report due to the influence of the worldwide economic slowdown especially in China. The weakness of overseas demand is becoming clearer.

Meanwhile, looking at price conditions DI, the price of crude oil has dropped further while the yen has appreciated, bringing a large decline in input price conditions DI for both the manufacturing and non-manufacturing industries. This has brought an improvement in the terms of trade (output price conditions DI – input price conditions DI).

Upward revision of recurring profits seen for all industries and corporations of all sizes

Sales projections of large corporations (all industries) for FY2015 grew +0.4% y/y, with recurring profits expected to be up by +4.7% y/y, reflecting the rebound from declines experienced after the increase in the consumption tax and showing a modest improvement in earnings. Recurring profits are expected to increase due to improved margins associated with price hikes and the low price of natural resources. The amendment ratio in comparison to the previous survey shows a downward revision for sales (-0.1%) and an upward revision for recurring profits (+3.5%).

It is noteworthy that recurring profits were revised upwards in all industries for corporations of all sizes reflecting the favorable business performance of the first half of FY2015. However, many corporations are viewing the second half with caution.

The assumed exchange rate in the first half of FY2015 for major manufacturers is 117.39 yen to the dollar. Considering the current yen exchange rate, manufacturers are being a bit conservative in their projections.

FY2015 capex projections favorable, especially for non-manufacturing

The FY 2015 capex projection for all corporations in all industries (incl. investment in properties but excl. that in software; all industries, large companies) is +6.4% y/y, an upward revision from the previous report (+3.4%). Capital expenditure plans on the September survey reflect a certain quirk in statistics whereby upward revisions tend to occur, especially for small enterprises. Upward revisions of capex projections on the current survey are considerably larger than the average year, especially for the non-manufacturing industries.

Large corporations attracting the most attention from the market revised projections by +10.9% y/y (+9.3% on the previous report). This exceeded market consensus considerably at +8.7%, despite original expectations that there would be a downward revision. On an industry by industry basis, major manufacturers revised their capex projections for FY2015 upwards by +18.7% y/y, while major non-manufacturers revised their capex projections upwards by +7.2% y/y. Upward revisions of capex projections on the current survey show a bit of caution on the part of major manufacturers, while non-manufacturers remain favorable in their level of willingness to invest. The manufacturing industry appears to have been somewhat influenced by the worldwide economic slowdown, as well as stagnant exports and production.

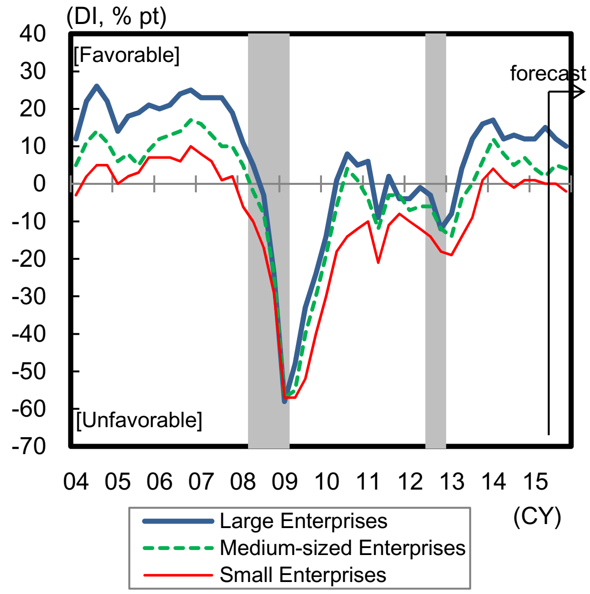
Meanwhile, production capacity DI for major manufacturers was +1%pt, down by -1pt from the previous survey. Meanwhile, major non-manufacturers were flat in comparison to the previous survey at -1%pt, continuing negative DI levels (deficiency). No sense of overcapacity was seen in production capacity DI. However, recent leading indicators for machinery and equipment – statistics on orders received and the coincident indicator shipment of capital goods, show some weakness. Continued monitoring of trends is required here.

