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BOJ March 2016 Tankan Survey

Business sentiment worsens considerably amongst large enterprises; sense of uncertainty increases regarding the future

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Summary

- In the BOJ March Tankan survey of corporate sentiment, the current trend in business sentiment has worsened considerably amongst large enterprises in both the manufacturing and non-manufacturing sectors. The survey also reveals that corporations have become more cautious regarding the future. Sluggish exports and production due to the slowdown in overseas economies are behind this development, as well as the appreciation of the yen since the end of last year and weak personal consumption.

- The business conditions DI for large enterprises worsened considerably at +6%pt in comparison to last survey's +12%pt, while at the same time falling below market consensus (+8%pt). The business conditions DI for large enterprises in the non-manufacturing sector worsened at +22%pt as compared to last survey's +25%pt, while at the same time falling somewhat below market consensus (+23%pt). At the same time, however, large enterprises in the non-manufacturing sector exhibited a faster pace of improvement than seen in the past giving a strong sense that adjustment is progressing. Hence the opinion is that these results should not be taken overly pessimistically in consideration of DI levels.

- Sales projections of large enterprises (all industries) for FY2015 fell by -1.6% y/y, with recurring profit projections up by +3.9% y/y. Both sales and recurring profit projections were revised downwards due to sluggish exports and weak personal consumption. This was especially notable for large enterprises in the manufacturing sector, which until now had been expecting earnings growth, making the downward revision in recurring profit projections especially large. The fact that many manufacturers now expect a decrease in earnings brings a note of caution. Sales projections of large enterprises (all industries) for FY2016 are also down by -0.4% y/y, with recurring profit projections down by -2.0% y/y. Declines in both earnings and recurring profits are seen. At the same time, considering past revisions, these projections seem to be somewhat on the weak side.

- The FY 2015 capex projection for enterprises of all sizes and all industries (incl. investment in properties but excl. that in software; all industries, large companies) is +8.0% y/y, a slight upward revision from the previous report (+7.8%). These results are considered to be on the high side considering past revisions. Meanwhile, the FY 2016 capex projection for enterprises of all sizes and all industries (incl. investment in properties but excl. that in software; all industries, large companies) is down by -4.8% y/y, falling below market consensus at -4.6%. However, capex projections on the current survey are about the same as they have been on average for recent years, hence there should be no cause for pessimism.

Business sentiment worsens considerably amongst large enterprises

In the BOJ March Tankan survey of corporate sentiment, the current trend in business sentiment has worsened considerably amongst large enterprises in both the manufacturing and non-manufacturing sectors. The survey also reveals that corporations have become more cautious regarding the future. Sluggish exports and production due to the slowdown in overseas economies are behind this development, as well as the appreciation of the yen since the end of last year and weak personal consumption. Our current assessment of the Japanese economy is that it is in a temporary lull, and that there is further downside risk due to the slowdown of overseas economies and yen appreciation. Looking at the BOJ Tankan Survey for March overall, it appears that corporations are more concerned than had been previously expected regarding this downside risk. On the other hand, capital expenditure appears to be maintaining a steady undertone in comparison to the weak corporate sentiment.

The business conditions DI for large manufacturers (+6%pt in comparison with last survey's +12%pt) worsened considerably, while at the same time falling below market consensus (+8%pt).

The materials industries worsened considerably at +3%pt in comparison to the previous survey's +9%pt. 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, and profitability on exports declined as well. In the end this appeared to push things more onto the negative side.

As for performance of individual industries, chemicals, as well as iron & steel, stood out as having especially worsened. The iron & steel industry was hit by the negative influence of declining market prices for steel products caused by excessive supply on the part of Chinese steel manufacturers. Meanwhile, chemicals found their earnings falling on the negative side now that the effects of improvements associated with cheap crude oil have run their course. Other industries have also worsened, including petroleum & coal products and ceramics, stone & clay. As for petroleum & coal products, the December BOJ Tankan Survey projected a major improvement in business sentiment, but contrary to the outlook announced at that time, the price of crude oil declined, hence causing the current result to fall below the December outlook. On the other hand, some industries improved, such as textiles and lumber & wood products. In the case of lumber & wood products, however, this is an area which tends to experience major fluctuations, and the opinion is that current performance may mean simply that there is some temporary factor which has strong influence at this time. As for pulp & paper and nonferrous metals, these areas were flat in comparison with the previous survey.

The processing industries saw a worsening of business sentiment for the third consecutive quarter at +7%pt in comparison to the previous survey's +12%pt. On a cautionary note, business sentiment in major export driven industries worsened across the board. In addition to sluggish exports and production, the appreciation of the yen since the end of last year is considered to be a factor in depressing corporate business sentiment in this area. Also, personal consumption (with the exception of services) has been weak recently, and this too appears to drag down business sentiment. Industries where the worsening of business sentiment is especially notable include production machinery, electrical machinery, automobiles, and business oriented machinery. As for production machinery and electrical machinery, this is due to sluggish exports and production, as well as yen appreciation, but is something that was already expected from previous outlooks and hence clearly a continuation of a previous situation. Meanwhile, automobiles worsened just slightly due to the negative impact of yen appreciation and the decline in domestic sales volume. Business oriented machinery had been improving, but the industry has been affected by weak capex related demand in both the domestic and overseas markets. The sense that the industry is about to peak out is growing stronger. Business sentiment worsened in other industries as well, including shipbuilding & heavy machinery, and general-purpose machinery. On the other hand, a slight improvement in business sentiment was seen in food & beverages and processed metals.

Business conditions DI for large non-manufacturing industries worsened (+22%pt) in comparison to the previous survey (+25%pt) and fell slightly below market consensus at +23%pt. At the same time, however, large enterprises in the non-manufacturing sector exhibited a faster pace of improvement than seen in the past giving a strong sense that adjustment is progressing. Hence the opinion is that these results should not be taken overly pessimistically in consideration of DI levels.

Looking at performance by industry, business conditions DI worsened notably in the areas of personal services and accommodations, eating & drinking services. Improvement had been continuing due to inbound consumption on the part of foreign tourists visiting Japan, but more recent trends, such as weak consumption and the slower pace of growth in foreign tourists visiting Japan have caused these areas to shift toward the negative side. However, one of the reasons for this is thought to be a reactionary decline in relation to the previously high pace of improvement, and hence this development should not be seen in an overly pessimistic light. Business sentiment in retailing has worsened for the same reasons, while other industries also saw a worsening, including communications, goods rental & leasing, wholesaling, and transport & postal activities. As for communications, the sense of this being a reactionary decline in response to the major improvements seen on the previous survey is very strong. There is also the possibility that the current rethinking of fees charged for cellular phone handsets and the communication fee structure by telecommunications carriers has had a negative effect on business. On the other hand, electric & gas utilities as well as construction and real estate showed improvement. As for electric & gas utilities, a worsening of business sentiment was projected on the December BOJ Tankan Survey, but due to the time lag before feeling the effects of improving profit margins due to the fall in energy import prices and yen appreciation, these industries are just feeling the positive effects now, and have hence considerably exceeded the December outlook. Construction and real estate were also expected to worsen as of the previous report, but instead showed improvement. This is thought to be due to the fact that domestic supply and demand for construction has been tightening, while the contract price has risen in accordance with the increasing cost of construction materials. Meanwhile, real estate has improved due to the declining trend in the office vacancy rate. As for other industries, information services and services for businesses have also improved somewhat.

Large enterprises in a broad range of 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 +3%pt (down by -3pt in comparison to the current survey), and +17%pt seen for major non-manufacturers (a decline of -5pt). Corporations have clearly become more cautious regarding the future due to fears of worldwide economic slowdown centering on China, sluggish exports and production, and weak personal consumption. Both the manufacturing and non-manufacturing sectors see a worsening of business prospects in the future in a broad range of industries.

Overseas supply and demand worsens in manufacturing industry

Taking a look at supply-demand conditions DI in the areas of domestic products and services for large enterprises, we see that both the manufacturing and non-manufacturing industries have worsened. This appears to be the negative effects of weak personal consumption and weak domestic capex spending. As for large manufacturers' supply-demand conditions DI for overseas products and services, the situation worsened for the third consecutive quarter due to the overseas economic slowdown, especially in China. The weakness of overseas demand was evident. Supply-demand conditions DI for overseas products and services is expected to improve in the future, but will likely lack vigor.