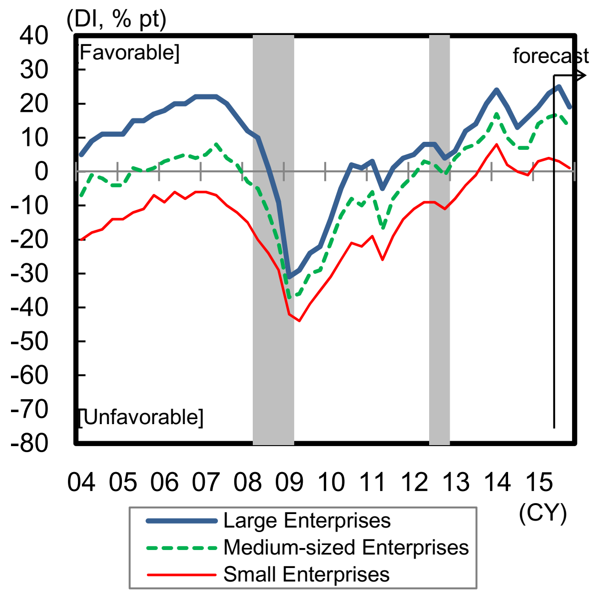
Expectations on the rise regarding economic policy measures and additional monetary easing

Market expectations are on the rise in regard to concrete policy measures such as a supplementary budget, as well as additional monetary easing by the BOJ in view of the current BOJ Tankan results and the index of industrial production announced yesterday. The government is saying that the trend toward gradual recovery is continuing (September monthly economic report), while the BOJ gives the same assessment in its September financial and economic monthly report. However, these statements are on the strong side in consideration of recent economic indices and this month's Tankan. Considering the negative outlook on the BOJ Tankan and the real GDP growth rate for the Jul-Sep 2015 period, which is expected to be weak, these assessments of the economy may be revised downward in the future.

Looking back at last year, Prime Minister Abe made the decision on the supplementary budget for FY2014 in light of the Jul-Sep 2014 period GDP results at the meeting of the Lower House Budget Committee held on October 3, 2014 after convening an extraordinary Diet session. It is pretty much certain at this point that just like last year, the Jul-Sep period GDP growth rate will fall below the outlook issued as of the Apr-Jun period. In addition, considering the fact that annual government revenue for the current fiscal year appears to be on the high side, there is a good chance that a supplementary budget will be put together at the extraordinary Diet session which is expected to be convened in November. Meanwhile, all eyes will be on the reshuffling of the cabinet planned for October 7 and whether or not anything is said about the supplementary budget. As for monetary policy, the BOJ has been saying since July that it will be carefully watching CPI results (less fresh foods and energy), and that from the viewpoint of prices, it would be difficult to decide immediately on additional monetary easing. Our main economic scenario assumes additional monetary easing after the beginning of next year. However, there is a possibility that the market may be surprised with monetary easing measures as early as this month (October). The issue which we are watching closely is the fact that downward risk is rising in relation to Japan's economic and price situation – much more so than in October of last year when the BOJ made its decision to expand quantitative and qualitative monetary easing.

Business Conditions DI Chart 1





Source: Bank of Japan; compiled by DIR.
Note: 1. Shaded areas denote economic down turns.
2. Due to changes in samples used in the forecast, there is some discontinuity between the December 2014 and March 2015 results.

(DI, % pt)