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

Major downward revision in recurring profits seen for large manufacturers

Sales projections of large enterprises (all industries) for FY2015 fell by -1.6% y/y, with recurring profit projections up by +3.9% y/y. Both sales and recurring profit projections were revised downwards due to sluggish exports and weak personal consumption. This was especially notable for large enterprises in the manufacturing sector, which until now had been expecting earnings growth, making the downward revision in recurring profit projections especially large. The fact that many manufacturers now expect a decrease in earnings brings a note of caution. There is also a good possibility that this will be negatively assessed on the financial markets. The recurring profit margins of large enterprises in all industries were also revised downwards, but they still maintain a high level, so there is still a chance that they may hit a record high for the third consecutive year for the first time since 1982 (though there have been several changes in standard statistics since that time). However, if the recurring profits of large enterprises in the manufacturing sector receive another downward revision, they will end up falling below the levels of 2014.

Sales projections of large enterprises (all industries) for FY2016 are also down by -0.4% y/y, with recurring profit projections down by -2.0% y/y. Declines in both earnings and recurring profits are seen. At the same time, considering past revisions, these projections seem to be somewhat on the weak side. The March BOJ Tankan Survey is the first time that sales projections for the following fiscal year have been in the negative numbers since FY2009. In the case of recurring profits, the general trend is that an upward revision ultimately occurs in many cases. But considering the fact that the corporate earnings environment has worsened recently, there is the possibility that a recurring loss could occur for the first time since FY2011 (five years ago). Looking at recurring profit projections for FY2016 by industry, we see that manufacturing expects -1.9% y/y, while non-manufacturing sees -2.1%. Considering past tendencies, both of these projections can be said to have been put together very carefully.

The assumed exchange rate in FY2016 for large manufacturers is 117.46 yen to the dollar. Corporations appear to be assuming that future exchange rates will move quite a bit more in the direction of a weaker yen in comparison to the current yen exchange rate. If exchange rates do not go as far in the direction of a weak yen as corporations are projecting, export oriented manufacturers will find exchange rates becoming a factor in pushing down earnings. We suggest caution regarding this point.

Revision of capital spending plans to remain at level of average year

The FY 2015 capex projection for all enterprises in all industries (incl. investment in properties but excl. that in software; all industries, large companies) is +8.0% y/y, a small upward revision from the previous report (+7.8%). This is considered to be a fairly major revision in comparison to the usual tendency. The FY 2016 capex projection for large enterprises in all industries (incl. investment in properties but excl. that in software; all industries, large companies) is -4.8% y/y, a figures which falls below market consensus (-4.6%). However, capital expenditure plans on the current (March) survey are still at about the same level as the average year, hence the fact of the decrease is not necessarily an especially negative factor.