	Large Enterprises						Small Enterprises					
	June 2015 Survey		Sept. 2015 Survey				June 2015 Survey		Sept. 2015 Survey			
	Actual result	Forecast	Actual result	Changes	Forecast	Changes	Actual result	Forecast	Actual result	Changes	Forecast	Changes
Manufacturing	15	16	12	-3	10	-2	0	0	0	0	-2	-2
Textiles	3	13	6	3	6	0	-21	-23	-16	5	-20	-4
Lumber & Wood products	-29	0	18	47	0	-18	-20	-20	-5	15	-9	-4
Pulp & Paper	7	-3	7	0	7	0	-15	-12	-5	10	-6	-1
Chemicals	15	11	14	-1	11	-3	8	8	12	4	10	-2
Petroleum & Coal products	0	17	-11	-11	0	11	-15	-18	-17	-2	-23	-6
Ceramics, Stone & Clay	20	18	14	-6	14	0	1	-2	2	1	1	-1
Iron & Steel	-3	10	-5	-2	-7	-2	5	7	-4	-9	-5	-1
Nonferrous metals	17	14	11	-6	14	3	-6	4	-2	4	-3	-1
Food & Beverages	18	17	13	-5	13	0	0	2	0	0	-1	-1
Processed metals	-7	0	-5	2	2	7	2	2	0	-2	0	0
General-purpose machinery	23	23	14	-9	12	-2	16	6	19	3	10	-9
Production machinery	37	36	32	-5	17	-15	11	7	19	8	4	-15
Business oriented machinery	22	24	16	-6	14	-2	17	10	13	-4	10	-3
Electrical machinery	19	17	12	-7	9	-3	1	2	-5	-6	-3	2
Shipbuilding & Heavy machinery, etc.	14	4	7	-7	3	-4	19	20	18	-1	11	-7
Motor vehicles	11	16	14	3	11	-3	12	10	5	-7	6	1
Basic materials	8	11	9	1	7	-2	-6	-5	-3	3	-5	-2
Processing	17	18	14	-3	11	-3	4	3	3	-1	0	-3
Nonmanufacturing	23	21	25	2	19	-6	4	1	3	-1	1	-2
Construction	34	33	38	4	31	-7	11	5	10	-1	3	-7
Real estate	35	30	38	3	32	-6	11	9	10	-1	5	-5
Goods rental & Leasing	28	28	34	6	26	-8	12	11	14	2	12	-2
Wholesaling	10	9	9	-1	6	-3	-2	-2	-5	-3	-3	2
Retailing	22	19	25	3	19	-6	-13	-12	-9	4	-9	0
Transport & Postal activities	24	15	23	-1	17	-6	0	-4	6	6	0	-6
Communications	28	17	33	5	6	-27	17	15	19	2	12	-7
Information services	28	27	25	-3	27	2	9	5	10	1	8	-2
Electric & Gas utilities	0	-5	0	0	-5	-5	17	17	22	5	13	-9
Services for businesses	29	29	31	2	24	-7	8	5	6	-2	1	-5
Services for individuals	24	22	35	11	23	-12	8	3	2	-6	-1	-3
Accommodations, Eating & Drinking services	26	22	31	5	15	-16	5	4	7	2	1	-6
All industries	19	18	19	0	14	-5	2	1	3	1	0	-3

Source: Bank of Japan.
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"

Sales and Current Profits Projections — Chart 2

Sales (Year-to-year % change)

		FY2014	FY2015 (Forecast)	Revision rate
Large Enterprises	Manufacturing	1.3	0.9	0.0
	Domestic Sales	-0.6	-0.1	-0.3
	Exports	5.9	3.3	0.4
	Nonmanufacturing	0.5	0.1	-0.2
	All industries	0.8	0.4	-0.1
Medium-sized Enterprises	Manufacturing	1.9	1.6	0.2
	Nonmanufacturing	0.2	1.1	-0.1
	All industries	0.6	1.2	-0.1
Small Enterprises	Manufacturing	1.2	0.3	-0.2
	Nonmanufacturing	0.0	-0.5	0.4
	All industries	0.2	-0.3	0.2
All Enterprises	Manufacturing	1.4	0.9	0.0
	Nonmanufacturing	0.3	0.1	0.0
	All industries	0.6	0.4	0.0

Current Profits (Year-to-year % change)

		FY2014	FY2015 (Forecast)	Revision rate
Large Enterprises	Manufacturing	11.5	3.8	3.0
	Basic materials	0.1	10.4	2.0
	Processing	16.1	1.5	3.4
	Nonmanufacturing	3.7	5.6	4.1
	All industries	7.6	4.7	3.5
Medium-sized Enterprises	Manufacturing	11.8	6.3	6.3
	Nonmanufacturing	-0.6	-1.0	1.4
	All industries	3.1	1.4	3.0
Small Enterprises	Manufacturing	8.6	2.9	4.5
	Nonmanufacturing	0.8	-1.1	4.8
	All industries	2.6	-0.1	4.7
All Enterprises	Manufacturing	11.2	4.0	3.5
	Nonmanufacturing	2.2	2.7	3.8
	All industries	5.9	3.3	3.7