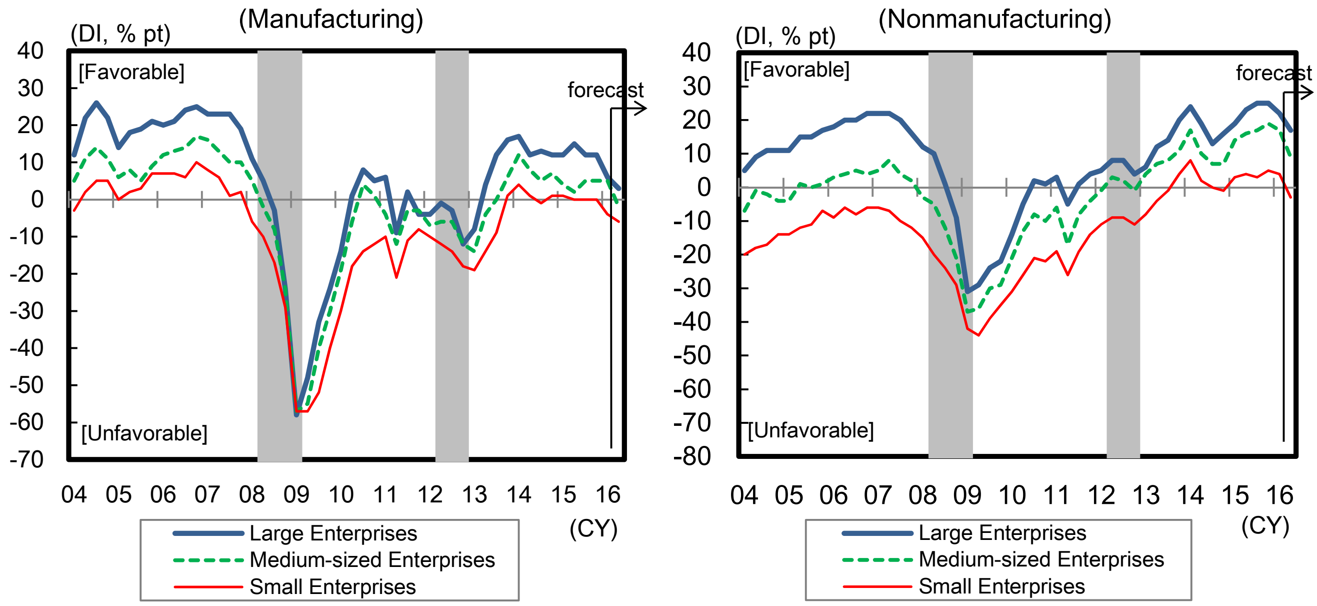
Looking at large enterprises by industry, we see that the manufacturing industry’s capex projections for FY2016 grew by +3.1% y/y, while large enterprises in the non-manufacturing sector were at -2.9% y/y. The pattern of revisions here is around the same as the average year, and is also along the lines of the previous outlook. Capital expenditure appears ultimately to be in better condition than corporate business sentiment on this report. The reason for this is a certain quirk in the Tankan statistics. A very large number of corporations in Japan produce their fiscal-year-end financial statements in March. This means that on the BOJ Tankan Survey for March, which is announced before corporations issue their fiscal-year-end financial statements, it is difficult to properly respond to figures appearing on the outlook for the next fiscal year. For this reason, there is a stronger tendency than usual on the part of manufacturers to produce a capex projection which is on the low side in response to the overseas economic slowdown. But at the same time we believe that this situation has most likely occurred only here and there in the statistics. Hence we still feel that it is important to remain cautious as regards downside risk in the future.

Looking at production capacity DI for large manufacturers, we see that it was at +4%pt, up by +1pt from the previous survey (an increase means a worsening of the situation). Meanwhile, large 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, the fact that manufacturing showed a worsening of production capacity DI is a point regarding which requires continued caution.

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

The results of this month’s BOJ Tankan Survey indicate that corporations feel uncertain about the future. At the same time, weak monthly economic indices in January and February 2016 bring the possibility that GDP results for the Jan-Mar period of 2016 may indicate negative growth for the second quarter in a row. Things being what they are, expectations are on the rise on the financial markets in regard to additional monetary easing by the BOJ and front-loading of the FY2016 budget by the government, as well as policy measures such as a supplemental budget for FY2016. The focus now is on the G7 summit to be held in Japan on May 26-27. Hopes are that the advanced nations will implement coordinated fiscal policies. There is also the question of whether or not China comes up with a full-fledged policy to bolster its economy. Meanwhile, we believe that the Fed may consider slowing the pace of its interest rate hikes considerably in comparison to what FOMC participants were assuming as of December 2015. If the Fed takes a dovish stance towards its monetary policy and a strong yen-weak dollar situation ensues (with the yen rate below 110 yen to the dollar), then business sentiment and capex projections especially of export oriented corporations would take a major downturn.

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					
	Dec. 2015 Survey		March 2016 Survey				Dec. 2015 Survey		March 2016 Survey			
	Actual result	Forecast	Actual result	Changes	Forecast	Changes	Actual result	Forecast	Actual result	Changes	Forecast	Changes
Manufacturing	12	7	6	-6	3	-3	0	-4	-4	-4	-6	-2
Textiles	-5	0	-3	2	-6	-3	-8	-14	-17	-9	-22	-5
Lumber & Wood products	17	6	41	24	12	-29	1	-10	0	-1	-13	-13
Pulp & Paper	3	3	3	0	7	4	-8	-10	-15	-7	-9	6
Chemicals	20	13	10	-10	4	-6	14	7	5	-9	-1	-6
Petroleum & Coal products	-11	5	-16	-5	5	21	-9	-20	-19	-10	-23	-4
Ceramics, Stone & Clay	13	9	9	-4	-3	-12	6	-4	-7	-13	-9	-2
Iron & Steel	0	-9	-22	-22	-21	1	-8	-15	-23	-15	-15	8
Nonferrous metals	0	-5	0	0	-5	-5	-4	2	-8	-4	-9	-1
Food & Beverages	17	9	20	3	16	-4	5	4	6	1	5	-1
Processed metals	0	5	4	4	3	-1	-2	-5	-7	-5	-3	4
General-purpose machinery	16	14	11	-5	15	4	9	4	4	-5	1	-3
Production machinery	22	9	12	-10	4	-8	7	-1	9	2	0	-9
Business oriented machinery	20	16	15	-5	12	-3	9	6	10	1	6	-4
Electrical machinery	3	6	-7	-10	-1	6	-5	-9	-7	-2	-10	-3
Shipbuilding & Heavy machinery, etc.	18	10	10	-8	7	-3	12	10	9	-3	9	0
Motor vehicles	11	3	5	-6	-1	-6	7	7	3	-4	6	3
Basic materials	9	6	3	-6	-1	-4	-1	-7	-10	-9	-12	-2
Processing	12	8	7	-5	5	-2	2	-1	1	-1	-1	-2
Nonmanufacturing	25	18	22	-3	17	-5	5	0	4	-1	-3	-7
Construction	41	31	45	4	32	-13	11	-1	10	-1	-3	-13
Real estate	35	26	37	2	26	-11	9	6	14	5	7	-7
Goods rental & Leasing	23	23	17	-6	23	6	17	10	14	-3	4	-10
Wholesaling	8	7	2	-6	4	2	-2	-4	-5	-3	-9	-4
Retailing	22	14	18	-4	13	-5	-9	-10	-10	-1	-9	1
Transport & Postal activities	26	17	21	-5	13	-8	9	0	5	-4	-6	-11
Communications	44	5	33	-11	11	-22	21	26	26	5	14	-12
Information services	30	27	31	1	24	-7	15	16	16	1	10	-6
Electric & Gas utilities	2	-5	5	3	3	-2	10	10	12	2	5	-7
Services for businesses	20	20	21	1	17	-4	8	-1	5	-3	1	-4
Services for individuals	32	16	16	-16	27	11	7	-2	-1	-8	-3	-2
Accommodations, Eating & Drinking services	32	18	22	-10	19	-3	9	4	5	-4	0	-5
All industries	18	13	13	-5	11	-2	3	-2	1	-2	-4	-5

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)

		FY2015 (Forecast)	FY2016 (Forecast)	FY2016 Revision rate
Large Enterprises	Manufacturing	-1.5	-0.6	-
	Domestic Sales	-3.1	-0.1	-
	Exports	2.1	-1.5	-
	Nonmanufacturing	-1.6	-0.3	-
	All industries	-1.6	-0.4	-
Medium-sized Enterprises	Manufacturing	0.6	0.9	-
	Nonmanufacturing	0.3	1.7	-
	All industries	0.4	1.5	-
Small Enterprises	Manufacturing	0.1	0.5	-
	Nonmanufacturing	-1.0	-0.4	-
	All industries	-0.7	-0.2	-
All Enterprises	Manufacturing	-0.9	-0.1	-
	Nonmanufacturing	-1.0	0.1	-
	All industries	-1.0	0.0	-

Current Profits (Year-to-year % change)

		FY2015 (Forecast)	FY2016 (Forecast)	FY2016 Revision rate
Large Enterprises	Manufacturing	-3.5	-1.9	-
	Basic materials	3.0	-5.9	-
	Processing	-5.8	-0.4	-
	Nonmanufacturing	11.9	-2.1	-
	All industries	3.9	-2.0	-
Medium-sized Enterprises	Manufacturing	7.7	-0.8	-
	Nonmanufacturing	5.0	2.1	-
	All industries	5.9	1.2	-
Small Enterprises	Manufacturing	0.2	2.4	-
	Nonmanufacturing	6.0	-7.9	-
	All industries	4.6	-5.4	-
All Enterprises	Manufacturing	-1.9	-1.3	-
	Nonmanufacturing	9.2	-2.8	-
	All industries	4.3	-2.2	-