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

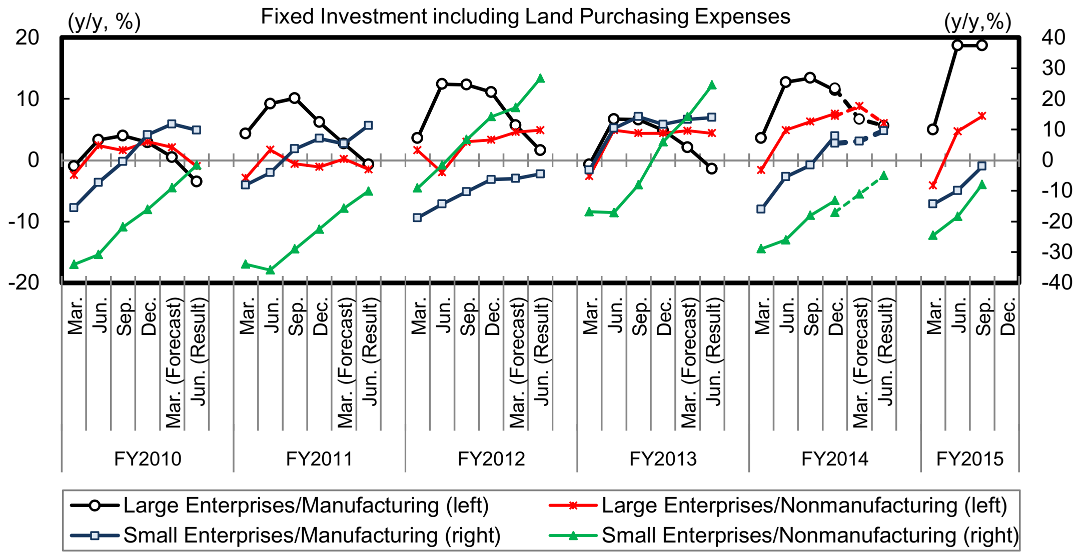
Developments of Fixed Investment including Land Purchasing Expenses (excl. software investment) — Chart 3

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

		FY2014	FY2015 (Forecast)	Revision rate
Large Enterprises	Manufacturing	5.6	18.7	0.0
	Nonmanufacturing	6.0	7.2	2.4
	All industries	5.9	10.9	1.5
Medium-sized Enterprises	Manufacturing	8.7	10.1	-1.5
	Nonmanufacturing	1.9	-2.0	1.2
	All industries	4.2	2.2	0.2
Small Enterprises	Manufacturing	9.6	-2.0	8.8
	Nonmanufacturing	-5.0	-7.9	12.8
	All industries	-0.8	-6.1	11.4
All Enterprises	Manufacturing	6.8	13.5	1.0
	Nonmanufacturing	3.1	2.9	3.9
	All industries	4.3	6.4	2.9

Software Investment (Year-to-year % change)

		FY2014	FY2015 (Forecast)	Revision rate
Large Enterprises	Manufacturing	5.5	4.3	0.8
	Nonmanufacturing	-1.5	2.6	0.3
	All industries	0.8	3.2	0.4
Medium-sized Enterprises	Manufacturing	3.6	9.7	-1.2
	Nonmanufacturing	-1.2	4.3	5.6
	All industries	-0.4	5.1	4.4
Small Enterprises	Manufacturing	1.3	-3.2	11.4
	Nonmanufacturing	29.7	-3.1	6.6
	All industries	19.7	-3.1	8.0
All Enterprises	Manufacturing	5.1	4.1	1.3
	Nonmanufacturing	0.6	2.4	1.6
	All industries	2.0	3.0	1.5



Source: Bank of Japan
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.