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

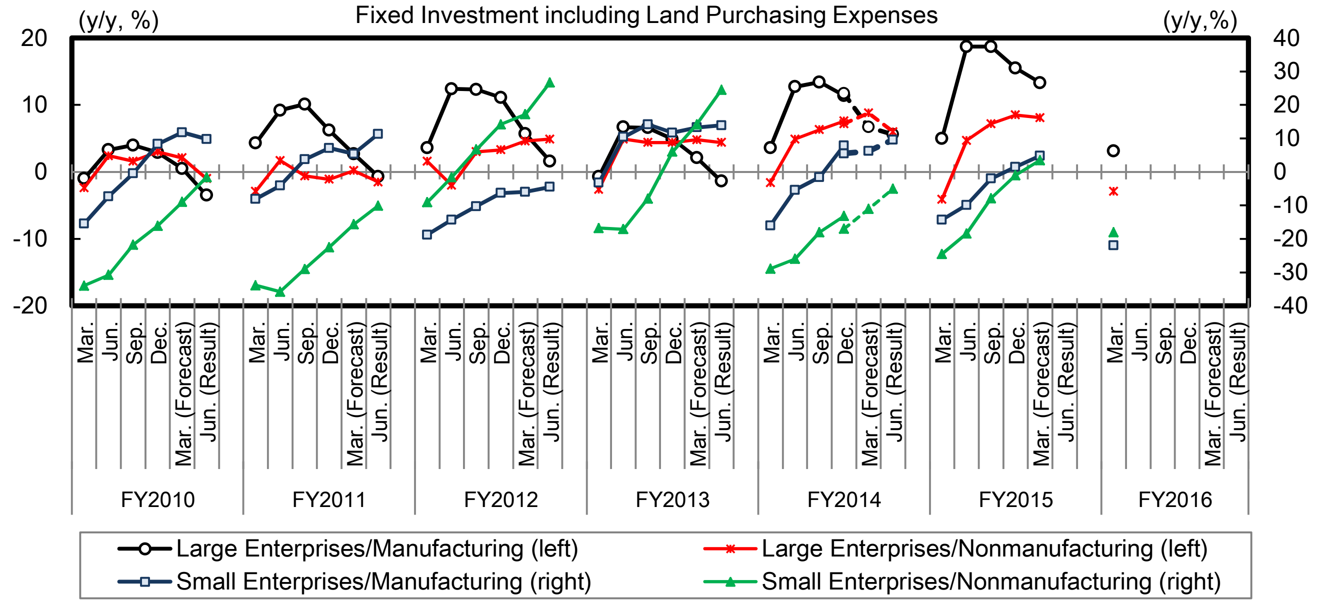
Developments of Fixed Investment including Land Purchasing Expenses (excl. software investment) — Chart 3

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

		FY2015 (Forecast)	FY2016 (Forecast)	FY2016 Revision rate
Large Enterprises	Manufacturing	13.3	3.1	-
	Nonmanufacturing	8.1	-2.9	-
	All industries	9.8	-0.9	-
Medium-sized Enterprises	Manufacturing	7.4	5.1	-
	Nonmanufacturing	4.2	-10.0	-
	All industries	5.3	-4.7	-
Small Enterprises	Manufacturing	4.8	-22.0	-
	Nonmanufacturing	3.5	-18.0	-
	All industries	3.9	-19.3	-
All Enterprises	Manufacturing	10.8	-0.9	-
	Nonmanufacturing	6.7	-6.8	-
	All industries	8.0	-4.8	-

Software Investment (Year-to-year % change)

		FY2015 (Forecast)	FY2016 (Forecast)	FY2016 Revision rate
Large Enterprises	Manufacturing	1.1	-0.7	-
	Nonmanufacturing	0.7	1.2	-
	All industries	0.9	0.5	-
Medium-sized Enterprises	Manufacturing	0.7	1.3	-
	Nonmanufacturing	4.5	13.4	-
	All industries	3.9	11.5	-
Small Enterprises	Manufacturing	-7.9	-10.6	-
	Nonmanufacturing	-9.8	-4.4	-
	All industries	-9.2	-6.3	-
All Enterprises	Manufacturing	0.4	-1.3	-
	Nonmanufacturing	0.5	2.8	-
	All industries	0.4	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.